

# 3.06—Land Transfer Tax Program

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## BACKGROUND

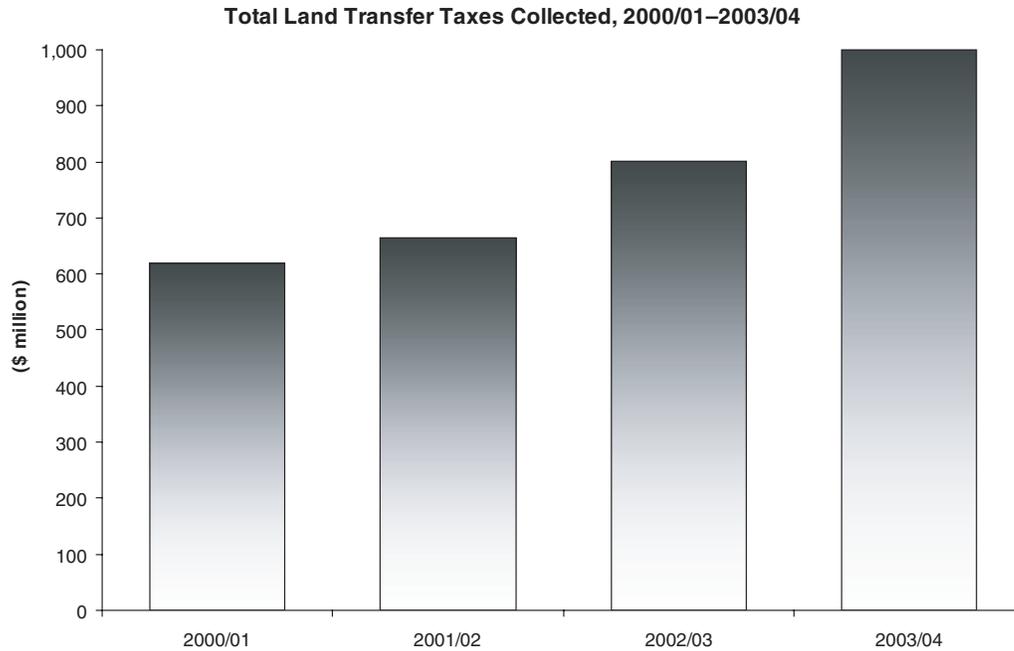
The *Land Transfer Tax Act* requires that purchasers pay a tax when an interest in ownership of land is transferred in Ontario. The tax is based on the taxable “value of consideration”—usually the amount paid by the purchaser and declared in a Land Transfer Tax Affidavit prepared by the purchaser’s lawyer. Land transfer tax is generally not payable when a property is transferred as a gift or an inheritance or is transferred to a Crown Corporation.

The progressive land transfer tax rates are as follows:

On amounts up to \$55,000	0.5%
On amounts over \$55,000 up to \$250,000	1.0%
On amounts exceeding \$250,000	1.5%
On amounts exceeding \$400,000 for a single-family residence only	2.0%

Currently, up to the first \$2,000 in land transfer tax may be waived or refunded for first-time homebuyers of newly constructed homes who meet prescribed conditions.

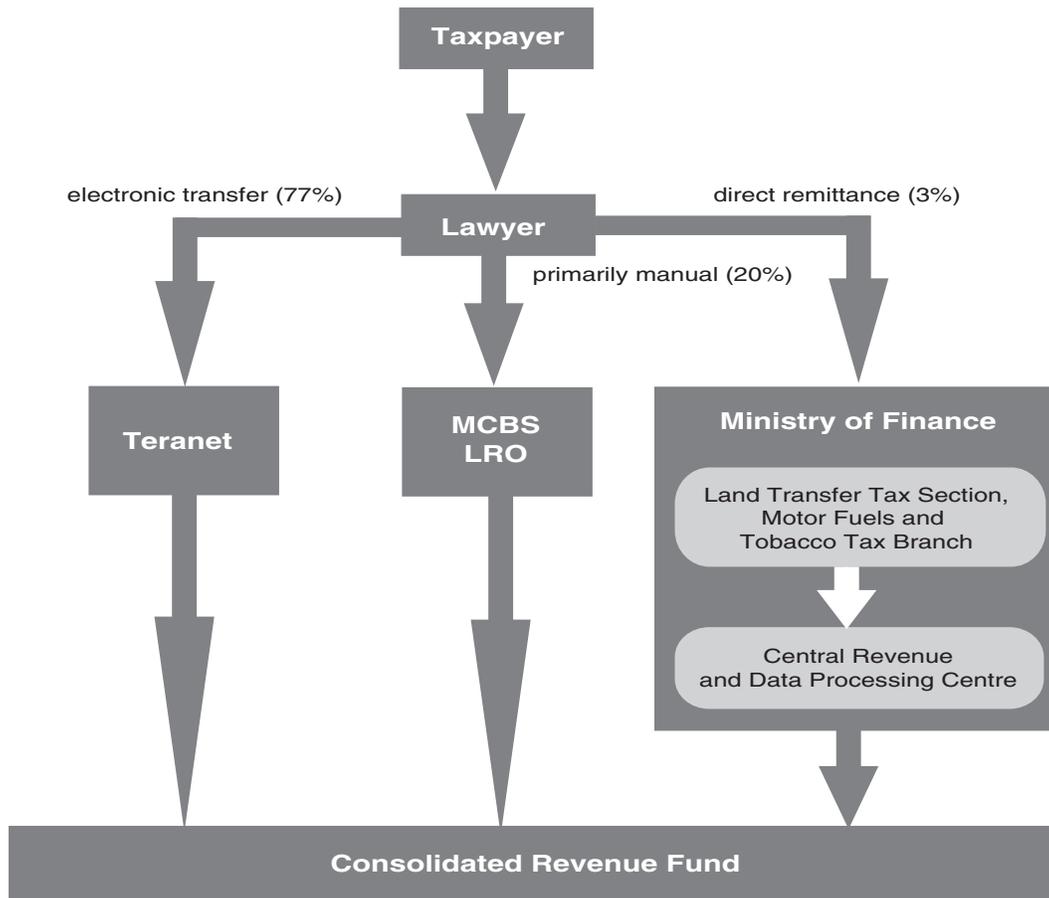
For the 2003/04 fiscal year, approximately 470,000 transfers in interest in land were reported to the Municipal Property Assessment Corporation for property tax assessment purposes. Also for the 2003/04 fiscal year, the total land transfer tax collected was approximately \$1 billion. Over the four-year period from 2000/01 to 2003/04, total land transfer taxes collected have increased substantially, as shown in the following bar graph.



*Source of data: Ministry of Finance*

The following flow chart shows the roles of each participant in the tax collection process. Note that Teranet in the flow chart refers to a private-sector company that has automated Ontario’s land registry system and collects and transfers tax funds electronically; and the Ministry of Consumer and Business Services (MCBS in the flow chart) operates 54 land registry offices (LROs in the flow chart). Although 21 of the 54 LROs offered electronic services through Teranet at the time of our audit, at LROs taxes are primarily collected manually, with cheques deposited to the Consolidated Revenue Fund.

## Flow of Land Transfer Tax from Taxpayer to Ministry, 2003/04



*Prepared by the Office of the Provincial Auditor*

The Land Transfer Tax (LTT) Section of the Ministry's Motor Fuels and Tobacco Tax (MFTT) Branch has overall responsibility for the administration of the Land Transfer Tax Program. This responsibility includes reviewing and auditing selected land transfer tax transactions, including those processed by Teranet and land registry offices, as well as verifying taxpayer eligibility for land transfer tax refunds or exemptions. At the conclusion of our audit in early 2004, a total of 29 full-time-equivalent staff positions were assigned to the LTT Section, of which five positions were vacant.

The LTT Section is supported in its administration of the program by the Ministry's Collection and Compliance and Tax Appeals branches and the Central Revenue and Data Processing Centre.

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## AUDIT OBJECTIVE AND SCOPE

The objective of our audit was to assess whether the Ministry had appropriate policies and procedures in place to ensure that the correct amounts of land transfer tax were being collected, refunded, and exempted in accordance with statutory requirements.

Our audit work was primarily conducted in the period from October 2003 to March 2004 and focused on the 2002/03 and 2003/04 fiscal years. Our audit was conducted in accordance with professional standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances. The criteria used to conclude on our audit objective were discussed with and agreed to by senior ministry management.

The scope of our audit included work at the following organizations and locations that administer land transfer tax transactions or program-related information: the MFTT Branch of the Ministry; three of the Ministry of Consumer and Business Services' (MCBS's) 54 LROs (which collectively received half of all land transfer tax revenue collected by LROs); the MCBS; the Shared Services Bureau; and the Municipal Property Assessment Corporation. In addition, we discussed various aspects of the Teranet system with the Chair of the Joint Committee for Electronic Registration of the Law Society of Upper Canada and the Ontario Bar Association.

The Ministry's Internal Audit Services Branch conducted an audit of Teranet's Remote Land Transfer Tax Administration and issued a report dated June 2003. We reviewed both this audit report—with the supporting working papers—and four MCBS internal audit reports on LROs that we received in December 2003, as well as one on Teranet that we received in March 2004. We relied on various aspects of the work done, as noted later in this report.

## OVERALL AUDIT CONCLUSIONS

Given that 97% of land transfer tax is not collected directly by the Ministry but rather by Teranet—a private-sector company—and by land registry offices (LROs) operated by another ministry, the Ministry of Finance must rely heavily on others to ensure it collects all land transfer tax owing. Such reliance is warranted only if the Ministry has adequate oversight and audit processes in place, particularly in the case of Teranet. We concluded that these processes required significant strengthening in several key areas, as follows:

- Although the Ministry was in the process of obtaining access to and making use of Teranet-based individual property registration data, at the conclusion of our audit fieldwork the Ministry had not yet established necessary procedures to effectively oversee the collection and submission of land transfer taxes by Teranet. Doing so is

especially important given that the taxes collected by Teranet have increased over the past four years from \$13.5 million (2.2% of total taxes) in the 2000/01 fiscal year to \$781 million (77% of total taxes) in the 2003/04 fiscal year. Internal auditors from both the Ministry of Finance and the Ministry of Consumer and Business Services also expressed the opinion that there could be a financial risk unless full access to Teranet data was obtained.

- LROs were not required to receive all the information they would need to ensure that the appropriate amount of tax, based on the taxable value of consideration, was remitted, regardless of whether the tax was collected through Teranet or directly by the LRO.
- The Ministry depends on LROs to identify high-risk transactions for possible follow-up and has provided LROs with a list of risk factors that would trigger this identification. However, based on our reviews and discussions, most of the transactions that exhibited one or more of these risk factors had not been referred to the Ministry for potential review and audit follow-up.
- It is essential for the Ministry to promote voluntary compliance through conducting sufficient, risk-based audits that serve notice to taxpayers that the information they report is subject to verification. However, we found that the focus of audit activity has increasingly been on lower-risk transactions, and this is likely one of the reasons why the dollar value of audit assessments has declined by 75% over the past four years.

We acknowledge that with just 24 staff, the ability of the Land Transfer Tax Section to undertake significantly enhanced oversight and audit procedures—especially with respect to more complex commercial land transfer transactions—may be limited by both the number and the mix of the staff currently involved. With this in mind, we recommended that the Ministry conduct a cost/benefit analysis to assess the feasibility of hiring additional staff with the qualifications to effectively identify and audit a larger number of high-risk land transfer transactions.

#### **Overall Ministry Response**

***We appreciate the Provincial Auditor's various observations and suggestions on the administration of the Land Transfer Tax (LTT) Program. Many of these issues were recognized by the Ministry in its move to an electronic LTT administration, and our improved access to Teranet data will provide the Ministry with an enhanced capacity for program oversight and audit selection, within a more efficient system that is also more convenient for the taxpayer.***

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# DETAILED AUDIT OBSERVATIONS

## THE COLLECTION PROCESS

Land transfer taxes are received from Teranet and land registry offices (LROs), as well as being directly remitted to the Ministry in a small number of cases. In the past four years, the proportion of land transfer taxes received from these three parties, respectively, has changed significantly, as shown in the following table.

**Sources of Land Transfer Tax Revenues Received,  
2000/01–2003/04**

Source	% of Total Revenue			
	2000/01	2001/02	2002/03	2003/04
Teranet	2.2	11.6	55.2	76.7
LROs	94.4	84.8	42.2	19.6
Ministry	3.4	3.6	2.6	3.7

*Source of data: Ministry of Finance*

Land transfer tax is usually paid at the time that a land transfer is registered. The registration and tax payment process follows option A, B, or C.

### *Option A*

A lawyer with a Teranet account electronically registers the land transfer with Teranet and remits the required tax by electronic funds transfer to a Teranet trust account, which is to transfer the funds within 24 hours to the Consolidated Revenue Fund to the credit of the Ministry of Consumer and Business Services (MCBS). The lawyer also provides Teranet with an electronic version of the Land Transfer Tax Affidavit (LTT Affidavit), which is printed out at an LRO. LRO staff are to review all aspects of the registration and certify that the information provided meets land registration requirements.

### *Option B*

A lawyer without a Teranet account goes to an LRO, where the land transfer is either electronically registered at a Teranet terminal in the LRO or—if there is no terminal—manually registered. In either case, the lawyer submits a paper copy of the LTT Affidavit and a cheque in payment of the land transfer tax. LRO staff daily deposit cheques received into the Consolidated Revenue Fund to the credit of the MCBS. LRO staff are to review all aspects of the registration and certify that the information provided meets land registration requirements.

### *Option C*

A lawyer remits the tax, along with supporting documentation (including the LTT Affidavit), directly to the Ministry's Land Transfer Tax Section (LTT Section).

Under options A and B, LRO staff send the LTT Affidavits that they receive and process to the Municipal Property Assessment Corporation (MPAC) for property assessment purposes. In cases where the value of consideration in the LTT Affidavit is greater than a predetermined threshold amount or where no taxes are paid, the MPAC forwards the paper copy of the LTT Affidavit to the LTT Section for review and possible follow-up. Under option C, the LTT Affidavit is submitted directly to the LTT Section, where staff review and may follow up on it and other supporting documentation.

The movement of land transfer taxes is recorded and monitored as follows:

- The MCBS provides the Shared Services Bureau (SSB), which provides business support services to ministries and agencies across the Ontario Public Service, with a weekly summary of revenue reported as collected by Teranet, while LROs apprise the SSB of the revenues they have collected.
- The SSB performs a weekly reconciliation of land transfer tax deposits to the land transfer tax receipts reported by Teranet and the LROs.
- Journal entries to record the revenue are provided to the Ministry of Finance weekly.

## ***SUPPORT FOR DECLARED VALUE OF CONSIDERATION AND EXEMPTIONS***

The Ministry entered into a revised Memorandum of Understanding (MOU) regarding the collection of land transfer taxes by LROs with the MCBS in December 2000. The MOU defines the respective roles and responsibilities of MCBS staff—including those in its LROs—as well as of the staff of the Ministry's Land Transfer Tax Section. According to the MOU, LRO personnel are expected to, among other things:

- collect land transfer tax at the appropriate tax rate based on the taxable value of consideration; and
- refer to the Ministry those LTT Affidavits that the Land Registrar in each LRO believes the Ministry should review or audit.

Ensuring that these expectations are met is especially important considering that the vast majority of LTT Affidavits are not forwarded to the Ministry (because the value of consideration does not exceed the predetermined threshold amount) and therefore are unlikely ever to be reviewed or audited.

We noted that compliance with both of the expectations was problematic.

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## Collecting Land Transfer Tax Based on Value of Consideration

With respect to the first expectation, we found that LRO staff were unable to definitively determine the true taxable value of consideration because supporting documents—including the agreement of purchase and sale and the statement of adjustments—are not required to be submitted when land transfer transactions are registered at Teranet and the LROs. Instead, LRO staff collect land transfer tax based on the declared value of consideration stated in the LTT Affidavit and the transfer or deed of land.

Certain events can cause the LTT Affidavit's declared value to differ from the true taxable value. For example, a person may purchase a new home and sign a contract for the base purchase price at a declared value of \$250,000. Later, the person may choose upgrades valued at, for example, \$25,000. The increased total—and taxable—value of \$275,000 is reflected in the purchase and sale agreement and a statement of adjustments, but the LTT Affidavit often does not get adjusted. One way to help ensure that the LTT Affidavit includes the value of taxable purchase price adjustments might be by adding a separate space on the form to record this information.

LRO staff told us that they currently do not obtain and review the supporting documents that would enable them to determine whether declared value differs from taxable value and that they would not be inclined to obtain the documents in the future.

In contrast, when land transfer tax payments are remitted directly to the Ministry's MFTT Branch, required documentation includes the agreement of purchase and sale and the statement of adjustments. We found in reviewing a small sample of files that the Ministry's review of agreements of purchase and sale and statements of adjustments resulted in the identification of additional tax owing for over 80% of the files. Although the taxes owing for three-quarters of these files were minimal and the Ministry did not request payment, the Ministry did request the payment of approximately \$10,000 in additional taxes identified as owing in the remaining one-quarter of the files.

It is important to note that the Ministry is able to assess whether additional taxes are owing in the above manner only when it receives the necessary documentation directly from the taxpayer or his/her lawyer—which it does for only about 3% of land transfers. The Ministry cannot routinely assess whether additional taxes are owing for the vast majority of land transfers that are processed and for which the applicable land transfer taxes are collected through LROs and Teranet. Although additional taxes owing on these transfers, if any, may be small for many of the individual cases, it is possible that the Ministry could be foregoing, on a cumulative basis, more substantial LTT revenues because the declared value of consideration in the LTT Affidavit is not checked against

supporting documentation, such as agreements of purchase and sale and statements of adjustments, especially for higher-risk and large-dollar-value transactions.

Purchasers and their lawyers may also be hindered in fulfilling their responsibility of declaring the true taxable value of consideration because educational materials they receive from the Ministry (described in more detail under “Training and Informational Materials”) do not provide specific guidance and examples on how to do so. Among such materials, even the *Guide for Real Estate Practitioners*, which was specifically developed to explain how to properly complete LTT Affidavits, does not include any such examples.

## Referring Matters to the Ministry

With respect to the responsibility of LROs to identify those LTT Affidavits warranting review and possible audit, in the 2002/03 fiscal year the Ministry provided LRO staff with a flagging list containing 22 risk factors to assist them in referring LTT Affidavits to the Ministry for further review and possible audit. We understand that any LTT Affidavit containing one or more of the 22 risk factors is to be forwarded to the Ministry. For example, an LTT Affidavit in which the purchaser claims tax exemptions should be flagged and forwarded. However, we found through discussions with LRO and ministry personnel that very few items were flagged and referred to the Ministry. For example:

- At two of the LROs we visited, staff did not use any of the 22 risk factors to flag LTT Affidavits.
- At the other LRO we visited, staff referred to the Ministry LTT Affidavits flagged for only five risk factors that they had selected from the list of 22 factors.

We found further indications that the Ministry was not receiving LTT Affidavits with identified risk factors in the working papers from Ministry of Finance internal audit’s review of Teranet transactions from August 2002. One of the risk factors from the flagging list is a purchaser’s claim for tax exemptions. However, there was no evidence that any of the following cases involving such claims had been referred to the Ministry for review or audit:

- In two of 11 cases, purchasers that claimed to be Crown Corporations and eligible for tax exemption on that basis were, in fact, not Crown Corporations.
- In 11 of 23 cases, purchasers claimed tax exemptions at LROs for having made direct payments to the Ministry, but there was no evidence for such payments ever having been made.

We were informed after the conclusion of our fieldwork in March 2004 that the Ministry determined that no tax was owing on any of these transactions.

## Recommendation

To help ensure that the value of consideration used to determine the amount of land transfer tax payable includes all aspects of taxable consideration and that Land Transfer Tax Affidavits (LTT Affidavits) and claims for exemptions that warrant further follow-up are referred to the Ministry, the Ministry should:

- provide in its educational materials—including the *Guide for Real Estate Practitioners*—a comprehensive list of the items that are to be included in the determination of taxable value of consideration;
- consider requiring that land registry offices (LROs) obtain, especially for higher-valued properties, additional documentation—such as agreements of purchase and sale and statements of adjustments—in order to substantiate the taxable value of consideration;
- consider changing the LTT Affidavit form to clearly request the inclusion of taxable purchase price adjustments in the determination of total taxable value of consideration; and
- work with LRO staff to ensure they are aware of the need to flag and submit to the Ministry those LTT Affidavits that contain any of the factors identified by the Ministry as high risk.

## Ministry Response

*The Ministry agrees with the Provincial Auditor that there are few situations where the gross sale price is not taxable. Therefore, the Ministry agrees that further clarification would be helpful and will provide further educational materials for more specific guidance in respect to common errors in the reporting of taxable value of consideration.*

*In the remote on-line electronic registration environment, it would be logistically impossible to match hundreds of thousands of electronic transactions with additional paper documents. Therefore, it would be more cost effective to place greater emphasis on taxpayer education and post-audit selection.*

*The Ministry will revise the instructions on the LTT Affidavit to more clearly define taxable value of consideration and will review the LTT Affidavit to determine whether improvement can be made.*

*In the light of the additional electronic data and with the automated audit selection capabilities that are now available to the Ministry of Finance, the flagging requirements in the LROs are changing. Staff at the Ministry of Consumer and Business Services and the Ministry of Finance will work together to revise processes and manual interventions that would be needed in the electronic environment.*

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## Training and Informational Materials

To facilitate LROs in collecting the correct amount of land transfer tax, both the current Memorandum of Understanding with the MCBS and the previous one require that ministry staff periodically visit LROs to provide them with staff training as well as informational guides and bulletins, including updates. In our last audit, in 1998, we identified two concerns in this area:

- Ministry staff had not visited any LROs or otherwise provided any training on land transfer tax issues for a number of years.
- The land transfer tax user manuals (LTT user manuals) and information guides and bulletins available to LRO staff were often incomplete and had not been updated in years.

As a result of these concerns, the Ministry undertook several initiatives from 2000 to 2002, including the following:

- The Ministry visited and provided training to staff at all 54 LROs and provided them with LTT user manuals.
- The Ministry developed a *Guide for Real Estate Practitioners* to facilitate the proper completion of LTT Affidavits.

During our interviews, LRO staff all expressed satisfaction with both the ministry training provided and the user manuals developed. We understand that the Ministry plans to revisit all LROs over a three-year cycle and provide updated training and materials as needed. Before the Ministry conducts these visits, we urge the Ministry to identify those areas where additional guidance may be required, such as in the identification and forwarding of high-risk LTT Affidavits and in the determination of taxable value.

## ***ENFORCEMENT ACTIVITIES***

### **Audit Coverage**

The objectives of the Ministry's enforcement activities are twofold: to assess whether additional taxes are owing for selected transactions; and to promote broad-based voluntary compliance with legislation by serving notice to taxpayers that the information they report may be followed up for completeness and accuracy.

The LTT Section conducts two types of enforcement activities: in cases of taxes directly remitted to the Ministry, mandatory reviews of all documentation submitted are done; in all other cases, discretionary audits are performed on transactions selected primarily from LTT Affidavits forwarded from the MPAC, LRO referrals, and other targeted initiatives.

In response to a recommendation made in our 1998 audit that the Ministry substantially increase the number of audits, the Ministry indicated it would allocate additional resources to land transfer tax audit. We noted that, on average, the number of annual reviews and audits has remained relatively constant in the last five years, even though the number of land registrations increased by one-third since our last audit in 1998.

We also noted that while LTT revenues have tripled over the last nine years, recent tax assessments resulting from audits and reviews have, on average, shown a slight decrease, as outlined in the following table.

**LTT Revenue and Assessments,  
1995/96–2003/04**

	LTT Revenue (\$ million)	Tax Assessments (\$ million)
1995/96	335	3.8
1996/97	444	6.6
1997/98	544	8.5
1998/99	470	3.1
1999/2000	565	12.5
2000/01	642	10.9
2001/02	665	5.0
2002/03	814	3.8
2003/04	1 billion	3.5

*Source of data: Ministry of Finance*

In addition, our review of available statistics for the 2001/02 and later fiscal years indicated that a disproportionate number of discretionary audits have been of first-time homebuyer refund claims. For example, in the 2002/03 fiscal year, 70% of all audits completed were for such claims—whereas audits selected because of, for example, potential issues regarding value of consideration, which can be higher risk and have potentially more lucrative results, were estimated to make up less than 12% of total audits completed. As for the results of the discretionary audits conducted in the 2002/03 fiscal year, we found the following:

- Thirty percent of the first-time homebuyer refund claim audits resulted in an assessment, where the average assessment was \$1,570.
- In contrast, approximately 70% of the other audits resulted in an assessment, with the average assessment being approximately \$9,700.

We therefore concluded that the Ministry’s audit coverage was not sufficiently focused on the risks of non-compliance and on maximizing the recovery of unremitted taxes.

We understand that the Ministry had not been able to audit more of the larger and more complex transactions because it lacked the necessary senior and more experienced staff required to do so.

We acknowledge that with just 24 staff, the ability of the LTT Section to improve the extent and effectiveness of its audit coverage—especially with respect to more complex commercial land transfer transactions—may be limited. It might therefore be prudent for the Ministry to analyze the costs and benefits of hiring additional staff with the qualifications to effectively identify and audit more higher-risk land transfer transactions.

### Recommendation

**To help meet its objective of assessing whether additional taxes are owed as well as to promote broad-based voluntary compliance with legislation, the Ministry should use a more risk-based approach in selecting land transfer transactions for audit and establish reasonable audit coverage goals.**

**To improve audit effectiveness, the Ministry should assess the costs and benefits of hiring additional staff with the qualifications to identify and audit higher-risk land transfer transactions.**

### Ministry Response

*Since the August 2003 agreement with Teranet to obtain electronic land registration and land transfer tax data, the Ministry has developed a system for enhanced data analysis to support improved audit selection processes. With the new data in an electronic format, the Ministry can now establish reasonable audit coverage goals and will use a more risk-based approach in selecting land transfer transactions for review.*

*The Ministry has developed a plan assessing the costs and benefits of hiring additional staff.*

## Audit Work Performed

In our *1998 Annual Report*, we noted that audit working-paper files often lacked documented audit programs and checklists. Including such material in files provides assurance that all necessary work has been undertaken. In this year's audit, we were pleased to find that standardized programs and checklists were completed in most cases and that there was evidence of supervisory review and approval of work completed.

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## First-time Homebuyer Refunds and Exemptions

First-time homebuyers who meet certain criteria are eligible for tax refunds or exemptions that equal the amount of tax paid or owing, up to a maximum of \$2,000. The Ministry's records for the 2002/03 fiscal year indicate that the vast majority of the almost 24,000 claims for tax refunds or exemption—totalling \$38 million—were granted to first-time homebuyers of newly constructed homes. In approximately 95% of cases, the refund or exemption is granted to these buyers when they register the land transfer at an LRO or through Teranet.

To be eligible for the exemption, the purchaser must meet the following criteria:

- Neither the purchaser nor the purchaser's spouse or same-sex partner—during the time of being a spouse/partner—has ever before owned a home anywhere in the world.
- The purchaser has purchased a newly constructed home.
- The purchaser occupies the home as his or her principal residence no later than nine months after the date of the land transfer or bestowal of the deed or title.

We reviewed a number of audits done on first-time homebuyer refunds and found that the audits in many cases did not establish the eligibility of first-time homebuyers for the exemptions.

We also found that whenever an exemption is granted, a paper copy of the Land Transfer Tax Refund Affidavit is to be forwarded to the Ministry for entry into its Refund Affidavit Database. This database is the basis for selecting transactions for further review or audit.

If an exemption or refund for any reason fails to get entered into the database, the associated transaction is in many cases not subject to audit selection or review and is not included in the Ministry's statistical information on the total number and amounts of refunds and exemptions claimed. Concerns about the extent to which database information was incomplete prompted program management to request that internal audit investigate the issue. Our review of Ministry of Finance internal audit files found that, for the month of August 2002, 402 (or 22%) of the 1,858 exemptions claimed through Teranet could not be located in the database. In February 2004, the Ministry indicated that 231 of these 402 exemptions were still not entered in the database. Once the Ministry is successful in obtaining access to Teranet-based individual property registration data, the identification of such exceptions can be done relatively cost effectively.

### Recommendation

In order to ensure that first-time homebuyer refunds and exemptions are provided only to eligible purchasers and that all refund and exemption transactions are recorded for possible audit selection or further review, the Ministry should ensure that:

- audits of first-time homebuyer claims establish the eligibility of the homebuyer for receiving a refund/exemption; and
- all information on refunds and exemptions claimed is entered into the Refund Affidavit Database.

### Ministry Response

*Audit file documentation standards will be enhanced to ensure that where the eligibility criteria are verified the results are clearly recorded.*

*The Ministry has manual processes currently in place to pursue missing affidavits from taxpayers or their solicitors and to capture all information onto a database. With improvements in data and technology, it will be possible to ensure by electronic means that all data is captured.*

## AUDITS OF TERANET AND LAND REGISTRY OFFICES

As noted previously, 97% of all land transfer tax revenue is collected either by Teranet (through electronic transfer) or by LROs (primarily manually).

With respect to the Teranet-based land transfer tax revenue, an agreement between the Ministry and Teranet effective August 1, 2003 includes the following provision:

Teranet is subject to audit by each of the [Ministry of Finance] and the Provincial Auditor, on reasonable notice, for the purpose of auditing Teranet's systems, data and processes as they relate to the collection of taxes, verification, storage and use of land transfer tax/retail sales tax related data. Financial systems and processes as they relate to the collection, accounting for and remittance of taxes are included in the scope of such audits.

We noted that, at the time our fieldwork was completed, no audits had been performed as a result of this agreement.

The internal audit branches of both the Ministry of Finance and the Ministry of Consumer and Business Services (MCBS) conducted audit work at Teranet that predated the August 1, 2003 agreement. However, while this audit work could provide some assurance, it could not verify that the Ministry of Finance received all of the revenue it was entitled to because the auditors lacked full access to Teranet data, systems, and processes. In that regard, in March 2004, we received an MCBS internal

audit report on Teranet dated November 2003. The conclusion and overall observations of this report included the following:

Without direct access to the Teranet system, we concluded there were gaps in the financial accountability and the ministries (MCBS [and the Ministry of Finance]) could be at a financial risk. There is no independent verification by the [m]inistry staff to ensure that the output from Teranet is accurate. Therefore, we were unable to verify [that] the net amount of revenue flowing to the ministries was fairly stated. It is recommended that Internal Audit or an independent accountant perform an annual audit of the Teranet system. In addition, the three ministries (MCBS, [Ministry of Finance,] and the Shared Services Bureau) should mutually agree to designate one ministry to perform a reconciliation of reports received from Teranet to ensure the accuracy of the financial data processed.

With respect to revenue collected by LROs, an agreement between the Ministry and the MCBS states the following:

MCBS will conduct periodic field audits on LROs to ensure compliance with established procedures. A representative sample of journal entries will also be examined to ensure that [land transfer tax] collected for those offices audited has been transferred to MFTT. Details of the results of MCBS LRO audits will be made available to [the Ministry of Finance's] Audit Services Branch on request. [The Ministry] will accept the audit findings of MCBS.

Our discussion with MCBS internal audit staff indicated that the frequency of audits of each LRO has been approximately once every 10 to 11 years. We also noted that, although MCBS internal audit completed and issued four LRO audit reports in the 2002/03 fiscal year, none of these were requested by or provided to the Ministry of Finance. In addition, we found in our review that the reports did not provide any specific assurance with respect to the completeness and accuracy of the land transfer tax collected by the LROs. In fact, one report suggested that the LRO needed to improve its procedures to meet its obligations under the Memorandum of Understanding with the Ministry.

### **Recommendation**

**To help ensure all land transfer tax revenue collected by Teranet and land registry offices (LROs) is transferred to the Ministry's Consolidated Revenue Fund, the Ministry should ensure that:**

- **an annual independent audit of the Teranet system is performed and any deficiencies or errors that relate to the submission and reporting of land transfer tax to the Ministry are identified and corrected on a timely basis; and**
- **the risk associated with auditing every LRO only once every 10 to 11 years is reconsidered and that the audits, when completed, are received and reviewed to determine whether they provide sufficient assurance that LROs have collected and transferred the correct amount of tax.**

### **Ministry Response**

***The Ministry recognized the need for oversight with respect to Teranet's involvement in the administration of the land transfer tax (LTT). Consequently an audit, which included a review of the collection, reconciliation, and reporting of LTT in Teranet, was undertaken and completed by Ministry of Finance internal audit in June 2003. The scope of the audit, at that time, was limited by the Ministry's lack of authority with respect to full access to Teranet data, systems, and processes.***

***Since the last audit in 2003, the Ministry has entered into an agreement with Teranet to permit an audit of Teranet's systems, data, and processes as they relate to the collection of taxes. Independent audits of the Teranet system will be performed on a regular basis. Any deficiencies disclosed would be addressed in a timely manner.***

***While every effort is made to have audit coverage for all registry offices in a timely fashion, audit resources and priorities have made it challenging to do so. Current audit planning for the offices is focused on high-risk areas based on a set of critical risk factors. Twelve LROs have been selected for audit in 2004/05.***

***The Ministry will work with the Real Property and Registration Branch at the Ministry of Consumer and Business Services to obtain comments and recommendations related to the collection of land transfer tax from the LRO audits.***

## **MANAGEMENT INFORMATION**

Sufficiently detailed and accurate information is required to manage and evaluate the effectiveness of the Land Transfer Tax Program. Examples of information that would be useful to facilitate management's administration and assessment of the program include:

- the total number of, and detailed information on, land transfers executed, divided into different categories—such as those involving developers, those involving commercial properties, those involving resale properties, those involving new homes, and so on;
- detailed information on the values of consideration of all land transfers executed, divided into different categories, such as those within certain dollar ranges; and
- the total number of, and detailed information on, land transfer registrations where first-time homebuyer tax refunds or exemptions were claimed.

At the time of our *1998 Annual Report*, 95% of all land transfer tax paid was collected—mostly manually—by LROs. In many cases it was impractical for the Ministry to collect and analyze the large amount of paperwork involved to obtain the

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information necessary for managing and evaluating the program. In fact, the only information it did receive was paper copies of LTT Affidavits that met certain criteria. Thus, effective management and evaluation of the program were much more difficult at that time.

At the time of our current audit, however, 75% of all land transfer tax revenues were collected through Teranet, and it is expected that this percentage will continue to increase over the next few years. As a result, a significant amount of information is maintained electronically at a centralized source.

As previously discussed, the Ministry can currently access Teranet's information only on *individual* property registrations. For some time, ministry management had been aware of the need for additional information of a *summary* nature to help it manage and evaluate the effectiveness of the program. As a result, in August 2003 the Ministry entered into an agreement to obtain such information from Teranet for a one-time programming fee of \$75,000 and an ongoing annual fee of \$31,000. As our audit ended in April 2004, Teranet was developing the necessary extracting software, and the Ministry was expecting to have summary information by fall 2004.

Summary information on the number, type, and value of transactions is essential for effective management oversight and, accordingly, we will follow up on the Ministry's access to this information and use of it in two years' time.

## **ACCOUNTS RECEIVABLE**

All land transfer tax accounts receivable that are outstanding for more than 45 days are referred to the Ministry's Collection and Compliance Branch. As of September 30, 2003, a total of 240 accounts representing \$48 million of land transfer taxes that had been referred to this branch were still outstanding. The majority of these accounts had been outstanding for more than 90 days.

Of the \$48 million in outstanding receivables, much of which was under objection or appeal, \$27 million—relating primarily to the transfer of land to four airport authorities in the late 1990s—received order-in-council approval for payment deferral; \$14.4 million was secured by instruments such as a letter of credit or a personal guarantee; and \$6.2 million was covered by liens or writs registered on taxpayer property. This left a balance of only about \$400,000 in outstanding receivables unprotected by security, liens, or writs. Due to the small amount subject to risk, we did not conduct a detailed audit review of this area.

## **OBJECTIONS AND APPEALS**

The *Land Transfer Tax Act* allows a person who objects to an assessment of taxes payable issued by the Motor Fuels and Tobacco Tax Branch to file an objection with the Tax Appeals Branch within 180 days of receiving a Notice of Assessment, Notice of Decision, or Statement of Disallowance. If the person is not satisfied with the

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subsequent decision of the Tax Appeals Branch, that person may appeal—within 90 days of receiving notice of the decision—to the Superior Court of Justice to have the decision overturned. The Ministry’s Legal Services Branch handles appeal cases. The Tax Appeals Branch reported that, as of September 30, 2003, 53 taxpayer objections were under review. Also as of this date, 71 appeal cases were filed with the Superior Court of Justice.

From the taxpayer’s perspective, timely resolution of objections and appeals is of the utmost importance. Management informed us that each officer was responsible for following up on and updating the objection files assigned to him or her. However, the Ministry has not set any time frames for follow-up actions and subsequent decisions on objections. In our review of a sample of objection files, we found that a long time elapsed between follow-up actions. In several instances, almost three years elapsed between follow-up phone calls, and there was no documentation to indicate that other follow-up actions had been taken during that time.

In addition, we found 37 appeal cases that had been filed with the court for more than five years and were not yet resolved. In reviewing a sample of appeal files, we found no evidence that the Tax Appeals Branch had followed up with the Legal Services Branch to determine the status of the appeals.

We also found that statistics that the Ministry prepared to demonstrate the effectiveness of land transfer tax assessments and provided to the Management Board of Cabinet were not a correct measure of the LTT Section’s performance. The Ministry applied its effectiveness measure as follows: first it subtracted the number of objections that in the current year resulted in a changed assessment from the total number of new assessments issued in the current year; then it divided this number by the total number of new assessments issued that year. However, since most of the new assessments would not have been objected to or appealed—and certainly not settled—this assumption is clearly untenable. Rather, each objection/appeal needs to be tracked through the objection/appeal process to its final outcome (which the Ministry currently does not do), and outcomes need to be related back to the assessment statistics for the year in which the objection/appeal originated. The Ministry acknowledged that the statistics reported to the Management Board of Cabinet are not a true measure of effectiveness and advised us that it is in the process of revising the statistics that it will report.

### **Recommendation**

#### **To improve the timeliness of objection decisions, the Ministry should:**

- **develop a flagging system to identify files on which no recent action has been taken;**
- **follow up with the appropriate officers to determine the reasons for delays in taking action; and**
- **determine the actions required to expedite resolution of the files.**

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**Ministry Response**

***Activities related to the review of objection files are recorded on the Ontario Tax Appeals System (OATS). The Ministry agrees that the system should contain enough information to demonstrate that timely action is being taken. OATS will be programmed to flag accounts for a manager's review when no action has been recorded on an account for six months. The manager will determine what action is needed to expedite completion of the file and ensure that an appropriate record is placed on the system.***

***Files are referred to the Legal Services Branch when the taxpayer commences an appeal under the provisions of the statute. Once a reply to the appeal is filed by the Legal Services Branch on behalf of the Ministry, the matter becomes a civil action in the Ontario Superior Court of Justice. It is the responsibility of the taxpayer who has commenced the action to pursue it through the courts.***