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## MINISTRY OF FINANCE

# 4.07—Provincial Personal Income Tax Revenue and Related Credits and Reductions

(Follow-up to VFM Section 3.07, 1999 Annual Report)

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## BACKGROUND

With the exception of Quebec, all Canadian provinces and territories have entered into a personal income tax collection agreement with the federal government. Under the terms of that agreement, the federal government processes and collects Ontario personal income tax, processes claims for provincial personal income tax credits and reductions, and remits the net proceeds to the province.

For the 1998/99 fiscal year, the province received approximately \$17.2 billion in personal income taxes net of \$1 billion in tax credits, which represented 31% of total provincial revenues for that year.

We concluded that the Ministry did not have the necessary information to assess whether provincial personal income taxes were correctly determined and whether personal income taxes were remitted to the province in as timely a manner as possible. In that regard, we found that:

- Revenue forecasts, and therefore in-year cash flows, were significantly less than the final determination of personal income tax revenues for the last three years. We estimated that the cost to the province of the resultant cash flow deficiencies for those years totalled \$189 million.
- The Ministry had very little input into, or information from, Revenue Canada about its audit procedures or its audit strategy, plans, and coverage of Ontario-based taxpayer returns.

In addition, the Ministry estimated that the federal government's benefit from retaining interest and penalties revenue received in excess of bad debts written off from Ontario personal income tax payers could exceed \$50 million per year. However, the federal government has not provided the Ministry with the data required to verify the actual federal benefit.

We also noted that the Tax Collection Agreement imposes a number of significant limitations on the province with respect to the implementation of tax policy changes and administrative practices, the necessity and advisability of which are no longer clear.

We made a number of recommendations to the Ministry to address our concerns. The Ministry agreed with the merits of our recommendations and committed to pursue corrective actions.

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## CURRENT STATUS OF RECOMMENDATIONS

For most of our recommendations, the Ministry's ability to act on them was, and continues to be, contingent on its ability to successfully renegotiate the tax collection agreement with the federal government. These negotiations were ongoing at the time of our follow-up. The status of action taken on each recommendation is as detailed below.

### **TIMING OF PERSONAL INCOME TAX FLOWS**

#### **PAYMENT FLOWS**

##### **Recommendation**

*To ensure that payments of Ontario personal income taxes are remitted to the province in the correct amount and on a more timely basis, the Ministry should consider negotiating the necessary amendments to the Tax Collection Agreement pertaining to cash flows.*

*As long as in-year payments to Ontario continue to be based on revenue forecasts and are subject to delay, the Ministry should seek compensation for the cash flow deficiencies for each year.*

##### **Current Status**

The federal Minister of Finance has stated verbally that the federal government will not profit from the administration of provincial taxes. Current negotiations with the federal government were seeking to firm up this commitment.

In the meantime, there is room to improve on the accuracy of the current estimation process. On an interim basis, the federal government has tentatively agreed to a new estimation formula that effectively allows Ontario input in determining the estimated in-year payments. This represents a substantial improvement in the current process.

The province was also investigating the feasibility and benefits of basing payments on a share of collections that would match entitlements more closely than the current estimation process.

### **INTEREST AND PENALTIES**

##### **Recommendation**

*To assess whether the federal government's retention of non-tax revenues is equitable, the Ministry should periodically receive the necessary information about non-tax revenues and accounts written off in respect of Ontario personal income tax.*

*The Ministry should use this information to consider whether it is beneficial to renegotiate the terms of the Tax Collection Agreement as it pertains to the sharing of interest and penalties revenues.*

##### **Current Status**

The matter of penalties and interest has been raised with the federal government on a number of occasions since the Provincial Auditor's Report was prepared. To date, the federal government has not provided adequate information to defend its position that it incurs financial loss from the administration of late accounts, including interest and penalties.

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Ontario is continuing to seek a proper resolution of this matter before it signs a new Tax Collection Agreement.

## **AUDITS OF PERSONAL INCOME TAX RETURNS**

### **Recommendation**

*In order to obtain assurance that the declaration and payment of personal income taxes to which the province is entitled are in the correct amount, the Ministry should:*

- *establish minimum audit requirements and renegotiate the Tax Collection Agreement with the federal government to require Revenue Canada [now the Canada Customs and Revenue Agency] to meet the Ministry's requirements for such things as audit coverage, selection criteria, and nature of the work to be performed; and*
- *obtain the necessary information from Revenue Canada to be able to assess whether it has met the Ministry's requirements.*

### **Current Status**

As noted in the report, under the current Tax Collection Agreement, the Ministry has no right to establish such things as minimum audit requirements. However, this matter has been identified by Ontario as an issue to be addressed in the context of a revised Tax Collection Agreement, currently under negotiation between the federal government and participating provinces.

## **TAX POLICY IMPLICATIONS**

### **Recommendation**

*The Ministry should consider whether the benefits under the Tax Collection Agreement continue to outweigh the restrictions, and, if considered advisable, renegotiate the Tax Collection Agreement in line with provincial interests.*

### **Current Status**

Ontario has stated publicly that an acceptable new Tax Collection Agreement should recognize legitimate provincial policy-making goals. In that context, Ontario has proceeded to implement a tax-on-income system, which gives the province direct control over its tax brackets, tax rates, and non-refundable tax credits.

The Provincial Auditor's recommendations continue to be a fundamental consideration for Ontario as it negotiates a new Tax Collection Agreement.

## **RELATED TAX CREDITS AND REDUCTIONS**

### **Property and Sales Tax Credits**

#### **Recommendation**

*In order to reduce the incidence of false and inaccurate claims, the Ministry should negotiate with Revenue Canada for increased audit coverage of property and sales tax credit claims to ensure that Revenue Canada annually audits more, if not all, of the claims meeting at least one of the Ministry's seven selection criteria.*

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*In addition, the Ministry should request that Revenue Canada audit a random sample from the remaining tax credit claims processed to ensure that any claim may be subject to audit and so that the degree of overpayment can be assessed for the program as a whole.*

### **Current Status**

We were advised that a formal agreement has been signed between the Ministry and the Canada Customs and Revenue Agency (CCRA, formerly Revenue Canada) to increase the audit coverage for property and sales tax credit claims to the desired amount at an annual cost of about \$1 million. The increased audit coverage commenced for the 1999 taxation year. The Ministry was awaiting results from the CCRA.

In addition, the CCRA conducted a random sample of audits for the 1998 taxation year. The Ministry was awaiting the results of the sample in order to review the compliance rate of the Property and Sales Tax Credit program.

## **Labour Sponsored Investment Funds**

### **Recommendation**

*In order to help ensure that Labour Sponsored Investment Funds and Eligible Small Businesses comply with the terms and conditions of the Community Small Business Investment Funds Act, the Ministry should increase its audit coverage to its target level. This would also permit excessive or ineligible claims to be identified, reassessed, and collected on a timely basis.*

### **Current Status**

Every Labour Sponsored Investment Fund (LSIF) must now complete an Annual Certificate of Compliance. Ministry auditors conduct an in-depth review of each certificate and any issues identified are further investigated during a field audit. The Ministry has completed either a desk audit or a field audit of all active LISFs in each of the last two years. In addition, the Ministry has significantly increased its audits of Eligible Small Businesses to approximately 100 during each of the last two years.

With respect to potentially ineligible tax credit claims, we were advised that the CCRA has conducted a review of the potentially ineligible 1996 accounts and issued appropriate reassessments for ineligible claims. In addition, a process is now in place to conduct reviews of LSIF tax credit claims on a timely basis so that any valid reassessments do not become statute barred.

## **Ontario Tax Reduction**

### **Recommendation**

*In order to help ensure that Ontario tax reductions are only provided to eligible individuals, and in the correct amount, the Ministry should negotiate minimum verification requirements with Revenue Canada so that it verifies, at least on a sample basis, claims for dependent children.*

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### **Current Status**

The Ministry requested the CCRA to review a sample of claims for disabled or infirm dependants and dependent children for the 1998 taxation year. We were advised that this review revealed that a very small percentage of the claims were not supported thus leading to the conclusion that there was a low risk of non-compliance.

A request has been made for the CCRA to conduct these sample reviews on an annual basis.