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Report of the  
**Auditor General  
of Canada**  
to the House of Commons

APRIL

**Chapter 2**  
Canada Customs and Revenue Agency—  
Tax Administration: Write-Offs and Forgiveness

*The April 2002 Report of the Auditor General of Canada comprises eight chapters, a Foreword and Main Points.  
The main table of contents is found at the end of this publication.*

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Chapter

# 2

Canada Customs and Revenue Agency  
Tax Administration: Write-Offs and  
Forgiveness

*The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.*

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# Canada Customs and Revenue Agency

## Tax Administration: Write-Offs and Forgiveness

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### Main Points

**2.1** Under legislation referred to as the “fairness provisions,” the Canada Customs and Revenue Agency can waive or cancel all or part of any interest or penalty owed by a taxpayer because of a delay or error by the Agency, circumstances beyond the taxpayer’s or employer’s control, or the taxpayer’s inability to pay it. During the year ended 31 March 2001, the Agency waived or cancelled \$185.3 million in interest and penalties.

**2.2** The controls the Agency has put in place to guard against inappropriate forgiveness of interest and penalties are deficient. While the Agency has improved its administration of the fairness provisions, the fact that it does not record the amounts waived in interest and penalties and the reasons for waiving them is still a concern. The approval and monitoring processes also need to be strengthened and consistency and procedural fairness enhanced.

**2.3** The *Financial Administration Act* or another legislative authority such as the *Bankruptcy and Insolvency Act* provides the Canada Customs and Revenue Agency with authority to write off uncollectible accounts. The Agency has reasonable controls in place to guard against inappropriate write-offs of taxes owed. However, it needs to strengthen the system by taking accrued interest into consideration and grouping related-party accounts together when considering approval to write off an account.

**2.4** The Agency needs to take administrative action and/or seek legislative action to minimize the effects of a recent court decision that held that provincial limitations, which range from 2 to 20 years, apply to the collection of federal income taxes. The decision could prevent the Crown from collecting over \$1 billion in owed income taxes and could result in different treatment of taxpayers who live in different provinces.

### Background and other observations

**2.5** The Agency manages a portfolio of taxes owed that is valued at over \$13 billion. Most taxpayers who still owe tax when they file a return pay the balance promptly. However, some do not. Unlike businesses in the private sector, which can choose whether and to whom they will grant credit, the Agency must accept as accounts receivable all taxes owed by taxpayers. For the three-year period ended 31 March 2001, taxes owed that were written off averaged about \$1 billion a year.

**2.6** The Agency needs to monitor activities carried out on Canada's behalf by the Province of Quebec for GST accounts receivable—activities that include write-offs and the administration of the GST fairness provisions.

**The Agency has responded.** The Agency agrees with our recommendations and in its responses has indicated a number of actions under way to deal with them.



## Introduction

2.7 Taxes are the government's largest source of revenue. Most taxpayers who still owe tax when they file a return pay the balance promptly. However, some do not. Unlike businesses in the private sector, which can choose whether and to whom they will grant credit, the Canada Customs and Revenue Agency (CCRA) must accept as accounts receivable all taxes owed by taxpayers.

2.8 Where the Agency collects taxes for a province under a tax collection agreement, the federal government pays the province the amount of provincial income taxes assessed, whether or not these amounts are ultimately collected. The federal government keeps any interest earned and certain penalties on provincial income taxes that are owed.

2.9 Under legislation, the CCRA does not start a legal action to collect income taxes owed until 90 days after it dates and sends a notice of assessment or reassessment. It will also hold off action to collect taxes that the taxpayer is contesting through the Agency's internal appeal process or through the Tax Court of Canada (except for large corporations, which are required in the interim to pay 50 percent of the tax amount in dispute). These restrictions on the Agency's ability to start collection proceedings do not apply to amounts that the taxpayer is considered to be holding in trust, such as employee deductions and GST collected.

2.10 Amounts not payable by taxpayers because the taxes assessed were being disputed totalled over \$3.8 billion at 31 March 2001 (compared with \$3.4 billion at 31 March 2000 and \$3.2 billion at 31 March 1999).

2.11 The CCRA's policy is to delete (write off) uncollectible taxes from its active inventory of accounts receivable after it has taken all reasonable collection action and exhausted all possible means of collection.

### Write-offs of taxes owed

2.12 The *Financial Administration Act* (FAA) and other legislative authorities such as the *Bankruptcy and Insolvency Act* provide the CCRA with authority to write off uncollectible accounts.

2.13 When taxes owed are written off under the FAA, the debtor is not relieved of responsibility for paying the debt; the CCRA deletes it from its active inventory only, so that resources are not allocated to work on accounts the Agency is unlikely to collect. If in the future the taxpayer is able to pay the debt, the Agency may collect it. However, debts written off under the *Bankruptcy and Insolvency Act* are permanently deleted.

2.14 **Controls in place.** The Agency has a number of controls in place to guard against inappropriate write-offs. Different levels of authority approve write-offs as their amounts increase; the higher the amount, the higher the level of authority to approve it (Exhibit 2.1).

#### Fact

##### Amount of taxes owed that the Agency wrote off

- in 1998–99: \$874.2 million
- in 1999–2000: \$876.0 million
- in 2000–01: \$1,158.8 million

Source: Canada Customs and Revenue Agency

**Exhibit 2.1 Levels of authority for write-off approval under the *Financial Administration Act***

Write-off amount	Required approval
Up to \$5,000	Team co-ordinator or Manager, Revenue Collections Section
Up to \$25,000	Assistant Director, Revenue Collections Division Section
Up to \$250,000	Review by an uncollectible debt review committee comprising the Director, Tax Services Office; the Assistant Director, Revenue Collections; and a manager not involved in the collection process  Approval by the Director, Tax Services Office; the Director General, Financial Administration; or the Assistant Commissioner, Regional Operations
Up to \$500,000	Assistant Commissioner, Finance and Administration Branch
Over \$500,000	Commissioner or Deputy Commissioner

Source: Canada Customs and Revenue Agency

**2.15** The Agency is able to identify a taxpayer whose account has been written off but who, based on returns filed subsequently, may now be in a position to pay it.

**2.16** In addition, a monitoring team visits tax services offices (TSOs) and audits amounts written off. These audits are done to ensure that every effort has been made to collect the account and that other policies and procedures are being followed.

### Forgiveness of interest and penalties

**2.17** The *Income Tax Act* and the *Excise Tax Act* impose various interest charges and penalties on a taxpayer who has failed to do the following:

- file an income tax return;
- pay all or part of an instalment due on taxes owed;
- withhold and remit payroll deductions (income tax, employment insurance, and Canada Pension Plan) from an employee's pay;
- pay taxes owed when due; and
- remit GST collected from customers as required.

**2.18** The Canada Customs and Revenue Agency can either cancel or waive (forgive) all or part of any interest or penalties on unpaid income tax and payroll deductions for 1985 and subsequent years and on GST for 1991 and subsequent years (Exhibit 2.2). These actions are referred to as the "fairness provisions." The fairness provisions permit the Agency to help taxpayers resolve problems that arise in the following circumstances:

- a delay or error by the Agency;

- circumstances beyond the taxpayer's or employer's control; and
- the taxpayer's inability to pay.

The fairness provisions are not intended, and are not to be used, as a way for the Agency to negotiate the settlement of a taxpayer's account.

**2.19** The fairness provisions are applied throughout the Agency. Taxpayers' requests to apply the fairness provisions are handled by the Agency at all service points across Canada, including tax services offices, tax centres, Customs border sites, and trade offices. Field office staff are responsible for processing fairness requests in an impartial, just, and consistent way. They are also responsible for making sure that fairness requests related to cancellation of interest and penalties on unpaid income tax, payroll deductions, and GST are recorded accurately in the fairness registry.

#### **Exhibit 2.2 Interest and penalties forgiven (\$ millions)**

These figures exclude amounts cancelled or waived under the *Customs Act* and the Voluntary Disclosures Program.

Type of forgiveness	1998–99	1999–2000 <sup>1</sup>	2000–01
Interest and penalties cancelled	65.2	64.3	68.2
Interest and penalties waived	No estimate made	9.1	117.1 <sup>2</sup>
Total	65.2	73.4	185.3 <sup>2</sup>

<sup>1</sup>The Agency estimated the amounts of interest and penalties waived starting in 1999–2000.

<sup>2</sup>Starting in 2000–01 the Agency included waivers that result from administrative policies, which amounted to \$98.3 million.

Source: Canada Customs and Revenue Agency

#### **Focus of the audit**

**2.20** A main objective of our audit was to determine whether the Agency has reasonable controls in place to guard against inappropriate write-offs and inappropriate forgiveness of interest and penalties. We did not audit the collection process. However, in the course of the audit we sought to identify opportunities for the Agency to reduce write-offs by improving its management of taxes owed.

**2.21** In Quebec, the Province collects GST for the federal government. Quebec is responsible for the daily GST operations in the province but Canada has the responsibility to provide direction and establish accountability. Our audit did not examine Quebec's write-offs of GST.

**2.22** For the purposes of this audit, we considered the fairness provisions related to the forgiveness—by cancelling or waiving—of penalties and interest on income taxes, GST, and payroll deductions. We did not include

the forgiveness of penalties and interest under the *Customs Act* or the granting of relief to taxpayers through other programs. Nor did we examine the application of the fairness provisions to the GST that Quebec administers for the federal government.

## Observations and Recommendations

### Write-offs of taxes owed

**2.23** Taxes owed are written off if the debt is uncollectible or does not warrant the further costs of collecting it. If in the future the taxpayer is able to pay the debt, the Agency has the right to collect it (except for debts written off under the *Bankruptcy and Insolvency Act*, which are permanently deleted).

#### Controls need to be improved

**2.24** Based on the files we reviewed, we found that the tax services offices we visited had respected the levels of delegated authority for approval. They had also followed the regulation stipulating the composition of the TSO committee that reviews and recommends the writing off of uncollectible debt.

**2.25** We found that the Agency does not apply interest charges after the date of the account's last transaction (such as a reassessment or a payment) and include them in the amounts submitted for write-off approval. Therefore, the amounts approved by the committees on uncollectible debt were less than the amounts actually owed.

**2.26** We also noted that not all accounts of related parties are grouped together when authority is sought to write them off. For example, if a number of related taxpayers together owed \$65,000 but no one account was over \$24,000, each account would require approval at the level of authority delegated for \$5,000 to \$25,000. In our view, control over write-offs could be enhanced by basing the level of authority required for approval on the total amount owed by all the related parties.

**2.27** Federal GST in Quebec is collected by the ministère du Revenu du Québec (Quebec Department of Revenue). Quebec officials have the authority to write off GST accounts in that province. The Agency has advised us that it cannot monitor the Department's activities for GST accounts receivable, including write-offs, because the Department's systems contain provincial sales tax information that is confidential.

**2.28 Recommendation.** The Agency should do the following:

- take accrued interest into account and group related-party accounts together when considering approval to write-off an account; and
- ensure that it has the right to monitor the activities for GST accounts receivable that the Province of Quebec carries out on Canada's behalf and establish a process to do so.

**Agency's response.** It is agreed that accrued interest should be taken into account when seeking approval to write off an account. However, some of the

CCRA's tax revenue systems cannot provide this information readily at the time of write-off. As some of the various tax revenue systems migrate to Standardized Accounting (SA), this type of information will become readily available. In the interim, estimates of accrued interest will be prepared for all write-offs. A review of the debt will be conducted prior to convening the Uncollectible Debts Review Committee to verify and update account balances where appropriate.

It is agreed that related-party accounts should be grouped together when seeking approval to write-off an account. When an account has been identified as uncollectible, CCRA policy states clearly that any related accounts are to be reviewed and submitted as uncollectible at the same time. This policy will be reiterated to ensure that the delegated write-off authority levels are respected.

The CCRA is currently reviewing the terms and conditions of the GST agreement with officials from the Province of Quebec. Discussions are under way with Quebec officials to establish a process to ensure that the CCRA can monitor the GST accounts receivable activities, which include write-offs of taxes and forgiveness of interest and penalties.

## Forgiveness of interest and penalties

**Cancel**—Applies to interest or a penalty already assessed.

**Waive**—Applies to interest or a penalty not yet charged.

**2.29** To help taxpayers resolve problems that arise in certain specific circumstances, the Agency can apply the fairness provisions and forgive all or part of any interest or penalties on unpaid income tax, payroll deductions, and GST. When the Agency reverses a penalty or interest that has already been assessed to the taxpayer, it **cancels** it. When a penalty or interest has not yet been charged to the taxpayer and the Agency determines at the taxpayer's request or on its own initiative that the amount will not be charged, it **waives** it.

### The fairness registry is of limited value

**2.30** **The fairness registry.** In 1994, we recommended that Revenue Canada (now the CCRA) develop systems for tracking requests and the corresponding decisions under the fairness provisions. In April 1996, the fairness registry began to record such requests but only for cancellation of interest and penalties.

**2.31** The Agency states that by recording all requests for cancellation, it will be better able to manage the resources used in handling fairness requests. It also states that all offices will have access to decisions granted in other offices. This will provide for more consistency nation-wide and will minimize the potential for "shopping" for the best fairness deal. The fairness registry will help account for the financial implications of relief granted under the fairness provisions, to be reported in the *Public Accounts of Canada*.

**2.32** **The CCRA cannot determine reliably how long it has taken to complete action on a fairness request.** The fairness registry could be used to determine the length of time that has elapsed before action on a fairness request is completed. However, we found that different locations within the Agency use different dates to indicate when a request is received.

**2.33** Many offices do not monitor the fairness registry to ensure that all entries are closed when action on the request is completed. As a result, many entries are shown as “open,” and the “entry age” increases when action on the request has in fact been completed. By not recording the receipt of fairness requests in a consistent way and not closing them in the fairness registry when action is completed, the CCRA is unable to determine accurately how long it takes to complete a fairness request so it can monitor whether customer service standards have been met.

**2.34 Information recorded in registry is inadequate.** Often the Agency does not record in the registry the reasons for denials and approvals of requests for fairness. Without this information, the registry is of limited value in helping other decision-makers apply the fairness provisions consistently.

**2.35** The registry does not show the penalty and interest amounts cancelled for each request. To determine the total number of requests and total amounts in penalties and interest forgiven in a fiscal year, the Agency uses a complex system involving seven mainframe computer applications and the fairness registry.

**2.36** There is no central record of the actual time spent administering the fairness provisions. Agency staff told us there has never been a separate budget established for fairness activities; they are just an aspect of collection activities.

**2.37** A lot of time is spent processing taxpayers’ fairness requests, especially in Revenue Collections, where whole teams are dedicated to fairness. Knowing how much time is involved would be useful for better monitoring and management of the fairness provisions. We noted that at least 10 divisions in the five TSOs we visited had developed their own systems to account for and control fairness requests. A standardized system could provide this type of information for use by all locations.

### **Cancellation approval process needs to be improved**

**2.38 The approval process.** We found that a taxpayer’s request to cancel a penalty or an interest charge of less than \$5,000 was usually approved or denied by Agency staff at the first level of supervision. A more senior official usually decided on requests involving amounts over \$5,000. If not satisfied with the decision, the taxpayer can ask the Agency for a subsequent review. Someone other than the original decision-maker is required to do that review.

**2.39** If the taxpayer is still not satisfied with the decision and believes that the CCRA did not exercise its discretion properly, the taxpayer is entitled to a judicial review by the Federal Court of Canada’s Trial Division. The scope of the Court’s review is restricted to the Agency’s exercise of discretion. The Federal Court will not overturn a decision by the Agency, but it may refer it back to the Minister of National Revenue for reconsideration.

**2.40** The composition of committees to review fairness requests (fairness committees) and their use in the decision-making process varies from office to office and from branch to branch within an office. These committees are

different from the committees that review uncollectible debts and are involved in a separate process. Fairness committees are a way of ensuring impartiality, accuracy, and consistency in making decisions. Local management determines the composition of the committees. In some cases, no committee is used; in other cases, a committee reviews only the taxpayer's initial request. In some cases two committees are used, one to review the initial request and one to review the subsequent request, if applicable.

**2.41 A rigorous approval process is needed.** When taxes owed are written off under the *Financial Administration Act*, the CCRA deletes the amount from its active inventory only. If in the future the taxpayer is able to pay the debt, the Agency may collect it. When interest and penalties owed are forgiven under the fairness provisions, the debtor is relieved of any responsibility to pay the debt. Forgiveness under the fairness provisions therefore represents a greater risk to the government's tax revenues than write-offs under the FAA, yet the approval process is not as rigorous.

**2.42** Write-offs under the FAA require approval at a higher level of authority as the amount increases (Exhibit 2.1), from \$5,000 and under to \$25,000, to \$250,000, to \$500,000, and over \$500,000. In contrast, we found that amounts cancelled under the fairness provisions usually involve only two approval levels, one for amounts under \$5,000 and one for amounts over \$5,000.

**2.43 Striving for consistent decisions.** One goal of tax administration is consistency. A taxpayer expects the same treatment from every tax services office across Canada given the same set of facts. To achieve consistency, the Agency's central administration communicates policies and guidelines on processing fairness requests. The decision-making framework and the final approval or denial of a fairness request are left to the local tax services office.

**2.44** The CCRA's *Performance Report* notes that for the most part, fairness provisions are applied consistently across programs and regions, but this assessment is based on weak data quality. The report also notes that the introduction of a systematic quality monitoring initiative in 2001–02 will allow the Agency to confirm the actual levels of consistency for future reporting.

**2.45** In some of the tax services offices we visited, staff commented that it was hard to maintain consistency with so many people involved in the process. During our examination, only two cases of inconsistent decision making came to our attention (see page 10).

**2.46 Procedural fairness must be ensured.** As already noted, a taxpayer who is not satisfied with the results of the administrative reviews by the local TSO may apply to the Federal Court of Canada's Trial Division to review the Agency's exercise of discretion.

**2.47** Two recent court decisions on applications for judicial review favoured the taxpayers, setting aside the Agency's decisions at the review level and referring the matter back to the Agency for reconsideration by persons not involved previously in the matter.

**2.48** In both cases, the Court found that the CCRA had breached its own internal procedures for ensuring that the same decision maker is not involved in both the initial review and the subsequent review. The Agency had allowed the same officials to participate at both levels of review.

**2.49** We looked at the procedures of five TSOs. In three of them, we found a total of five situations where the same officials can have significant influence at both levels of review. Based on descriptions in reports by the program monitoring unit in Revenue Collections, it is possible that there are five other TSOs where the second review is not independent enough from the first.

#### Two cases of inconsistent treatment of taxpayers

**Case 1.** A large service provider with locations across the country changed its payroll provider. The payroll provider set the frequency of payroll deduction remittances incorrectly, which delayed remittances to the Agency in many locations.

Requests to cancel the penalty for late remittances were sent to various tax services offices across Canada. Four requests were approved; two others have not yet been reviewed; and one was denied twice although it was known that four requests had been approved.

**Case 2.** A tax services office (TSO) approved the cancellation of penalties for late filing by a number of taxpayers because of their financial hardship. When the TSO sent the decisions to a taxation centre for processing, the centre disagreed with the decisions. It said the taxpayers could have avoided the penalties had they filed their returns on time without payment. The centre also noted that other TSOs were denying similar requests.

#### The monitoring process needs to be extended and improved

**2.50** The program monitoring unit of the Revenue Collections Directorate visits TSOs to ensure that they are applying the Directorate's policy and procedures correctly in administering the fairness legislation and are handling requests as quickly as possible. Since February 1998, the unit has reviewed the fairness process in 37 tax services offices; it has reviewed over 1,100 fairness request files.

**2.51** In the majority of the locations it visited, the monitoring unit concluded that generally all decisions had been made in accordance with the CCRA's policy and guidelines and had been considered by people at the proper levels.

**2.52** The monitoring unit reviews only fairness requests processed by the Revenue Collections Directorate, that is, all fairness requests involving financial hardship. It does not review the way the fairness provisions are applied in other areas such as audit, appeals, and client services. We saw no indication that anyone else monitors fairness activities in those areas.

**2.53** Local offices do not use management reports routinely for monitoring. Several locations do not monitor the accuracy of the "open" items in the fairness registry. We found that they had not used or were not aware of standard reports available to assist them in monitoring.



### Controls on waiving penalties and interest are deficient

**2.54** As noted before, a waiver is a decision not to charge a penalty or interest to a taxpayer and not to record it in the taxpayer's account. A waiver may be granted at the taxpayer's request or on the Agency's initiative—for example, under a policy that allows a taxpayer to submit payroll deductions late without penalty once every 13 months.

**2.55** A waiver can also be granted at the end of an audit when the reassessment amount is being determined. If the Agency has delayed completing the audit or issuing the reassessment, it may decide not to charge the taxpayer interest accrued over a certain period of time. In such a case, the auditor and his or her supervisor make the decision; the assistant director may approve it, depending on local practice.

**2.56** In 2000–01 the estimated total value of waivers, including automatic waivers (which are not subject to the criteria for the fairness provisions), was \$117.1 million—over 70 percent more than the \$68.2 million in interest and penalties that were cancelled (Exhibit 2.2). Yet, the approval process for waivers is less rigorous than for cancellation, which in turn is less rigorous than the process for approving the write-off of taxes under the FAA. We saw no indication, for example, that fairness committees were used for waivers or that waivers were subjected to any monitoring reviews.

**2.57** Waivers are not recorded in any system: there is no audit trail. However, the *Financial Administration Act* requires that they be reported in the *Public Accounts of Canada*, and the CCRA started to report them just two years ago, based on estimates.

**2.58** In 1994, we recommended that the Agency develop systems for tracking requests and decisions under the fairness provisions and monitor the circumstances that led to adjustments. In 1996 we noted that the system the Agency planned for tracking fairness requests would record only amounts cancelled and not amounts waived. We recommended that both amounts be recorded. In 1998 the Agency told us it was enhancing the system to track and report interest and penalties waived at the reassessment stage.

**2.59** We have found, however, that the deficiency in the system still exists. In our view, prudent management would require that the Agency record all the costs to the government when it waives interest and penalties under the fairness provisions. It could accomplish this by charging the interest and penalties on the assessment or reassessment and subsequently cancelling them. The Agency also needs to ensure that it keeps an appropriate audit trail.

**2.60** As the governments of Canada and Quebec agreed in 1992, Quebec manages the daily GST operations in the province but Canada has authority to provide direction and establish accountability.

**2.61** As we have noted, the CCRA advised us that it cannot monitor the Province's activities, including the cancellation and waiving of interest and penalties under the fairness provisions. Forgiven interest and penalties on GST administered by Quebec totalled \$3.0 million for 2000–01, \$4.4 million

for 1999–2000, and \$5.7 million for 1998–99. We have recommended (paragraph 2.28) that the Agency ensure that it has the right to monitor the activities carried out on Canada’s behalf by the Province of Quebec for GST accounts receivable and establish a process to do so.

### Policy on late remittance of trust funds is not consistent

**2.62** The CCRA’s policy is to allow an employer to remit payroll deductions late without penalty once every 13 months. The circumstances under which a penalty can be waived or cancelled do not apply. But there is no similar policy on late remittance of other funds held in trust, such as GST. The policy thus provides late remitters of payroll deductions a benefit that late remitters of GST do not enjoy.

**2.63 Recommendation.** The CCRA should do the following:

- enhance existing procedures and systems to ensure that they provide appropriate and accurate information to better manage the fairness requests;
- review the process for approving fairness requests, both the initial request and the subsequent request, in each TSO division to ensure that the same officials do not participate in the decisions at both levels of review;
- expand its monitoring to all areas in the Agency involved in granting relief under the fairness provisions;
- ensure that the reasons for waiving interest and penalties are recorded with their actual amounts and that these amounts are reported to Parliament; and
- re-examine its policy on late remittance of funds held in trust to ensure that it is applied consistently and fairly.

**Agency’s response.** The CCRA has taken or plans to take a number of measures in response to this recommendation.

In June 2000, the CCRA initiated an extensive review of all the fairness provisions guidelines. The intent of the review was to set out more clearly the purpose and intent of the fairness provisions, the delegation of the Minister’s powers and duties, the roles and responsibilities of those involved in the review process, and the procedural rules when requests are reviewed. As a result of this review, enhanced guidelines were developed and published in the *Fairness Provisions Reference Guide*, which was released in June 2001 to all employees involved in the fairness provisions process. The Guide was also put on the CCRA Intranet to allow ready access for all CCRA employees.

Through the leadership of the National Fairness Committee the Agency continues to address existing, proposed, and future fairness provisions policy issues and to look for opportunities to enhance the Agency’s overall procedures.

The CCRA recognizes the importance of improving its tracking, monitoring, and reporting for fairness provisions workloads. In June 2001, the Agency launched the Fairness Systems Review, an initiative aimed at enhancing the accuracy and adequacy of the reporting of interest and penalties that are

waived and cancelled under the fairness provisions, and improving the tracking and monitoring of fairness provisions requests. During this review, the systems used to manage requests, including the fairness registry, will be thoroughly examined to achieve the necessary enhancements.

As noted in paragraph 2.50, the Agency carries out extensive monitoring activities in relation to fairness requests involving financial hardship. As recommended by the Auditor General, the Agency will ensure that monitoring activities are expanded to include all areas involved in granting relief under the fairness provisions and that the results of these activities are available on a national basis. As stated in the CCRA's 2000–01 *Annual Report*, while we do not have a systematic review in place at the national level to monitor and confirm consistency of decisions to either cancel or waive interest and penalties, we do provide officers with tools and guidelines to help ensure consistency, supported by fairness committees at most local tax services offices. Plans are in place to institute a systematic fairness monitoring process for all business lines, as part of the Agency's Quality Monitoring Initiative.

With respect to ensuring that the same officials are not involved in deciding fairness requests at both levels of review, as previously noted, the *Fairness Provisions Reference Guide*, issued in June 2001, clearly defines the decision-making framework for fairness requests including the requirement that second reviews must be performed by officials other than the original decision makers. Furthermore, in September 2001, after the two court decisions referred to in paragraph 2.47 were published, all areas involved in the review of fairness provisions requests were reminded to ensure that the decision-making framework is understood and consistently followed. The steps that the Agency has taken to clarify and reinforce the decision-making framework for fairness requests among employees will ensure that the same decision maker is not involved in both initial and subsequent reviews and that discretion is exercised in a proper and appropriate manner.

With respect to recording the reasons for waivers, the CCRA records the justification for granting waivers in several ways. The reasons for waiving interest and penalties for client-requested waivers are recorded for each case in Agency systems. The reasons supporting automated waivers are based on administrative policies or directives. With respect to recording and reporting on the amounts waived, beginning with the 1999–2000 fiscal year, the Agency has been reporting estimated amounts of interest and penalties waived under the fairness provisions in the Public Accounts. As part of the Fairness Systems Review, the Agency is reviewing the reporting mechanisms for waivers to determine how they can be reported based on actual amounts.

As recommended by the Auditor General, the CCRA is re-examining its policy on late remittances. One of the options under consideration is a system of graduated penalties, similar to that of other tax administrations.

## Improving the management of taxes owed

### Over a billion dollars owed in income taxes may not be collectible

**2.64** The Agency estimates that as a result of a recent court decision, it could be barred from collecting over \$1.1 billion owed in taxes. The decision held that provincial limitation laws apply to collection proceedings under the *Income Tax Act*. This means that collection action on income tax debts in all provinces may become statute-barred, depending on the age of the debt, the specific provincial limitation period involved, and the nature of the collection action.

**2.65** The periods for provincial statutes of limitation range from two years in Alberta to 20 years in Ontario. The limitation period may be extended if the taxpayer makes a voluntary payment or acknowledges the debt in writing, or if the CCRA certifies the debt in the Federal Court. Taxpayers in a province with a brief limitation period could be subject to more rigorous collection actions than taxpayers in a province with a longer limitation period.

**2.66** The Agency believes that the court decision affects only income tax debts and not debts of GST, excise tax, customs duties, or excise duty.

**2.67** On 6 December 2001, the Supreme Court of Canada granted the Crown leave to appeal the decision. The Agency has advised its staff to review their inventories of income tax receivable accounts on a priority basis and identify those that may be at risk, take appropriate measures to collect debts sooner, and take preventive measures to extend the limitation period wherever possible.

### Amounts owed in funds held in trust have increased 27 percent

**2.68** The total amount owed in funds held in trust (payroll deductions and GST) increased from \$3.7 billion at 31 March 1999 to \$4.7 billion at 31 March 2001. Businesses that do not remit employee deductions and GST are, in effect, keeping trust money that does not belong to them.

### Using statutory declarations

**2.69** Before deciding whether to enter an arrangement for payment of owed taxes or to waive or cancel interest or a penalty because of financial hardship, the Agency often requires the taxpayer to provide information on his or her financial position, income, and expenses as well as closer-than-arm's-length transactions and transfers of assets. Obtaining this information by a signed statutory declaration would emphasize to taxpayers the importance of providing accurate information, thus helping the CCRA to improve its collections.

### Deferral of corporate tax instalments for small businesses

**2.70** The federal Budget of 10 December 2001 introduced a legislative change designed to help small businesses meet immediate cash flow needs by deferring for six months their corporate tax instalments for January, February, and March 2002. The government estimates that this will defer the payment of \$2 billion in taxes by small businesses until next year.

**2.71** This change presents a challenge to the Agency because the amount that small businesses owe in the future will be an estimated \$2 billion higher.

**2.72 Recommendation.** The CCRA should do the following:

- ensure that it takes appropriate administrative action and/or seeks legislative action to minimize the effects of the recent court decision that may prevent the Crown from collecting taxes owed;
- develop an appropriate enforcement strategy to deter businesses from keeping trust money that does not belong to them;
- consider adopting a policy of obtaining signed statutory declarations from taxpayers to improve controls over the collection of taxes owed and the cancellation and waiver of interest and penalties; and
- develop a means of administering the recent legislative change in a way that reduces the risk of collecting deferred instalments of corporate taxes owed by small businesses.

**Agency's response.** The CCRA agrees and will take the following measures in response to these recommendations:

- The Agency will continue in its efforts to ensure that appropriate action, both on the operational and legislative sides, is taken with respect to any decision made by the Supreme Court.
- To deter businesses from keeping trust money that does not belong to them, the Agency is currently developing and analyzing risk profiling strategies to better target clients who pose a potential risk in terms of not remitting trust funds voluntarily.
- The Agency will analyze the possibility of signed statutory declarations from taxpayers.
- The Agency recognizes the implications of the deferring of instalment payments of corporate tax on small business and will take appropriate action to protect the Crown's interest.

## Conclusion

**2.73** The Agency needs to strengthen the policies and procedures it has in place to guard against inappropriate writing off of taxes owed and to provide for fair, consistent, and equitable treatment of taxpayers. For example, it needs to group together all related-party accounts when write-off approval is sought and to take into account accrued interest when referring debts to the committees that review uncollectible debts.

**2.74** The policies and procedures the Agency has put in place to guard against the inappropriate forgiveness of interest and penalties and to provide for fair, consistent, and equitable treatment of taxpayers are deficient. While the Agency has improved its administration of the fairness provisions, it still has much to do. For example, it needs to improve the information in the fairness registry; enhance procedural fairness; record its reasons for waiving interest and penalties and the actual amounts it waives; and strengthen the approval process. The Agency needs to be consistent and fair in waiving the interest due on funds held in trust that are remitted late.

**2.75** To improve controls over the collection of taxes owed and the cancellation and waiver of interest and penalties, the Agency needs to consider adopting a policy of obtaining statutory declarations from taxpayers.

**2.76** The Agency needs to improve its monitoring of write-offs and forgiveness activities. It needs to monitor the activities carried out on Canada's behalf by the Province of Quebec for accounts receivable. It should expand its monitoring to cover all directorates involved in approving fairness requests.

**2.77** Although the audit focussed on the Agency's policies and procedures for the writing off of taxes owed and the forgiveness of interest and penalties, we identified a number of opportunities to improve the collection process that we believe can reduce write-offs. The Agency needs to develop an enforcement response to deter businesses from keeping trust money that does not belong to them. In administering the legislation introduced in December 2001 that allows small businesses to defer corporate tax instalments, it needs to find a way to reduce the risk to collecting the taxes owed. The Agency also needs to take action that will minimize the effects of the recent court decision that could limit its ability to collect over \$1 billion in owed income taxes.

## About the Audit

### Objectives

The objectives of our audit were the following:

- to assess whether the CCRA has reasonable controls in place to guard against inappropriate write-offs of taxes owed and inappropriate forgiveness of interest and penalties; and
- to identify opportunities to improve the management of taxes owed.

### Scope and approach

The audit focussed on the Agency's policies and procedures related to the writing off of taxes owed and the forgiveness of interest and penalties.

In Quebec the Province collects GST for the federal government. Quebec is responsible for the daily GST operations in the province, but Canada has authority to provide direction and establish accountability. Our audit did not examine Quebec's write-offs of GST.

For the purposes of this audit, we considered fairness provisions related to the cancelling or waiving (forgiveness) of penalties and interest on unpaid income taxes, GST, and payroll deductions. We did not include the forgiveness of penalties and interest under the *Customs Act* or the granting of relief to taxpayers through other programs. Nor did we examine the application of the fairness provisions to the GST that Quebec administers for the federal government.

We conducted our audit work at the Agency's head office, five tax services offices, and two tax centres. We reviewed selected cases, interviewed management and staff, and analyzed monitoring reports and other information.

### Criteria

Our audit was based on the following criteria:

- The CCRA should have in place policies and procedures to guard against inappropriate write-offs of taxes owed and inappropriate forgiveness of interest and penalties, while providing taxpayers with fair, consistent, and equitable treatment.
- The CCRA should have an appropriate framework in place for monitoring and evaluating the results of write-off and forgiveness activities to ensure compliance with its policies and procedures.

### Audit team

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