



**STAFF REPORT
ACTION REQUIRED
with Confidential Attachment**

Canada Revenue Agency (CRA) – Employer Compliance Audit

Date:	May 10, 2010
To:	City Council
From:	City Manager Deputy City Manager and Chief Financial Officer City Solicitor
Wards:	All
Reason for Confidential Information:	This report contains communications about litigation or potential litigation that affects the City. This report is subject to solicitor/client privilege. This report contains communications about labour relations or employment-related matters.
Reference Number:	P:\2010\InternalServices\PPEB\cc10008ppeb (AFS #12062)

SUMMARY

The purpose of this report is to provide Council with the results of the recent Canada Revenue Agency (CRA) Employer Compliance Audit and to obtain direction with regard to the action to be taken to implement and respond to the results of the audit.

RECOMMENDATIONS

The City Manager, Deputy City Manager and Chief Financial Officer and the City Solicitor recommend that:

1. City Council adopt the recommendations and instructions to staff contained in Confidential Attachment 1.
2. City Council authorize the payment of funds required to carry out the instructions contained in Confidential Attachment 1 from the Benefits Reserve Fund.

3. The advice that is subject to solicitor-client privilege contained in Confidential Attachment 1, together with Appendix 2, remain confidential.
4. City Council authorize the public release of Recommendations 1, 2, 3, 4, 5 and 6 together with Part III of Confidential Attachment 1 at the conclusion of the City Council meeting.
5. City Council authorize the release of the balance of Confidential Attachment 1, including Appendix 1, at the conclusion of the objection and appeal process, as determined by the City Solicitor.

Financial Impact

The financial impacts of this report are set out in Confidential Attachment 1.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

There have not been any other reports submitted to Council with regard to this matter.

ISSUE BACKGROUND

In May 2008, the Canada Revenue Agency (CRA) began conducting an Employer Compliance Audit on the City of Toronto regarding taxable benefits. The scope of the CRA's audit was initially for the years 2005, 2006 and 2007. After a year of significant discussions and exchange of information between the City and the CRA, the CRA agreed to drop the year 2005. The CRA was reviewing the following areas with regard to taxable benefits:

- Councillor Expenses;
- Passes and Complimentary Tickets; and,
- Parking – controlled and uncontrolled parking lots.

The CRA's audit covered a period in excess of two (2) years. The City consistently took the position that none of the items under review were taxable benefits, and provided supporting documentation to this effect. With respect to employee parking, the CRA originally was reviewing over 3,000 employees who had access to various controlled lots. In addition, they were reviewing all of the City's uncontrolled parking locations. Staff in Pension, Payroll and Employee Benefits and Facilities Operation worked with the CRA auditor, Division Heads and employees in an effort to remove individuals from the list. As a result of these efforts, approximately 1300 employees were taken off the list with the remaining 1746 employees being reassessed for parking. The 1746 employees include: Non-union -- 929; Local 79 -- 700; Local 416 – 42 and Local 3888 – 57.

Generally, employer provided benefits are taxable to an employee under paragraph 6(1)(a) of the *Income Tax Act*. Paragraph 6(1)(a) of the Act states:

“Amounts to be included as income from office or employment – There shall be included in computing the income of a taxpayer for a taxation year as income from an office or employment such of the following amounts as are applicable:

- (a) Value of benefits – the value of board, lodging and other benefit of any kind whatever received or enjoyed by the taxpayer in the year in respect of, in the course of, or by virtue of an office of employment.”

The above reference in the *Income Tax Act* regarding benefits is broad. Depending on the circumstances surrounding a benefit or allowance, it may or may not be taxable. Employers therefore rely on the CRA’s published interpretation bulletins and other published statements to assist in determining the nature of the benefit and its tax status.

The next steps in the process for affected employees will be as follows:

- 1) Employees will begin to receive a Notice of Reassessment for each of 2006 and 2007 directly from the CRA. At that time, they will have an opportunity to object to the reassessments by filing a separate Notice of Objection in respect of each of 2006 and 2007 within 90 days of the mailing date of each Notice of Reassessment.
- 2) If the result at that stage is unsatisfactory, employees may appeal the reassessments to the Tax Court of Canada by filing a Notice of Appeal as early as 90 days after filing a Notice of Objection.

While the review period of the audit was January 2006 to December 31, 2007, the results of the audit will impact years 2008, 2009 and all future years.

Attachment 2 to this report provides an overview of the Federal Tax Procedure from the Employer Compliance Audit stage through the Objection stage and then finally to the Appeal stage.

COMMENTS

City's Practice In Respect of Parking Access as a Taxable Benefit:

In determining whether the access to Parking is considered to be a taxable benefit, the City has relied on: (1) the CRA's own published Employers' Guide Taxable Benefits and Allowances (Form T4130); and (2) the CRA's written statement in a 1995 Audit completed on the Municipality of Metropolitan Toronto with respect to parking access at Metro Hall.

(i) Employers' Guide Taxable Benefits and Allowances (Form T4130):

The CRA has publicly stated for almost two decades that where the employer cannot determine the fair market value of parking access, the employer should not add a benefit to the employee's remuneration. An example is "scramble parking", which the CRA defines as parking where there are fewer spaces than there are employees who require parking, and spaces are available on a first-come first-served basis.

The CRA posts a questionnaire on its website that invites employers to answer a series of questions about benefits, including "Do you provide 'scramble parking' to your employees?" In the context of that questionnaire, the CRA defines "scramble parking" as existing:

...where there are fewer parking spots than there are employees wishing to use a spot, so on any given day, whether or not an employee is able to find a parking spot is random or uncertain. There must be significantly fewer spots than employees desiring a spot.

The CRA provides this advice to employers as to how they should treat this type of parking for tax purposes:

Scramble parking is still a benefit to the employee, but in the absence of the ability to accurately assign a value to the benefit because of the random or uncertain nature of it, a benefit is not included in income.

The City relied on this policy when considering whether parking access should or should not be treated as giving rise to a taxable benefit for employees. It is clear in the City's situation there are significantly more parking clearances than available spaces (i.e., at least 3 times more clearances than spots for each of the 6 controlled parking lots). In this case, it remains the City's view that no fair market value could be determined because there were fewer available parking spaces in the lots than security clearances. As such, based on the CRA's guidelines and direction, the City did not assess a taxable benefit.

(ii) CRA's 1995 Audit of the Municipality of Metropolitan Toronto:

In 1995, the CRA specifically reviewed the parking access provided by the Municipality of Metropolitan Toronto to employees in respect of the 1991-1993 years. This is the same Metro Hall parking facility to which the City provides employees with access today. At the conclusion of that audit, the CRA stated as follows:

(2) PARKING - the following summarizes the privileged parking available to some Metro employees. Where parking is provided

based on position or office held, these individuals have a reserved spot. Parking available to other employees is on a first come basis, thus scramble parking.[emphasis added]

Following this audit, the former Metro Toronto changed its parking policy such that there was no longer any reserved parking and all parking was on first-come first-served basis, to comply with the above statement. The City has continued this revised practice.

The City has continued to reasonably rely on this statement as well as the CRA's published definition of "scramble parking" and concluded that its unreserved parking provided to employees was considered by the CRA to be scramble parking.

As a result, the City and the seven (7) former municipalities prior to amalgamation have always treated the parking access as a non-taxable benefit in accordance with the CRA's published guidelines and direction and based on the CRA's own determination following its 1995 audit.

Staff in the Pension, Payroll & Employee Benefits Division and Accounting Services will be reviewing all of the CRA's published interpretation bulletins to ensure that the City's policies which govern payments and/or reimbursements are in accordance with the CRA's published bulletins and to ensure that employees are provided with a guideline outlining their responsibility for logging and maintaining supporting documentation, in case of a future audit. Again, it should be noted that ultimately, it is an employee's responsibility to maintain information to demonstrate the business requirements behind any benefit or reimbursement which is deemed to be non-taxable, as a result of a business requirement. In addition, the City of Toronto is not responsible for situations where the CRA changes the treatment of payments and/or reimbursements.

CRA's Proposed Adjustments (February 5, 2010):

The CRA completed their audit and provided the City with their proposal letter on February 5, 2010. The CRA proposed the following items be reassessed as taxable benefits:

1. Parking Access at six (6) controlled parking garages: City Hall, Metro Hall, East York Civic Centre, Scarborough Civic Centre, North York Civic Centre and 111 Wellesley Street. The amounts to be assessed for each garage are summarized in chart 1 below:

Chart 1: CRA's Proposed Values / Amount of Taxable Benefit		
	2006	2007
City Hall	\$2,820.00 (\$235.00 / Month)	\$2,848.20 (\$237.35 / Month)
Metro Hall	\$2,880.00 (\$240.00/Month)	\$2,908.80 (\$242.40 / Month)
North York Civic Centre	\$1,584.00 (\$132.00 / Month)	\$1,599.84 (\$133.32 / Month)
Scarborough Civic Centre	\$804.00 (\$67.00 / Month)	\$812.04 (\$67.67 / Month)
East York Civic Centre	\$708.00 (\$59.00 / Month)	\$715.08 (\$59.59 / Month)
111 Wellesley Street	\$1,056.00 (\$88.00 / Month)	\$1,066.56 (\$88.88 / Month)

2. Council Member Expenses
3. Golf Passes
4. Toronto Zoo Passes
5. Sony Centre Tickets
6. Toronto Transit Commission (TTC) Passes
7. Toronto Parking Authority Passes (for former mayors).

Appendix 1 to the Confidential Attachment summarizes the CRA's February 5th proposal for each of the above noted areas, the City's response, and the CRA's Final Adjustments. This information is confidential because these matters have not been finalized and there are on-going discussions between the City and the CRA.

The total value of the CRA's proposed adjustments for the taxable benefits was \$3.77 million for 2006 and \$3.83 million for 2007.

Review Period, February 5, 2010 to March 15, 2010:

Following receipt of the CRA's proposal letter on February 5, 2010, the City had 30 days to provide a written response along with any additional information for consideration prior to any reassessments being issued by the CRA. The deadline for the City's response was the end of the business day on March 5, 2010. At the request of the City, this deadline was extended to March 15, 2010.

During this period, the City met with representatives from the CRA, conducted drop-in sessions with Councillors, communicated with impacted employees and each of the Union / Associations. The City also made five (5) submissions with regard to each of the items proposed by the CRA to be assessed as taxable benefits.

CRA's Final Adjustments (April 16, 2010):

On April 16, 2010, the CRA provided the City with its final assessment letter and the final list of items it would reassess as taxable benefits. The substance of the final assessment letter is set out in the Confidential Attachment.

Council Member Expenses & Councillor Parking

The CRA has agreed that expenses paid through the Council Expense Policy as well as Councillors' parking are not taxable benefits and will not be assessed as such.

Benchmarking of Other Municipalities:

Pension, Payroll & Employee Benefits (PPEB) regularly benchmarks its policies and practices with other municipalities. The information we received during these reviews confirmed that the City's treatment of parking was consistent with other municipalities who were also not treating parking as a taxable benefit based on the same understanding and reliance of the CRA's administrative policies and guidelines.

We are aware of a number of municipalities who have recently been contacted by the CRA and have undergone Employer Compliance Audits, which resulted in the determination by the CRA that parking access should be treated as a taxable benefit and have reassessed employees for prior years. We gathered information, on a confidential basis, from these municipalities, which is summarized in the Confidential Attachment 1 – Appendix 2.

The CRA has now concluded the audit and on April 16, 2010, provided the City with its final letter and list with regard to the items it intends to assess as taxable benefits. On April 20, 2010, an electronic list of employees who will be re-assessed was received from the CRA. Staff are now requesting further direction from Council with regard to the action to be taken to respond to and/or implement the results of the audit.

CONTACTS

Giuliana Carbone, Treasurer
Phone: 416-392-8427, E-mail: gcarbone@toronto.ca

Celine Chiovitti, Director, Pension, Payroll and Employee Benefits
Phone: 416-392-3901, Email: cchiovit@toronto.ca

Darragh Meagher, Director, Employment Law
Phone: 416-392-8948, E-mail: dmeaghe@toronto.ca

SIGNATURE

Joseph P. Pennachetti
City Manager

Anna Kinastowski
City Solicitor

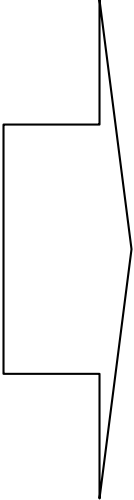
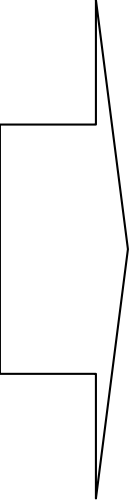
Cam Weldon
Deputy City Manager and
Chief Financial Officer

ATTACHMENTS

Confidential Attachment 1: Canada Revenue Agency (CRA) Employer Compliance Audit

Attachment 2: Federal Tax Procedure – Employer Compliance Audit – from Audit to Appeal

Attachment 2 – Federal Tax Procedure – Employer Compliance Audit – From Audit to Appeal

<u>Audit and Assessment</u>		<u>Objection</u>		<u>Appeal</u>
<ul style="list-style-type: none"> • Canada Revenue Agency (CRA) conducts audit of employer to review taxation of employee benefits • CRA auditor issues a proposal letter (a “30-day letter”) that describes proposed tax adjustments to employee benefits • Employer has 30 days to respond • Response includes additional facts and legal arguments • CRA considers employer response to proposal letter • CRA issues T4s or T4As and Notices of Reassessment to affected employees • Reassessments increase an employee’s taxable income by the value of the benefit, with the result that additional tax and interest will be payable • Employee may object to reassessment by filing Notice of Objection • Employees may form a “group” to deal with next steps 		<ul style="list-style-type: none"> • Notice of Objection must be filed within 90 days of date of mailing of Notice of Reassessment • No prescribed form but CRA suggests taxpayers use Form T400A • Objection must include certain information (<i>i.e.</i>, taxpayer name, SIN, reassessment date, taxation year, facts and reasons for objection) • Send to CRA Chief of Appeals via mail, fax, courier, hand delivery • The CRA is required to respond with “all due dispatch” but no requirement to respond within specific time period • Objection assigned to Appeals Officer, who considers taxpayer’s submissions and makes adjustments or confirms reassessment • If confirmed, CRA will issue Notification of Confirmation to taxpayer • Taxpayer may appeal to Tax Court of Canada 		<ul style="list-style-type: none"> • Tax Court of Canada – An independent and impartial federal court not affiliated with either CRA or Department of Justice • Notice of Appeal may be filed where objection not resolved within 90 days of filing objection • If objection is confirmed, taxpayer must file Notice of Appeal no later than 90 days after date of mailing of confirmation • Where tax in dispute is less than \$12,000, taxpayer may elect “informal” (<i>i.e.</i>, streamlined) procedure • At court hearing, Tax Court judge will consider evidence (including expert valuation evidence) and arguments of parties • Generally, Tax Court will decide (a) whether there was a taxable benefit to taxpayer, and (b) what is value of that benefit, if any • If taxpayer successful, CRA will reassess in accordance with decision • Tax Court decisions may be appealed to Federal Court of Appeal