THE BRASS TAX

THE SQUARE PEG

Cryptocurrency reporting doesn't fit neatly into Canada's tax law. Should the government change the Income Tax Act to accommodate it or place the reporting burden on crypto-asset service providers?

JOHN OAKEY

Canadians must report their income from all sources both inside and outside of Canada. The federal income tax system imposes information reporting systems on the payer, like T4, to ensure taxpayer compliance, but these reporting systems have limited or no functionality outside of Canadian borders.

To deal with this situation, specified foreign property (SFP) rules—subject to non-filing penalties—were introduced in 1996 to impose a self-reporting requirement on Canadian resident taxpayers to disclose foreign property. As Paul Martin, then–finance minister, said when the government introduced the draft rules, "These reporting requirements will give Revenue Canada more ability to scrutinize offshore investments held by Canadians and to ensure the complete reporting of income."

Twelve years later, a computer programmer under the pseudonym Satoshi Nakamoto introduced the concept of cryptocurrency—Bitcoin. As the years went by and mainstream adoption of Bitcoin and other cryptocurrencies evolved, some investors started to ask: Is cryptocurrency a Canadian or foreign asset?

For those with a keen technical understanding of distributed ledger technology (DLT), the correct answer is: both. A unit of crypto is not necessarily situated in any particular country, which makes it that much more difficult for Canadian taxpayers and accounting professionals to determine if it is a domestic or foreign asset for tax purposes. Cryptocurrency owners may believe their holdings reside in Canada because the digital information is typically accessed while in Canada through a digital wallet on their phones, thumb drives, laptops or online trading platforms.

For the Canada Revenue Agency (CRA), though, which wants to ensure Canadians aren't hiding their cryptocurrency assets outside of Canada, the tricky question is figuring out when a unit of crypto should be considered a foreign asset, and thus subject to reporting by taxpayers as SFP.

The problem is that the SFP rules in the Income Tax Act weren't designed with cryptocurrency and DLT in mind, leaving CRA's guidance akin to squeezing a square peg into a round hole.

Almost a decade ago, CRA attempted to answer the question: Is cryptocurrency SFP? CRA concluded that cryptocurrency was considered "funds or intangible property." If those funds or intangible property were "situated, deposited or held outside of Canada," then they should be classified as specified foreign property and thus subject to reporting. CRA's attempt to answer the question stopped short of providing guidance on the actual location where cryptocurrency is situated, deposited or held.

Knowing that CRA can't actually determine the true location of cryptocurrency, CPA Canada rephrased the question to CRA in its 2023 document, "CPA questions to CRA." "Can CRA provide examples of cryptocurrency that is situated, deposited or held outside Canada for classification as specified foreign property?"

CRYPTO'S BORDERLESS NATURE CHALLENGES ACCOUNTANTS IN DISCERNING ITS DOMESTIC OR FOREIGN STATUS FOR TAXATION

The rephrasing of the question, albeit subtle, allowed CRA more latitude to provide guidance. In this document, CRA states, "[I]t is our view that, where crypto trading platforms (CTP) are resident in Canada and comply with Canadian regulations, cryptocurrency held through such CTPs for the benefit of Canadian clients will typically not be considered as 'situated, deposited or held' outside Canada."

Although this guidance is not definitive, Canadian taxpayers now have some assurance that cryptocurrency assets held in a Canadian resident's CTP are not reportable as specified foreign property. For anyone else who holds cryptocurrency outside of a Canadian CTP, the lack of clarity around foreign reporting remains. The bottom line is that the Department of Finance hasn't created anything new, and CRA has just taken the existing legislation and made one aspect of holding cryptocurrency squeeze into the existing rules as best it could.

All of which begs another question: Should Parliament update the Income Tax Act to directly address self-reporting of cryptocurrency assets?

Canada is not the only country that has been slow to respond. The United States has lagged with modernizing its laws to address the reporting of cryptocurrency by its taxpayers. The Financial Crimes Enforcement Network (FinCEN) has not updated its Notice 2020-2, which states that a foreign account holding virtual currency is not reportable on the Foreign Bank and Financial Accounts, even though the notice states amendments are intended.

The IRS has also never come out with an official position regarding cryptocurrency and reporting under the Foreign Account Tax Compliance Act. Like Canada, the United States seems more preoccupied with making crypto exchanges and forcing custodians to report cryptocurrency transactions than individual taxpayers. Unlike CRA, though, the IRS did introduce, starting in 2019, a question on the 1040 inquiring about cryptocurrency transactions. Starting in 2024, U.S. persons engaged in a trade or business receiving $10,000 or more in crypto payments will have mandatory reporting.

Meanwhile, the Organisation for Economic Co-operation and Development (OECD) in October 2022 proposed the Crypto-Asset Reporting Framework (CARF) as an amendment to its Common Reporting Standard, which has been adopted by more than 100 countries, including the G20. Full implementation of CARF is ongoing with Canada, United States and over 40 other countries intending to start exchanging information by 2027.

The principle behind the OECD's framework is to impose reporting obligations on crypto-asset service providers to increase transparency, and thus allow tax administrators to have better visibility on crypto transactions and income.

The European Union has recently moved to the adoption of DAC8, which closely resembles aspects of the OECD's CARF, establishing an information-exchange platform that will provide national tax administrators with more visibility on crypto-asset service provider activities.

1 in 4

The number of Canadians who owned some form of crypto in 2023

As we look around the international community, the focus by tax authorities on cryptocurrency reporting is falling not on taxpayers, but rather on crypto-asset service providers.

With Canada and a significant number of other countries adopting CARF to gather and share cryptocurrency information received directly from crypto-asset service providers, is self-reporting of cryptocurrency assets by Canadian taxpayers necessary, either as foreign or Canadian?

As Mark Greenberg, managing director for Canada of the crypto platform Kraken, pointed out in an August 2023 interview with Nasdaq, about one in four Canadians now own some form of crypto and over 30 per cent plan to invest in crypto assets this year. Sooner or later, they'll all need to know whether their crypto holdings are reportable as foreign property or not. ◆

John Oakey, CPA, is Vice-President of Taxation at CPA Canada.

ILLUSTRATION BY KAGAN MCLEOD; PHOTOGRAPH BY GETTY

GUEST COLUMN

A REVOLUTION IN LEARNING

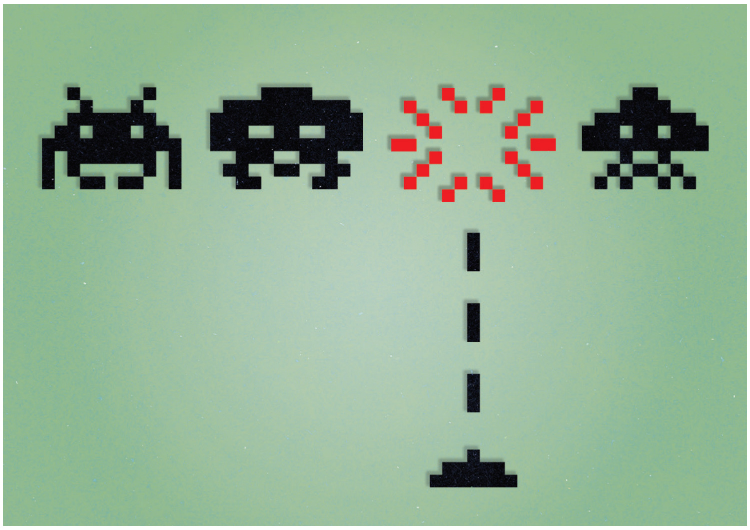
How the tech-driven transformation of education will impact the CPA learning experience and education as a whole

MAGDALENA SERWIN

ILLUSTRATION BY KAGAN MCLEOD

In the fall of 2023, I attended the AI and Learning Symposium in Las Vegas, a prelude to DevLearn, one of the biggest educational conferences in North America. The conference, attended by public, private and not-for-profit education leaders, reinforced the fact that we're in a global technological transformation, with AI as the emerging trendsetter in education.

It reminded me of a time 15 years ago, when I started designing and delivering e-learning. During that period, participants experienced several challenges, like disparities in Internet speeds and varying degrees of technology proficiency. On the educator's side, we were still in the process of mastering the skill of creating high-quality e-learning. Years later, when the pandemic struck, the world had no option



THE BRASS TAX

GAME OVER

The government essentially beta-tested some new tax rules. Here's why that's a bad idea.

JOHN OAKEY

In the gaming industry, it's a well-established strategy: software developers release early versions of their games so eager users can beta-test them—in other words, search for bugs and glitches—and then feed their discoveries back to the developers to fix the glitches before releasing their products. This approach to crowd-sourcing the identification of problems also saves the developers huge sums they'd otherwise have to spend on internal quality controls.

We can probably all agree that what works in the software industry isn't necessarily the most effective approach for developing public policy and regulation. Beta testing tax legislation isn't as much fun as a video game.

Yet, it seems in recent years, this is precisely how the federal government has managed some new federal tax rules, such as the Underused Housing Tax (UHT) and updates to reporting requirements for bare trusts: release new tax legislation to taxpayers and their advisers as beta testers, then scramble to repair the damage on the fly.

In the case of the UHT, a tax meant to target foreign owners ended up affecting countless Canadians who indirectly owned their residential properties through a specified Canadian trust, partnership or corporation. These Canadian tax filers and their CPAs had to invest a significant amount of time in understanding the rules and completing the UHT filings, even though most Canadian taxpayers were ultimately exempt from the tax. It was a nonsensical process that added cost and stress for everyone involved, yielded no additional tax revenue, and failed to improve the housing market. After receiving plenty of negative feedback from stakeholders, including CPA Canada, the Department of Finance, this past November, introduced amendments to the UHT to "help facilitate compliance."

The new rules for reporting bare trusts is a more recent example. These changes to the Income Tax Act emerged from a Department of Finance that seems to be struggling to keep up with the torrent of tax-oriented legislative activity coming from the federal government. The application of the final version of these rules turned out to be so broad that it would have imposed reporting obligations on all sorts of situations involving bare trusts that were never intended to fall within their scope. After months of sounding the alarm that there were serious flaws in the system, just days before the filing deadline for countless bare trusts across Canada, the decision was made, albeit at the last minute, to exempt bare trusts for the 2023 tax year. Canada Revenue Agency indicated in its announcement that it will "work with the Department of Finance to further clarify its guidance on this filing requirement."

TAXPAYERS AND CPAs TRY TO COMPLY WITH THE RULES, BUT THERE ARE BUGS IN THE SYSTEM

This is a problem, and we need to get in front of it.

In both cases, it seems as if the federal government has opted to beta-test its new tax rules rather than take the appropriate time to properly consult with and listen to expert external advice and then work out the bugs and glitches *before* the rules go into effect. In the meantime, taxpayers and accountants are forced to spend an enormous amount of time and resources trying to comply, only to find out that there were bugs in the system.

Not all of the government's recent tax legislation has followed this trajectory. Take, for example, recent changes in the tax treatment of intergenerational transfers of shares in a corporation. For years, section 84.1 of the Income Tax Act made

ILLUSTRATION BY KAGAN MCLEOD

it more advantageous from a tax-planning perspective for those shares to be transferred to a third party than to a child or grandchild. The Department of Finance eventually drafted changes that wouldn't penalize family members with a deemed dividend, thus enabling genuine intergenerational transfers of businesses to benefit from capital gain treatment and even a lifetime capital gains exemption. In this case, though the changes have evolved since the introduction of Bill C-208, the government did consult with stakeholders including the Joint Committee on Taxation of the CBA and CPA Canada, and the Department of Finance made some important modifications based on those recommendations—yet, in this fast-paced legislative environment, it seems that such outcomes are becoming the exception and not the rule.

Clearly, we have an opportunity to learn from debacles such as the implementation of the UHT and trust reporting rules. The federal government should take a more cautious and collaborative approach to tax reform. Tax legislation is intricate and highly technical, and everyone benefits when the Department of Finance takes its time and leverages the necessary resources in the Canadian tax community to draft effective legislation that balances policy objectives and the compliance burden imposed upon taxpayers.

2023
The year the last-minute decision was made to exempt bare trusts for the tax year

While beta-testing may be great for catching the bugs in a video game, it's not the right approach to implementing tax legislation. I prefer the wisdom of another profession: measure twice, as the old carpenters' adage goes, and cut once. It's a pragmatic philosophy that surely applies to tax policy as well. ◆

John Oakey, CPA, is vice-president of taxation at CPA Canada.

SHAM, WOW

A catalogue of recent cons

BY ANDREW RAVEN

FOREVER YOUNG

Think being young and Internet savvy will prevent you from falling victim to an online scam? Think again.

Nearly one-third of Canadians between the ages of 18 and 34 have lost money in a web-based fraud, according to a recent study by TD Bank.

"Growing up as a digital native and being more technologically savvy doesn't mean you're immune to the dangers of online scams," says TD fraud expert Sophia Leung.

Why are so many millennials and Gen Z-ers falling for online fraudsters?

TD says one reason is due to scams becoming remarkably elaborate. In a series of recent cases, fraudsters built phony cryptocurrency trading apps, duping people into forking over real money for worthless digital portfolios.

The kicker in this whole situation: TD believes fraudsters may have swindled many more young people than the survey suggests. More than 40 per cent of respondents said they would feel too embarrassed to report being defrauded.

SICKLY BEHAVIOUR

Toronto police have arrested a 34-year-old man, accusing him of impersonating a canvasser for the SickKids Foundation, a charity attached to one of the city's best-known children's hospitals, the Hospital for Sick Children.

Police say they received reports of a man who spent months knocking on doors in Toronto's downtown core asking for cash donations to the foundation.

Officers say he had a false identity badge and became "physically intimidating" when residents questioned his credentials.

The man, from the city of Vaughan, Ontario, faces more than a dozen charges, including fraud-related and parole violations.

Police believe he duped multiple victims but no details were available on how much money he made off with.

In a press release, police said canvassers for SickKids are forbidden from asking for cash donations. Legitimate canvassers have an ID number and a QR code that can be scanned for more information about them.

FREQUENT FLYER

Scams don't get much bolder than this. British police arrested a former airline employee for allegedly orchestrating a $5-million immigration fraud from a check-in desk at London's Heathrow Airport.

Police said the 24-year-old accepted bribes from passengers bound for Canada, waving them through check-in even though they did not have a valid visa. Some passengers forked out more than $40,000 CAD for a flight.

Once in Canada, the flyers applied for asylum, according to reports.

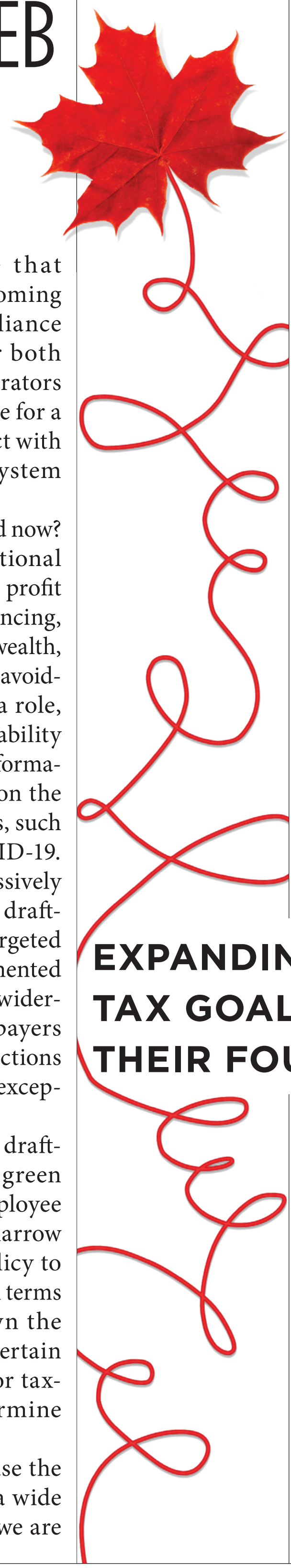
The 24-year-old suspect was arrested earlier this year. But after making bail, he reportedly fled to India, where he owns multiple homes.

PHOTOGRAPHS BY **ISTOCK**

THE BRASS TAX

THE TANGLED WEB

Canada's tax system has become so complex and difficult to navigate that it now needs a comprehensive, top-to-bottom overhaul



JOHN OAKEY

I think it's undeniable that Canada's tax system is becoming too complex and its compliance demands too difficult for both taxpayers and tax administrators to properly manage. It's time for a review of the Income Tax Act with the aim of ensuring the system remains workable going forward.

Why is the system becoming so complicated now? Some of the reasons may include international pressure to combat aggressive tax planning, profit shifting, money laundering and terrorist financing, along with domestic pressure to redistribute wealth, deal with deficit financing, and minimize tax avoidance and evasion. Technology also plays a role, providing governments with a new-found ability to data-mine copious amounts of collected information. We're also seeing a growing reliance on the federal tax system to solve current problems, such as the economic disruption caused by COVID-19.

Another change that is creating an excessively difficult system is an evolution in legislative drafting. The focus has changed from specific, targeted anti-avoidance provisions that were implemented only when they became necessary to much wider-reaching provisions under which all taxpayers undertaking certain broadly defined transactions are caught and only those that meet narrow exceptions are released.

We are also seeing problems in legislative drafting for tax incentives, such as the recent green technology investment tax credits and employee ownership trust rules, where the rules are narrow and complex, and often go beyond tax policy to legislating government-approved commercial terms and conditions. Complexity waters down the effectiveness of tax incentives to promote certain behaviour when it becomes too difficult for taxpayers to understand the rules and determine whether they qualify.

As the government finds more ways to use the federal income tax system to accomplish a wide range of goals beyond revenue collection, we are starting to see a breakdown of the basic principles on which the system is built, such as certainty, simplicity, effectiveness, predictability, fairness and efficiency. This situation disproportionately hurts small businesses more than larger ones, who are better able to hire advisers to help them navigate the system.

We don't have to look very far to see evidence of increasingly difficult tax compliance demands:

Trust reporting
This new policy was intended to combat money laundering and terrorist financing. However, when bare trusts were added to the legislation, the level of uncertainty was significantly increased, making compliance so difficult that CRA needed to exempt bare trusts from the reporting rules for 2023. This exemption came just days before the filing deadline and cost an estimated $1 billion in taxpayer resources for unnecessary compliance.

Underused housing tax
These provisions aimed to address the housing crisis by focusing on vacant foreign-owned residential properties. However, the negligible number of such properties contrasts starkly with the actual housing shortage. This tax led to extensive reporting by Canadians who indirectly owned their residential property through a corporation, partnership or trust, necessitating deadline extensions. CPA Canada advocated for the exclusion of Canadians with indirect ownership, which eventually resulted in legislative changes.

EXPANDING FEDERAL INCOME TAX GOALS UNDERMINES THEIR FOUNDATIONAL PRINCIPLES

Mandatory disclosure rules
These rules broadly define "avoidance transaction" to include regular tax planning and impose harsh non-compliance penalties. The rules' vagueness leads to high administrative and compliance costs, pushing professionals to report extensively to avoid penalties. Given that vagueness, the CRA was forced to produce its own interpretive guidance to make the regime workable.

General anti-avoidance rule
Recently enacted GAAR amendments also bring uncertainty, particularly around transactions significantly lacking economic substance. This ambiguity will likely compel over-reporting by taxpayers and practitioners seeking to sidestep possible penalties. Following the 2024 federal budget's change to the capital gains inclusion rate, the CRA's Income Tax Rulings Directorate has stated that the "crystallization of an accrued gain, solely as a means of ensuring access to the current inclusion rate, would not, in itself, be subject to GAAR." With the potential lack of economic substance in crystallization transactions, this statement may actually create further confusion about the general application of GAAR.

While tax rules aim to achieve policy objectives, their design is as crucial as the objectives themselves. Recent approaches have led to broad, complex rules that increase compliance costs and administrative burdens. What's needed is a thorough review of the act, a sentiment shared by CPA Canada in our 2024 pre-budget submission, which recommended prioritizing a principled approach to tax policy and administration that is driven by purpose and vision. Such a review can help ensure that Canada's tax system remains guided by good basic principles so that compliance costs can remain reasonable and taxpayers can have simplicity, fairness, predictability and certainty of outcome. ◆

0.13
The percentage of Canadians with an average income of $1.4 million that are expected to pay more personal income tax on their capital gains in any given year

John Oakey, CPA, is vice-president of taxation at CPA Canada.

ILLUSTRATION BY KAGAN MCLEOD; LEAF BY ISTOCK

SHAM, WOW

A catalogue of recent cons

BY ANDREW RAVEN

HEAVY LIES THE CROWN

A 25-year-old Ontario man who billed himself as the "Crypto King" has been arrested, the latest development in a sensational case that in many ways has mirrored the dramatic rise and fall of the cryptocurrency markets.

Aiden Pleterski, from Whitby, Ontario, is facing one count each of fraud and money laundering following a sprawling, cross-border police investigation that dates back more than 18 months.

Pleterski, from Whitby, styled himself as a crypto savant, raking in money from investors by promising huge returns, police said after his arrest. While Pleterski flaunted a lavish lifestyle in social media posts, at some point in 2022, his investors lost access to their money, police allege.

During a press conference announcing Pleterski's arrest, securities officials said the amount defrauded from investors was "massive."

According to previous reporting, Pleterski, who was not a registered trader, had raised more than $40 million. Just 2 per cent of that was put into the markets, with allegedly millions instead going toward luxury cars, vacations and private jet rentals.

FRAUD BY THE NUMBERS

A man who masterminded a decades-long scheme to forge paintings attributed to famed Indigenous artist Norval Morrisseau has pleaded guilty to fraud.

David Voss admitted in a court in Thunder Bay, Ontario, to overseeing an assembly-line process that churned out thousands of fake Morrisseau tableaux, a case that has been called Canada's largest art fraud.

The CBC reported that to forge the paintings, Voss would draw an outline in pencil and number areas to be coloured in by a roster of painters.

Investigators later used these pencil markings to identify scores of forgeries, which spanned from 1996 to 2019.

Voss reportedly sold the paintings to auction houses and consignment stores across Canada. In 2023, police charged eight people in connection with the plot, seizing more than 1,000 suspected forgeries, some of which had sold for tens of thousands of dollars.

Morrisseau, who died in 2007, is considered the grandfather of contemporary Indigenous art in Canada. He founded the Woodlands School and was known for his brightly coloured paintings that featured traditional scenes.

THE RISE OF SYNTHETICS

Toronto police have arrested a dozen people in connection with a sprawling fake-identity scam that defrauded businesses, including multiple banks, out of $4 million.

The suspects allegedly created nearly 700 fictitious identities, using them to open hundreds of bank and credit accounts dating back to 2016. Police say the scammers used the credit accounts for in-store and online purchases, cash withdrawals and electronic transfers.

Officers called the scam "synthetic identity fraud," which is often used to launder money from human trafficking, drug dealing and armed robbery.

Police said they seized dozens of "electronic templates" for creating fake IDs, hundreds of debit and credit cards, and $300,000 in cash.

Police believe more people were involved in the scam and said the investigation was ongoing.

PHOTOGRAPHS BY AIDEN PLETERSKI, ONTARIO PROVINCIAL POLICE