



**HOUSE OF COMMONS
CANADA**

**CHAPTER 4, "INTEREST ON ADVANCE DEPOSITS
FROM CORPORATE TAXPAYERS - CANADA
REVENUE AGENCY," OF THE SPRING 2009
REPORT OF THE AUDITOR GENERAL OF
CANADA**

**Report of the Standing Committee on
Public Accounts**

**Hon. Shawn Murphy, MP
Chair**

APRIL 2010

40th PARLIAMENT, 3rd SESSION



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THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

has the honour to present its

SEVENTH REPORT

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied Chapter 4, “Interest on Advance Deposits from Corporate Taxpayers – Canada Revenue Agency,” of the Spring 2009 Report of the Auditor General of Canada and has agreed to report the following:

INTRODUCTION

Under Canada's self-assessment tax system, corporate taxpayers file their tax returns, voluntarily report their income and expenses, and calculate the amount of tax they owe. It is common for the Canada Revenue Agency (the Agency) to re-examine corporate tax returns and to issue reassessments. Corporations who have underpaid usually must pay interest on the taxes they owe. A corporation can reduce or entirely eliminate the possibility of interest charges on taxes owing due to a reassessment by submitting sufficient funds to the Agency in advance, that is, by making an advance deposit.

In 1991, the Agency began to accept voluntary payments from corporate taxpayers on deposit and pay interest on these deposits. The rate of interest is defined by the *Income Tax Regulations* and is at least 2% higher than the government's cost of borrowing short-term funds.¹ (According to the Agency's website, the current interest rate for overpayments is 3%.²) Corporate taxpayers have been keeping advance deposits exceeding \$4 billion with the Agency.

During its financial audits of the Agency, the Office of the Auditor General (OAG) was informed that most of the corporate advance deposits were not required for known or expected reassessments. Consequently, the OAG decided to conduct a performance audit to examine the Canada Revenue Agency's administrative practices with respect to advance deposits and to assess whether the deposits were managed with due regard for economy. The audit examined the 50 largest accounts of corporate taxpayers for the past three fiscal years. This audit was included in the Auditor General's Spring 2009 Report.³

¹ The rate is set under the *Income Tax Regulations*, Part XLIII, section 4301(b).

² See <http://www.cra-arc.gc.ca/nwsrm/rlss/2009/m12/nr091203-eng.html>. This page was accessed on 9 March 2010. (en français: <http://www.cra-arc.gc.ca/nwsrm/rlss/2009/m12/nr091203-fra.html>).

³ Auditor General of Canada, Spring 2009 Report, Chapter 4, *Interest on Advance Deposits from Corporate Taxpayers—Canada Revenue Agency*.

As the Public Accounts Committee believes that the government's tax system must be well managed in order to maintain credibility, the Committee held a hearing on this audit on 26 October 2009.⁴ From the Office of the Auditor General, the Committee met with Sheila Fraser, Auditor General of Canada; John Rossetti, Assistant Auditor General; and Vicki Plant, Principal. From the Canada Revenue Agency, the Committee met with Linda Lizotte-MacPherson, Commissioner; George Arsenijevic, Assistant Commissioner, Assessment and Benefit Services Branch; and Brian McCauley, Assistant Commissioner, Legislative Policy and Regulatory Affairs Branch. From the Department of Finance, the Committee met with Louise Levonian, Assistant Deputy Minister, Tax Policy Branch; and Brian Ernewein, General Director, Tax Policy Branch.

ADMINISTRATIVE FRAMEWORK AND ACTION PLAN

As taxpayers are subject to interest charges for taxes that might be later assessed, corporate taxpayers requested permission to make supplementary payments in order to limit their exposure to interest charges for taxes that are in arrears. While the *Income Tax Act* contains no provisions about accepting advance deposits remitted to prepay tax that might be due after a reassessment, the Canada Revenue Agency began to accept advance deposits in 1991 as an administrative practice.

The Agency's stated practice is to accept advance deposits only where there is a real risk of reassessment. However, the audit conducted by the OAG found that the Agency has no comprehensive policy or guidance for its employees to use when managing advance deposits from corporate taxpayers. As a result, the Agency accepts deposits from corporations without determining to which tax year the amounts relate, and without checking the likelihood of reassessment. Further, the Agency does not have a process in place for checking its own files to see if a reassessment is in the works and if the amount deposited is in line with the amount likely to be reassessed.

According to the audit, the Agency concluded, when preparing its financial statements, that in most cases the amount of funds on deposit significantly exceeded its

⁴ House of Commons Standing Committee on Public Accounts, 40th Parliament, 2nd Session, Meeting 35.

estimates of additional tax that might be payable under future assessments. The Agency recognized in 1991 that some corporations might maintain excess funds on deposit to profit from advantageous short-term interest rates. The OAG concluded that by unnecessarily holding deposits that exceeded the amount of tax owed or likely to be owed, the Agency is effectively borrowing those funds at a higher rate than necessary. The OAG estimated that the government has incurred at least \$30 million in excess interest costs in each of the past three fiscal years (2005-06, 2006-07, and 2007-08).

The Agency has launched a number of management initiatives to refund as many of the advance deposits that are determined to be excessive as possible, but with little success. If corporations, when contacted, choose to leave their funds on deposit, the Agency accepts their decisions.

In the opinion of the OAG, the Agency is not required by the *Income Tax Act* to accept or retain funds if the Agency determines that the funds are not needed to cover a potential reassessment. The OAG recommended that the Agency should inform the Department of Finance's Tax Policy Branch about the issue so the Department can assess the need for legislative or regulatory change. Also, the Agency should develop and consistently apply a robust administrative policy framework for managing advance deposits. The Agency agreed with the recommendation.

Linda Lizotte-MacPherson, the Commissioner of the Canada Revenue Agency, told the Committee that the Agency has developed an administrative framework and an action plan to improve their management of advance deposits. According to the Commissioner:

When a large advance deposit is not earmarked for a specific taxation year, corporate taxpayers will be contacted in order to get this information. Then the CRA will evaluate any perceived risks to determine that a reasonable amount is being placed on deposit. If our conclusions differ significantly from those of the corporate taxpayers, additional information will be requested. If no information is provided or if we conclude that the amount on deposit is not justified, we will issue a refund.⁵

⁵ Meeting 35, 15:40.

In other words, the Agency has updated its procedures, introduced stricter requirements, and instituted a more robust review process.

The Committee is pleased that the Canada Revenue Agency has developed an enhanced administrative framework for managing advance deposits from corporations. However, the Committee is concerned that the Agency only took action upon the completion of an audit by the OAG, even though concerns about this issue were first raised in 1991. There should have been further indication that there was a problem when attempts to return excessive advance deposits to corporations were not successful and previous management initiatives to resolve the problem did not work.

While the Committee hopes that the Canada Revenue Agency's new framework will help to resolve some of the concerns with respect to advance deposits, especially with respect to consistency, the Committee is concerned that it introduces a significant administrative burden on the Agency's employees who will be required to conduct an advance assessment of whether a reassessment will be required. It is a potentially problematic solution because the Agency could face liability if mistakes were made in the advance assessment and deposits were returned to corporations who later faced reassessments and were charged interest for outstanding taxes owing that had formerly been on deposit. Most importantly, an administrative solution does not resolve the underlying incentive for corporations to keep excessive advance deposits with the Agency.

SETTING THE INTEREST RATE

The Department of Finance is responsible for developing federal taxation policies. Louise Levonian, Assistant Deputy Minister at the Tax Policy Branch of the Department of Finance, told the Committee that the rate of interest paid to corporate taxpayers who provide advance deposits to the government should be set at a rate that encourages taxpayers to pay their taxes and allows taxpayers to protect themselves from potential arrears interest charges, which are non-deductible, due to

reassessments. The interest on advance deposits acts as a fair compensation to taxpayers for the government holding onto more money than was necessary for a potential reassessment. The interest rate should take into consideration the rate of return that might have been earned had the taxpayers kept the funds in their possession.

The rate paid for advance deposits is set under the *Income Tax Regulations*. The Auditor General explained how the interest rate is calculated: “The calculation begins by taking the average rate for 90-day treasury bills sold during the first month of the previous quarter. That rate is then rounded up to the next whole percentage, and a further two percentage points are added to the rounded figure.”⁶

It would seem that the interest rate paid for advance deposits has been quite favourable because it has been two percentage points higher than the rate for treasury bills. If the amounts on deposit were greater than what was likely to be required in the event of reassessment, then it is probable that corporations were keeping the funds with the Agency due to the favourable interest rate. Indeed, the audit states that, “In most other cases, the Agency concluded that the amount of funds on deposit significantly exceeded its estimates of additional tax that might be payable under future reassessments.”⁷ It is on this basis that the OAG concluded that the government had paid out \$30 million more in interest payments than was necessary.

However, the Commissioner of the Canada Revenue Agency contested this claim. She said, on several occasions, “We have no evidence that suggests corporations were placing amounts on deposits for any reason other than anticipation of a future reassessment.”⁸ She also said, “CRA’s position is that we did not waste taxpayers’ money.”⁹ Instead, the Agency’s conclusion that the amounts on deposit

⁶ Meeting 35, 15:30.

⁷ Chapter 4, paragraph 4.20.

⁸ Meeting 35, 16:20.

⁹ *Ibid.*, 16:30.

exceeded its estimates of additional tax payable was based on “accounting principles that require the amounts on deposit to be recorded as a liability on the financial statements until the reassessment of taxes is complete.”¹⁰

The Committee believes that these statements are troubling because they seem to indicate that the Agency does not genuinely believe that there is a problem that needs to be resolved and raises doubts about the Agency’s commitment to take action. If no money has been wasted, then it is not clear why the Agency is going through the considerable time and effort to “enhance” its administrative practices.

More importantly, the Committee is quite concerned that the Commissioner may be contradicting the factual statements made in the audit. The OAG provides draft audit reports to the departments and agencies audited, and it is at this stage that any factual disagreements should be resolved. It is not appropriate for departments and agencies to wait until the Public Accounts Committee’s hearing to bring these disagreements to light, especially in the final moments of the hearing. The Committee recognizes that there may be disagreements between the OAG and the government, but these should be clearly stated, and hopefully resolved, in advance. As the Agency has not presented any credible evidence to doubt the OAG’s findings, the Committee must believe that the facts, as stated in the OAG’s report, are accurate.

In other words, the Committee believes that the OAG is correct when it notes that corporations have been keeping excessive advance deposits with the Agency and that this has resulted in unnecessary interest payments of \$30 million per year. This conclusion is supported by common sense. Corporations quite simply would not leave excess deposits with Agency if it was not in their interest to do so. It is not necessary to have specific, concrete evidence of corporations trying to take advantage of the favourable interest rate; the mere fact of excess advance deposits indicates a problem.

¹⁰Ibid., 16:30.

The Committee believes that the underlying cause of corporate taxpayers providing advance deposits in excess of what is necessary for potential reassessments is the favourable interest rate. An administrative solution would not address this incentive and thus could lead to considerable tension between the Agency and corporate taxpayers over what amounts of advance deposits are reasonable. It is not necessary for the Government of Canada to provide such a favourable interest rate, as the audit report's examples of Alberta, Ontario, and the United States demonstrate.¹¹ The Committee believes that a reasonable interest rate is one that would not encourage corporations to leave excessive advance deposits with the Agency.

The Committee is very pleased to note that the government has recognized that this is an issue and in Budget 2010 announced that the interest rate paid on tax overpayments will be changed. According to the Budget, as of 1 July 2010 "the interest rate payable by the Minister of National Revenue to corporations will be set at the average yield of three-month Government of Canada Treasury Bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point."¹² In other words, the interest rate paid on advance deposits will no longer be set at a rate two percentage points higher than government treasury bills. The government calculates that this will result in savings of \$645 million over the next five years.

With this action, it is clear that the government has responded to the findings of the audit and has removed the incentive for corporations to leave excessive advance deposits with the Canada Revenue Agency. While the change in interest rate should resolve this issue, the Committee is, nonetheless, concerned that it took an audit report to bring light to an issue that has been around for a number of years, and that officials from the Agency appeared to contradict the findings of the audit. As the Agency has previously had difficulty resolving this issue, the Committee would like to monitor the success of this change, and recommends:

¹¹ Chapter 4, exhibit 4.1.

¹² Government of Canada, *Budget 2010*, Annex 5: Tax Measures.

RECOMMENDATION 1

That the Canada Revenue Agency provide the Public Accounts Committee with information at the end of each fiscal year from 2009-2010 to 2010-2011 on the amount held on deposit from corporations at the end of the fiscal year and the amount of interest paid on those deposits during the fiscal year.

RECOMMENDATION 2

That the Canada Revenue Agency provide the Public Accounts Committee with its policy framework and proposed regulations for managing advance deposits.

CONCLUSION

Managing Canada's tax system in order to ensure that taxpayers are treated fairly while at the same time ensuring that the government receives appropriate funds is a complex and difficult task. The Committee understands why the government provides corporations the opportunity to make advance deposits with the Canada Revenue Agency and why the government provides interest on those deposits. However, the interest paid must be set in a way that preserves the integrity of the tax system and gives due regard to economy in the handling of public funds. The Committee commends the government for committing in Budget 2010 to take action to resolve this issue by lowering the interest rate paid on advance deposits, and hopes that this will eliminate the problem by removing the incentive for corporations to keep excessive advance deposits with the government.

APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
<u>40th Parliament, 2nd Session</u>		
Canada Revenue Agency	2009/10/26	35
George Arsenijevic, Assistant Commissioner Assessment and Benefit Services Branch		
Linda Lizotte-MacPherson, Commissioner		
Brian McCauley, Assistant Commissioner Legislative Policy and Regulatory Affairs Branch		
Department of Finance		
Brian Ernewein, General Director Tax Policy Branch		
Louise Levonian, Assistant Deputy Minister Tax Policy Branch		
Office of the Auditor General of Canada		
Sheila Fraser, Auditor General of Canada		
Vicki Plant, Principal		
John Rossetti, Assistant Auditor General		

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (40th Parliament, 3rd Session: [Meeting No 2](#); 40th Parliament, 2nd Session: [Meetings Nos. 35 and 45](#)) is tabled.

Respectfully submitted,

Hon. Shawn Murphy, MP

Chair