
MINISTRY OF FINANCE

4.08—Gasoline, Fuel, and Tobacco Taxes

(Follow-up to VFM Section 3.08, *2001 Annual Report*)

BACKGROUND

For the 2002/03 fiscal year, the Ministry collected commodity taxes on gasoline, fuel, and tobacco that totalled \$4.2 billion. For the 2000/01 fiscal year, the amount of taxes collected totalled \$3.25 billion, which represented approximately 6.7% of the province's total taxation revenue from all sources.

We concluded in 2001 that the Ministry's policies, procedures, and technology systems did not provide the information necessary to ensure that all gasoline, fuel, and tobacco taxes due were being declared and paid in accordance with statutory requirements.

With respect to the collection of gasoline and fuel taxes, we found that the Ministry did not:

- obtain information on the amounts of gasoline and diesel fuel produced in Ontario and reconcile those amounts to reported sales to ensure that tax was being paid on all gasoline and fuel production except for legitimate tax-exempt sales;
- regularly compare the billions of dollars of reported tax-exempt sales and purchases between collectors to ensure that large discrepancies were adequately resolved or assessed for tax; and
- verify the completeness and accuracy of reported imports and exports by comparing them to independent information provided by inter-jurisdictional transporters, including pipelines.

With respect to the collection of tobacco taxes, we found that:

- information on the quantity of cigarettes produced in Ontario was not obtained and compared to the quantity of reported sales to ensure that tax was being paid on all cigarette production except for legitimate tax-exempt sales;
- a more effective system for marking tax-paid cigarettes needed to be implemented;
- the completeness and accuracy of reported tobacco imports and exports was not verified with independent information such as that provided by inter-jurisdictional transporters of tobacco products;
- there was no assurance that the tax on tobacco imports by unregistered importers was being declared and paid; and
- the Ministry needed to consider the need for developing an allocation system for the sale of tax-exempt cigars on native reserves similar to the one in place for cigarettes.

At the time of our audit, we had made recommendations for improvements in each of these areas and received commitments from the Ministry that it would take the necessary corrective action.

CURRENT STATUS OF RECOMMENDATIONS

In June 2003, the Ministry advised us of the current status of the actions taken to address each of our recommendations. We are pleased to note that in many areas, substantial progress appears to have been made in implementing the necessary corrective action, as detailed in the following.

GASOLINE AND DIESEL FUEL TAXES

Gasoline and Diesel Fuel Production

Recommendation

To help ensure that all gasoline and diesel fuel produced in Ontario is accounted for as either taxable or tax-exempt sales, the Ministry should require refiners to submit information on gasoline and diesel fuel produced, compare it to reported taxable and tax-exempt sales, and periodically verify the accuracy of the production information received.

Current Status

The Ministry revisited the legal implications of this recommendation and determined that legislative authority was necessary to require refiners to submit information on production. As a result, new registration requirements for manufacturers are now in place in Section 2.1 of the *Fuel Tax Act* and Section 2.1 of the *Gasoline Tax Act* and were effective as of July 1, 2003. A bulletin outlining the registration requirements was published in February 2003. Another bulletin outlining the specific reporting requirements will be issued upon the filing of regulations establishing the reporting details.

It is estimated that implementation of the reporting requirements will take approximately 12 months from when the requirements are established if a manual system for registration and reporting is established, or 24 months if a more effective electronic system is developed. Funding for and availability of information technology resources may impact on these estimated delivery time frames.

Gasoline and Diesel Fuel Tax Return Processing— Tax-exempt Sales and Purchases Between Collectors

Recommendation

To help ensure that the correct amounts of gasoline and diesel fuel taxes are declared and paid, the Ministry should:

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- *verify the accuracy of reported tax-exempt sales and purchases between collectors and ensure that large discrepancies are identified, followed up, and assessed where warranted; and*
 - *clearly communicate what constitutes a sale.*

Current Status

The Ministry has identified stronger accountability and reporting mechanisms and discussed them with industry stakeholders. These discussions revealed practical problems with respect to reporting sales information, including the need for an identifier on “swap” contracts (wherein collectors trade petroleum products on an in-kind basis) so that the information in the contracts can appear on invoices.

The Ministry has prepared a draft bulletin that addresses concerns raised by industry stakeholders in the course of the discussions noted above. The Ministry is expected to issue the bulletin before the end of 2003, pending further industry consultations and resolution of technical challenges to the implementation of reporting requirements.

Gasoline and Diesel Fuel Tax Return Processing— Gasoline and Diesel Fuel Imports and Exports

Recommendation

To help ensure that all imports and exports of gasoline and diesel fuel are accounted for and that the correct amount of tax is declared and paid, the Ministry should:

- *ensure that all gasoline and diesel fuel tax collectors and inter-jurisdictional transporters, including pipelines, submit the information required of them by law;*
- *verify the accuracy of reported imports and exports by comparing them to information provided by inter-jurisdictional transporters—when significant variances are identified, they should be investigated and resolved on a timely basis;*
- *provide the Canada Customs and Revenue Agency with an up-to-date list of registered importers to ensure that unregistered importers pay the applicable tax at the time of import; and*
- *develop the appropriate tax return forms for inter-jurisdictional pipeline transporters.*

Current Status

The Ministry informed us that reporting requirements for collectors and inter-jurisdictional transporters, including pipelines, with respect to imports and exports have been brought to the attention of non-compliant registrants. A bulletin outlining requirements for transporters, including pipelines, was published in April 2003. In addition, Bill 198 established more effective sanctions for failure to file sales and transporter returns.

To facilitate the verification of reported information, the Ministry was considering, at the time of our follow-up, electronic service-delivery options under the electronic reporting initiative of the Canadian Fuel Tax Project (a project mandated to simplify and standardize the administration of fuel taxes across all Canadian jurisdictions).

An updated border collection agreement for petroleum tax collection that includes a provision for regular information exchanges between the Canada Customs and Revenue Agency (CCRA) and the Ministry has been reviewed by the Ministry's Legal Services Branch. Finalization of the agreement with the CCRA is expected by the end of the 2003/04 fiscal year. The agreement should ensure that the CCRA has up-to-date information on registered importers to enable the collection of taxes from unregistered importers.

Tax return forms and schedules for inter-jurisdictional pipeline transporters have been finalized and are currently in use.

Gasoline Tax Refunds

Recommendation

To ensure that only eligible gasoline sales are exempted from tax, the Ministry should review refund vouchers submitted by collectors for completeness and reasonableness of exemptions claimed based on assessed risks and follow up on questionable or incomplete vouchers to determine whether or not the purchases qualify as tax-exempt.

Current Status

The Ministry informed us that the review of the refund claims in collector returns using risk-based sampling techniques had been suspended during our audit in 2001 while resources were redirected to other activities. The Ministry advised us that this review was resumed in June 2001 and that refund claims continue to be monitored. As a result, eight warning notices had been issued to non-compliant retailers; those retailers are now required to file their returns and supporting vouchers directly with the Ministry.

The Ministry also informed us that the vouchers submitted by retailers that previously submitted questionable claims are now closely scrutinized prior to authorizing any refund.

Fuel Acquisition Permits

Recommendation

To ensure that tax-exempt diesel fuel purchased by holders of Fuel Acquisition Permits is used only for eligible purposes, the Ministry should:

- *monitor and assess the reasonableness of the tax-exempt diesel fuel purchases reported by Fuel Acquisition Permit holders; and*

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- *conduct periodic audits or inspections of all types of permit holder facilities, based on the assessed risks.*

Current Status

The Ministry informed us that it now annually reviews renewals of Fuel Acquisition Permits used to buy tax-exempt diesel fuel for kerosene repackaging, and field inspections of permit holder facilities are conducted where actual business practices could not be confirmed as appropriate.

The Ministry also informed us that it reviewed, prior to the 2002 renewal cycle, all of the 163 accounts of permit holders buying the tax-exempt fuel for tobacco curing. Only 86 permits were renewed. Inspectors visited approximately 30 of the 86 tobacco curers granted renewals and found that the curing process had changed such that the curing process no longer required clear diesel fuel. The Ministry has since cancelled all remaining permits for tobacco curers.

The Ministry is also participating in the exempt sales sub-project of the Canadian Fuel Tax Project to determine alternative methods of administering tax-exempt sales.

TOBACCO TAXES

Tobacco Tax Return Processing—Cigarette Production and Control

Recommendation

The Ministry should ensure that all cigarette manufacturers:

- *submit the required schedules indicating the number of Ontario-marked cigarettes produced, shipped, and on hand; and*
- *provide information about the amount of yellow tear-tape acquired and used.*

The Ministry should then use that information to assess the reasonableness of reported taxable sales.

Current Status

The Ministry informed us that all registered manufacturers were notified of the mandatory requirement to file the appropriate inventory distribution and sales schedules with their monthly returns and are now doing so on a regular basis. Upon receipt of the returns, Ministry staff routinely reconcile the two schedules and follow up on any discrepancies.

Amendments to the *Tobacco Tax Act* require tear-tape manufacturers to account for the manufacture and sale of tear-tape and to limit sales to registered manufacturers. The amendments also require that cigarette manufacturers purchase tear-tape only from manufacturers that have been issued a manufacturing permit by the Ministry and that every

permit holder “account for and take reasonable steps to safeguard tear-tape in its possession.” However, at the time of our follow-up, the amendments had not yet been proclaimed and were therefore not in force.

Tobacco Tax Return Processing—Tobacco Imports and Exports

Recommendation

To ensure that tobacco product import and export reports are complete and accurate and that the correct amount of tax has been declared and paid, the Ministry should:

- *obtain the required information from all inter-jurisdictional transporters or, if that information is unavailable, obtain other evidence, such as customs declarations, to assess the completeness and accuracy of reported imports and exports; and*
- *regularly obtain information from the Canada Customs and Revenue Agency detailing tobacco-product imports by unregistered importers and use it to determine whether the correct amounts of tobacco tax have been declared and paid.*

Current Status

Transporters carrying tobacco are now required to register with the Ministry and report the names of the exporters and importers for which they are carrying tobacco. Failure to do so is being treated as a non-compliance issue, and the Ministry informed us that it has contacted specific transporters to address deficiencies. The Ministry was expecting that, by September 2003, it would be reviewing monthly returns submitted by transporters and, where necessary, taking appropriate follow-up action. In that regard, a regulation detailing the requirements for inter-jurisdictional tobacco transporter returns had been drafted and reviewed, and approval was pending. Also, a bulletin outlining inter-jurisdictional tobacco transporter requirements had been drafted and approved.

An updated report on tobacco product imports was received from the CCRA in late 2002, after a protracted delay due to legal and policy issues. The report has been analyzed and integrated into the Ministry’s audit plan for the 2003/04 fiscal year. In addition, after the border collection agreement for petroleum tax collection (see “Current Status” of “Gasoline and Diesel Fuel Tax Return Processing—Gasoline and Diesel Fuel Imports and Exports”) is finalized, the Ministry is to commence negotiations with the CCRA to enhance the border collection agreement for tobacco tax collection.

Cigar Taxes

Recommendation

To ensure that the quantity of tax-exempt cigars sold on native reserves is reasonable, the Ministry should consider the need for an allocation system for cigars similar to the one in place for the sale of tax-exempt cigarettes, and if considered advisable, initiate its development.

Current Status

The Ministry informed us that it has completed a study of the advisability of an allocation system for cigars; the study was being reviewed at the time of our follow-up.

SECURITY REQUIREMENTS

Recommendation

To help protect its financial interests, the Ministry should:

- *consider whether its best interest would be served by requiring security from all registrants; and*
- *ensure that all registrants required to post security do so in the stipulated amount.*

Current Status

The Ministry informed us that it was reviewing the grandfathering concession whereby registrants in operation before 1992 were exempted from security requirements. The review was expected to be completed this year. In this regard, we noted that three collectors lost their exempted status due to amalgamations and were requested to post financial security.

The Ministry also informed us that it is to annually review the required amount of security for all collector accounts through desk audits. In addition, linking accounts in the Ministry's Motor Fuels and Tobacco Tax Branch to the Ministry's core tax systems, such as ITAS (Integrated Tax Administration System) and BASYS (the Ministry's commodity sales tax system), should help the Ministry identify changes in the pertinent entities (manufacturers, collectors, and importers) on a timely basis.

GASOLINE, DIESEL FUEL, AND TOBACCO TAX AUDITS

Recommendation

To ensure that audit work is completed satisfactorily and clearly determines whether or not the correct amount of gasoline, diesel fuel, and tobacco tax has been declared and paid, the Ministry should:

- *develop detailed audit programs that comply with the work requirements of the Ministry's own Audit Procedures Manual for inclusion in each audit file;*

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- *encourage supervisory input at the planning stage to ensure high-risk areas are appropriately addressed;*
 - *ensure that the required work is completed satisfactorily and that any unresolved variances are assessed when warranted to prevent the results of further audit work from becoming statute barred; and*
 - *complete audits on a three- to four-year cycle to ensure that returns do not become statute barred.*

Current Status

The Ministry informed us that revised audit programs are in place and being tested in the field. According to the Ministry, these programs provide greater detail as regards work requirements and facilitate supervisory input and review of completed work.

Field and desk audit plans are being co-ordinated to ensure audits are completed prior to statute barring of potentially material tax liabilities.

FIELD INSPECTIONS

Recommendation

To maximize the benefits of its inspection program for encouraging compliance with gasoline, diesel fuel, and tobacco tax requirements, the Ministry should:

- *assess whether the number of inspectors is sufficient to promote voluntary compliance on a broad scale;*
- *base its performance targets for the type, number, and location of inspections to be undertaken on the periodic assessment of known risks of tax evasion schemes; and*
- *monitor the results of inspections by type, number, and location, and periodically make any changes needed to ensure that its resources remain effectively deployed.*

Current Status

The Ministry has recognized that more inspectors are needed to provide an appropriate level of province-wide coverage. An increase in inspection resources has been proposed, but the Ministry advised us that the need for additional inspections must compete for limited resources with the needs of other ministry enforcement and audit functions.

A computer-based planning and management information system is being investigated for use in the Motor Fuel and Tobacco Tax Branch's field inspection unit. A results-reporting feature will be included for better monitoring of performance. In the meantime, manual forms are being used for performance monitoring, with spreadsheet software being used to control and analyze results reporting.

BUSINESS PROCESS RE-ENGINEERING

Recommendation

Given that many of our preceding recommendations could be implemented most efficiently and effectively through the use of information technology, the Ministry should give priority to completing its business re-engineering project as soon as possible.

Current Status

The Ministry advised us that the business re-engineering project was implemented in November 2002. Additional functionalities are being added to accommodate budget and legislative changes and new business requirements.

EFFECTIVENESS MEASURES

Recommendation

To determine the extent to which it is meeting its objectives of encouraging voluntary compliance with and deterring the evasion of gasoline, diesel fuel, and tobacco taxes, the Ministry should develop and implement the necessary performance indicators.

Current Status

The Ministry informed us that performance indicators resulting from audits are being statistically summarized and analyzed for assessment amounts and trends. At the time of our follow-up, a similar system for inspections was being developed.