

Land Transfer Tax Program

Follow-up to VFM Section 3.06, *2004 Annual Report*

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. In 2004, up to the first \$2,000 in land transfer tax could be waived or refunded for first-time homebuyers of newly constructed homes who met prescribed conditions.

During the 2005/06 fiscal year, approximately 470,000 transfers in interest in land—which is about the same number as in the 2003/04 fiscal year—were reported to the Municipal Property Assessment Corporation for property assessment purposes. The total land transfer tax collected in 2005/06 was approximately \$1.13 billion (approximately \$1 billion in 2003/04).

In our *2004 Annual Report*, we concluded that, given that 97% of land transfer tax is not collected directly by the Ministry of Finance (Ministry) but rather by Teranet—a private-sector company—and land registry offices (LROs) that are operated by another ministry, the Ministry of Finance must rely heavily on others to ensure it collects all land trans-

fer tax owing. We noted that such reliance is warranted only if the Ministry has adequate oversight and audit processes in place, particularly in the case of Teranet. However, we concluded that these processes required significant strengthening because:

- While some progress had been made, the Ministry had not yet established adequate procedures to effectively oversee the collection and submission of land transfer taxes by Teranet. In that regard, internal auditors from both the Ministry of Finance and the Ministry of Consumer and Business Services also expressed the opinion that there was a financial risk unless full access to Teranet data was obtained by the Ministry.
- LROs were not required to receive all the information from taxpayers that they would need to ensure that the appropriate amount of tax, based on the taxable value of consideration, was remitted.
- The Ministry had not ensured the LROs were referring higher-risk transactions to the Ministry for potential review and audit follow-up, as required.
- The focus of the Ministry’s audit activity had increasingly been on lower-risk transactions. This was likely one of the reasons why the dollar value of audit assessments had declined by 75% over the previous few years.

We made a number of recommendations for improvement and received commitments from the Ministry that it would take action to address our concerns.

Current Status of Recommendations

According to information received from the Ministry of Finance, progress is being made in implementing all of the recommendations we made in our *2004 Annual Report*. The current status of action taken on each of our recommendations is as follows.

SUPPORT FOR DECLARED VALUE OF CONSIDERATION AND EXEMPTIONS

Collecting Land Transfer Tax Based on Value of Consideration, and Referring Matters to the Ministry

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.*

Current Status

The Ministry informed us that it believes that greater emphasis on educating taxpayers and their lawyers through bulletins, guides, instruction amendments, and electronic newsletters on the Teranet website is the most effective means of ensuring that the value of consideration declared includes all aspects of taxable consideration. The Ministry also advised us that greater focus on selecting transactions for audit after their completion will help assess compliance with these requirements.

To address common errors in the reporting of taxable value of consideration, the Ministry released two bulletins: *Calculating Land Transfer Tax*, released in September 2005, and *Determining the Value of Consideration for the Transfer of New Homes*, released in March 2006. The latter bulletin provides examples of factors to be taken into account in determining the value of consideration.

Given the emphasis it puts on taxpayer education and on selecting transactions for audit after their completion, the Ministry has decided not to ask land registry offices (LROs) to collect additional information.

For paper registrations, which represent about 15% of all registrations, the LTT Affidavit instructions have been revised to identify certain adjustments that need to be made in calculating the total taxable value of the consideration. For electronic registrations, which represent about 85% of all registrations, the Ministry decided not to revise the instructions but to inform taxpayers and lawyers through bulletins, guides on the Tax Revenue

Division website, and electronic newsletters on the Teranet website.

With respect to LROs flagging and submitting LTT Affidavits that contain factors identified by the Ministry as high risk, the Ministry informed us that, in most cases, this is no longer necessary for electronic registrations because the Ministry can now identify those same transactions electronically for further review and follow-up. In the case of paper registrations, at the time of our follow-up the Ministry was in the process of negotiating with the Ministry of Government Services—which had become responsible for LROs—a new Memorandum of Understanding that is to include a requirement to refine the flagging requirements.

ENFORCEMENT ACTIVITIES

Audit Coverage

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.

Current Status

We were informed that the Ministry now uses electronic land transfer tax and land registration information for data-matching and audit-selection purposes. Risk-based audit-selection criteria have been developed and implemented. As of December 31, 2005, the Ministry was evaluating the available preliminary pilot data. The results of this evaluation are also to be used for projecting audit recoveries and establishing reasonable audit coverage goals. The Land Transfer Tax Section is also partici-

pating with the Tax Revenue Division's other audit programs in the Risk-based Audit Selection project announced in the *2004 Ontario Budget*.

The Ministry also informed us that 25 additional staff positions were approved in 2005 to establish two new audit units in the Land Transfer Tax Section. By March 2006, all staff had been hired and training was initiated.

First-time Homebuyer Refunds and Exemptions

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.*

Current Status

The Ministry indicated that, at the time of this follow-up, it was including all hard copies of evidence verifying eligibility for the refund/exemption in the audit file. We were informed that all staff had been trained on the new procedures by July 2005.

Changes to the *Land Transfer Tax Act* in December 2004 permitted refund claims to be made electronically. According to the Ministry, at the time of our follow-up, over 95% of refunds were being claimed electronically. In these cases, the refund database is updated automatically. In the case of paper-based refund claims, the database continues to be updated manually. We were informed that the significantly reduced volume of paper-based claims allows the Ministry to better manage and control the Refund Affidavit Database.

AUDITS OF TERANET AND LAND REGISTRY OFFICES

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.*

Current Status

According to the Ministry, changes to the *Land Transfer Tax Act* in December 2004 clarified the Minister of Finance's authority to designate Teranet as a "collector" of land transfer tax and provided for the Ministry to audit it. The Ministry's internal audit service has tabled its terms of reference with Teranet, and the audit fieldwork commenced in January 2006. The Ministry informed us that its internal audit service has allocated time in its annual audit and consulting plan to continue reviews of Teranet through 2008.

We were advised that, in the case of Land Registry Offices, the Ministry of Government Services Internal Audit Branch completed 10 LRO audits in the 2004/05 year and concluded that controls were

adequate. It also completed 13 LRO audits in the 2005/06 fiscal year and identified no significant concerns in these audits. It plans to conduct four LRO audits in 2006/07.

We were informed that the decision to decrease the number of LRO audits was due in part to significantly decreased numbers of physical transactions conducted at these sites since the introduction of electronic registration. Ministry statistics show that the number of electronic registrations increased from 1.4 million in 2004 to 1.8 million in 2006, while the number of paper registrations fell from 612,000 to 371,000 in the same period.

OBJECTIONS AND APPEALS

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.*

Current Status

The Ministry informed us that, on the 15th of each month, a report is generated for each manager of the Tax Appeals Branch that lists all inactive files from the past six months. The managers are to review these files with the responsible appeals officers to determine the reasons for any delays and to establish any necessary corrective actions.