Intelligence MEMOS

C.D. HOWE INSTITUTE

INSTITUT C.D. HOWE INSTITUTE
Trusted Policy Intelligence | Conseils de politiques de confiance

From: Alexandre Laurin and Nicholas Dahir

To: Diane Lebouthillier, Minister of National Revenue

Date: February 10, 2022

Re: NOT SO FAST, PLEASE, ON AUTOMATIC TAX FILING

In Canada, most government cash benefit payments require recipients to file a tax return.

Individuals who fail to participate in the tax system – often society's most vulnerable – too often forgo important government benefits (or even some government services that are tied to tax return information.)

In its September 2020 Speech from the Throne, the federal government said it would "work to introduce free, automatic tax filing for simple returns to ensure citizens receive the benefits they need."

Our new C.D. Howe Institute Commentary explores the issue.

We first outlined various automated filing models. Some countries do not require any tax filing for people in simple tax situations, particularly employees for whom tax withheld at source by the employer and remitted to the tax authority is adjusted throughout the year such that the year's total amount corresponds to the exact tax liability. Individuals facing a more complicated tax situation, or eligible for additional tax relief, must often file a tax return.

In other countries, particularly in Scandinavia, tax filing is quasi-automatic: eligible taxpayers with basic sources of income receive prepopulated tax forms with their tax liabilities already computed; taxpayers need only verify the prefilled information for accuracy. The completeness of these forms and the accuracy of the tax authority's computations can vary with the complexity of filers' tax situations. Beyond Scandinavia, the majority of taxpayers in Spain, Slovenia and Austria are able to use this method.

And the greater the number of taxpayers with basic tax returns, the more practical it would be to fully automate tax filing.

In Canada, the CRA already receives an impressive volume of financial and income information on taxpayers from their employers, financial institutions, and benefit administrators. But the tax system is complex: there are many deductions and credits recognizing specific personal circumstances, expenses, or activities – both federally and provincially.

Our analysis indicates that only one in three filers would have a tax return simple enough to enable the CRA to accurately compute their taxes and benefits with the financial and income information it has on hand.

Making a widely available, fully automatic filing system practical would require a fundamental simplification of the underlying tax system. For example, eliminating tax and benefit provisions recognizing spousal income, eliminating tax recognition of childcare and medical expenses, changing the tax treatment of spousal support and improving third-party reporting for income sources such as rental and self-employment income are a few examples of tax policy and process changes that could reduce the challenge of implementing automatic tax filing.

But tax simplification is a complicated affair in itself in Canada's federal system. Tax preferences are used extensively by federal and provincial governments to achieve economic, social or purely redistributive objectives. Any real attempt at tax simplification is bound to lead to redistributive and economic impacts difficult to sustain politically.

On balance, the current self-assessment with Auto-Fill by the CRA appears well adapted to this country's complex tax system.

Fully automatic filing for all is a blunt instrument to get to the narrower problem of non-filing eligible benefit recipients. We estimate that about 4.2 percent of potential tax filers – more than 1 million people – do not participate in the tax system, but there are better options.

More targeted strategies to reach non-filers are preferable. We propose that decoupling the requirement to file a tax return from eligibility to receive benefits is worth serious consideration.

Despite practical challenges, establishing a new body specifically tasked with delivering income-tested benefits to Canadians could make this possible, better serving the poverty-reduction objectives of government support programs that are now tied to tax filing.

Alexandre Laurin is Director of Research at the C.D. Howe Institute, where Nicholas Dahir is a Research Assistant.

Trusted Policy Intelligence / Conseils de politiques dignes de confiance