Canada Revenue Agency | Agence du revenu du Canada

OVERALL FEDERAL TAX GAP REPORT

Estimates and key findings for non-compliance, tax years 2014 to 2018

Canada

Aussi disponible en français sous le titre : Rapport sur l'écart fiscal fédéral global

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Message from the Minister

It is my pleasure to present the Canada Revenue Agency's (CRA) first overall federal tax gap report. Shortly after I began serving as Minister of National Revenue, the Government of Canada made the commitment to study the tax gap. Starting in 2016, the CRA published a series of reports analyzing different components of the federal tax gap. The Overall Federal Tax Gap report brings together all previously published tax gap components with updated estimates and key findings up to tax year 2018. Understanding how and why taxpayers are non-compliant is critical to help preserve the integrity of the tax system and to protect Canada's revenue base, which supports programs and benefits that improve the quality of life for all Canadians.

This report shows that the increasing impact of the CRA's compliance and collection activities have played a key role in keeping the federal tax gap low and stable, even during a growing economy. The CRA's compliance and collection activities had a particularly strong impact on reducing the corporate income tax gap. While some compliance and collection activities are still ongoing for more recent tax years, the CRA is expected to continue reducing the tax gap relative to what it would be without investments from recent budgets.

We know that the vast majority of Canadians pay their fair share and we are committed to making sure that all taxpayers abide by tax laws. It is important that the CRA use every tool at its disposal to ensure that Canadians and Parliamentarians have confidence in the fairness of the tax system. It is equally important that we continue to seek innovative ways to understand and combat non-compliance.

Looking ahead, we will continue our work to better understand Canada's tax gap and we will keep the lines of communication open with stakeholders and all Canadians as we progress in this important work.

I am proud to continue the work to ensure that the CRA is a trusted, fair and helpful agency that meets Canadians' needs and expectations, and maintains the integrity of Canada's tax and benefits administration.

Original signed

The Honourable Diane Lebouthillier, P.C., M.P.

Minister of National Revenue

Message from the Commissioner

I am pleased to present the Canada Revenue Agency's (CRA) first overall tax gap report. The publication of this document supports the Government of Canada's commitment to encouraging an open and transparent discussion on tax non-compliance. By estimating the tax gap, the CRA can get a clearer picture of how and why taxpayers are non-compliant. A more insightful understanding of the tax gap can also help the CRA better target its compliance and collections activities over time and help to ensure a tax system that is fair and responsive for all taxpayers. This, in turn, allows the CRA to continue protecting Canada's revenue base, the foundation for all government programs, services, and benefits that improve the quality of life for all Canadians.

Studying the overall tax gap is a complex endeavor. The CRA began estimating individual components of the tax gap in 2016, beginning with the tax gap for Goods and Services Tax/Harmonized Sales Tax. Since then, we have published reports annually, each one estimating different tax gap components (personal income tax, international tax gap for personal income tax, corporation income tax, excise gap and payment gap). Each report required us to develop a unique methodology for the different tax gap components which was not an easy task. This report takes all the best practices and lessons learned over the past six years and culminates them into our first overall tax gap that includes all these components.

Estimating the overall tax gap gives us a solid foundation to analyze certain trends, and is one tool in our toolbox that will help us focus our compliance and collection activities. As the environment in which we operate continues to evolve, we will extract insights from our data to identify key areas of improvement and opportunities for innovation, in our quest for excellence as a world-class tax and benefits administrator.

Original signed

Bob Hamilton

Commissioner of the Canada Revenue Agency

Tax gap overview

What is the tax gap?

Broadly defined, the tax gap is the difference between the taxes that would be paid if all obligations were fully met in all instances, and taxes that are actually paid and collected.

In other words, it is a measure of potential tax revenue loss resulting from tax non-compliance.

Why measure it?

Tax gap measurement encourages an open and transparent discussion on tax non-compliance. In addition, a more insightful understanding of the tax gap can help the Canada Revenue Agency (CRA) better target its compliance and collections activities. Understanding how and why taxpayers are non-compliant is critical to help preserve the integrity of the tax system and to protect Canada's revenue base, which supports programs and benefits that improve the quality of life for all Canadians.

Why is there a tax gap?

Although it is sometimes seen as a measure of tax evasion or fraud, the tax gap is the result of both intentional and unintentional actions. For instance:

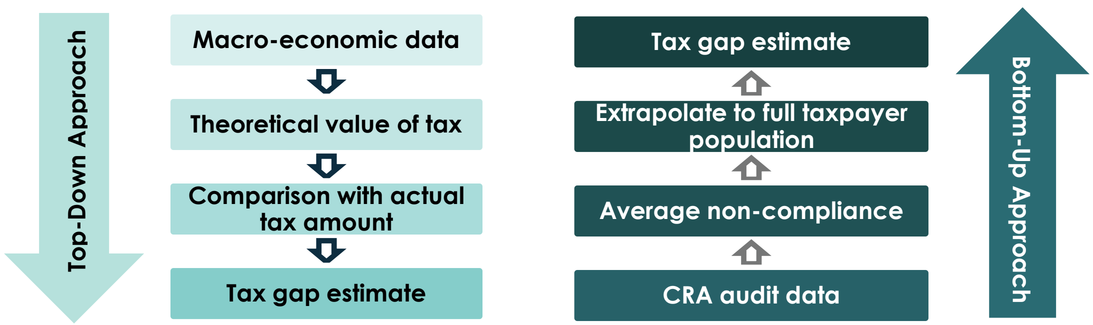
- Hiding income or over-claiming deductions or credits
- Complex tax rules that increase mistakes on tax forms
- Ignorance of tax obligations
- Bankruptcies during a recession resulting in unpaid tax debt

Since external circumstances can affect non-compliance, tax gap levels are not fully under the control of the federal government. Accordingly, it is unlikely that every dollar of the tax gap can be collected. Nevertheless, the CRA continues to reduce the tax gap as much as possible so that the tax system is fair for all Canadians.

How is it measured?

Tax gap estimation is complex and requires nuanced analysis. It is generally difficult to measure the tax gap directly since it involves income, assets, and economic activities that are deliberately hidden or errors that can be difficult to detect. Therefore, it is important to look at a wide range of data and develop appropriate methodologies for each part of the tax gap (also referred in this report as "tax gap components"). Tax gap estimates are normally prepared using historical data with certain adjustments to project to more recent tax years. As a result, tax gap estimates often have a time lag between the tax years being examined and the publication year. The ability to project tax gap estimates can be limited depending on the availability and quality of data. To manage uncertainty for particular tax gap components, there are often upper- and lower- bound estimates.

In general, there are two main approaches to estimating the tax gap:



The tax gap can be presented before and after accounting for compliance and collection results:

- **Gross tax gap** – Tax gap estimate **before** accounting for compliance and collection actions
- **Net tax gap** – Tax gap estimate **after** subtracting compliance and collection results from the gross tax gap

How is the CRA reducing the tax gap?

The CRA's compliance and collection efforts have been instrumental in identifying and reducing Canada's tax gap. Since the gap can arise from a variety of sources, the CRA takes a multifaceted approach to reduce tax non-compliance.

Executive summary

For tax year 2018, Canada's federal tax gap is estimated to be between $35.1 billion to $40.4 billion before accounting for CRA compliance and collection activities (gross tax gap).

While some compliance and collection activities are still on-going, the CRA is expected to reduce the tax gap by 42% to 48%. Therefore, the federal tax gap after accounting for CRA compliance and collection activities is estimated to be $18.1 billion to $23.4 billion (net tax gap) which is 7% to 9% of federal tax revenue.[1]

Federal tax revenue for fiscal year 2018-19 was $271.8 billion.

Key Findings:

- During fiscal years 2014-15 to 2018-19, Canada's federal tax revenue increased from $236.6 billion to $271.8 billion.
- As Canada's federal tax revenue increased, so did the potential federal tax gap. However, the CRA is holding the federal tax gap stable up to 9% of federal tax revenues. While some audits and collections are still on-going, the impact of CRA's compliance and collection activities is projected to increase over time (see Figure 1).
- The total gross tax gap was reduced, on average, by 39% to 45% during tax years 2014 to 2018. These activities had a particularly strong impact on the corporation income tax (CIT) gap, reducing the gap by an average of 48% to 59% during tax years 2014 to 2018.
- During tax years 2014 to 2018, around 80% of the total gross tax gap was related to reporting non-compliance while the other 20% was related to payment non-compliance. For the personal income tax (PIT) gap, around 70% was related to reporting non-compliance and 30% was related to payment non-compliance. For the CIT gap, 95% was related to reporting non-compliance and 5% was related to payment non-compliance.
- Although certain net tax gap amounts represent potential tax revenue loss that are difficult to identify (for example, complex international tax evasion), they can also include tax debt that is uncollectable by definition (for example, write-offs as a result of bankruptcy). Therefore, it is unlikely that the net tax gap will reach zero. However, the CRA continues to reduce the tax gap as much as possible to maintain the integrity of the tax system. In each of the following chapters, descriptions of key compliance and collection activities are provided.
- Tax gap figures in this report are estimates based on the most updated information available, but there are many sources of uncertainty and potential error. Where possible, errors are shown using error margins or upper and lower bounds. Although the CRA only began estimating the tax gap since 2016, Canada has become one of the leading countries

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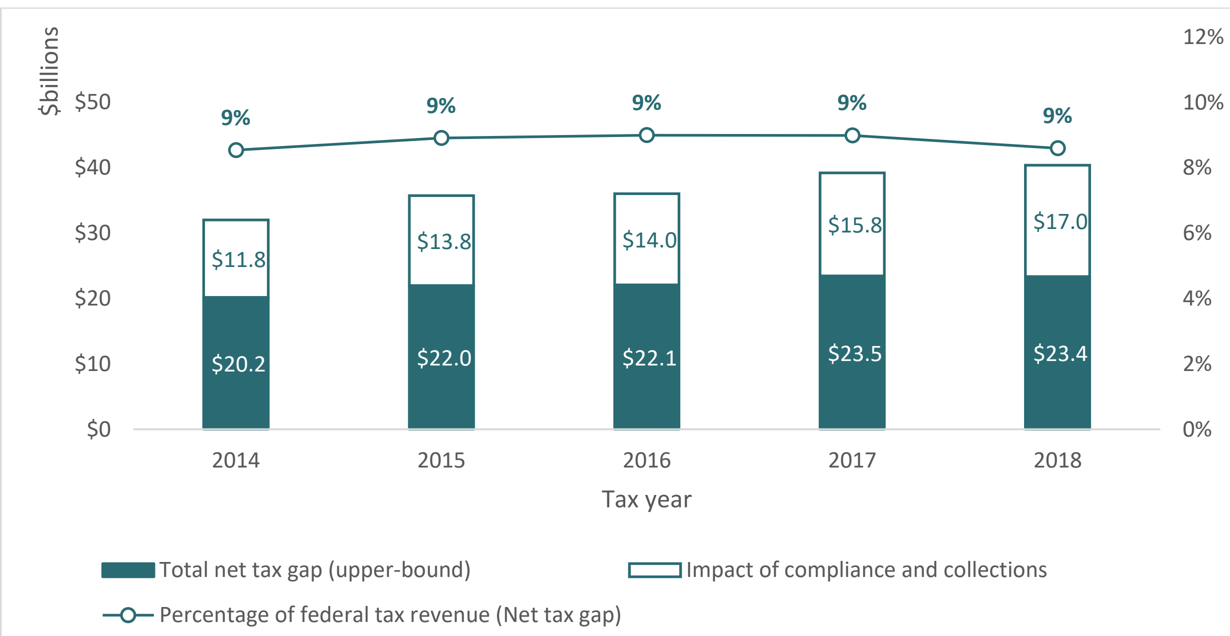
[1] Tax gap estimates as a percentage provides a better measure of compliance over time. It takes into account some of the effects of inflation, economic growth as well as changes to the tax base and tax rates. Percentages of corresponding federal tax revenues for the net tax gap are based on the Public Accounts of Canada.

that both estimate and publish their tax gaps and we are playing an important role in providing methodological advice to the international community.

Understanding how and why taxpayers are non-compliant is critical to help preserve the integrity of the tax system and to protect Canada's revenue base, which supports programs and benefits that improve the quality of life for all Canadians. It is important to note that other countries have been studying the tax gap for much longer than Canada as it can take time to understand long-term tax gap trends. Over time, estimating Canada's tax gap can allow the CRA to better understand non-compliance and use this knowledge to adjust how it delivers programs and services.

The graph below shows Canada's overall federal tax gap for the 2014 to 2018 tax years, using upper-bound estimates. Increasing dollar amounts are mainly due to the growing Canadian economy rather than increasing levels of tax non-compliance. As stated above, the figure highlights that the CRA is holding the federal tax gap stable at approximately 9% of federal tax revenues. With additional investments from recent budgets, the CRA has increased its ability to identify and target tax non-compliance. Therefore, the CRA expects the federal tax gap to decrease over time relative to what it would be without these investments.

Figure 1: Total net tax gap for tax years 2014 to 2018, in $billions*



* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

1. Introduction

In April 2016, the Government of Canada committed to estimating the federal tax gap to encourage an open and transparent discussion on tax non-compliance. Acting on this commitment, the CRA established a dedicated unit to examine and publish a series of reports analyzing Canada's tax gap.

From 2016 to 2020, the CRA studied different components of the federal tax gap and published seven reports, with a focus on the 2014 tax year. In 2016, tax year 2014 was selected as the main year of analysis because it had the most comprehensive data available from a tax gap perspective. Later reports focused on other components of the tax gap for tax year 2014 to make consistent comparisons. Through this process, the CRA took a step-by-step approach in developing appropriate methodologies for different tax gap components and established a baseline for tax gap estimation in Canada. For most components, the analysis excluded illegal activities given the data limitations and uncertainties about the amount of taxes that could actually be assessed and collected on these activities.

2016
- Tax Gap in Canada: A Conceptual Study
- Estimating and Analyzing the Tax Gap Related to the Goods and Services/Harmonized Sales Tax

2017
- Tax Assured and Tax Gap for the Federal Personal Income Tax System

2018
- International Tax Gap and Compliance Results for the Federal Personal Income Tax System

2019
- Tax Gap and Compliance Results for the Federal Corporate Income Tax System

2020
- Tax Gap for Federal Excise Duty on Cigarettes
- Payment Tax Gap and Collection Efforts

2022
- Overall Federal Tax Gap Report: Estimates and Key Findings for Tax Years 2014-2018
- Tax Gap Methodological Annex

Canada's first overall tax gap report, entitled "Overall federal tax gap report: estimates and key findings for tax years 2014-2018", brings together all previously published tax gap components with updated estimates and key findings up to tax year 2018. The 2018 tax year was selected as the latest year of analysis in order to examine the most recent audit and collection results, which can take a couple of years to complete. Although the methodologies have remained mostly consistent with previous reports, certain elements were refined to improve the quality and timeliness of tax gap estimates. For example, the payment gap methodology was adjusted so that it could be added to the reporting gaps to estimate the total gross tax gap.[2] In addition to presenting the total gross tax gap,

[2] In particular, the payment gap in this report focuses on non-payment of federal taxes owing after the payment deadline for each type of taxpayer. For more details, see tax gap methodological annex published separately on Canada.ca.

this report also examines the impact of CRA's compliance and collection activities in reducing that gap. The resulting net tax gap is presented for all major tax types for the 2014 to 2018 tax years.

The overall tax gap estimate contains estimates with different methodologies and therefore, caution must be taken when interpreting results. In addition, the overall tax gap includes estimates for major components of the Canadian tax system, but it is not fully comprehensive due to data limitations and certain components that have not been estimated at this time. The CRA will continue to examine and add to the overall tax gap to make it as comprehensive as possible.

With methodological refinements and the latest available data, this report provides updated tax gap estimates for all tax gap components published to date. Since tax gap trends may fluctuate based on improvements in tax gap methodology or updates to the underlying data, it is important to treat the tax gap as an evolving measure. As a result, tax gap estimates in this report cannot be directly compared to estimates in the CRA's previous tax gap reports. The estimates presented in this report were produced in consultation with key stakeholders including the Department of Finance Canada, Statistics Canada, Public Safety Canada, the Canada Border Services Agency (CBSA), the Royal Canadian Mounted Police (RCMP), and Health Canada.

This report is organized as follows. Sections 2 to 5 provide analysis for each major tax gap component: personal income tax (PIT), corporation income tax (CIT), goods and services tax/harmonized sales tax (GST/HST), and excise revenue.[3] At the beginning of each section, a summary of key findings and tax gap estimates is provided. Each section presents the reporting and payment gaps, the gross and net tax gaps, and key CRA's compliance and collection activities. Section 6 brings together all the tax gap components and summarizes the main findings of the report.

In addition to this overall tax gap report, the CRA has published a separate document called "Tax gap methodological annex" on Canada.ca. This document contains more technical details related to the methods used to estimate the different components of the federal tax gap. The purpose of this annex is to bring together methodologies for all tax gap components in a single document and present key methodological updates.

This report and the methodological annex provide an overview of the major components of Canada's federal tax gap as well as the methodologies used to estimate each tax gap component. The publication of these documents supports the Government of Canada's commitment to encouraging an open and transparent discussion on tax non-compliance. In addition, a more insightful understanding of the tax gap can help the CRA better target its compliance and collections activities, as well as ultimately improve the integrity of the tax system. The tax gap estimation program helps to ensure a tax system that is fair and responsive for all taxpayers. This allows the CRA to continue protecting Canada's revenue base, which supports programs and benefits that improve the quality of life for all Canadians.

[3] Excise revenue includes excise duties, taxes, and other specific levies.

2. Personal income tax (PIT) gap

The PIT gap is estimated by combining the reporting and payment gaps related to individual taxpayers. The PIT reporting gap is comprised of two main forms of non-compliance: (1) individuals not reporting income earned through Canada's underground economy and; (2) potential tax revenue loss from hidden offshore investment income. The PIT payment gap is generally comprised of unpaid taxes and repayable deductions and credits. The net PIT gap is calculated by accounting for the impact of CRA's compliance and collection efforts related to individuals.

Key findings:

- The federal PIT system is largely "tax assured" or at a low risk of non-compliance. This is due to the fact that the CRA uses information collected from third parties to verify tax returns and in some instances third parties are liable for paying taxes on behalf of individuals.
- The domestic component of the PIT reporting gap was largely due to underground economic activity by individuals hiding some form of income. During tax years 2014 to 2018, it was estimated that around 78% of the federal tax loss from the underground economy was due to employees hiding some form of compensation, while the other 22% was from self-employed individuals. While the proportion related to self-employed individuals appears small, only 15% of Canadians were self-employed in 2018.
- While the international component of the PIT reporting gap grew during tax years 2014 to 2017, there was a reversal of this trend in tax year 2018. This was largely due to a smaller stock of global wealth and lower income from realized capital gains. Additional sensitivity analysis found that improving the reporting rate of foreign income could have a significant impact on this tax gap component.
- Around 5% of individuals had taxes owing after the payment deadline and contributed to the PIT payment gap for each tax year. Most of the payment gap was due to few individuals with large amounts of unpaid taxes while a smaller portion was due to repayable deductions and credits.
- Through CRA's compliance and collection efforts, the gross tax gap was reduced by an average of 32% to 37% for tax years 2014 to 2018. Most of this impact was due to a reduction in the payment gap.
- The resulting net PIT gap was relatively low and stable during tax years 2014 to 2018, representing between, on average, 5% to 7% of the federal PIT revenue.

Table 1: PIT gap estimates for tax years 2014 to 2018, in $billions*

	2014	2015	2016	2017	2018
Reporting gap: domestic underground economy	$7.0	$7.3	$7.4	$7.9	$7.7
Reporting gap: hidden offshore investment income	$1.1 to $2.9	$1.3 to $3.5	$1.5 to $3.6	$1.5 to $4.2	$1.0 to $3.0
Payment gap	$1.8	$4.8	$5.1	$6.2	$6.3
PIT gross tax gap	$9.9 to $11.7	$13.4 to $15.6	$14.0 to $16.1	$15.5 to $18.3	$15.0 to $17.0
% of PIT revenue**	7% to 8%	9% to 10%	9% to 11%	10% to 12%	9% to 10%
Impact of CRA's compliance and collections	-18% to -22%	-33% to -39%	-34% to -39%	-36% to -42%	-39% to -45%
PIT net tax gap	**$7.8 to $9.6**	**$8.2 to $10.4**	**$8.6 to $10.7**	**$9.0 to $11.8**	**$8.3 to $10.3**
% of PIT revenue**	**5% to 7%**	**5% to 7%**	**6% to 7%**	**6% to 8%**	**5% to 6%**

* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

** Percentages of PIT revenue are based on the Public Accounts of Canada. See Table A4 for federal tax revenue amounts.

2.1 PIT reporting gap

For tax years 2014 to 2018, most of the PIT reporting gap stemmed from Canada's underground economy. Around 70% of the PIT reporting gap was related to the underground economy while around 30% was related to hidden offshore investment income. That said, international non-compliance remains an important component of the PIT reporting gap given that it generally implicates a smaller number of individuals with links to offshore corporations and trusts. The importance of reducing international tax non-compliance is also noticeable in public discourse. According to recent public opinion research, Canadians feel it is more important to address offshore non-compliance compared to domestic non-compliance.[4] Both the domestic and international components of the PIT reporting gap are presented below.

2.1.1 Domestic underground economy

One of the key characteristics of Canada's PIT system is the extensive system of arm's-length third-party reporting of information. This means that a significant amount of information in an individual's tax return is automatically verified using information slips received directly from third parties. For example, employers must file T4 slips to the CRA which contain information such as employees' salary, withheld taxes, and contributions to Employment Insurance and the Canadian Pension Plan. In addition, certain credits are fixed amounts because they are specified by legislation

[4] Annual Corporate Research 2019-2020.

such as the basic personal amount. Through this process, the CRA is able to quickly identify potential errors and omissions made by individuals on their tax returns. When income, deductions, or credits have third-party reporting requirements or are fixed amounts that are specified in legislation, they are considered "tax assured" because they are at a low risk of non-compliance. In contrast, when there is no third-party information to verify self-reported amounts (e.g., self-employment income), it is considered "tax non-assured".

The CRA's 2017 tax gap report explored these compliance indicators and found that the PIT system was largely assured.[5] As a result, the PIT reporting gap tends to originate from non-assured areas of the tax system such as income earned through the underground economy.[6]

The PIT reporting gap is estimated using Statistics Canada's underground economy estimates. In particular, potential sources of unreported taxable income are identified and the federal marginal effective tax rates are applied. During tax years 2014 to 2018, individuals hiding some form of compensation accounted for between 77% to 78% of the estimated tax loss while hidden income from self-employment accounted for the remaining 22% to 23%. While the tax gap related to self-employed individuals appears smaller, it is important to note that only about 15% of Canadians were self-employed in 2018.[7] Hidden income earned in construction accounted for around 26% to 28% of the estimated tax loss and other underground economic activities accounted for around 50% to 52%. These other activities include maintenance and repair of vehicles, child care services, and services related to household maintenance (other than renovation). For tax years 2014 to 2018, the PIT reporting gap from the underground economy ranged between $7.0 billion to $7.7 billion in constant 2018 dollars or around 5% of federal PIT revenue. To illustrate the estimation process, the table below presents PIT gap estimates related to the underground economy for tax year 2018.

[5] For example, the report found that 86% of assessed income, 74% of deduction, and 83% of credit amounts were tax assured for tax year 2014.

[6] In this report, the underground economy is defined as economic activity or transactions in goods or services that are partially or entirely hidden from the government in order to evade paying taxes and other government reporting obligations. For most tax gap components, the analysis excludes illegal activities completely given the data limitations and uncertainties about the amount of taxes that could actually be assessed and collected on these activities.

[7] Self-employed Canadians: Who and Why? by Lahouaria Yssaad and Vincent Ferrao. Statistics Canada, 2019.

Table 2: Potential federal tax loss for selected activities of the underground economy, tax year 2018*

	Estimated hidden taxable income ($billions)	Federal marginal effective tax rate	Estimated federal tax loss ($billions)	Share of total
Compensation to employees				
Construction	$8.0	21.7%	$1.7	22.6%
Tips	$6.7	13.9%	$0.9	12.1%
Trade-related activities	$2.8	21.4%	$0.6	7.8%
Other activities	$12.6	21.6%	$2.7	35.6%
Sub-total	$30.0		$6.0	78.1%
Self-employed individuals				
Construction	$2.4	18.1%	$0.4	5.8%
Rent/rooming and boarding	$0.7	24.1%	$0.2	2.2%
Other activities	$5.0	21.5%	$1.1	14.0%
Sub-total	$8.1		$1.7	21.9%
Total	**$38.1**		**$7.7**	**100%**

* All amounts are in constant 2018 dollars. Totals may not add due to rounding.

2.1.2 Hidden offshore investment income

Estimating the potential tax loss from offshore activities can be difficult given the unique challenges of detecting unreported foreign income. In general, international tax non-compliance implicates a relatively small portion of individuals who do not report their offshore accounts or those that use sophisticated means to hide income through a complex web of offshore companies and trusts. In certain cases, these complex structures are marketed by professionals as tax schemes that promise to reduce taxes.[8] Data on these offshore corporations and trusts are sparse and it can be difficult to distinguish between legitimate uses of these financial entities from tax non-compliance. Offshore leaks, such as the Panama and Paradise Papers, as well as formal information sharing agreements, including electronic funds transfers and common reporting standards, have increased the amount of data on these offshore entities and have helped the CRA investigate potential cases of international tax non-compliance. In addition, the CRA conducts internationally-focused audits of high-risk individuals and their related financial entities. For tax years 2014 to 2018, the CRA continues to identify international tax non-compliance with $550 million in federal tax already assessed by these audits. Corporations and trusts related to high-risk individuals accounted for the majority of this amount. Since internationally-focused audits can take many years to complete, the CRA expects to assess additional federal taxes for tax years 2014 to 2018 in the future. Since these audits are highly

[8] The CRA has many tools to identify and address abusive tax schemes including audits of promoters, third-party penalties, and even jail time in some cases.

targeted and tend to focus on high-net-worth individuals[9], it was not possible to extrapolate the results to the wider population to estimate the international tax gap using a bottom-up approach.

To overcome this limitation, academic studies have attempted to estimate international tax non-compliance using macro-economic data such as global financial statistics and international banking data. In recent years, key contributions to the academic literature have increased the feasibility of estimating the international tax gap using a top-down method. In 2018, the CRA estimated Canada's first international tax gap for tax year 2014 by adopting the methodology developed by academics which captures potential tax loss from hidden offshore investment income.[10] Building on the findings of this report, the CRA used the latest available macro-economic data at the time of writing this report to update the offshore investment income tax gap for tax years 2014 to 2018.[11]

During tax years 2014 to 2017, there was a general increase in the PIT reporting gap from hidden offshore investment income from $2.9 billion to $4.2 billion (upper-bound estimates). There was a reversal in this trend in tax year 2018, as this tax gap component was estimated to be between $1.0 billion to $3.0 billion.

These trends were heavily influenced by the direction of global offshore wealth and investment income earned through realized capital gains, which varied significantly from one year to another. This suggests that addressing the international component of the PIT gap may require a better understanding of tax non-compliance related to capital gains in the international market.

While all tax gap estimates have some degree of uncertainty, the international component of the PIT reporting gap is particularly difficult to estimate since it relies on many assumptions that are difficult to verify. For example, the allocation of hidden wealth between each type of assets can vary from year to year, Canadian offshore investments could have higher or lower yields, and the actual underreporting rate could have fluctuated based on external factors such as CRA's compliance efforts. Given these sources of uncertainty, a sensitivity analysis was conducted to assess the variability of the tax gap estimate based on the assumptions chosen. This analysis found that this tax gap component is particularly sensitive to the reporting rate of foreign income. For example, a 10% increase in the reporting rate could have resulted in a 9% reduction in the international tax gap estimate.

[9] In general, the CRA defines high-net-worth individuals as those who either alone or together with associates control a net worth of at least $50 million.

[10] The CRA's methodology is based on the work of Zucman (2013-2017, which include publication with various co-authors) and Pellegrini et al. (2016). More information is available in the CRA's methodological annex.

[11] In certain cases where the latest data were not available, certain assumptions were necessary to update the international components of the tax gap estimate. More details can be found in the methodological annex.

2.2 PIT payment gap

Individuals are generally required to file an Income Tax and Benefit Return (T1 return) and pay their balance owing by April 30th of the following year.[12] If individuals do not pay enough taxes during the year or they claimed benefits to which they are not entitled, they may have a balance owing at the payment deadline. When individuals do not pay their balance owing by the deadline, they contribute to the payment gap. There are two main sources of the PIT payment gap: unpaid taxes and repayable deductions and credits. The majority of the PIT payment gap was due to unpaid taxes for tax years 2014 to 2018. On average, 91% of the payment gap was from unpaid taxes and 9% was due to repayable deductions and credits.

> **This suggests that the majority of payment non-compliance stems from individuals not paying their taxes rather than having to pay back unentitled deductions and credits.**

In general, the payment gap was largely due to a small number of individuals with a large amount of taxes owing. Analysis of the payment gap showed that tax year 2014 was an unusual year with lower levels of payment non-compliance compared to the other tax years.[13] For example, for tax year 2014, the payment gap was $1.8 billion in constant 2018 dollars or 1% of federal PIT revenue. During tax years 2015 to 2018, the PIT payment gap ranged between $4.8 billion and $6.3 billion in constant 2018 dollars or 3% to 4% of federal PIT revenue. Non-compliant individuals at the payment deadline were more likely to be married/common-law males aged 45 to 64 with reported income between $25,000 and $93,000 from Alberta or Quebec. Individuals with long-standing tax debt were more likely to be unmarried males aged 35 to 54 from Ontario.

Based on the CRA's 2020 study, the PIT payment gap for a specific year tends to be at its highest level during the first following year before declining rapidly. Accordingly, the PIT payment gap covered in this report has already decreased significantly and will continue to do so. That said, this gap will stabilize over time as a higher fraction of remaining amounts become uncollectible (i.e., write-offs).

2.3 PIT gross and net tax gaps

The PIT gross tax gap is calculated by combining the PIT reporting and payment gaps. Looking at the average of the annual distribution for tax years 2014 to 2018, 48% of the gross PIT gap was related to the underground economy, 22% was related to hidden offshore investment income, and 30% was related to the payment non-compliance. The Figure below shows the distribution of the PIT gross tax gap for tax years 2014 to 2018.[14]

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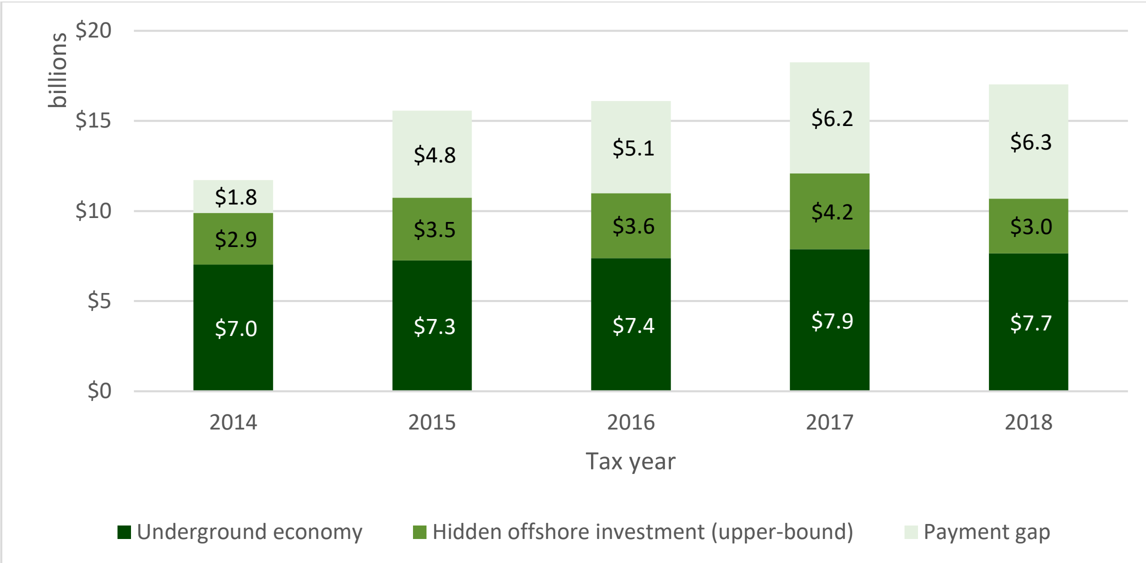
[12] The due date can slightly vary due to particular circumstances (e.g., falls on a weekend or extended due to a pandemic). For more information, please visit: [Payments for individuals - Payments to the CRA - Canada.ca]

[13] This could be, in part, due to the filing deadline changing from April to May for tax year 2014.

[14] Upper-bound estimates were used for the PIT reporting gap related to hidden offshore investments.

Figure 2: Distribution of PIT gross tax gap for tax years 2014 to 2018, in $billions*



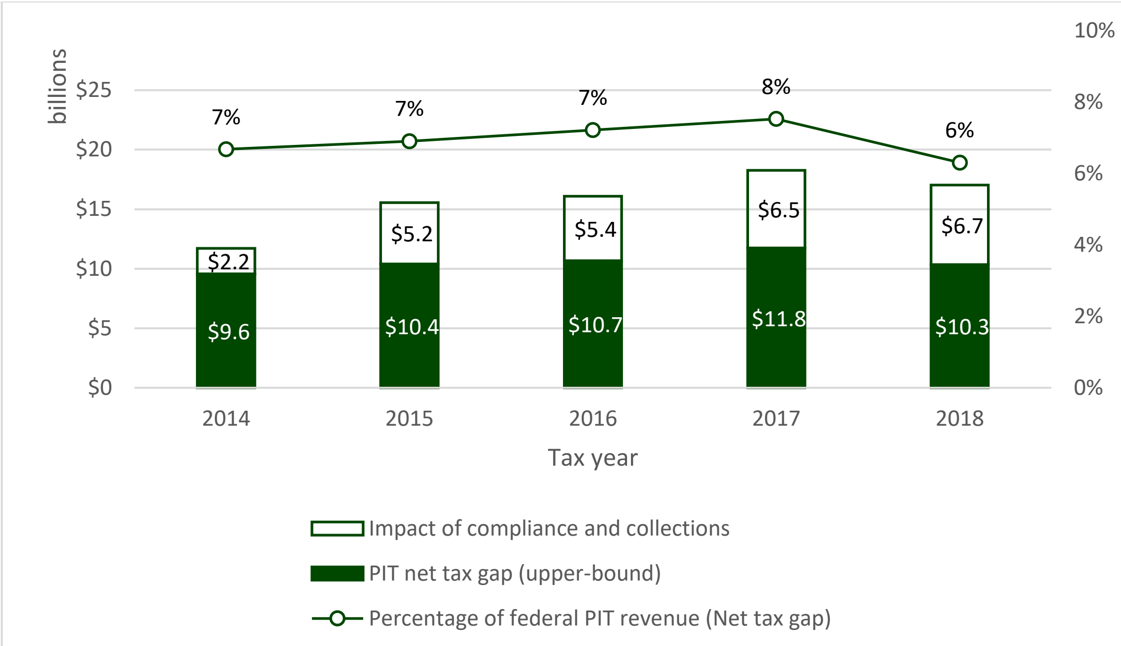
* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

After accounting for both compliance and collection efforts by the CRA, the total PIT gross tax gap was reduced by an average of 32% to 37% for tax years 2014 to 2018.

> **The CRA's compliance and collection efforts had a robust impact on reducing the PIT gap. Most of this impact was due to a reduction in the payment gap.**

As shown in Figure 3, the net tax gap during tax years 2014 to 2018 remained relatively stable ranging between, on average, 5% to 7% of federal PIT revenue. The impact on reducing the PIT gap has increased over time and for tax year 2018, there was a drop in the net PIT gap as a percentage of federal PIT revenue to 6%. This was partly due to CRA's compliance and collection efforts as well as higher federal PIT revenue in 2018-19.

Figure 3: PIT net tax gap for tax years 2014 to 2018, in $billions*



* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

2.4 Compliance and collection activities related to the PIT gap

As shown in the previous section, the CRA's compliance and collection activities have reduced the PIT gross tax gap by identifying and collecting taxes owed by individuals. When it comes to the PIT gap, CRA's compliance and collection activities can impact a large number of people with a wide range of financial circumstances. This wide distribution of individuals can make it difficult for the CRA to address non-compliance comprehensively. Therefore, compliance interventions generally follow an escalating approach, from encouraging compliance through respectful and empathetic service (e.g., educational outreach) to enforcing it (e.g., audits). While encouraging compliance can indirectly reduce the tax gap (e.g., by reducing mistakes), CRA audits directly identify the reporting gap and reassess the taxpayer with additional taxes owing. Subsequently, the CRA's collection efforts help reduce the payment tax gap by collecting outstanding tax debts.

The first step towards reducing the PIT gap is through voluntary compliance by ensuring that individuals are able to fulfill their tax obligations. Given that the tax system can be fairly complex, the CRA focuses on providing services and programs to millions of Canadians with the goal to be trusted, fair, and helpful by putting people first. For example, the CRA invests in free tax clinics to help individuals prepare their income tax and benefit returns through the Community Volunteer Income Tax Program. This program not only helps reduce filing non-compliance but also ensures that Canadians are receiving their entitled benefits. For those that prepare taxes online, the CRA also offers an "auto-fill my return" option in My Account which populates the returns of taxpayers who are using third-party software. Once the return is populated, the taxpayer only needs to review the information to ensure accuracy and completeness before filing it. The CRA is also making further improvements to provide more convenient access to services, making information more helpful and easier to understand, and ensuring Canadians feel understood, respected, and valued.[15]

Addressing the underground economy through public education and compliance actions also remains a top priority for the CRA. As such, the CRA has had a dedicated underground economy strategy since 2014. The latest three-year strategy[16] focuses on four areas to prevent, detect, and address unreported or under-reported sales or income:

1. Finding undeclared income and hidden commercial transactions through data analysis, legislative tools and other information sources including leads from Canadians.
2. Correcting behaviour that is not compliant (through audits, penalties, criminal investigations and prosecutions, where warranted).
3. Staying up to date on the underground economy (through stakeholder engagement, working with other levels of government, and international information sharing).
4. Reducing the social acceptability of participating in the underground economy by raising awareness of risks with consumers and conveying strong messages about negative consequences for those who avoid or evade their tax obligations.

In addition to the underground economy, the CRA also prioritizes identifying and addressing international tax non-compliance. As such, the CRA requires Canadian taxpayers to report their income from both domestic and foreign sources and submit additional forms on their foreign assets including their involvement in certain foreign corporations and trusts. For example, individuals as well as other financial entities (i.e., corporations, trusts, and partnerships) are required to file a Foreign Income Verification Statement (Form T1135) for "specified foreign property" they own.[17] For tax year 2018, there were around 365,000 T1135 filers that reported $266 billion in foreign assets, $4.1 billion in foreign income, and $4.2 billion in capital gains. Although individuals represented the majority of T1135 filers (78%), corporations, trusts, and partnerships together reported the majority of the total value of foreign assets, income, and capital gains. This suggests the importance of a holistic approach to address international PIT non-compliance. Top countries where foreign assets and income were reported tended to be the US and China. These findings remained relatively consistent for tax years 2014 to 2018.

The Government of Canada is committed to reducing international tax non-compliance. For example, starting in 2021–2022, the government will invest an additional $606 million over five

[15] For more details on how the CRA is putting people first through service improvements, visit : https://www.canada.ca/en/revenue-agency/campaigns/putting-people-first-cra.html

[16] In light of the COVID-19 pandemic, and the strategic choices that were made in real time, the third comprehensive underground economy strategy has been deferred for publication until 2022. In the interim, the underground economy business plan 2021-2022, published on Canada.ca, describes the CRA's work to address the underground economy over the 2021–2022 period. As such, the plan extends the focus set out in previous strategies to manage risk.

[17] Specified foreign property is defined in subsection 233.3(1) of the Income Tax Act. Additional information on T1135 can be found in the CRA's 2018 tax gap report.

years to hire additional offshore-focused auditors to identify individuals who avoid taxes by hiding income and assets offshore.[18] This will enhance the audit function targeting higher-risk taxpayers, including those of high-net-worth Canadians, and strengthen the Government's ability to address tax crimes. This is expected to further reduce international tax non-compliance and result in $1.4 billion in additional tax revenue over five years[19] with a more conservative estimate of $782 million.[20]

[18] 2021 Federal Budget

[19] Fall Economic Statement (FES) 2020, Section 4.8.2.3

[20] Costing note on the Fall Economic Statement (FES) 2020, Section 4.8.2.3 Strengthening tax compliance, PBO.

Figure 4: Examples of CRA offshore information sharing activities

Examples of CRA Offshore Information Sharing Activities

Examples of Activities	Objective	Main Target Group
Offshore Tax Informant Program (OTIP)	OTIP allows the CRA to award payments to individuals who provide specific and credible information on major international tax non-compliance.	Major international tax non-compliance
Related Party Initiative (RPI)	RPI is a dedicated program to identify, risk assess, and take compliance action with a focus on addressing non-compliance of the wealthy.	High-net-worth individuals and their related networks including corporations and trusts
Electronic Funds Transfers (EFT)	The CRA analyzes international EFT information for transfers of $10,000 or more, as well as those to and from certain jurisdictions of concern.	Higher-risk international transfers
Common Reporting Standard (CRS)	Through CRS, the CRA receives information from financial institutions around the world on offshore financial accounts held by Canadian individuals and entities.	Canadian taxpayers with offshore accounts
Offshore Compliance Advisory Committee (OCAC)	OCAC is an independent expert advisory committee on offshore tax evasion and aggressive tax planning. The mandate of this committee is to advise the Minister of National Revenue and the CRA on strategies to combat offshore tax non-compliance.	Program and policy changes based on the advice and recommendations of the committee

The CRA also takes a forward-looking approach to manage emerging risks. For example, in 2018, the CRA established a dedicated cryptocurrency unit to build intelligence in this space. As part of its ongoing activities, this unit conducts audits focused on risks related to cryptoassets as part of a broader strategy focused on emerging technologies and business models. The CRA detects and addresses non-compliance in Canada's cryptoasset sector through the engagement with international partners to share best practices, develop international reporting standards, and for outreach with the tax community. The CRA leverages third-party data, like Unnamed Persons requirements, Request for information and Exchange of information with our treaty partners. The unit has invested in and is developing tools and job aids on top of the continual performance of compliance activities, which include audits and reviews. Moreover, the CRA is working on publishing tax tips and social media posts regarding cryptoasset reporting to enhance taxpayer awareness and education of tax reporting requirements. Ongoing research is required to better develop our understanding of the potential impact and how to address cryptoassets on Canada's tax gap.

Finally, the CRA's collection efforts reduce the outstanding tax debt by supporting taxpayers who want to resolve their debt, working with those who cannot pay the full debt amount, and addressing non-compliance through enforcement interventions for a small minority of deliberate non-compliant taxpayers. First, the CRA calls individuals with tax debt in order to collect taxes owing in full. If full payment is not possible, individuals can negotiate a payment arrangement with the CRA. If phone calls are unsuccessful, letters are sent and if there is still no contact, third party searches are used to locate the taxpayer. When the CRA is unable to locate the taxpayer, the CRA attempts to trace assets or income in order to take legal action to resolve the tax debt. In some cases, certain tax debts become uncollectable such as when a taxpayer goes bankrupt. After the CRA has exhausted all possible means of collection, uncollectible taxes are written-off (i.e., deleted from active inventory of accounts receivable). Through these measures, the CRA fosters voluntary compliance through respectful and empathetic service before taking direct actions to collect taxes owing through various channels.

3. Corporation income tax (CIT) gap

The CIT gap is estimated by combining the reporting and payment gaps related to corporations resident in Canada. The CIT gaps are estimated separately for incorporated small and medium-sized enterprises (SMEs) and large corporations due to their unique characteristics. The net CIT gap is calculated by accounting for CRA's compliance and collection efforts related to these corporations.

Key findings:

- During fiscal years 2014-15 to 2018-19, Canada's federal CIT revenue increased from $41.7 billion to $50.4 billion. Despite this increase in the tax base, the CRA is holding the CIT gap stable as a percentage of federal CIT revenue.
- Incorporated SMEs contributed to around 30% of the CIT reporting gap before accounting for CRA's compliance actions. Although there was a steady increase in the SME reporting gap during tax years 2014 to 2018, this gap as a percentage of federal CIT revenue remained relatively stable at around 7% to 8% each year. This suggests that the increase in this gap was mainly due to an increasing SME tax base.
- It is estimated that large corporations contributed to around 70% of the CIT reporting gap before accounting for CRA's compliance actions, despite representing 1% of all corporations in Canada. Similar to SMEs, there was an increase in the large corporation reporting gap during tax years 2014 to 2018 but this gap as a percentage of federal CIT revenue remained relatively stable at around 17% to 21%. The increase in this gap was mostly due to higher corporate revenues.
- Around 3% of corporations had a payment gap during tax years 2014-2018. For certain corporations, the payment tax gap increases after couple of years as they are reassessed. However, corporations tend to pay their taxes owing quickly. This suggests that payment non-compliance is a less significant factor for corporations, particularly for large corporations.
- The CRA's compliance and collection efforts had a significant impact on reducing the CIT gap for tax years 2014 to 2018, leading to a decline of between, 48% to 59% on average.
- The resulting net CIT gap remained relatively stable for tax years 2014 and 2018, usually ranging between, on average, 10% to 16% of federal CIT revenue.
- It can take time to assess the impact of CRA's compliance and collection activities for the corporate population since it can take multiple years to complete comprehensive audits. This is particularly true for large corporations given their size and their global operational scope. With additional investments from recent budgets, the CRA has increased its ability to identify and target tax non-compliance. Therefore, the CRA expects the federal CIT gap to decrease over time relative to what it would be without these investments.

Table 3: CIT gap estimates for tax years 2014 to 2018, in $billions*

	2014	2015	2016	2017	2018
Reporting gap: small and medium enterprises	$2.6 to $3.4	$2.8 to $3.6	$2.9 to $3.7	$3.1 to $4.0	$3.3 to $4.2
Reporting gap: large corporations	$7.2 to $9.0	$6.7 to $8.3	$7.4 to $ 9.2	$7.9 to $ 9.8	$9.0 to $11.3
Payment gap	$1.2	$0.6	$0.5	$0.7	$0.7
CIT gross tax gap	$11.0 to $13.5	$10.1 to $12.5	$10.8 to $13.4	$11.7 to $14.5	$13.0 to $16.2
% of CIT revenue**	26% to 32%	23% to 29%	25% to 31%	24% to 30%	26% to 32%
Impact of CRA's compliance and collections	-50% to -62%	-46% to -57%	-46% to -57%	-47% to -58%	-49% to -60%
CIT net tax gap	**$4.2 to $6.7**	**$4.3 to $6.7**	**$4.6 to $7.2**	**$4.9 to $7.7**	**$5.1 to $8.3**
% of CIT revenue**	**10% to 16%**	**10% to 16%**	**11% to 17%**	**10% to 16%**	**10% to 17%**

* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

** Percentages of CIT revenue are based on the Public Accounts of Canada. See Table A4 for federal tax revenue amounts.

3.1 CIT reporting gap

The CIT reporting gap is estimated by using internal audit data and applying appropriate methodologies to extrapolate to the wider population. Since corporations can range from small businesses to multinational corporations, the CIT reporting gap is estimated separately for SMEs and large corporations.[21] For example, around 99% of all corporations in Canada are SMEs across diverse industries. The majority of these SMEs are small Canadian-controlled private corporations (CCPCs) that are generally subject to a lower tax rate. In contrast, large corporations only represent 1% of all incorporated businesses, but they tend to operate on a much larger scale and contribute to about half of the total CIT revenue at the federal level. In addition, large corporations and their economic activities are generally more complex and global. The CIT reporting gap estimates for SMEs and large corporations are presented below.

3.1.1 Small and medium-sized enterprises

In general, the CRA conducts targeted audits of taxpayers that are at a higher risk of non-compliance. These risk-based audits support the CRA's overall compliance strategy, which aims to minimize the compliance burden for a large number of taxpayers reporting correctly while dedicating valuable resources to high-risk areas. However, given the large number of SMEs in

[21] SMEs are defined as corporations with less than or equal to $20 million in total gross revenues or up to $50 million for certain industry sectors. Large corporations are defined as corporations with total gross revenues above the SME threshold. For more details, refer to the tax gap methodological annex on Canada.ca

diverse industry sectors, the CRA also conducts periodic random audits to better understand compliance trends and enhance risk-assessment systems. Based on the results from the latest random audits, about half of SMEs that were randomly audited made at least one reporting error on their tax returns for tax year 2011.[22] Among audited SMEs, about 38% of them were assessed with an average assessment ranging between $1,690 to $2,160 in additional federal tax liability in constant 2018 dollars. Extrapolating the results to the entire SME population, the CIT reporting gap from SMEs is estimated to be between around $2.5 billion to $3.1 billion for tax year 2011.

Given that the most recent stratified random audit results for incorporated SMEs were for tax year 2011, it was necessary to develop a method to extrapolate the findings to more recent tax years. Two growth rates were used to project the SME reporting gap for tax years 2014 to 2018.

1. The first growth rate accounts for changes in the SME tax base and certain tax laws. For example, this growth rate would account for the economic growth of SMEs due to higher income levels and changes to deductions, credits, and tax rates.

2. The second growth rate accounts for fluctuations in non-compliance behaviours in the underground economy compared to the income actually reported to the CRA.[23]

During tax years 2014 to 2018, there was a steady increase in the SME reporting gap from, on average, $3.0 billion to $3.8 billion. However, the SME income related to the underground economy is estimated to have grown at a slower pace compared to the income reported to the CRA.[24] In addition, the SME reporting gap as a percentage of federal CIT revenue remained relatively stable at around 7% to 8% each year.

> **This suggests that the increase in the SME reporting gap was more likely due to an increasing tax base rather than an increase in non-compliance levels.**

3.1.2 Large corporations

Unlike SMEs, the CRA relies almost exclusively on risk-based audits for large corporations given the relatively small number of taxpayers in this population. The CRA continually monitors this population and risk assesses 100% of the identified corporations on a regular basis. Large corporations that are determined to be at a higher-risk of non-compliance are subject to rigorous compliance audits where the CRA examines relevant books and records to ensure that all tax obligations have been met. While risk-based audits allow the CRA to focus its efforts on higher-risk taxpayers, non-compliance identified through these audits cannot be directly extrapolated to the population given that audits are selected based on the risk of non-compliance. Therefore, the CRA

[22] The latest random audits for incorporated SMEs were conducted during fiscal years 2013-14 and 2014-15 for tax year 2011.

[23] Specific details on these growth rates can be found in the methodological annex.

[24] Additional details can be found in the methodological annex.

uses two statistical methods to minimize this selection bias and estimate the federal CIT reporting gap for large corporations.

1. The first method is called the extreme value methodology which was first adapted by the US Internal Revenue Service to develop its tax gap estimate for large corporations. This method has also been employed in similar contexts in the academic literature.[25] One key limitation of this method is that it can underestimate the tax gap.[26] Therefore, the CIT reporting gap from the extreme value methodology is used as a lower-bound estimate.

2. The second method is called cluster analysis, which refers to an unsupervised machine learning technique in the field of artificial intelligence. In contrast to the extreme value method, cluster analysis can overestimate the tax gap.[27] Therefore, the CIT reporting gap from cluster analysis is used as an upper-bound estimate.

Based on these two methods, the CIT reporting gap related to large corporations was estimated for tax years 2014 to 2018. During these years, there was an increase in the reporting gap from large corporations ranging between, on average, $7.6 billion to $9.5 billion in constant 2018 dollars.

> **However, the increase from tax year 2014 to 2018 (around 26% for the upper-bound estimate) was mainly due to an increasing tax base. For example, corporate tax revenue from 2014 to 2018 grew by 21%. Other factors, such as higher non-compliance levels, seem to have been less relevant to this increase.**

3.2 CIT payment gap

Corporations resident in Canada are required to file a Corporation Income Tax Return (T2 return) every tax year whether or not there is any tax payable. In general, T2 returns must be submitted no later than six months after the end of their fiscal year.[28] Most corporations pay income tax in monthly or quarterly instalments and the balance owing is due within either two or three months after the end of the corporation's reporting period depending on the balance-due day. Unlike individuals, the payment deadline can vary for each corporation depending on the reporting period.

In general, SMEs contributed the most to the CIT payment gap for tax years 2014 to 2018. On average, more than 90% of the CIT payment gap was related to SMEs while less than 10% was related to large corporations except for tax year 2014 when the ratio was slightly different. However, large corporations tend to have delayed payment non-compliance five or six years after a given tax year due to reassessments that identify additional taxes owing. Similar to the PIT payment gap, a small number of corporations were mainly responsible for the CIT payment gap. During tax years 2014 to 2018, the CIT payment gap was, on average, $0.7 billion or 2% of federal CIT revenue.

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[25] Bloomquist, K.M., S. Hamilton, and J. Pope. "Estimating corporation income tax under-reporting using extreme values from operational audit data." Fiscal Studies, 35, 4 pp. 401-419. 2014.

[26] Additional details on the extreme value method can be found in the methodological annex.

[27] Additional details on cluster analysis can be found in the methodological annex.

[28] For example, if a corporation's fiscal year ends on March 31, the filing deadline would be September 30.

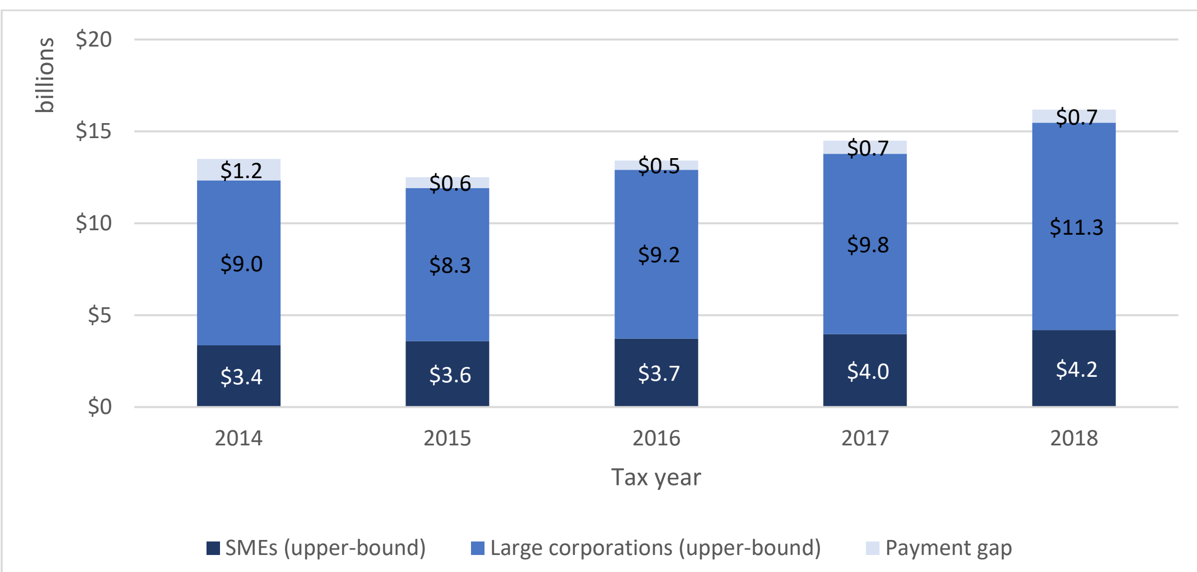
This suggests that payment non-compliance is a relatively minor issue for corporations. Non-compliant SMEs at the payment due date were more likely to be relatively new CCPCs from Alberta in the professional, scientific and technical services, as well as transportation and warehousing sectors. SMEs with long-standing tax debt (10 years as of 2020) tended to be CCPCs from Alberta and Quebec mostly in the construction sector. Non-compliant large corporations at the payment due date also tended to be CCPCs from Alberta in the construction and retail trade sectors, but they were older than the non-compliant SMEs. Large corporations with long-standing tax debt tended to be public corporations from Nova Scotia and Quebec in the Finance and insurance as well as professional, scientific and technical services sectors.

Based on the CRA's 2020 study, CIT payment gap tends to be at its highest level after the fifth or sixth year as complex audits with high adjustments are completed around that time. However, further analysis for tax years 2014 to 2018 showed that, at the aggregate level, the payment gap may not decline significantly even after 10 years.

3.3 CIT gross and net tax gaps

The CIT gross tax gap is calculated by combining the CIT reporting and payment gaps. Looking at the average of the annual distribution of the gross tax gap for tax years 2014 to 2018, 27% of the gross CIT gap was related to reporting non-compliance by SMEs, 68% was related to reporting non-compliance by large corporations, and 5% was related to the payment non-compliance by both types of corporations. Figure 5 shows the distribution of the gross CIT gap by components using upper-bound estimates.

Figure 5: Distribution of CIT gross tax gap for tax years 2014 to 2018, in $billions*



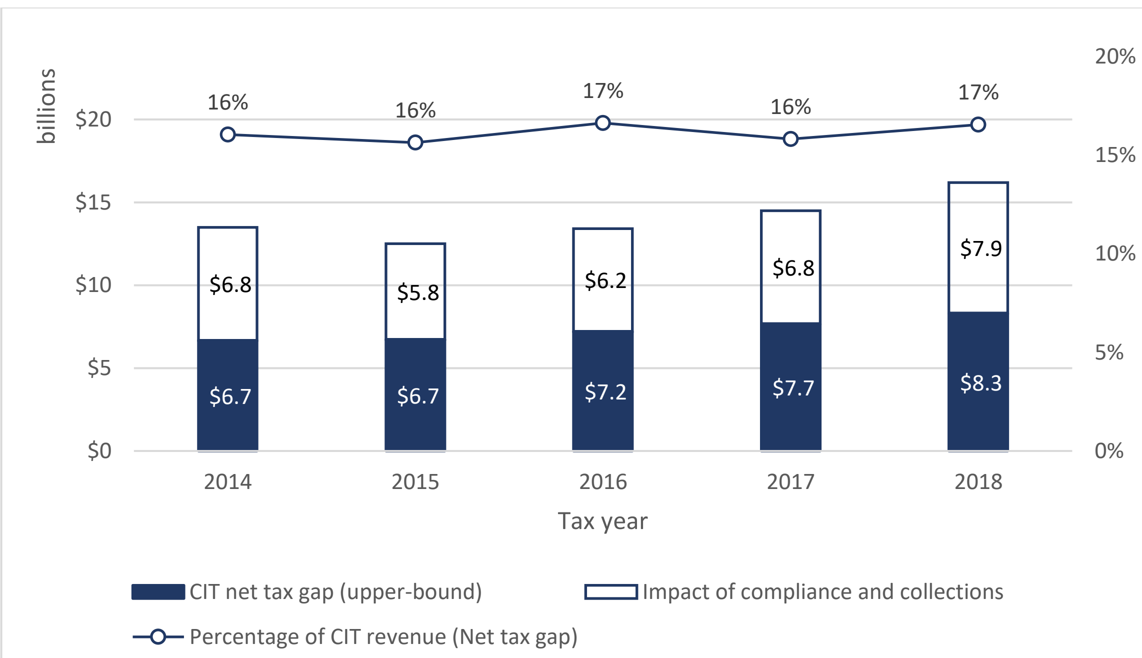
* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

Unlike for individual taxpayers, it can take longer to assess the impact of CRA's compliance and collection activities for the corporate population since it can take multiple years to complete comprehensive audits. This is particularly true for large corporations given their size and their global operational scope. This is one of the main reasons tax gap analysis focuses on previous tax years and requires frequent updates. Given that certain audits and collection activities are not all finalized, it was necessary to project the potential federal tax adjustments for more recent years using historical data.[29]

After accounting for the projected impact of CRA's compliance and collection efforts, the CIT gross tax gap is estimated to decline by an average of 48% to 59% for tax years 2014 to 2018.

As shown in Figure 6, the upper-bound net tax gap estimate was, on average, $7.3 billion or 16% of federal CIT revenue. The CRA's compliance and collection activities had a substantial impact on reducing the CIT gap, particularly for tax year 2018, reducing the gap by $7.9 billion. While the net CIT gap as a dollar amount is smaller than the net PIT gap, the percentage of corresponding federal revenue is higher. This is because the proportion of federal CIT revenue is much smaller than the federal PIT revenue. For example, around 60% of the total federal tax revenue came from PIT whereas around 18% came from CIT during 2014 to 2018.[30]

Figure 6: CIT net tax gap for tax years 2014 to 2018, in $billions*



* All amounts are in constant 2018 dollars. Totals may not add due to rounding. Does not include non-residents.

29 Details related to this projection method is provided in the methodological annex.

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3.4 Compliance and collection activities related to the CIT gap

While the impact of CRA's compliance and collection activities can take longer to materialize for corporations, current results suggest that the CRA is effectively reducing the CIT gap. Given that the size and scope of corporations can range so widely, the CRA takes a multi-facetted approach to improve corporate compliance through both domestic and international measures. This section describes some of CRA's key compliance and collection efforts targeted at SMEs and large corporations.

For incorporated SMEs, the CRA focuses on using a wide range of interventions that are tailored to the risk of non-compliance, recognizing that SMEs are diverse and face different tax compliance challenges. With this approach, the CRA is better able to respond effectively and efficiently to both prevent and reduce the tax gap. For SMEs with a low risk of non-compliance, the CRA focuses on initiatives such as educational outreach and reminder letters to encourage voluntary compliance and reduce common reporting errors. For higher-risk SMEs, the CRA uses detection capabilities to ensure that audit and enforcement activities are directed towards the right corporations.

For large corporations, the CRA takes a more comprehensive approach to monitor and address tax non-compliance with the help of auditors, lawyers, economists, data scientists, and industry specialists. This is mainly due to the fact that large corporations and their economic activities tend to be more complex and global which present additional challenges of identifying tax non-compliance. For example, the CRA continually monitors its risk assessment processes to ensure that 100% of the identified large corporate population is risk-assessed on an annual basis. In addition, collaboration with international partners have been crucial in detecting and addressing tax non-compliance of multinational corporations. For example, Canada is part of the OECD's Forum on Tax Administration which promotes the coordination of strategies that will ensure that multinationals are paying their fair share of tax. The CRA is also part of the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC), which facilitates cooperation and information sharing between 42 tax administrations to tackle international non-compliance. Figure 7 lists some of CRA's key compliance activities related to corporations as well as their key target group.

Figure 7: Examples of CRA's compliance activities for corporations

Examples of CRA Compliance Activities for Corporations

Examples of Activities	Objective	Main Target Group
CRA video series	Educational videos for businesses on how to avoid common mistakes.	Lower-risk SMEs
Industry Campaign Approach	CRA works with industry associations to provide businesses with sector-specific tax information that will help them comply with their tax obligations.	Lower-risk SMEs
Liaison Officer service	In-person visits or seminars to help small businesses better understand their tax obligations.	Lower-risk SMEs
Underground economy specialist teams	CRA teams with advanced training in identifying unreported and under-reported income.	Higher-risk SMEs
Risk algorithms & business intelligence tools	Detection tools and predictive models to better identify tax non-compliance, including complex tax schemes.	Higher-risk SMEs & large corporations
Nudge experiments	Combination of economics and psychology to influence behaviours and choices related to income tax return filing.	Non-filing corporations
Enforcement Actions	Audits, penalties, criminal investigations.	Higher-risk SMEs & large corporations
Integrated audit teams	Integrated teams of specialists auditing high-risk multinational corporations and unravelling complex international and abusive tax avoidance transactions.	Higher-risk large corporations
Voluntary Disclosures Program (VDP)	VDP offers taxpayers, including corporations, a chance to voluntarily correct inaccurate or incomplete information on a previously filed tax return or to disclose omitted information that should have been provided to the CRA.	All taxpayers
Country-by-Country Reporting (CbC)	Through CbC, the CRA receives information on multinational corporations and their global operations in each tax jurisdiction where they do business.	Large corporations

The CRA's collection efforts also reduce the outstanding tax debt of corporations. Similar to individuals, the CRA takes an escalating approach to collect tax debt. This includes contacting the shareholders of corporations before taking legal actions to collect taxes. In certain circumstances, the CRA may still collect taxes even when there is an ongoing legal dispute. For example, the CRA can start collecting 50% of assessed income tax for large corporations even if they have filed for an objection or an appeal. In addition to the standard process of resolving tax debt, the CRA also takes proactive measures to reduce payment non-compliance. For example, to contribute to the CRA's efforts in identifying non-filers participating in the underground economy, the CRA reviews newly registered corporations to provide referrals to collections to address non-compliance.

4. Goods and services tax/harmonized sales tax (GST/HST) gap

The federal GST/HST gap includes both the reporting and payment gaps. The reporting gap represents the difference between the federal GST/HST liability that would result from full compliance and the tax revenues assessed by the tax administrations (CRA and CBSA).[31] The reporting GST/HST gap includes reporting non-compliance related to GST and the federal portion of HST. The payment gap represents the GST/HST amounts due but not remitted to the CRA by the payment due date.[32] Since the federal government is responsible for the unrecoverable amounts of the provincial portion of the HST as per the Coordinated Integrated Tax Coordination Agreement, the federal payment gap also includes the provincial component of the HST that is not collected.

Like other tax gap components, the net GST/HST gap is calculated by accounting for CRA's compliance and collection efforts, including voluntary remittances occurring after the payment due date.[33]

Tax gap estimates may vary from year-to-year but the fluctuations can be due to factors other than changes in non-compliance. For GST/HST in particular, part of the volatility in tax gap estimates reflects the normal operation of the tax system. For example, the GST/HST revenues are a function of both GST/HST on sales of goods and services and input tax credits claimed in respect of GST/HST paid on business inputs. Businesses have up to four years to claim their input tax credits and they are not required to allocate and report these amounts to preceding periods. Therefore, the tax gap can fluctuate based on the timing of businesses claiming these credits.

Key findings:

- The reporting gap averaged $4.1 billion over 2014 to 2018. It represents about two thirds of the gross GST/HST gap.
- The payment gap averaged $2.3 billon and remained relatively stable over 2014 to 2018.
- CRA's compliance and collection efforts played an important role in reducing the gross GST/HST gap for tax years 2014 to 2018 – leading to a decline of about 40% on average over the period.
- After accounting for the CRA's compliance and collection efforts, the net GST/HST gap averaged $3.9 billion over 2014 to 2018.

[31] The GST/HST reporting gap was estimated in partnership with the Department of Finance given their expertise in this area.

[32] GST/HST amounts outstanding in relation to amounts assessed by the CBSA are not included in the payment gap due to data limitation. Further improvements will be explored in the next overall tax gap report.

[33] Compliance and collection efforts by the CBSA that reduces the tax gap are not accounted for in the estimates.

- Although there is some fluctuation in the dollar amounts, the net GST/HST gap as a percentage of GST/HST revenue remained relatively stable for tax years 2014 to 2018, ranging between 8% to 10%.

Table 4: GST/HST gap estimates for tax years 2014 to 2018, in $billions*

	2014	2015	2016	2017	2018
Reporting gap	$4.1	$4.8	$3.9	$3.6	$4.3
Payment gap	$2.2	$2.3	$2.2	$2.4	$2.2
GST/HST gross tax gap	$6.2	$7.1	$6.1	$6.0	$6.5
% of GST/HST revenue**	16%	17%	14%	14%	14%
Impact of CRA's compliance and collections	-45%	-39%	-38%	-40%	-34%
GST/HST net tax gap	**$3.4**	**$4.3**	**$3.8**	**$3.6**	**$4.3**
% of GST/HST revenue**	**9%**	**10%**	**9%**	**8%**	**9%**

* All amounts are in constant 2018 dollars. Totals may not add due to rounding.

** Percentages of GST/HST revenue are based on the Public Accounts of Canada. See Table A4 for federal tax revenue amounts.

4.1 GST/HST reporting gap

The federal GST/HST reporting gap represents the difference between the federal GST/HST theoretical liability that would result from full compliance and the actual taxes assessed.

The total theoretical federal GST/HST liability is estimated by determining the tax base that would result from full compliance using a top-down approach and leveraging a number of economic and administrative data sources, and then multiplying this base by the federal GST/HST rate.[34]

The difference between this theoretical liability and the federal portion of the assessed GST/HST represents the federal GST/HST reporting gap. Amounts for assessed GST/HST are based on data for declared GST/HST revenue from the CRA and the CBSA for tax years 2014 to 2018.[35]

During tax years 2014 to 2018, the GST/HST reporting gap averaged $4.1 billion or 12% of GST/HST revenue. As mentioned above, many factors can influence the fluctuation of the

[34] Additional details can be found in the methodological annex.

[35] Certain adjustments were made to account for foregone revenue due to intentional tax policy design that would count as legitimate assessed tax. Additional details can be found in the methodological annex.

GST/HST reporting gap including changes in the tax base or tax laws, the timing of businesses claiming input tax credits, and changes in non-compliance behaviours.

Given the top-down or aggregate approach used to estimate the GST/HST reporting gap, it is difficult to explain the exact cause of the fluctuations. That said, the net GST/HST gap as a percentage of GST/HST revenue remained relatively stable for tax years 2014 to 2018, ranging between 8% to 10%.

4.2 GST/HST payment gap

GST/HST registrants collect and remit the GST/HST owing to the CRA. Registrants generally must file a GST/HST return and remit taxes on a predetermined schedule. The due date for the GST/HST return and payment is determined by a registrant's reporting period – generally on a monthly, quarterly, or annual basis.[36] When GST/HST registrants do not pay their outstanding balance before the payment deadline, their accounts are considered to be in arrears and contributes to the GST/HST payment gap.

During tax years 2014 to 2018, the GST/HST payment gap was relatively stable and averaged $2.3 billion or 6% of GST/HST revenue.

Similar to other tax gap components, only a small number of taxpayers tended to have large tax gap amounts.

Non-compliant businesses at the payment due date were more likely to be relatively young corporations or individuals from Alberta and Ontario in the construction sector. GST registrants with long-standing tax debt (10 years as of 2020) were more likely to be individuals mostly in the construction sector. Overall, corporations were more likely to have a higher payment tax gap at the payment due date but individuals were more likely to tax debt after 10 years.

4.3 GST/HST gross and net tax gaps

The gross GST/HST gap includes both the GST/HST reporting and payment gaps before accounting for compliance and collection actions. It averaged about $6.4 billion over 2014 to 2018. The reporting gap accounted for about two thirds of the overall gross GST/HST gap during the period. Figure 8 shows the distribution of the gross GST/HST gap.

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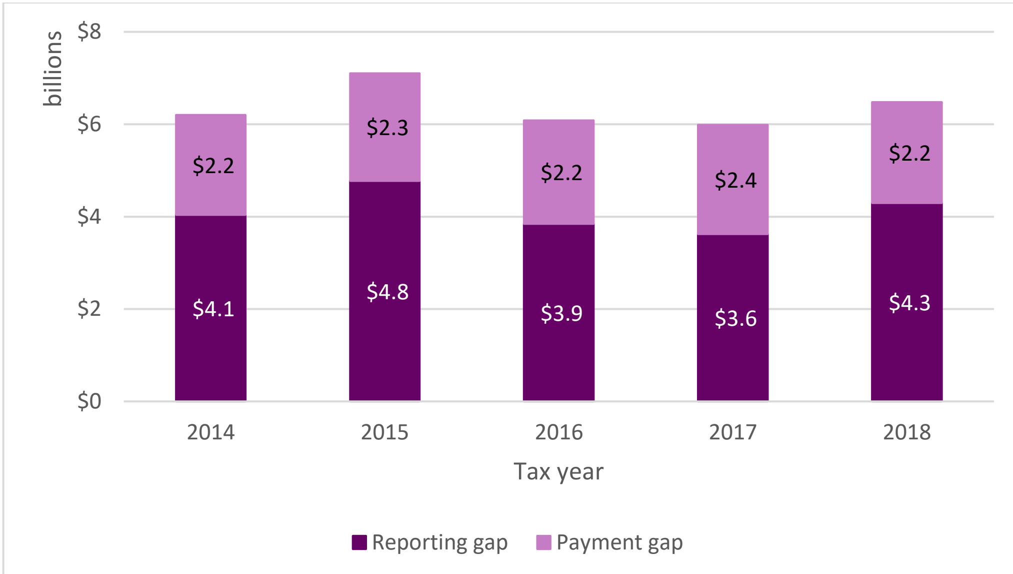
[36] For more information, visit: Complete and file a return – When to file. As well, small suppliers are generally not required to file GST/HST returns. For additional information, visit: Small suppliers.

Figure 8: Distribution of GST/HST gross tax gap for tax years 2014 to 2018, in $billions*



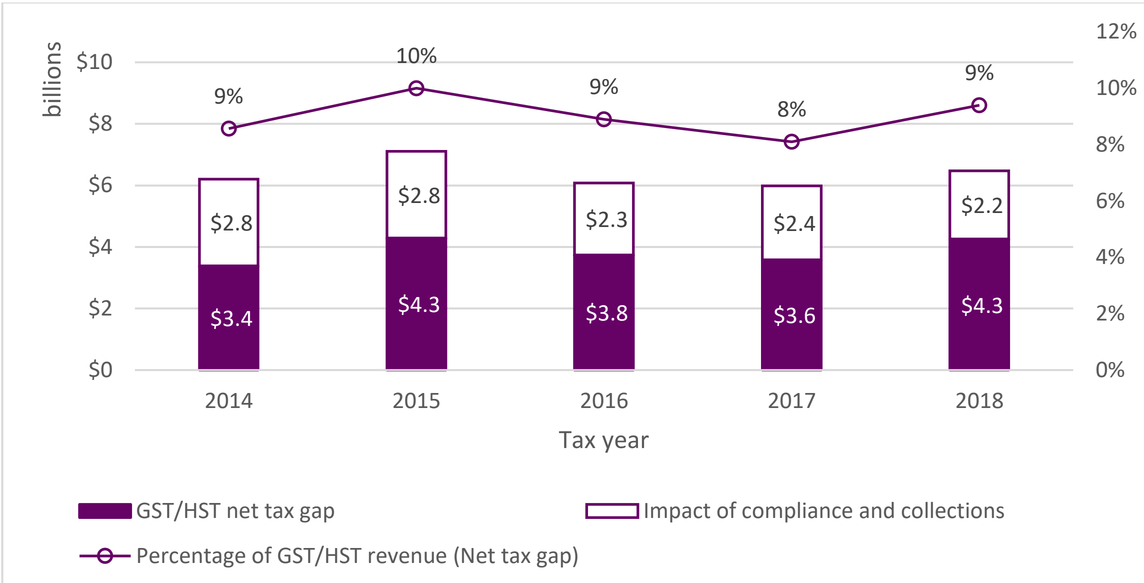
* All amounts are in constant 2018 dollars. Totals may not add due to rounding.

As shown in Figure 9, CRA's compliance and collection efforts played an important role in reducing the gross GST/HST gap – reducing the GST/HST gap by about 40% on average over the period.

> **This suggests that the CRA's compliance and collection activities are making a robust impact on reducing the GST/HST gap.**

After accounting for the CRA's compliance and collection efforts, the net GST/HST gap averaged $3.9 billion over 2014 to 2018 (see Figure 9). As a share of federal revenues, the net GST/HST gap was between 8% and 10% over the period.

Figure 9: GST/HST net tax gap for tax years 2014 to 2018, in $billions*



* All amounts are in constant 2018 dollars. Totals may not add due to rounding.

4.4 Compliance and collection activities related to the GST/HST gap

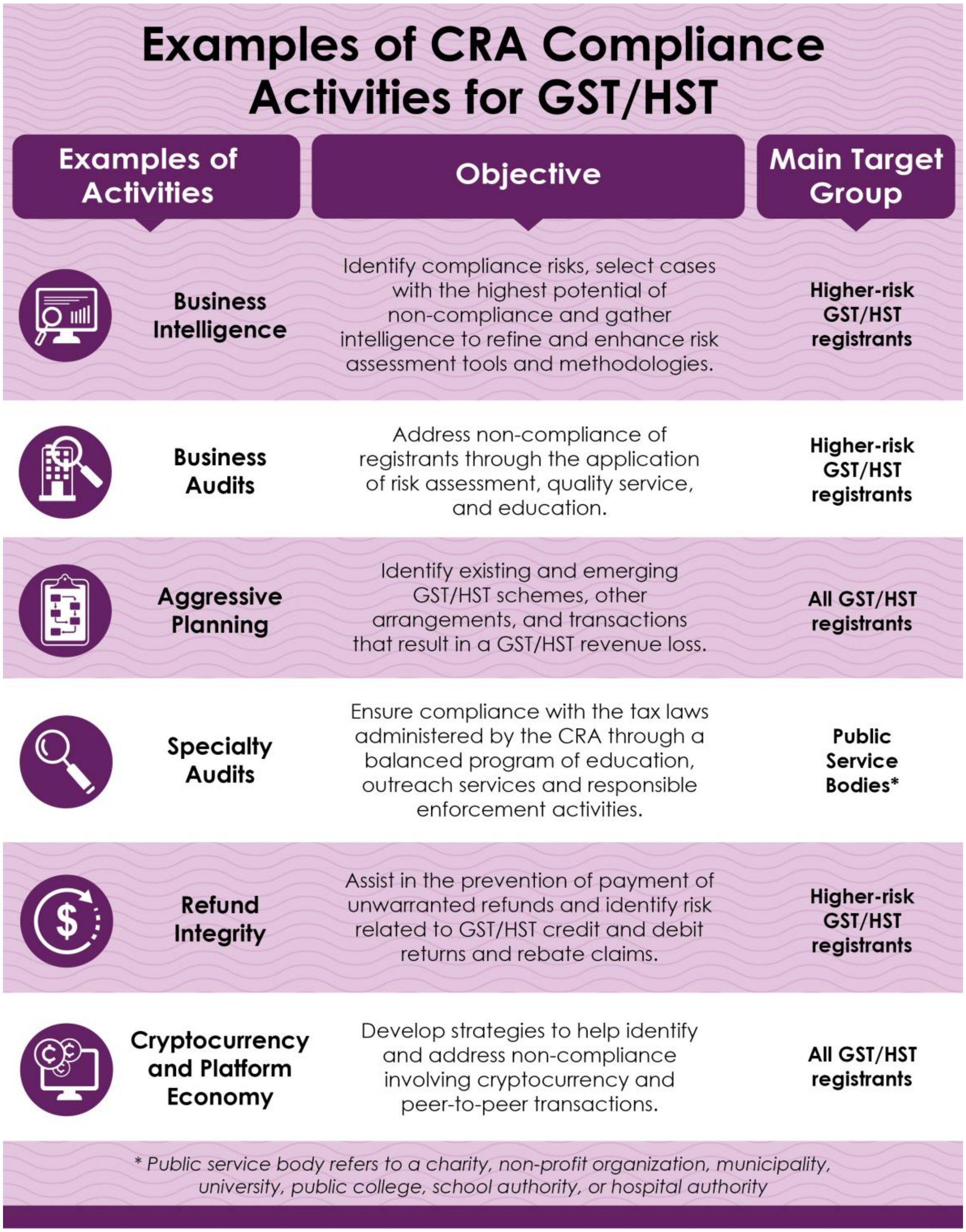
As seen in the graph above, the CRA's compliance and collection activities have a significant impact on reducing the GST/HST gap. When it comes to reporting non-compliance, the CRA focuses its efforts on auditing high-risk GST/HST registrants. In the past, most audits of smaller businesses[37] were combined audits - one audit covering both income tax and GST/HST. However, the CRA has shifted from a generalized approach to a specialized compliance approach. Therefore, high-risk businesses can be subject to a full GST/HST audit in addition to other audits. The GST/HST audits often target complex transactions or specific non-compliance initiatives such as the underground economy. They also involve comprehensive audit procedures and other evidence gathering techniques at the registrants' premises. As a result, these compliance activities can take some time which limits the number of audits that can be completed. To mitigate these limitations, the CRA has a National Desk Audit program designed to identify compliance gaps and address segments of the population with little audit presence. This program uses a balanced compliance strategy which seeks to educate GST/HST registrants first before taking appropriate enforcement to maintain voluntary compliance.

When it comes to payment non-compliance, the CRA also takes a balanced approach by providing various options to pay outstanding debt, such as payment arrangements and taxpayer relief provisions, before taking legal action which could result in serious financial or legal consequences. The notice of assessment or reassessment is considered the written warning for GST/HST amounts owing and the CRA will also give a verbal warning by phone. Afterwards, the CRA can proceed

[37] Small businesses are defined as owner operated businesses, small corporations and partnerships with annual revenues of less than $6 million.

with collection actions. Given that many GST/HST registrants are small businesses that want to comply with Canada's tax laws, the CRA places emphasis on voluntary compliance before taking direct actions to collect taxes owing.

Figure 10: Examples of CRA's compliance activities for GST/HST



5. Excise gap

The excise gap is calculated by combining the reporting and payment gaps related to the potential federal excise revenue loss. The reporting gap focuses on the illegal production/smuggling of cigarettes by unlicensed manufacturers because it is regarded as the main source of tax loss related to federal excise duties, taxes, and other specific levies in Canada.[38] This report does not estimate reporting non-compliance for other products subject to excise duties, taxes, and other specific levies because there is limited scope for significant illegal production.[39] That said, tax gap related to other excisable products will be examined in the future. Non-compliance related to recently added CRA programs such as cannabis excise duty and the federal fuel charge (introduced in late 2018 and 2019 respectively) will be incorporated in a future tax gap report. In contrast, the excise payment gap covers non-compliance related to all excise licensees and registrants in Canada since they can all have tax debt.[40] The net excise gap is calculated by accounting for CRA's compliance and collection efforts related to these excise licensees and registrants.

Key findings:

- In general, excise licensees/registrants that remit excise duties and taxes are highly regulated and therefore are largely compliant. This was evident as both the reporting and payment non-compliance was very low.
- This suggests that CRA's broader mandate with respect to playing a key role in regulating domestic production has helped keep the excise gap relatively low during tax years 2014 to 2018.
- When there is an increase in non-compliance, particularly in the payment gap, the CRA's collection efforts are highly effective in reducing the excise gap.

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[38] There are well-documented instances of an active illegal market of tobacco products in Canada and cigarette duties typically account for about 90% of the excise duty revenue from tobacco products for the federal government.
[39] This is due, in part, to the nature of the commodity (e.g., weight, volume, variety, consumer demand elements, and higher costs related to production) and the required production infrastructure, which is difficult to conceal from the authorities.
[40] CBSA administers excise compliance for importers and therefore this component was not included in the CRA's payment gap analysis.

Table 5: Excise gap estimates for tax years 2014 to 2018, in $billions**

	2014	2015	2016	2017	2018
Reporting gap: illegal production/smuggling of cigarettes	$0.5	$0.5	$0.4	$0.3	$0.4
Payment gap	$ - *	$ - *	$ - *	$0.1	$0.2
Excise gross tax gap	$0.5	$0.5	$0.4	$0.4	$0.6
% of excise revenue***	5%	5%	4%	4%	5%
Impact of CRA's compliance and collections	-1%	-2%	-3%	-11%	-34%
Excise net tax gap	**$0.5**	**$0.5**	**$0.4**	**$0.4**	**$0.4**
% of excise revenue***	**5%**	**4%**	**4%**	**4%**	**4%**

* The excise payment gaps for tax years 2014 to 2016 were negligible due to high levels of regulation and compliance. The exact tax gap amount is not reported to maintain taxpayer confidentiality.

**All amounts are in constant 2018 dollars. Totals may not add due to rounding.

*** Percentages of excise revenue are based on the Public Accounts of Canada. See Table A4 for federal tax revenue amounts.

5.1 Excise reporting gap

Similar to the CRA's 2020 report on the federal cigarette duty gap, the excise reporting gap was estimated using a method called gap analysis. Gap analysis is a common method used to estimate tax non-compliance for tobacco products, including cigarettes.[41] It is also aligned with the approach used by the United Kingdom to estimate the tax gap for excise duties on their tobacco products.[42] In general, this method estimates the potential consumption of illegal cigarettes by comparing total consumption levels with legal consumption levels. The excise duty rate is then applied to the assumed level of illegal consumption to estimate the federal tax loss.[43] In the previous excise report, a second method was used to test the reliability of the estimate and it was found that both methods produced a very similar estimate for tax year 2014. Unfortunately, it was not possible to apply the second method to verify the results from the gap analysis beyond 2014 due to data limitations. Therefore, the excise reporting gap estimates in this report are from gap analysis exclusively.

> **The excise reporting gap was on average $0.4 billion or 4% of federal excise revenue for tax years 2014 to 2018.**

41 Hana Ross, "Understanding and measuring tax avoidance and evasion: A methodological guide".

42 Her Majesty's Revenue and Customs. "Measuring tax gaps 2020 edition: Tax gap estimates for 2018-19." 2020.

43 Detailed information on gap analysis can be found in section 5 of the methodological annex.

5.2 Excise payment gap

The producer or importer of excise goods (also referred to as excise licensees and registrants) remits the excise duty or tax to the CRA. In general, the CRA collects excise duties and taxes for domestically-manufactured products while the CBSA collects them for imported products.[44] Licensees/registrants that remit excise duties and taxes are highly regulated and therefore are largely compliant. This is evident in the low excise payment gaps during tax years 2014 to 2018. Excise duties and taxes are typically paid on a monthly or semi-annual basis. The excise payment gap includes unpaid excise duties and taxes as well as all uncollectable tax debt (i.e., write-offs).

For tax years 2017 and 2018, the payment gap ranged between around $0.1 billion to $0.2 billion, most of which came from a very small number of licensees/registrants. For tax years 2014 to 2016, the payment gap was negligible.

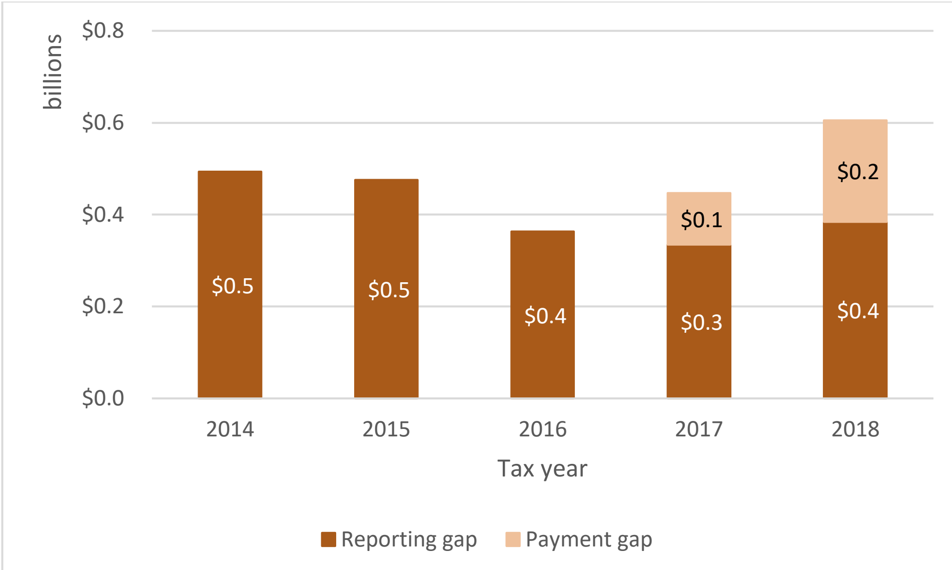
For example, the excise payment gap for tax year 2014 was less than 0.1% of the total payment gap. Given the small number of non-compliant licensees/registrants and the negligible payment gap, the exact payment gap amounts for tax years 2014 to 2016 could not be reported to maintain taxpayer confidentiality. For similar reasons, descriptive statistics related to non-compliant producers/importers could not be published.

5.3 Excise gross and net tax gaps

The excise gross tax gap is calculated by combining the excise reporting and payment gaps. Figure 11 shows the distribution of the gross excise gap for tax years 2014 to 2018.

[44] Since this report relied on CRA data, excise taxes and duties on imported products were not included in the analysis. Nevertheless, the excise payment gap from imported products is not expected to be significant. For example, in 2014-15, 86% of the revenue from excise taxes and duties came from CRA and 14% from CBSA.

Figure 11: Distribution of gross excise gap for tax years 2014 to 2018, in $billions*

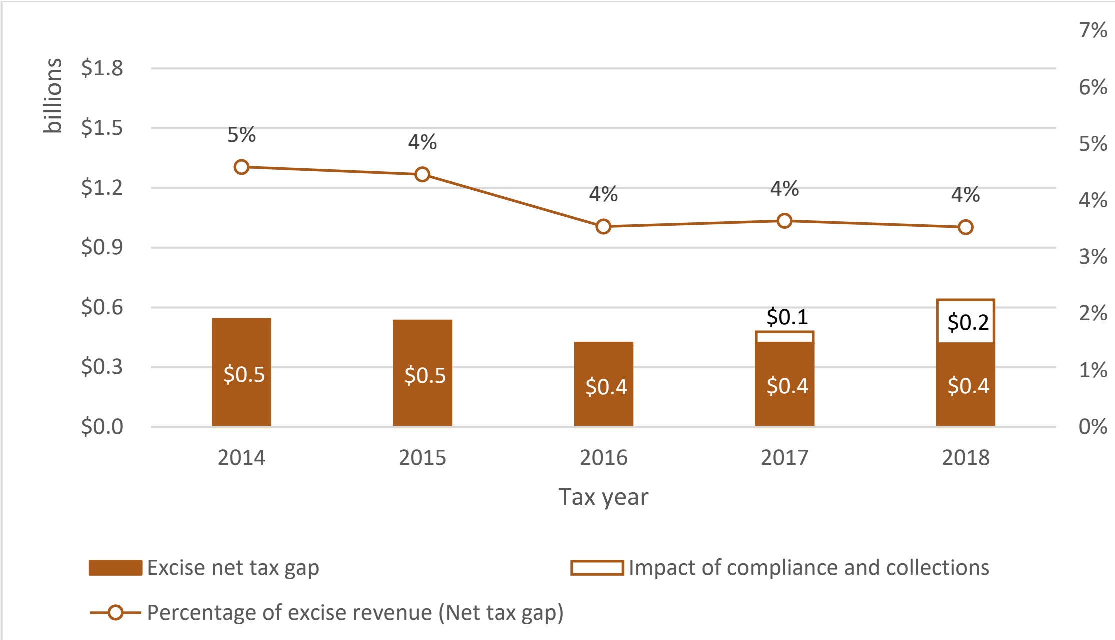


* All amounts are in constant 2018 dollars. Totals may not add due to rounding.

The CRA has a broad mandate with respect to excise revenue. It not only collects the revenue, but it also plays a key role in regulating domestic production. This regulatory function helps minimize the risk of tax non-compliance and as a result, most producers in Canada are generally compliant. This is one of the main reasons why the gross and net tax gaps are relatively similar to one another, particularly for tax years 2014 to 2016. During tax years 2017 to 2018, there was an increase in the excise payment gap. However, the CRA's collection efforts had a strong impact on reducing this non-compliance by 11% and 34% for tax years 2017 and 2018 respectively. As shown in Figure 12, the net excise gap has remained relatively stable at 4% of federal excise revenue on average.

> **This suggests that in general there is low levels of excise non-compliance, and in certain cases where there are higher levels of non-compliance, the CRA is able to effectively recover these amounts as seen in tax year 2018.**

Figure 12: Excise net tax gap for tax years 2014 to 2018, in $billions*



* All amounts are in constant 2018 dollars. Totals may not add due to rounding.

5.4 Compliance and collection activities related to the excise gap

As mentioned above, products that are subject to excise duties and taxes are highly regulated. Canadian companies manufacturing these products must obtain a licence and only licensees can legally produce excisable goods in Canada. All licensees and certain registrants are subject to periodic audits by the CRA to verify, for example, reported quantities of goods manufactured, inventories, and/or sales, as well as excise liabilities calculated. The CRA also conducts regulatory reviews of licensees and registrants such as checking whether excise stamps are applied correctly to tobacco or cannabis products.

In the context of the tobacco industry, the CRA's responsibility is to ensure compliance with the Excise Act, 2001, which governs federal tobacco taxation and regulates certain activities related to the manufacturing, possession, and sale of tobacco products. To ensure that Canada's tobacco legislation is applied effectively, the CRA also works with other government departments and agencies including the RCMP, CBSA and the Department of Justice. In addition, the CRA's tobacco taxation activities play an important role in Canada's Tobacco Strategy (CTS), which is a comprehensive federal initiative led by Health Canada to reduce tobacco consumption among Canadians. The CRA receives additional funding under the CTS which allows the CRA to conduct full audits of each tobacco licensee every year. Furthermore, it allows the CRA to conduct a minimum of eight regulatory review visits per location, based on risk assessment and compliance history. In particular, regulatory reviews may include verification of exports, inventories of raw materials, and other specific production and reporting activities. The CRA also consults with provinces and territories, the Department of Finance, Health Canada and other federal departments and agencies on the development of administrative and legislative proposals related to tobacco control and taxation. The CRA has held the position of Chair of the Federal-Provincial-Territorial Tobacco Steering Committee for several years. Finally, the CRA assists the RCMP and the Department of Justice by providing technical expertise and administrative enforcement support services. This includes providing affidavits and/or expert court witness testimony such as explaining the workings of the excise tobacco regulatory framework.

When it comes to payment non-compliance, an escalating approach (similar to the approach outlined for PIT, CIT, and GST/HST) is used to collect excise debt. This includes contacting excise licensees and registrants by phone and letters before taking direct action to resolve the debt. In some cases, the CRA can hold a third party responsible for all or part of the debt. It is important to note that collection efforts related to excise debt can have certain legislative restrictions. For example, the Excise Act limits the scope for collection actions against debt related to the production of beer. Overall, payment non-compliance from excise licensees and registrants are minor and when there are outstanding debts, the CRA is able to effectively recover these amounts.

Figure 13: Examples of CRA's compliance efforts and cooperation in the tobacco industry

Examples of CRA's compliance efforts and cooperation in the tobacco industry

Examples of Activities	Objective
Audit	All licensees and certain registrants are subject to periodic audits by the CRA to verify, for example, reported quantities of goods manufactured, inventories, and/or sales, as well as excise liabilities calculated.
Regulatory review	CRA conducts a minimum of eight regulatory review visits per location, based on risk assessment and compliance history. In particular, regulatory reviews may include verification of exports, inventories of raw materials, and other specific production and reporting activities.
Federal Excise Stamping Regime	Tobacco excise stamps containing overt and covert security features are affixed to packages of tobacco products to indicate the excise duties have been paid on the product. There are different stamps depending on the quantity, tobacco type, and jurisdiction the tobacco products are destined for. The appropriate stamp must be applied at the time of packaging in Canada or prior to importation of the tobacco product into Canada.
Cooperation with the Royal Canadian Mounted Police	The CRA assists the RCMP and the Department of Justice by providing technical expertise and administrative enforcement services. Examples include providing affidavits and/or expert court witness testimony that an accused holds or does not hold a licence or has any legal reason to possess unstamped tobacco or to explain the workings of the excise tobacco regulatory framework to a court.
Cooperation with Health Canada	The CRA plays an important role in the Canada's Tobacco Strategy (CTS), a comprehensive federal initiative led by Health Canada to reduce tobacco consumption among Canadians. The CRA receives additional funding under the CTS which allows the CRA to conduct full audits of each tobacco licensee every year.

6. Conclusion

This report examined the overall federal tax gap for all major tax components in Canada. With refined methodologies and the latest data available, it was possible to combine all previously published tax gap components and provide updated estimates for tax years 2014 to 2018. These estimates and their trends over time provide valuable information on the general health of the tax system and can provide important insights for the CRA and the public. Through an ongoing effort to understand different components of Canada's tax gap, the CRA will continue to preserve the integrity of the tax system and protect Canada's revenue base that supports programs and benefits that improve the quality of life of all Canadians.

Below is a summary of the key findings of this report.

PIT

- Non-compliance related to Canada's underground economy, hidden offshore income, and unpaid taxes all played an important role in contributing to the PIT gap.
- Most of the reduction in the gross PIT gap was from reducing payment non-compliance.
- In general, the federal PIT system is largely "tax assured" or at a low risk of non-compliance.

CIT

- Reporting non-compliance related to large corporations was the most important factor in contributing to the CIT gap while reporting non-compliance by SMEs and payment non-compliance was less prominent.
- CRA's compliance and collection activities had the largest impact on reducing the CIT gap by, on average, 48% to 59% for tax years 2014 to 2018.
- The net CIT gap as a percentage of federal CIT revenue stayed relatively stable around 10% to 16% on average.

GST/HST

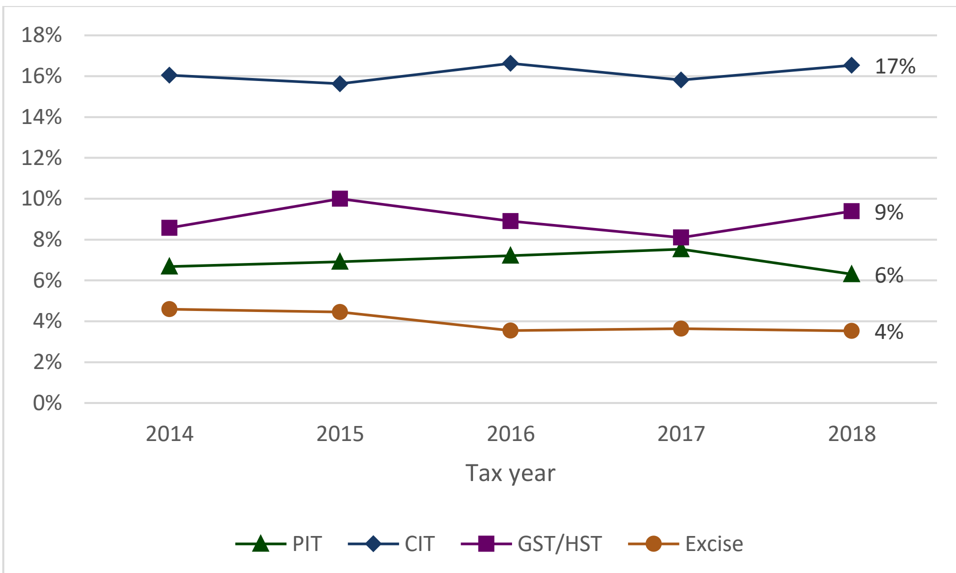
- CRA's compliance and collection efforts played an important role in reducing the gross GST/HST gap for tax years 2014 to 2018 – leading to a decline of about 40% on average over the period.
- Although there is some fluctuation in the dollar amounts, the net GST/HST gap as a percentage of GST/HST revenue remained relatively stable for tax years 2014 to 2018, ranging between 8% to 10%.

Excise

- In general, excise licensees/registrants that remit excise duties and taxes are highly regulated and therefore are largely compliant.
- This was evident as both the reporting and payment non-compliance was very low.
- This suggests that CRA's broader mandate with respect to playing a key role in regulating domestic production has helped keep the excise tax gap relatively low.

It is important to reiterate that many factors contribute to the tax gap. A growing economy may increase the overall level of income that makes up the tax base and increase the tax gap. Changes to tax forms may reduce mistakes and improve compliance. A recession could lead to higher levels of bankruptcies, resulting in higher payment gaps. To account for some of these factors, it is best practice to analyze the tax gap as a percentage of corresponding tax revenues. The graph below presents the net tax gaps for each tax type as a percentage of corresponding federal tax revenue. This represents the net tax gap trend, while accounting for inflation and certain changes in the tax system such as changes to the tax base or tax rates.

Figure 14: Net tax gap (upper-bound estimates) as a percentage of corresponding federal tax revenue for tax years 2014 to 2018*



* Percentages of corresponding federal tax revenues for the net tax gap are based on the Public Accounts of Canada. See Table A4 for federal tax revenue amounts.

The publication of tax gap estimates and their underlying methodologies helps deliver on the Government of Canada's commitment to foster an open and transparent discussion on tax non-compliance. In this regard, Canada is among the international leaders, alongside the United Kingdom, Australia, and the United States. In addition, tax gap estimates in conjunction with other information on non-compliance can provide insight into the overall health of the tax system. Tax gap estimates can help tax administrations better understand the composition, scale, and trend of non-compliance. Tax gap may also provide insight into potential weaknesses in tax policy and legislative frameworks, which can provide the basis for discussions aimed at improving Canada's tax system. Understanding how and why taxpayers are non-compliant is critical to help preserve the integrity of the tax system and to protect Canada's revenue base, which supports programs and benefits that improve the quality of life for all Canadians.

Annex

Table A1: Tax gap estimates in nominal dollars for tax years 2014 to 2018, in $billions*

	2014	2015	2016	2017	2018
PIT: reporting gap (underground economy)	$6.7	$7.0	$7.2	$7.8	$7.7
PIT: reporting gap (hidden offshore investment income)	$1.0 to $2.7	$1.2 to $3.3	$1.4 to $3.5	$1.4 to $4.1	$1.0 to $3.0
PIT: payment gap	$1.7	$4.6	$5.0	$6.1	$6.3
CIT: reporting gap (SMEs)	$2.5 to $3.2	$2.7 to $3.5	$2.9 to $3.6	$3.1 to $3.9	$3.3 to $4.2
CIT: reporting gap (large corporations)	$6.8 to $8.5	$6.4 to $8.0	$7.2 to $8.9	$7.7 to $9.7	$9.0 to $11.3
CIT: payment gap	$1.1	$0.6	$0.5	$0.7	$0.7
GST/HST: reporting gap	$3.8	$4.6	$3.7	$3.6	$4.3
GST/HST: payment gap	$2.0	$2.2	$2.2	$2.3	$2.2
Excise: reporting gap (illegal production of cigarettes)	$0.5	$0.5	$0.4	$0.3	$0.4
Excise: payment gap	$ - **	$ - **	$ - **	$0.1	$0.2
Total gross tax gap	$26.2 to $30.3	$29.9 to $34.4	$30.4 to $35.0	$33.2 to $38.6	$35.1 to $40.4
Impact of CRA's compliance and collections	-37% to -43%	-38% to -44%	-39% to -45%	-40% to -47%	-42% to -48%
Total net tax gap	**$15.0 to $19.1**	**$16.7 to $21.1**	**$16.9 to $21.4**	**$17.6 to $23.1**	**$18.1 to $23.4**

* Totals may not add due to rounding.

** The excise payment gaps for tax years 2014 to 2016 were negligible due to high levels of regulation and compliance. The exact tax gap amount is not reported to maintain taxpayer confidentiality.

Table A2: Tax gap estimates in constant 2018 dollars for tax years 2014 to 2018, in $billions*

	2014	2015	2016	2017	2018
PIT: reporting gap (underground economy)	$7.0	$7.3	$7.4	$7.9	$7.7
PIT: reporting gap (hidden offshore investment income)	$1.1 to $2.9	$1.3 to $3.5	$1.5 to $3.6	$1.5 to $4.2	$1.0 to $3.0
PIT: payment gap	$1.8	$4.8	$5.1	$6.2	$6.3
CIT: reporting gap (SMEs)	$2.6 to $3.4	$2.8 to $3.6	$2.9 to $3.7	$3.1 to $4.0	$3.3. to $4.2
CIT: reporting gap (large corporations)	$7.2 to $9.0	$6.7 to $8.3	$7.4 to $9.2	$7.9 to $9.8	$9.0 to $11.3
CIT: payment gap	$1.2	$0.6	$0.5	$0.7	$0.7
GST/HST: reporting gap	$4.1	$4.8	$3.9	$3.6	$4.3
GST/HST: payment gap	$2.2	$2.3	$2.2	$2.4	$2.2
Excise: reporting gap (illegal production of cigarettes)	$0.5	$0.5	$0.4	$0.3	$0.4
Excise: payment gap	$ -**	$ -**	$ -**	$0.1	$0.2
Total gross tax gap	$27.7 to $32.0	$31.1 to $35.7	$31.3 to $36.1	$33.7 to $39.2	$35.1 to $40.4
Impact of CRA's compliance and collections	-37% to -43%	-38% to -44%	-39% to -45%	-40% to -47%	-42% to -48%
Total net tax gap	**$15.9 to $20.2**	**$17.4 to $22.0**	**$17.4 to $22.1**	**$17.9 to $23.5**	**$18.1 to $23.4**

* Totals may not add due to rounding.

** The excise payment gaps for tax years 2014 to 2016 were negligible due to high levels of regulation and compliance. The exact tax gap amount is not reported to maintain taxpayer confidentiality.

Table A3: Tax gap estimates as percentage of corresponding federal tax revenue for tax years 2014 to 2018*

	2014	2015	2016	2017	2018
PIT: reporting gap (underground economy)	4.9%	4.8%	5.0%	5.1%	4.7%
PIT: reporting gap (hidden offshore investment income)	0.7% to 2.0%	0.8% to 2.3%	1.0% to 2.4%	0.9% to 2.7%	0.6% to 1.9%
PIT: payment gap	1.3%	3.2%	3.4%	4.0%	3.9%
CIT: reporting gap (SMEs)	6.3% to 8.1%	6.6% to 8.4%	6.8% to 8.6%	6.4% to 8.2%	6.6% to 8.3%
CIT: reporting gap (large corporations)	17.2% to 21.5%	15.5% to 19.3%	17.0% to 21.1%	16.2% to 20.2%	17.8% to 22.4%
CIT: payment gap	2.8%	1.4%	1.2%	1.5%	1.4%
GST/HST: reporting gap	10.2%	11.7%	9.1%	8.2%	9.5%
GST/HST: payment gap	5.5%	5.7%	5.3%	5.3%	4.8%
Excise: reporting gap (illegal production of cigarettes)	4.2%	4.1%	3.2%	2.9%	3.3%
Excise: payment gap	-%**	-%**	-%**	1.0%	1.8%
Total gross tax gap	**12% to 14%**	**13% to 14%**	**13% to 15%**	**13% to 15%**	**13% to 15%**
Total net tax gap	**7% to 9%**	**7% to 9%**	**7% to 9%**	**7% to 9%**	**7% to 9%**

* Percentages of corresponding federal tax revenues for the net tax gap are based on the Public Accounts of Canada. See Table A4 for federal tax revenue amounts.

** The excise payment gaps for tax years 2014 to 2016 were negligible due to high levels of regulation and compliance. The exact tax gap percentage is not reported to maintain taxpayer confidentiality.

Table A4: Federal tax revenue for fiscal years from 2014-15 to 2018-19, in $billions*

Tax Revenues	2014-15	2015-16	2016-17	2017-18	2018-19
PIT	$143.4	$150.8	$148.0	$156.0	$163.9
CIT	$41.7	$43.1	$43.5	$48.6	$50.4
GST / HST	$39.6	$40.9	$42.2	$44.4	$45.4
Excise	$11.9	$11.9	$11.8	$11.8	$12.1
Total	**$236.6**	**$246.8**	**$245.5**	**$260.8**	**$271.8**

* All amounts are in constant 2018 dollars. The amounts were retrieved from the Public Accounts of Canada. A fiscal year was approximated to a tax year (for example, 2014-15 was used to calculate percentages for 2014 tax year)

Glossary

Term	Definition
Appeal	A taxfiler who disagrees with a CRA Notice of Assessment can file a Notice of Objection with the CRA. The review of the Notice of Objection will result in a reassessment, a confirmation, or a determination. If the taxfiler does not agree with the CRA, they may appeal to the Tax Court of Canada within 90 days. If the appeal proceeds to a court hearing, the appeal is resolved by having both parties appear in court to present their versions of the facts to a judge. The judge will then decide the appeal based on the evidence and arguments presented to the Court.
Assessed income	A taxfiler's reported income after any adjustments made by the CRA through assessments or re-assessments.
Assessed tax	Tax that is determined to be payable based on assessed income. Usually indicated on a taxfiler's Notice of Assessment.
Audit	The examination of taxfilers' books and records to determine the taxes, interest, and penalties payable under the law.
Bottom-up approach	Generally uses a tax administrator's internal taxpayer data to estimate the amount of taxes theoretically owing. Often, for tax gap purposes, a statistically representative sample of audits is used to estimate the rate of non-compliance, which is then extrapolated to the overall population to produce a tax gap estimate.
Collection activities	Range of activities the CRA can undertake to recover unpaid amounts from individuals and businesses. Recovery options range from voluntary payment plans to legal action.
Compliance activities	Range of activities that follow an escalating approach from encouraging compliance through respectful and empathetic service (e.g., educational outreach) to enforcing it (e.g., audits).
Excise duty or tax	A levy on production and importation of certain goods. The most common goods subject to excise duty or tax are tobacco products, alcoholic drinks, and fuel products (e.g., gasoline).
Gross tax gap	Tax gap estimate before accounting for compliance and collection actions. The total gross tax gap is estimated by combining all previously published tax gap components before accounting for the CRA actions.

Term	Definition
Input tax credit	Credit that GST/HST registrants can claim to recover the GST/HST paid or payable for property or services they acquired, imported into Canada, or brought into a participating province for use, consumption, or supply in the course of their commercial activities.
Net tax gap	Tax gap estimate after subtracting compliance and collection results from the gross tax gap. The total net tax gap is estimated by combining all previously published tax gap components, after accounting for compliance and collection actions.
Notice of assessment or re-assessment	The notice sent to taxfilers explaining the results of the CRA's assessment of their tax returns or the notice that is sent to a taxfiler if a previously filed return is reassessed as a result of either a taxfiler's request for an adjustment to an already assessed return, or when a return is changed as the result of a CRA review or audit.
Payment gap	Tax gap resulting from assessed taxes that are not fully paid by the payment deadline. A taxfiler can have a payment gap for multiple taxation years.
Random audit	An audit where the entity audited is selected based on a random and representative sample of the target population.
Registration / non-filing gap	The registration or non-filing gap, when people or corporations fail to register or file their tax returns on time, was not explicitly estimated in this report due to data limitations.
Reporting gap	Tax gap resulting from when taxpayers fail to provide complete or accurate information on their tax returns by under-reporting income or claiming deductions or credits to which they are not entitled. In some cases, reporting non-compliance can include over-claiming credits and deductions.
Risk-based audit	An audit where the entity audited is selected based on risk factors determined by the tax administrator.
Tax assured	Tax assured measures the proportion of the tax base where the revenue body has justified trust through its activities or others' activities that tax is "under control" and so assured as accurate and paid. For the purposes of this report, all income for which there is third-party reporting is considered "tax assured" as well as low-risk credits and deductions.
Tax gap	The tax gap represents the difference between the taxes that would be paid if all obligations were fully met in all instances, and the tax actually paid and collected.

Term	Definition
Tax non-compliance	Taxpayers who do not comply with tax laws intentionally or unintentionally. Tax non-compliance can occur at any point – for example, failing to file a return, incorrect use of deductions, credits or income, or for failing to pay all taxes due.
Top-down approach	Broadly speaking, top-down methodology uses independent external data (usually national accounts data) to estimate the tax base, a figure that is then used to calculate a theoretical value of tax that should be paid and collected, by applying the appropriate tax rate to a high level figure.
Write-offs	Write-offs are amounts that were assessed as taxes payable but for various reasons are deemed to not be collectible. Write-offs include amounts that are legislatively uncollectible such as the expiry of the collections limitation period and accounts that have an insolvency event under the Bankruptcy and Insolvency Act.