

# 2022+

## Underground Economy Strategy



Canada Revenue  
Agency

Agence du revenu  
du Canada

Canada

## **2022+ Underground Economy Strategy**

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# Executive Summary

The 2022+ Underground Economy Strategy (the 2022+ strategy) is the Canada Revenue Agency's (CRA) fourth published guiding document on the underground economy (UE) since 2014, providing an overview of the Agency's response to the UE and its efforts in reducing UE-related tax non-compliance. Changes from previous UE strategies include an update to the definition of UE and the adoption of an evergreen approach, recognizing that UE work is part of the core mandate of the CRA, requiring ongoing, adaptive approaches and a whole of Agency approach.

Traditionally, the CRA has developed UE strategies on a three-year cycle. The creation of an evergreen (rather than time-bound) strategy reflects the persistent, evolving and adaptive nature of the UE and the corresponding need to remain flexible in our response to and mitigation of the UE. The design of the 2022+ strategy includes a consistent overarching model of the CRA's approach and will guide the CRA's short-, medium-, and long-term objectives and internal operations. With the 2022+ strategy in place, the CRA's focus will be on the achievement of concrete actions that align with its overarching priorities.

The 2022+ strategy adopts a model of three pillars to minimize UE-related tax non-compliance, which align with the CRA's commitment to apply the right intervention to the right risk. The three pillars are:

- 1. Identify** UE activities by improving the CRA's capacity to identify emerging issues and increase the efficiency and effectiveness of the data research, analysis and collection process, as well as maximizing the use of data the CRA has. Through enhanced use of data and analytics, the CRA can more readily identify UE activities as they arise, and act appropriately to address them early.
- 2. Prevent** UE activities from occurring through early outreach and ongoing visibility. The CRA is expanding its tax education programs to work with those who unintentionally participate in the UE, making it easier for them to comply. A focus on providing early tax education in the form of outreach and targeted assistance to taxpayers, such as those entering into business or new Canadians who are not familiar with the Canadian tax system, can also help prevent non-compliance.
- 3. Address** UE activities using tailored approaches based on the level of risk of non-compliance for a given taxpayer. The CRA has a wide range of tools to address various types of non-compliance that can also be extended to the UE. The CRA fully intends to deploy all compliance tools necessary to address all aspects of the UE. For instance, the CRA reserves full audit interventions such as net worth analysis to target and address cases with the highest level of non-compliance.

**Figure 1:** 2022+ strategy pillars



The CRA developed the 2022+ strategy by adopting the [People First<sup>1</sup>](#) approach to make sure that the most appropriate intervention is applied to the level of risk, without causing unnecessary burden on taxpayers. This approach is consistent with the federal government’s response to the global pandemic recovery, by ensuring that the CRA’s interactions with taxpayers minimize disruptions as they continue to recover from the effects of the COVID-19 pandemic and adapt to new market conditions.

## What is the underground economy?

The 2022+ strategy presents a refined definition of the UE following internal consultations within the CRA and research done on UE in other comparable jurisdictions to increase its clarity and precision.

The CRA’s definition of the UE is as follows:

**The underground economy** includes economic transactions in goods or services which are unreported, resulting in failure to comply with tax laws administered by the Canada Revenue Agency.

For more precision, this includes situations in which transactions are underreported or unreported, both of which contribute to the growth of the UE. Underreporting or not reporting is considered part of the UE, regardless of whether the taxpayer is intentionally non-compliant or just unaware of their tax obligations.

<sup>1</sup> For more information, visit [Canada.ca](https://Canada.ca), and search for [Putting people first at the CRA](#).

## The UE is divided into three segments:

**Hidden:** economic activities that taxpayers who are registered with a goods and services tax / harmonized sales tax (GST/HST) number conceal from authorities to avoid taxes, increase the benefits they receive, or both. For example, when a contractor offers to take payment in cash so they can avoid reporting the income and the GST/HST, they are participating in the UE by hiding or concealing the activity.

**Informal:** economic activities carried out by taxpayers who provide taxable goods and services, and either do not report their business income to the CRA, are not registered with a GST/HST number and/or do not remit the taxes that they collect. For example, when an individual rents out their accommodations on a digital platform and does not register a business or report the income to the CRA, they are participating in the UE by undertaking an informal transaction.

**Illegal:** economic activities that are not legal. Income earned from activities such as theft, fraud, and the sale of narcotics is taxable and has to be reported as income, despite its illegal nature.

The UE continues to evolve, finding new ways to keep pace as digital technologies, global platforms, and crypto assets gain prominence, and especially as the COVID-19 pandemic accelerates digitization, which continues to have a deep and lasting effect on the Canadian economy. UE activity negatively affects economic growth in Canada as compliant businesses struggle to compete with those that do not fully comply. When an employee, a self-employed person, or business does not report all of their income and benefits, they are potentially participating in the UE. This results in a tax gap<sup>2</sup>, and it represents a loss of tax revenue which adversely affects all Canadians.

Studies<sup>3</sup> have shown that there is a multitude of factors that contribute to the growth of the UE. Reducing the cost and effort required to comply may have a positive influence on a taxpayer's ability to meet their reporting obligations.

The 2021-2022 Annual Corporate Research done by [Quorus Consulting Group Inc.](#) found that about 20% of tax intermediaries<sup>4</sup> and small and medium-sized enterprises felt that Canadian businesses pay too much in taxes for the level of service provided by the federal government, and this may lead to non-compliance. Demonstrating how taxes collected pay for many of the services that Canadians enjoy and benefit from can help change the perception of the tax burden. Similarly, lowering the cost of compliance by designing tools and mechanisms that ease the burden on the taxpayer is expected to help reduce UE-related tax non-compliance.

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<sup>2</sup> The [tax gap report](#) is posted on Canada.ca under "Corporate Reports" on the "CRA reports" web page.

<sup>3</sup> [IZA World of Labor – The shadow economy in industrial countries](#)

<sup>4</sup> The term **tax intermediaries**, as used in the Annual Corporate Research, refers to third-party tax advisors, such as tax planners, tax preparers, accounting firms, bookkeeping firms, and industry associations.

Another factor that influences the UE is the perceived tolerance of the UE by a tax administration. The same 2021-2022 Annual Corporate Research found that 30% of small and medium-sized enterprises and approximately 40% of tax intermediaries<sup>5</sup> believe that businesses are very likely to get caught by the CRA for cheating on taxes. Additionally, only about 30% of small and medium-sized enterprises but 50% of tax intermediaries feel that the CRA's efforts to reduce income tax cheating by businesses are effective. Addressing these perceptions through ongoing outreach, education, assisted compliance and audit activities, in addition to regular communications about results, can help address these perceptions.

## Scope of the underground economy

The CRA is continuously monitoring UE activities to determine its scope and scale. To better understand the nature of the UE, the Agency has, since 2009, collaborated with Statistics Canada to quantify the extent of the UE in Canada. The findings, coupled with information from other sources, help the CRA in refining the focus and actions to combat the UE.

The estimated gross domestic product (GDP) at market prices for UE activity in Canada reached \$68.5 billion, or 2.7% of total GDP, in 2021. From 2019 to 2021, the UE as a proportion of GDP has remained fairly stable between 2.7% and 2.8%. Both the overall and underground economies experienced a dip in 2020 at the onset of the COVID-19 pandemic, and UE activity subsequently stabilized to pre-pandemic levels in 2021.<sup>6</sup>

According to Statistics Canada, in 2021 four industries accounted for more than half of all UE activity:

- residential construction (35%)<sup>7</sup>
- finance, insurance, real estate, rental, leasing, and holding companies (12.7%)
- retail trade (10.5%)
- accommodation and food services (7.3%)

These industries have been the main contributors to UE activity within Canada since Statistics Canada's study began in 1992.

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<sup>5</sup> The term **tax intermediaries**, as used in the Annual Corporate Research, refers to third-party tax advisors, such as tax planners, tax preparers, accounting firms, bookkeeping firms, and industry associations.

<sup>6</sup> Source: [Statistics Canada](#)

<sup>7</sup> Residential construction represented a much higher percentage of the UE in 2021 than it has in the past. The percentage contribution of residential construction to total UE grew steadily from 24.3% in 2014 to 29.4% in 2020, followed by a sharp rise to 35.0% in 2021. This was in line with an equivalent increase in economy-wide spending on residential structures.

# CRA's response to the underground economy

The CRA's efforts to address the UE has been an ongoing process. Before 2022, the CRA published three strategies, covering the periods [2015–2018](#), [2018–2021](#), and [2021–2022](#). Each new strategy was intended to be a guiding document which incorporated lessons learned and priorities identified, as well as changes in the operating and external environment, while expanding on the CRA's understanding of the UE.

**Figure 2:** Evolution of UE strategy

Building on past UE themes:	2015-2018 Strategy	2018-2021 Strategy	2021-2022 Business Plan	2022+ Strategy
Further refine our understanding of the UE	✓	-	-	✓
Reduce the social acceptability of participation in the UE	✓	✓	✓	✓
Address evolving business models	-	✓	✓	✓
Leveraging third party data and information	-	✓	✓	✓
Deploy a range of initiatives to encourage compliance and reduce participation in the UE	✓	-	-	✓

*In the 2022+ UE strategy, the previous strategy themes have been replaced by a model with three pillars to minimize UE-related tax non-compliance: Identify, Prevent and Address.*

The themes introduced in the CRA's previous UE strategies remain relevant and helped to shape the 2022+ strategy. These include:

**Refining the CRA's understanding of the UE** – The CRA continues to refine its understanding of and approach to addressing the UE, in response to relevant external and internal factors.

**Reducing the social acceptability of participation in the UE** – Although public perception and social acceptability are sometimes difficult to measure, understanding and evaluating them remains a priority for the CRA. One of the most effective ways the CRA engages the public on these concepts is through public opinion research.



**Using third-party data** – The CRA has made significant progress in obtaining relevant third-party data, particularly through the use of legislative tools such as unnamed persons requirements.<sup>8</sup> The CRA remains focused on advancing the use of analytics tools and matching multiple data sources to extract insightful information that informs our actions.

**Addressing evolving business models** – The CRA continues to monitor and respond to the external environment. Since the previous UE strategies, the CRA has developed comprehensive approaches on emerging business models that are enabling the digital economy such as platforms and crypto assets. This will continue to strengthen the CRA's ability to design compliance actions that can effectively address the dependencies between these business models and the UE.

**Deploying a range of initiatives** – To maximize effectiveness in addressing the UE, the CRA continues to use a wide range of compliance approaches and allocates resources accordingly. This ongoing requirement is the basis of the 2022+ strategy.

## Communicating the CRA's position

The CRA will continue to communicate to Canadians the importance of complying with their tax obligations, and how it is working to deter non-compliance among those who unknowingly or intentionally participate in the UE. Without interventions, there is a risk that changes in the social and economic environment can progressively add to the growth of the UE.

By working to curtail or reduce the UE, Canadians' trust and confidence in the integrity and fairness of Canada's tax system can be maintained. Businesses benefit from a dynamic and competitive economy, free from the manipulations created by non-compliant transactions. In addition, keeping the UE in check benefits Canadians by contributing resources that fund government programs.

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<sup>8</sup> This type of requirement is authorized by the courts and enables the CRA to obtain information from an individual or a company about third parties (unnamed persons). After the CRA gets this information, it can verify if an unnamed person correctly reported their income, and that applicable goods and services tax / harmonized sales tax was sent to the CRA. For reference, visit [Canada.ca](https://www.canada.ca), and search for [Unnamed persons requirements in real estate](#).

## Pillars of focus

Reducing participation in the UE has been, and continues to be, a priority for the CRA. To get ahead of the UE, the CRA will be strategic in its approach, finding efficient and effective ways to address non-compliance and make sure that its response is appropriate for the level of risk presented.

The target audiences for the 2022+ strategy are employees, partnerships, proprietors, and small and medium-sized businesses. Those businesses are significant contributors to the Canadian economy. We will take into consideration the impact of the pandemic in our approaches to help businesses hardest hit by COVID-19 to meet their tax obligations using an empathetic approach.

In 2021, small businesses made up 98.1% of all employer businesses in Canada. In 2020, small businesses employed 9.7 million individuals, about two thirds of the total labour force. By comparison, medium-sized businesses employed 3.2 million individuals (21.2% of the labour force) and large businesses employed 2.3 million individuals (14.8% of the labour force). As such, extending education and outreach efforts to a larger proportion of the population of small and medium-sized businesses, as well as their employees, can help reduce UE-related tax non-compliance.

The majority of Canadians and Canadian businesses are compliant and pay the correct amount of tax. Taxpayer segmentation research helps the CRA identify and tailor its interactions with taxpayers based on their behavioural attributes and characteristics. A study by the CRA segmented taxpayers on a spectrum of low to high risk and estimated the proportion of the population in each segment, their compliance behaviour, and their attitude towards taxation. Further research will allow the CRA to identify non-compliant taxpayers, prevent them from participating in the UE, and depending on their behaviour post-intervention, re-evaluate future compliance actions.

### Pillar 1 – Identify activities

To understand the breadth and depth of the UE, the first step is to identify where these activities take place, and who is potentially or actively involved. The CRA has a number of business intelligence tools at its disposal to identify elements and participants in the UE.

The CRA generates business intelligence for the UE by segmenting the population, assigning risk values of non-compliance, and doing statistical data analysis. The CRA also does ongoing research that analyzes emerging compliance issues, which later informs a spectrum of compliance actions appropriate for the associated risks.

The CRA is aware of regional differences in risk sectors, characteristics of participants, and the overall composition of the UE. Information gathered through public opinion research on the UE will be used by the CRA to inform and adapt its approach to more effectively address the UE risk factors unique to each region.

It is recognized that, while there are traditional known high-risk UE sectors, the UE landscape continues to change. There is ambiguity about the long-term effect of the pandemic on the composition of the UE. However, research is underway to understand the effects of COVID-19 on the small and medium-sized business population to recalibrate risk assessment profiles and possible treatments.

## Pillar 2 – Prevent activities

Having identified the participants of the UE, the CRA is better positioned to design the most effective preventive measures for each segment and sector. Education and outreach activities continue to serve as effective tools in preventing UE activity. CRA qualitative research found that the CRA has an important role to play in providing tax education to minimize non-compliance and the misreporting of results by taxpayers and businesses that do not fully understand the tax laws. The CRA will continue to use tools that seek to inform taxpayers about their tax obligations and their role in reducing UE-related tax non-compliance.

The CRA's [Liaison Officer Service](#) helps self-employed individuals and small-business owners understand their tax obligations, as part of ongoing efforts to encourage voluntary compliance and to prevent errors and actions that result in UE-related non-compliance. The tax gap report found that about half of small and medium-sized businesses that were randomly audited made at least one reporting error on their tax return for the 2011 tax year, suggesting that incorporating education and outreach activities such as the Liaison Officer Service can benefit the CRA and taxpayers.

The CRA is working on other programs related to prevention, including its assisted compliance pilot project and a trade school initiative. Through these channels, the CRA will communicate the effects of the UE and the role that taxpayers can play in diminishing the UE. This approach is shown to have a positive effect in reducing participation in UE activities. A focus on providing early tax education to new businesses and immigrants can also help prevent non-compliance. Information and guidance around UE are incorporated into the UE package that is distributed to newcomers.

## Pillar 3 – Address activities

According to the CRA's 2021-2022 Annual Corporate Research, more than half of the tax intermediaries and small and medium-sized businesses that responded indicated that it is important for the CRA to recover unpaid taxes when people work under the table for cash. Approximately half of the respondents of this study agreed that there is a moderate likelihood that most people who cheat on their taxes will get caught. This indicates that the CRA needs to continue to be active in this area, because inaction or perceived inaction can potentially encourage UE participation and hurt the CRA's reputation.

To address UE activities, the CRA has developed a compliance approach that recommends a broad spectrum of interventions: education, assisted compliance, and audits. This enables the CRA to address non-compliance appropriately, tailoring its actions to reflect the degree of non-compliance.

The CRA's compliance response is proportionate to the risk associated with a case. Sophisticated taxpayers demonstrating willful and deliberate non-compliance will continue to be a priority and receive the appropriate level of intervention, including audits.

## Implementation and evaluation of the strategy

The 2022+ strategy is focused on short-, medium-, and long-term objectives that take into consideration the persistent, evolving and adaptive nature of the UE. The 2022+ strategy is designed to provide a consistent overarching model of the CRA's priorities, which will guide the CRA's operations.

The CRA's responsibility in the UE space will continue in the years to come, and the 2022+ strategy will enable the CRA to monitor and address risks in the UE environment as they develop, leading to proactive action. It will also allow the CRA to measure the impact of actions taken to reduce UE-related tax non-compliance.

Information gathered through public opinion research on the UE, the CRA's annual corporate research, tax gap reports and other measurement tools will be used to design performance indicators, which will allow the CRA to track and evaluate initiatives that impact participation in the UE in Canada.

## Conclusion

The CRA's goal remains constant: to reduce UE-related tax non-compliance. The 2022+ Underground Economy Strategy aims to provide continuity for the ongoing work that the CRA has been doing in this area, while allowing for innovation in its approach to this priority work. The 2022+ strategy will position the CRA to continuously **identify, prevent and address** UE activities by monitoring the environment, addressing new and emerging UE-related risks as they occur, and evaluating and improving how it addresses UE activities in Canada.