

APPENDIX 1

ADMINISTRATION OF MUNICIPAL LAND TRANSFER TAX, REVENUE SERVICES DIVISION

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Auditor General's Office

Jeffrey Griffiths, C.A., C.F.E.
Auditor General
City of Toronto

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EXECUTIVE SUMMARY

As a new tax measure introduced in February 2008 under the *City of Toronto Act, 2006*, the Municipal Land Transfer Tax (MLTT) Program has generated nearly \$200 million in annual tax revenue.

Why we conducted this audit

Given that this is a new program with significant revenue generated, the Auditor General's 2009 Audit Work Plan included a review of the administration of the municipal land transfer tax.

City in 2008 executed a 10-year agreement with Teranet

The Revenue Services Division of the Office of the Treasurer has overall responsibility for the administration of the MLTT. In 2008, the City executed a 10-year agreement with Teranet Enterprises Inc. (Teranet) for collecting the tax. The City also has a five-year renewal option. Teranet also has a long-term contract with the Ontario Government for managing a similar program under the Provincial *Land Transfer Tax Act*.

By way of background, Teranet has been administering the collection of land transfer tax for the Province of Ontario since 1999. Various audits in relation to land transfer tax transactions have been conducted by the Office of the Provincial Auditor of Ontario as well as the Audit, Inspections and Resource Taxes Branch, Ministry of Revenue of the Province.

Issues identified in this report

The issues identified in this report include the need to:

- initiate a joint audit of Teranet's system with the Province, and also request Teranet to provide an auditor's report on controls at a service organization (Canadian Institute of Chartered Accountants Handbook Section 5970 report). Such a report will attest to the effectiveness of Teranet's management information system controls

- ensure that Teranet submits to the City its Compliance Monitoring Report
- ensure that only those fees included in the City’s Municipal Land Transfer Tax By-law are charged to property purchasers
- conduct more verification to ensure MLTT is properly charged on rebates/refunds
- ensure compliance with the interest and penalty charging provisions contained in the Municipal Land Transfer Tax By-law
- review and, where appropriate, make amendments to the Municipal Land Transfer Tax By-law.

This report contains nine recommendations.

BACKGROUND

The municipal land transfer tax mirrors the provincial tax

The City’s new municipal land transfer tax (MLTT) came into effect on February 1, 2008 and mirrors, but is not identical to, the existing provincial land transfer tax under the Ontario *Land Transfer Tax Act*.

Rates vary by property consideration value

As illustrated in Table 1, which is reproduced from City of Toronto Municipal Code Chapter 760, Taxation, Municipal Land Transfer Tax By-Law No. 1423-2007 (the "MLTT By-Law), MLTT is calculated on the property’s gross sale price (“consideration value”) and property type as follows:

Table 1: Municipal Land Transfer Tax Rates

Value of Consideration	1 to 2 single family residences	All Other Properties
Up to and including \$55,000	0.5% plus	0.5% plus
\$55,000 - \$400,000	1.0% plus	1.0% plus
\$400,000 - \$40 Million	2%	1.5% plus
Over \$40 Million	2%	1.0%

For clarification and by way of example, municipal land transfer tax on a single family residence property with a consideration of \$500,000 would be:

First \$55,000 tax is 0.5%	\$275
From \$55,000 to \$400,000 tax is 1%	\$3,450
From \$400,000 to \$500,000 tax is 2%	<u>\$2,000</u>
Total tax owing	<u>\$5,725</u>

MLTT can be waived or reduced in certain defined conditions

MLTT can be waived or reduced if certain eligibility criteria are met. For example, full tax exemption is granted to organizations such as the Crown and Crown agencies, school boards, post secondary institutions and hospitals, as specified in Section 268 of the *City of Toronto Act, 2006*, in addition to all purchases of property made by the City and its local boards.

Special tax rebates authorized by City Council

Two special tax rebates were also authorized by City Council. They include a full MLTT rebate on all conveyances registered on or after February 1, 2008 if the related agreements of purchase and sale had been entered into on or before December 31, 2007. First-time purchasers meeting eligibility criteria will also receive a tax rebate up to a maximum amount of \$3,725 (the tax applicable on a home valued at \$400,000).

Teranet collects both MLTT and the provincial land transfer tax

In order to manage and collect the new MLTT in the most cost effective manner, the City entered into a 10-year agreement with Teranet. Teranet is a private company that runs the Provincial electronic land registry system. Teranet has been managing the administration and collection of provincial land transfer tax since 1999. Consequently, the infrastructure in relation to the administration of the City's land transfer tax was already in place and, as such, there was no need to design or implement a new management information system in relation to the new tax.

Most MLTT payments are collected by Teranet

As indicated in Table 2, almost all municipal land transfer tax revenue is collected through Teranet's on-line registration and payment system. Less than two per cent of the payment transactions occur manually at either designated provincial offices or the North York Civic Centre.

Table 2: Municipal Land Transfer Tax Revenue, 2009 & 2008

	2009			2008		
	Number of Transactions	Revenue \$ (in millions)	%	Number of Transactions	Revenue \$ (in millions)	%
Teranet	29,834	181.3	98.6	25,019	158.1	95.4
City & provincial offices	341	2.6	1.4	322	7.6	4.6
Total	30,175	183.9	100.0	25,341	165.7	100.0

Lawyers can register property transfers on-line

When a property is transferred from one person to another, the purchaser, through their lawyer, uses Teranet's on-line system to register the property and make the necessary tax payment. At the time of registration, certain on-line forms related to the municipal land transfer tax need to be completed if the property requiring registration is located in Toronto. The registrant pays the total provincial and municipal land transfer taxes to a Teranet trust account.

The City receives tax proceeds daily

At the end of each business day, MLTT funds deposited to the Teranet trust account are transferred electronically to the City's account.

The City pays Teranet a set fee for each registered MLTT transaction

The City pays a set fee for each registered MLTT transaction. A lower fee is paid for each registered transaction involving tax exemption or rebate, or if the related municipal tax payable is less than a minimum threshold. Additional fees were paid for one-time services such as system design and changes, communication and rebate processing.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

<i>Why we did this audit</i>	The Auditor General's 2009 Audit Work Plan included a review of the municipal land transfer tax due to the inherent risks of establishing controls in a new program and because of the significant revenue generated.
<i>Audit objective</i>	The objective of this review was to assess the extent to which current control procedures ensure the effective administration and collection of the municipal land transfer tax.
<i>Audit scope</i>	<p>Our review included an examination of management controls exercised by the Revenue Services Division over the administration of the MLTT including:</p> <ul style="list-style-type: none">• Teranet's delivery of services according to terms and conditions as specified in the City's agreement• fees paid to Teranet for administering and collecting the municipal land transfer tax• rebates and refunds processed. <p>This audit covered the period from February 1, 2008 to September 30, 2009.</p>
<i>Scope limitation</i>	Due to the arrangements in place between the Province and Teranet, we were not provided access to system programming and source data by Teranet, and therefore were not able to assure ourselves that all information in the form of various reports submitted by Teranet is complete. Consequently, this review was restricted to transactions reported by Teranet to the Revenue Services Division.
<i>Audit methodology</i>	<p>Our audit methodology included the following:</p> <ul style="list-style-type: none">• review of the <i>City of Toronto Act, 2006</i>, the MLTT By-law, and Council and Standing Committee reports and minutes• review of budget documents, management reports, City policies, procedures and related records

- review of related draft Memorandum of Understanding between the City and the provincial government on the administration of the MLTT
- review of the City's contract with Teranet Enterprises Inc.
- discussions with staff of Teranet Enterprises Inc. and review of reports pertaining to the administration of the MLTT
- review of Teranet's audited Financial Statement– Year Ended December 31, 2007, issued by Deloitte & Touche LLP
- review of the Auditor General of Ontario's reports on the provincial land transfer tax program
- discussions with staff of the Ontario Ministry of Revenue's Audit, Inspections and Resource Taxes Branch, and the Ontario Ministry of Government Services, Ontario Internal Audit, Government Services Audit Service Team
- discussions with staff of Revenue Services and Legal Services Divisions
- analysis of system data using specialized audit software and other procedures deemed appropriate
- review of documents relating to the municipal land transfer tax program.

Compliance with generally accepted government auditing standards

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

A. TERANET'S SYSTEM CONTROL SHOULD BE THE SUBJECT OF AN INDEPENDENT ASSESSMENT

The City relies significantly on Teranet's system

The City relies on Teranet to process almost all MLTT transactions and remit the proceeds to the City. Significant reliance is placed on Teranet's management information system and administrative controls to ensure the accuracy of MLTT calculations. Staff regularly analyze and reconcile revenue deposits in the City's bank account to supporting summary reports provided by Teranet.

The City's right to audit

While the City's agreement with Teranet contains a right to audit clause, our ability to access system programming and raw source data is limited by arrangements in place between Teranet and the Province, and by Provincial ownership of data residing in the electronic registry system. This restricted access limits the City's ability to ensure that all revenue submitted to the City is accurate and complete.

The City needs assurance on Teranet's internal controls

In order to provide assurance that Teranet's internal system controls are operating effectively, the City, in consultation with the Province, should either seek a joint audit (Province and City) of Teranet's systems or an independent audit report (Canadian Institute of Chartered Accountants Handbook Section 5970 report – auditor's report on controls at a service organization). Such a report will attest to the effectiveness of controls and is a regular process where entities are relying on a third party to administer transactions on their behalf.

Recommendation:

1. The Deputy City Manager and Chief Financial Officer:

- a. review with the Province the potential of coordinating audit resources in order to conduct a joint audit of Teranet Enterprises Inc.'s systems**
- b. in consultation with the Province, give consideration to requesting Teranet Enterprises Inc. to provide to the City and the Province an independent auditor's report on controls at a service organization (Canadian Institute of Chartered Accountants Handbook Section 5970 report).**

B. ENHANCED MANAGEMENT OVERSIGHT NEEDED

As the City's exclusive MLTT tax collector for electronic registrations, Teranet provides services such as:

- calculating and collecting MLTT based on established City eligibility and exemption criteria, in accordance with the MLTT By-law
- electronically transferring MLTT revenue to the City daily
- following up on returned electronic tax remittances
- submitting certain regular and special reports to the City.

Our review identified that services rendered by Teranet generally comply with prescribed contract terms and conditions.

As part of this review, we recalculated the MLTT charged on certain property transfer transactions and found that MLTT was correctly calculated according to criteria and rates adopted by City Council.

While our review found that staff of the Revenue Services Division selectively review certain reports presented by Teranet, a more structured, risk-based approach to overseeing Teranet's responsibilities will ensure that service requirements are met.

Recommendation:

- 2. The Deputy City Manager and Chief Financial Officer formalize policies and procedures designed to mitigate the risk of errors in the services rendered by Teranet Enterprises Inc.**

B.1. The City Has Not Been Assured of System Protection Over Unauthorized Access

The City has not received the required compliance monitoring report

The City has not received a compliance monitoring report as required by the agreement with Teranet.

The objective of the compliance report is to identify the extent to which personal information collected through municipal land transfer tax remittance and stored in Teranet's management information system is protected from unauthorized access. The report would allow the City to demonstrate its due diligence in protecting the personal privacy of information collected by Teranet.

Recommendation:

- 3. The Deputy City Manager and Chief Financial Officer request from Teranet Enterprises Inc. its Compliance Monitoring Report. The Compliance Monitoring Report be reviewed to ensure it is independent, can be relied upon and any areas of concern are adequately addressed.**

B.2. Fees Charged on Insufficient Funds Cheques Are in Excess of the Amount Approved By Council

Overcharging administration fees on insufficient funds

The Municipal Land Transfer Tax By-law sets a \$35 fee when a payment of MLTT is not honoured by the financial institution by reason of insufficient funds. Teranet was charging taxpayers \$40 for returned payments.

In addition, while the current MLTT By-law provides no explicit authority for an additional fee, Teranet was charging an additional \$100 fee if an outstanding payment was not paid within 10 days. We were advised that Teranet applies the same penalties in similar circumstances involving the provincial land transfer tax.

While the amounts in question are not significant, a process which provides assurances of compliance with all provisions in the City's MLTT By-law needs to be established.

Teranet has amended its fee structure, and has agreed to refund the affected taxpayers.

Recommendation:

- 4. The Deputy City Manager and Chief Financial Officer request Teranet Enterprises Inc. to ensure that only those fees approved by City Council are charged on municipal land transfer tax transactions. Further, Revenue Services Division establish a process to ensure Teranet complies with the provisions contained in the Municipal Land Transfer Tax By-law No. 1423-2007.**

B.3. Additional Reviews Are Required on Municipal Land Transfer Tax Rebates and Refunds

A full or partial tax rebate or exemption will be provided to a property transferee meeting certain eligibility criteria. Most of these rebates relate to first-time purchasers or purchase and sale transactions that were executed on or prior to December 31, 2007. Eligible individuals can claim the rebate while paying the tax on-line, or can pay the full MLTT amount and then submit a MLTT rebate application form.

Over 7,300 rebates were granted during the first seven months of this program

During the first seven months of this tax program, over 7,300 eligible tax rebates and exemption refunds totalling \$16.8 million were granted. Of the total, about 77 per cent were processed electronically on Teranet's system. The remaining 23 per cent were approved by Teranet's staff through manual review of hard copy applications.

Teranet was paid to process manual rebate applications and audit certain transactions

The City paid Teranet a one-time service fee for processing manual rebate applications and auditing all approved tax rebates and refunds during the seven-month period ending August 31, 2008 (prior to the full automation of the MLTT collection process by Teranet). Rebates and refunds after this period are processed by Revenue Services staff.

With respect to auditing rebates and refunds, Teranet was required to audit set percentages, based on sale price, of approved rebate and refund transactions processed during the first seven months.

Our review identified that the above services provided to the City generally met requirements specified in the Teranet agreement. Teranet regularly submitted the related transactions to the City. These transactions however, were not reviewed, even on a sample basis, by staff of Revenue Services to ensure that manually processed rebates were granted by Teranet according to the City's eligibility criteria, and that Teranet carried out audit activities according to contract specifications.

Two rebate overpayments were identified during our review

In our test sample representing six per cent of rebate and refund applications manually processed by Teranet, we identified a small number of transactions that require additional follow-up work by staff of the Revenue Services Division. Included in those transactions were two rebate overpayments totalling nearly \$1,700 which, upon notification from our office, have now been recovered in full by Revenue Services.

While this amount is not significant, this overpayment was identified during our review of only six per cent of transactions during the relevant seven-month period.

Recommendation:

- 5. The Deputy City Manager and Chief Financial Officer complete a sample review of municipal land transfer tax rebates granted by Teranet Enterprises Inc. during the seven-month period ending August 31, 2008 to ensure that the City's rebate eligibility criteria were met.**

C. MORE VERIFICATION TO ENSURE MUNICIPAL LAND TRANSFER TAX IS PROPERLY CHARGED

Subsequent inspection of supporting documentation ensures the correct MLTT is charged and rebated

Over 50,000 transactions totalling nearly \$350 million in tax revenue have been processed on-line since February 1, 2008. Supporting each electronic transaction is an on-line form which reports the property's gross sale value for tax calculation. Information used for MLTT calculation is dependent on information entered on behalf of property transferees by their lawyers. Furthermore, first-time home purchasers are eligible for an MLTT rebate within certain limits. Information used for first-time home purchaser rebates is similarly dependant on information entered on behalf of property transferees by their lawyers.

Subsequent inspection of documentation in support of the sale value and first-time home purchaser rebate eligibility will substantiate information declared and ensure the correct MLTT is charged and rebated.

Our review identified that only limited verification had been conducted on these transactions.

An inspection of necessary documentation retained by the taxpayer will determine whether the correct property value was reported for MLTT calculation and will confirm rebate eligibility.

Auditors from the Ministry of Revenue regularly conduct risk-based audits of provincial land transfer tax transactions. The Revenue Services Division intends to leverage the provincial audit process by formalizing arrangements with the ministry in areas such as auditing and enhancing the sharing of information. Staff expect to finalize arrangements with the Ontario Ministry of Revenue in 2010. Revenue Services will also hire additional staff in 2010 to work closely with provincial audit staff on regular verification of documentation in support of MLTT payments and rebates.

Recommendation:

- 6. The Deputy City Manager and Chief Financial Officer review the level of ongoing resources required in order to effectively audit the various documentation provided by third parties to support the payment and rebate of municipal land transfer tax. Such a process be conducted in collaboration with the Province in order to leverage the current provincial audit program.**

D. OPPORTUNITIES FOR ADDITIONAL REVENUE OR COST SAVINGS

Our review identified areas that have potential for generating additional revenues or reducing administration costs. These opportunities are summarized below.

D.1. Recovering Rebate Application Processing Costs

In 2009, staff costs estimated at \$76,000 were incurred on manually processing nearly 400 rebate applications. Staff need to manually approve a rebate or refund application only if an applicant does not apply for a rebate/refund at the time of registration.

On-line rebate application should be encouraged

It is important to note that the Teranet electronic registration system has certain system design features that allow a registrant to apply for an immediate tax exemption or rebate at the time of registration. Manually processing a rebate or refund application is unnecessary if the registrant selects the on-line rebate or exemption option.

Charging a cost recovery fee on manual rebate/refund requests where the conveyance is registered electronically will likely encourage rebate/exemption applicants to promptly apply on-line, therefore saving staff time necessary to manually process rebate/refund applications.

Recommendation:

- 7. The Deputy City Manager and Chief Financial Officer consider the possibility of recovering staff costs relating to the processing of manual rebate and refund applications on electronically registered conveyances.**

D.2. Generating Revenue By Implementing By-Law Provision Requirements

The Municipal Land Transfer Tax By-law sets out provisions such as enforcement measures including the charging of interest, penalties, dispute resolution mechanisms, as well as conditions and authorities governing program administration.

Approved enforcement measures are not followed

Our review identified that the City is not encouraging prompt payment by charging interest and penalties on late payments. Interest and penalties are not being charged because divisional staff are either not familiar with by-law provisions or unsure of how they should be implemented. Implementing these existing by-law provisions would reduce staff time to follow-up late payments. In addition, potential interest and penalties in the range of \$35,000 to \$50,000 could possibly be generated from following relevant by-law provisions identified below.

Interest not always charged/applied on insufficient funds accounts

- Additional revenue, estimated at \$10,000 a year, could be generated if interest is charged on non tax payment due to insufficient funds in the purchaser's or representing agent's account. While the City By-law authorizes that monthly interest at 1.25 per cent be charged on taxes due, interest has not always been charged.

No penalties on failure to remit necessary documentation for audit inspection

- In late 2008, Teranet completed a sample review of rebate transactions which they processed prior to the full automation of MLTT collection. As a result, the City was notified of certain accounts requiring possible recovery of the MLTT or requiring additional supporting documentation to validate the rebate/exemption claimed. This was required because either the rebate recipients failed to provide appropriate supporting documentation to Teranet for audit and review, or the rebate condition was not met. At the completion of our audit fieldwork in March 2010, nearly 250 cases with potential MLTT rebate recovery totalling \$1 million were pending follow up review by staff of Revenue Services. Certain of the cases had been outstanding for over 19 months.

The MLTT By-law authorizes a penalty charge to be imposed on failure to provide the necessary documentation required for audit by the City, and the Chief Financial Officer can establish policies and procedures necessary to implement this measure.

Penalties were not imposed on long overdue accounts

- Penalties were also not imposed on long overdue accounts even though some of them were more than 12 months overdue. The MLTT By-law authorizes a penalty charge equal to 5 per cent of the unpaid balance and not to exceed \$100,000, and the Chief Financial Officer can establish policies and procedures necessary to implement this measure.

Recommendation:

- 8. The Deputy City Manager and Chief Financial Officer encourage prompt payment by developing policies to implement interest, financial penalties and other enforcement measures permitted by the Municipal Land Transfer Tax By-law No. 1423-2007.**

E. CERTAIN SECTIONS OF THE MUNICIPAL LAND TRANSFER TAX BY-LAW REQUIRE CLARIFICATION

Different interpretation of the By-law provision has resulted in some recipients not receiving any interest payment while some were overpaid

The MLTT By-law requires the City to pay taxpayers interest on rebates. The City is to pay interest at the rate of 4.5 per cent per annum on tax rebates from the application submission date. No interest payment is required where the interest amount is less than \$1.

Our review identified that because of different interpretations of the above By-law provision by both Teranet and City staff, certain recipients did not receive any interest payment while others were overpaid. Any overpayments or underpayments of interest were nominal.

Possible revisions to the above By-law provision, developing clear administrative directives and providing adequate staff training are viable measures to ensure correct processing of interest payments that relate to municipal land transfer tax refunds.

Another discrepancy noted in our review relates to the processing of first-time purchaser rebates.

To be eligible for the City's first-time purchaser rebate which offers a maximum rebate amount of \$3,725, the purchase must meet certain criteria.

By-law was ambiguous as to the correct calculation of one specific rebate

Our review identified that the way staff calculated the rebate for a purchaser whose spouse had previously owned a home before becoming a spouse was different from the wording appearing in the City By-law. However, staff calculations were consistent with both Council direction and the calculation of these rebates by the Province in respect of the provincial land transfer tax.

Our discussion with City Legal indicated that the related City By-law section contained some ambiguity as to the correct calculation of the rebate in this scenario. The City Solicitor has, with Council approval, since addressed this concern by making the necessary By-law amendment to clarify the calculation required.

A full review of the MLTT By-law may identify additional areas requiring amendment

While our review identified the need to amend or clarify certain specific MLTT By-law provisions, a full review of the MLTT By-law may identify additional areas requiring clarifications or amendment given the City's experience with the MLTT By-law to date.

Recommendation:

9. The Deputy City Manager and Chief Financial Officer:

- a. **in consultation with the City Solicitor, review the Municipal Land Transfer Tax By-law No. 1423-2007 to identify any provisions requiring clarification or amendment, and report to City Council, if necessary, on any revisions identified**
- b. **develop clear written guidelines to ensure consistent application of provisions in the Toronto Municipal Land Transfer Tax By-law No. 1423-2007 by staff of the Revenue Services Division.**

CONCLUSION

This report presents the results of our review of the administration of municipal land transfer tax, Revenue Services Division.

Addressing the recommendations in this report will help ensure that this new tax program is effectively managed and administered according to the intent of City Council.