

## Chapter 4

### Section 4.13

Ministry of Revenue

# Retail Sales Tax Program

Follow-up on VFM Section 3.13, *2007 Annual Report*

## Background

The Ministry of Revenue (Ministry) administers the *Retail Sales Tax Act*, which imposes a general sales tax of 8% on the retail price of most goods and services sold to final consumers in Ontario. As of March 31, 2009, approximately 427,000 vendors (420,000 in 2007) were registered to collect and remit retail sales tax (RST) to the province. RST receipts for the 2008/09 fiscal year totalled approximately \$17.3 billion, net of \$192 million in refunds (\$16.2 billion in 2006/07), which represents about 28% of the province's total tax revenue. Over the last decade, RST revenues have increased by an average of about 5% to 6% annually.

In our *2007 Annual Report*, we concluded that the enhanced information that ongoing technology developments can provide, along with certain improvements in the audit and collection processes, would all be necessary before the Ministry could be assured that all the RST owing was being collected. Some of our more significant observations were:

- While the Ministry had implemented certain measures to identify non-registered vendors at their place of business or at points of sale, procedures were not yet adequate to ensure that all Ontario vendors—particularly new vendors—selling taxable goods and services were registered with the Ministry.
- The audit selection process was suffering from several deficiencies, including the following:
  - The auditable tax roll used for selecting vendors for audit excluded many vendors registered in Ontario, such as those vendors registered for less than two years and those that designated themselves to be part-time.
  - No standardized province-wide criteria had been developed for selecting vendors for audit on the basis of the risk of non-compliance, despite the Ministry's previous commitments to do so.
  - While audit coverage had increased since our last audit in 2000, the Ministry's coverage of each of its three categories of vendors based on level of sales and amount of tax remitted was still below its targets.
- Outstanding accounts receivable had increased to \$967 million as of December 31, 2006, from \$587 million at the time of our last audit in 1999/2000, an increase of approximately 65%. In contrast, in the same period, RST revenues had increased to approximately \$16.2 billion from \$12.6 billion, an increase of 29%.
- The Ministry's information system did not have the ability to prioritize accounts-receivable for collection. Our review of a sample of open collection files found that it often took a number of months for a collector to initiate contact on a file, and approximately one-quarter of the files had no collection activity for periods exceeding two years.

- At the time of our audit, approximately 35,000 vendors with active accounts had been in default in filing their returns. Of those we reviewed, over eight months had elapsed, on average, between the referral of the account to the Ministry's Non-Filer Unit and the compliance officer's attempt to contact the vendor. After the initial contact, many files continued to have an extended period of inactivity.

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

## Status of Recommendations

According to information received from the Ministry of Revenue, significant progress has been made towards implementing many of the recommendations we made in our *2007 Annual Report*. However, in 2009, the government announced that a single, federally administered sales tax—the Harmonized Sales Tax—was to be implemented in July 2010. As noted throughout this follow-up, transition plans need to ensure that improvements made in addressing the recommendations we made in our *2007 Annual Report* are not lost in the transition to the federal government.

The status of action taken on each of our recommendations is as follows.

### OVERVIEW OF PROGRAM

#### Tax Roll Maintenance

##### Recommendation 1

*To help ensure that the tax roll for vendors that sell taxable goods and services is complete and accurate and that the appropriate amount of tax is remitted, the Ministry of Revenue should:*

- *ensure that it can match the government's business names registry with its new management*

*information system—which would allow it to follow up with businesses that are on the names registry but not the RST vendor database; and*

- *at future meetings relating to interprovincial taxation, raise the possibility of reciprocal tax collection agreements with other provinces whereby all provincial sales taxes are collected at the point of sale and remitted to the province where the taxable goods are ultimately shipped and consumed.*

#### Status

The Ministry has made some progress in the area of tax roll maintenance. The Ministry informed us that it had signed a Memorandum of Understanding with the Companies and Personal Property Security Branch of the Ministry of Government Services in April 2008, agreeing to receive semi-annually information relating to businesses under the *Business Names Act* and the *Limited Partnership Act*. The Ministry plans to review and match this information to that in its database so it can determine which vendors are not registered for RST purposes. The most recent information received covered the period ending October 2008. We understand that, subsequent to our follow-up, the Ministry matched that information to its own database and found a high degree of correlation. The Ministry also relies on audit referrals, matching of federal data, and referrals from the Ministry of Labour for this purpose.

In addition, the Ministry established an Interprovincial Best Practices Committee in 2008 to discuss common areas of interest, including interprovincial reciprocal tax collection. The Ministry has also conducted a review of all existing agreements with other provinces to determine their effectiveness and any potential enhancements. In 2009, the government announced that Ontario would be participating in the federally administered Harmonized Sales Tax. After this transition takes place, reciprocal tax collection is to be negotiated with the Canada Revenue Agency.

## ENFORCEMENT: RST AUDITS

### Auditable Tax Roll

#### Recommendation 2

*In order to ensure that potentially high-risk vendors are not systematically excluded from audit selection, we encourage the Ministry of Revenue to revise its audit selection process to include both newly registered and part-time vendors.*

#### Status

The Ministry informed us that it had acted on this recommendation by creating an automated audit-selection system called Flexible and Integrated Risk Systems (FAIRS), which was implemented in March 2009. The Ministry uses the system to ensure that no vendors are excluded from the auditable tax roll for audit-selection purposes.

The Ministry also demonstrated to us that it has included new registrants and part-time vendors in the audit-selection process.

### Audit Selection

#### Recommendation 3

*To help ensure that it meets its goals of ensuring that the correct amount of tax is remitted to the province and of encouraging voluntary compliance in the broader vendor community, the Ministry of Revenue should:*

- *complete the development of an automated, centralized evidence-based risk-assessment system for selecting vendors for audit and implement it as soon as possible; and*
- *specify the approximate number or percentage of higher-risk refunds issued subject to audit that are to be audited each year and ensure that the audits are carried out.*

#### Status

As mentioned above, the Ministry implemented the automated risk-assessment and audit-selection system (FAIRS) in March 2009. This system is to include an enhancement, expected to be rolled out

in October 2009, for the selection of refunds subject to audit.

The Ministry has not specified what percentage of higher-risk refunds issued subject to audit is to be audited each year, as we recommended. However, the Ministry advised us that, in light of the RST program's move to the federally administered Harmonized Sales Tax, all refunds issued by the Ministry subject to audit will be considered for review. In that regard, it has recently performed a manual risk assessment on all refunds issued subject to audit to determine their potential tax exposure and to assist in ensuring that audits are selected appropriately.

### Audit Coverage

#### Recommendation 4

*To ensure that all vendors are given due consideration for audit selection and to encourage voluntary compliance through an adequate and representative level of audit coverage, the Ministry of Revenue should:*

- *continuously monitor its audit coverage for all three vendor categories and endeavour to meet its audit coverage goals for each as soon as possible;*
- *select audits from all segments of the vendor population; and*
- *facilitate the audit selection and results assessment process by reducing and more clearly defining the number of different vendor profile codes it uses.*

#### Status

To support the wind-down of the RST program, the Ministry developed a strategy for audit selection. This strategy focused on high-risk areas. In particular, the main focus was on large vendors, which account for 75% of the total tax remitted, and on those small and medium vendors that are considered to be high risk.

To facilitate audit selection, the Ministry used the new system, FAIRS, to generate information on all of the large vendors (10,000 in total), review and assess the risk of each one, and select and prioritize

audits accordingly. The Ministry also used FAIRS to identify small and medium vendors that are high risk; audits will be selected from those identified.

The Ministry has not determined when it will conclude its audits of the RST program because the Canada Revenue Agency has not yet committed to performing audits after the transition.

We were informed that the Ministry had completed the transition from profile codes to North American Industry Classification System (NAICS) codes, which are consistent with the codes used by the Canada Revenue Agency. Although we recommended that the number of codes used be reduced, the new system has resulted in an increase from 255 to 790 codes. The Ministry told us this approach was necessary to classify businesses more specifically and was also a requirement of their new tax administration and audit software, ONT-TAXS. It has grouped similar codes into peer codes to facilitate better audit selection and risk evaluation.

## Audit Working Papers

### Recommendation 5

*To help ensure that the confidentiality of taxpayer information is maintained and provide evidence that audits have been adequately planned and conducted, the Ministry of Revenue should ensure that:*

- *all audit working paper files are securely stored and available for review; and*
- *audit working paper files contain the documentation necessary to demonstrate that all required work has been adequately planned and completed, and reviewed and approved by an audit manager.*

### Status

The Ministry informed us that it has made the following improvements with regard to our recommendations on audit working papers:

- In one location, the Ministry piloted an electronic working-paper process for all “no change” audits. The pilot was deemed a success and the process was subsequently

implemented at all locations. The Ministry then began to look for other types of audits for which working papers could be stored electronically.

- The Ministry migrated to new tax administration and audit software, ONT-TAXS, which allows all supporting documents to be scanned and attached to the file electronically. This permits complete electronic storage of the audit working papers.
- It strengthened the policy on audit documentation, which is contained in the risk-based Integrated Audit Handbook released in June 2009. It also developed training, which is to be delivered in October 2009, to help managers and auditors increase their awareness of the documentation requirements of an audit file.
- It established in April 2009 an Audit Review unit, comprised of an audit manager and two senior operations officers, which is responsible for reviewing a sample of files after assessments have been issued for compliance with documentation standards and reporting to the Ministry’s senior management. The unit plans to begin these reviews in the third quarter of 2009/10.

At the time of our follow-up, the Ministry had not yet addressed our concerns regarding the security of hardcopy audit working papers nor had it improved its processes around the review and approval of this information by an audit manager. However, subsequent to our follow-up, the Ministry informed us that it intends to add a module to its electronic files to record the audit managers’ review and approval of the working papers.

## Penalties

### Recommendation 6

*In order to deter taxpayers from remitting an incorrect amount of tax, the Ministry of Revenue should comply with its policy that penalties be imposed in all cases where an assessment was issued due to the taxpayer’s*

*neglect, carelessness, wilful default, or fraud, unless the reasons for not doing so are clearly documented and approved by the audit manager.*

*In addition, in cases involving the potential imposition of a significant penalty (that is, exceeding a predetermined threshold amount), the Ministry should assess the merits of having more senior staff review the case and decide whether or not to impose the penalty.*

### Status

The Ministry indicated that it has fully implemented our recommendations on penalties. In June 2009, it released the risk-based Integrated Audit Handbook, which includes policies on penalty application and proper documentation and approval. An Audit Handbook Advisory Committee, comprised of managers and auditors from all program areas, was also established and has been meeting regularly to discuss these policies.

The Audit Review unit that the Ministry established in March 2009 in response to the above recommendation is to include a review of penalties as part of their documentation-standards review to ensure their consistent application and compliance with legislation and will report results to the Ministry's senior management.

## Monitoring of Audit Staff

### Recommendation 7

*In order to maximize productive audit hours and resultant audit assessments, the Ministry should:*

- *investigate the reasons for relatively high absenteeism rates among auditors and take the necessary corrective action;*
- *ensure that auditors comply with the Ministry's flextime policy and limit time-banking deficits to no more than 14½ hours at any point in time;*
- *continue to monitor auditors' time charged to travel, with a view to further reducing time charged to travel; and*
- *identify best practices and other strategies used by those auditors who consistently have high audit recovery rates.*

### Status

The Ministry informed us that it had made the following improvements to the monitoring of audit staff since our *2007 Annual Report*:

- It committed to ensuring that all staff who exceed the Ministry's absence threshold enter the Attendance Support Program and has been monitoring this process.
- Since January 2008, it has been sending monthly reports on absenteeism to senior managers to follow up on.
- It has required that managers track absenteeism through the government's information system (WIN) and review timesheets on a monthly basis to ensure that the 14.5-hour time-banking limit has not been exceeded.
- It has updated the ministry policy on time-reporting, including flextime and its limits. This policy is reiterated in the Integrated Audit Handbook to encourage compliance.
- In March 2009, it established an Audit Handbook Advisory Committee, comprised of managers and auditors from all program areas, which meets regularly to identify and share best practices in audit methodologies to maximize revenue recovery.

We reviewed an attendance report on short-term sickness absences provided by the Ministry for January to March of 2009 and noted that it included what actions were taken to address absences. The Ministry informed us that, although managers have been reviewing and monitoring travel time to identify staff with above-average time charged to travel, no significant reduction in the amount of hours charged to travel has been noted.

## COLLECTION FUNCTION

### Outstanding Accounts Receivable

#### Recommendation 8

*To address the increase in outstanding accounts receivable, the Ministry of Revenue should be more proactive in taking prompt and rigorous collection action*

and ensure that all collection activity is adequately documented.

### Status

The Ministry has made some progress in implementing our recommendations on collection efforts. Its new tax administration and audit software (ONT-TAXS) includes a collections function, which the Ministry began to use in November 2008. As a result, the Ministry now prioritizes its tax collectors' workloads on the basis of a risk-scoring methodology. The Ministry informed us that it expected the new methodology to move the right account to the right collector, facilitating prompt and consistent collection action, and that its collection staff have been acting on 85% of accounts within a 90-day period. However, the outstanding accounts receivable balance had increased to \$1.05 billion as of March 31, 2009, from \$967 million at the time of our audit, and a further \$273 million had been written off.

With regard to documentation, ONT-TAXS includes a function for documenting each stage of the collection process. This should help ensure that all activities performed by the collector are consistently and effectively noted in the system, including the results achieved.

## Overdue Returns and Non-filers

### Recommendation 9

*To give it the best chance of receiving outstanding RST returns and the required remittances, the Ministry of Revenue should ensure that:*

- *initial contact with defaulting vendors is made on a more timely basis; and*
- *after initial contact, follow-up with defaulting vendors is made on a continuous and timely basis until the matter is resolved.*

### Status

In January 2009, the Ministry began issuing automated estimated tax assessments to Retail Sales Tax vendors that had not filed their RST returns on time. Any vendor in default is immediately issued an automated estimated tax assessment, and this process continues on a monthly basis.

The Ministry informed us that, from January to June 2009, it had issued approximately 83,000 estimated assessments to approximately 63,000 vendors, which resulted in \$34 million in RST recoveries. The Ministry expects that the number of new RST referrals to the Collections branch as a result of returns in default will decrease over time as vendors become more educated about the requirement to file on time.

## SPECIAL INVESTIGATIONS

### Recommendation 10

*In order to ensure that all cases that warrant investigation are in fact investigated, and that the results of the investigations and any prosecutions are considered during future audits, the Ministry of Revenue should:*

- *obtain the level of staff required to ensure that all referrals that warrant investigation are in fact investigated; and*
- *analyze and, where warranted, communicate the results of investigations and prosecutions to all auditors and audit managers for consideration in their work.*

### Status

The Ministry informed us that its Special Investigations branch had hired two additional staff members earlier this year to assist with investigations for the RST program. However, at the time of this follow-up, these resources were being redirected to higher priority or more pressing areas. As the RST program began winding down in anticipation of the new Harmonized Sales Tax, the investigators were to complete the RST investigations they have been assigned and only in extreme circumstances were they to take on any additional RST cases.

The Ministry has also implemented a procedure to communicate the results of investigations and prosecutions to all auditors and audit managers. A memo with the results of each court case is issued within two weeks of receiving the notification from the Ministry's prosecutors at the Legal Services Branch.