Treasury Board and Finance—Collection of Outstanding Corporate Taxes

SUMMARY

Why we did this audit

The Department of Treasury Board and Finance has chosen to administer Alberta's corporate taxes through its Tax and Revenue Administration (TRA) division, as opposed to the Canada Revenue Agency, which administers corporate taxes for other provinces except Quebec. CRA pays other provinces the amount of provincial taxes assessed, irrespective of whether it ultimately collects these amounts from corporations. Thus, CRA bears the credit risk if corporations do not pay their taxes. In return, CRA keeps any interest earned and penalties on provincial income taxes that corporations owe. In contrast, the department retains the interest and penalties on Alberta's corporate taxes, but it also bears the credit risk.

As a result, we assessed whether the department has effective and efficient systems to collect outstanding corporate taxes in a timely manner, because it becomes more difficult and expensive to collect accounts the longer they remain outstanding. TRA focuses its resources on collecting high-risk and high-value receivables, but must also collect smaller amounts so as to enforce compliance consistently. Thus, any improvement in its ability to collect outstanding taxes efficiently within a reasonable time affects the province's cash flows.

What we found

The department has adequate systems to collect corporate taxes, but these systems need improvement to deal with the increasing number of outstanding taxes. TRA recently updated its information system to improve the way compliance officers manage files. It also added compliance officers to deal with increased caseloads.

However, we identified the following matters that the department should resolve:

- Several key policies and procedures are outdated, not comprehensive enough or do not exist to ensure compliance officers take consistent collection actions. TRA management also identified this issue but has not made its resolution a priority. We identified other gaps; for example, the lack of policies and procedures for assessing a taxpayer's ability to pay may allow compliance officers to treat taxpayers differently.
- New staff are trained when they start and work closely with a senior compliance officer for three months. Much of the training focuses on how to use the computer systems and to perform certain collection actions. Staff also consult with each other continuously about how to deal with collection files. However, the department does not have a comprehensive and ongoing training program after the three-month period for collection staff. Training materials are also not comprehensive and current.
- TRA expects each compliance officer to close a targeted number of files per month and collectively aims to collect a targeted amount annually. However, it does not have adequate internal and external performance measures and targets to assess the timeliness and effectiveness of collections. Management also does not analyze the collection results to assess whether various collection activities are working or not. Nor does it publicly report the effectiveness of its collections program.

- TRA management reviews monthly reports about the total number of outstanding files, their value, how long they have been overdue as well as the number of files in objection, assigned to compliance officers and unassigned and new files expected. The reports do not summarize key information such as the risk levels assigned to files, status of collection actions (for example, legal or payment arrangements) or the grouping of values (for example, accounts under or over $1,000, $10,000) in collection. Different collection strategies are required for different types of files. Without this information, management may not be using or developing appropriate collection strategies to deal with the increasing workload.

What should be done

The department should:

- update and maintain its tax collection policies and procedures
- improve its program for training staff in using its policies and procedures
- develop adequate performance measures to assess the timeliness and effectiveness of collections, and publicly report on its collection activities
- update its management information and periodically analyze the files to identify emerging issues and develop strategies to deal with backlog of files submitted for write-off and low value accounts

Why this is important to Albertans

Corporate taxes are a large source of government revenue. While most corporations pay what they owe promptly when they file a return, some do not. In such cases, the department must collect outstanding amounts effectively and efficiently, while also treating corporations consistently. To reassure Albertans that all corporations are paying the taxes they owe, the department must also evaluate and report on whether its tax collection program is working.

AUDIT OBJECTIVES AND SCOPE

Our audit objective was to determine if the department has effective and efficient systems to collect corporate taxes owed in a timely manner. Our audit focused on the collection of corporate income taxes, except where there is an outstanding objection by a corporation to the tax assessment.[1]

We interviewed compliance officers, reviewed tax collection policies and procedures, and tested a sample of collection files. We reviewed industry best practices for collections and interviewed staff from CRA, and the Department of Service Alberta responsible for crown debt collections.

We conducted our field work from February 2014 to August 2014. We substantially completed our audit on August 15, 2014. We conducted our audit in accordance with the Auditor General Act and the standards for assurance engagements set by the Chartered Professional Accountants of Canada.

[1] For tax year-ends after May 27, 2013, the department may collect 50 per cent of taxes from large corporations that dispute their assessments. This does not apply to tax year-ends before this date. Legislation previously prevented the department from collecting on those amounts from corporations until after the dispute had been resolved.

Background

Department responsibilities

TRA administers tax and related programs under Alberta's *Corporate Income Tax, Fuel Tax, Tobacco Tax* and *Tourism Levy Acts*. The division has four branches:

- tax services
- audit
- revenue operations
- strategic and client services

Historical corporate tax information

Revenues from corporate income taxes have increased over the last three years. The amount that corporations owe in overdue taxes, penalties and interest has increased even more, along with the amounts the department expects it will not be able to collect from corporations.

Year	Total corporate tax revenue (millions)	Interest and penalties (millions)	Corporate taxes owed at March 31 (millions)	Value of tax assessments under objection (millions)	Allowance for doubtful accounts (millions)	Allowance as % of outstanding receivable	Written off (millions)
2013–2014	$ 5,358	$ 128	$ 885	$ 557	$ 377[2]	42.6%	$ 43
2012–2013	4,713	42	741	414	248	33.5%	63
2011–2012	3,621	57	733	463	123	16.8%	2

Source: Ministry annual reports and internal department documents

Corporations may owe taxes related to one or multiple tax year-ends. The number of corporations that owe corporate taxes increased from 37,458 (related to 47,487 tax year-ends) in 2010 to 45,596 (related to 60,392 tax year-ends) in 2014. At March 31, 2014 there are 364 corporations objecting to $557 million (related to 851 tax year-ends) in taxes, penalties and interest assessed. Legislation[3] limits the department's options for collecting these disputed amounts.

The length of time that corporate taxes, penalties and interest have been overdue at March 31, 2014 were:

Age	Total outstanding at March 31, 2014 (millions)	Value of tax assessments under objection (millions)	Remaining balance where collection actions can be taken (millions)
Less than one year	$ 327	$ 166	$ 161
1 – 2 years	152	131	21
2 – 3 years	76	37	39
3 – 4 years	55	33	22
4 – 5 years	19	7	12
Over 5 years	256	183	73
Total	885	557	328

Source: Department internal documents

[2] The department has been improving its methodology to calculate the allowance for doubtful accounts over the last three years.
[3] *Alberta Corporate Tax Act* (Section 60), for tax year-ends after May 27, 2013, allows the department to collect 50 per cent of taxes from large corporations that dispute their assessments. This does not apply to tax year-ends before this date.

The collections group includes a manager, three group leads, four senior compliance officers, and 16 compliance officers. Compliance officers generally have a set workload of 320 files that they work on at a time. Files relate to a corporation who may owe taxes on one or multiple tax year-ends. Compliance officers work to collect the total balance outstanding. TRA expects compliance officer to close 79 files per month.

How Alberta's tax collection system works

Corporations with taxable income over $500,000 are required to pay monthly installments based on an estimate of their annual corporate taxes. TRA assesses the Alberta corporate taxes once corporations file their annual tax returns. All corporations must also file annual tax returns with and pay installments to the CRA. The department may also reassess the taxes based on objections and appeals, information received from corporations, CRA or from audits it conducts. Corporations must pay outstanding balances within two or three months of their tax year-ends. Most corporations pay their taxes on time, but some do not.

Taxpayers have 90 days from the assessment or reassessment date to object. Generally, legislation prevents TRA from forcing payment before the 90 days except when it can determine and convince a court that ultimate collection is in jeopardy if TRA delays collection actions. For tax year-ends after May 27, 2013, the department may collect 50 per cent of the assessed taxes for large corporations that object to their assessments. This is similar to CRA's practices.

Corporations that file an objection to the tax assessment sometimes pay their taxes to avoid any penalties and interest. Once the objection is concluded their payment applies to any outstanding taxes and the balance results in a refund from either the government or an amount that corporations still owe to the government.

For medium- and high-risk accounts, supervisors assign files to a compliance officer immediately after assessment/reassessment to start collection activities. They send letters or call the taxpayer, but usually cannot start enforcement actions until the 90-day objection period has passed.

For low-risk files above a certain threshold, TRA automatically sends a letter 35 days after the date of notice of assessment and a second letter if the balance remains outstanding after another 30 days. Supervisors may assign the files to a compliance officer after another 25 days to start collection activities. This assignment depends on the compliance officer's workload.

TRA tries to collect the full balance owing or arrange for payment in full within a certain period. When it is not possible to arrange a payment, TRA can take legal action in accordance with the *Alberta Corporate Tax Act*. Legal actions include, but are not limited to:

- garnisheeing bank accounts
- setting off the debt against other government payments
- putting a lien on a taxpayer's assets
- seizing assets

FINDINGS AND RECOMMENDATIONS

Documented policies, procedures and training

Background

Clearly documented and well-understood policies and procedures are an important part of an internal control system. These documents should articulate management's expectations and direct compliance officers in their day-to-day activities to achieve a desired result. They should also lead to consistent administration of tax collections. Combined with relevant and ongoing training, policies and procedures equip compliance officers with direction and guidance when they exercise professional judgment in complex situations.

One of TRA's goals is to ensure compliance officers take a consistent and uniform approach with all taxpayers. This can only be achieved with comprehensive, current and clearly documented policies and procedures and relevant and timely training.

RECOMMENDATION 6: MAINTAIN POLICIES AND PROCEDURES AND TRAIN STAFF

We recommend that the Department of Treasury Board and Finance:
- update and maintain its policies and procedures for tax compliance officers
- review its training program to ensure it provides relevant and ongoing training to tax compliance officers

Criteria: the standards we used for our audit

The department should provide tax compliance officers with appropriate and comprehensive policies and procedures and train staff to undertake collection activities consistently.

Our audit findings

KEY FINDINGS

- Several collection policies and procedures are outdated or do not exist for certain collection actions.
- Compliance officers do not consistently use risk assessments to prioritize their caseload.
- Staff are trained when they start, but there is no formal ongoing training program.

Clearly documented policies and procedures—TRA's collection policies and procedures are available to tax compliance officers on the division's internal website. Managers and supervisors discuss changes in staff meetings or send emails to put changes into practice immediately. However, the formal policies and procedures are not updated nor comprehensive. As a result, there is an increased risk that tax compliance officers may take an inconsistent approach to collections.

This approach to collections policies and procedures does not:
- provide new employees with current and complete requirements for collection actions
- provide collections staff with ongoing guidance on what the division requires

Management identified these matters but asserted that their day-to-day business tends to take priority over updating their policies and procedures. However, we also identified additional areas where TRA lacks policies and procedures such as assessing the financial viability of taxpayers when considering a payment arrangement or the steps that a tax compliance officer must complete before submitting a corporate tax file for write-off. Senior compliance officers sometimes have to send files back to compliance officers because they did not perform all the necessary steps.

The Department of Service Alberta's Crown debt collections division maintains detailed process flow-charts for handling collection files and legal processes for collections. TRA should talk to Service Alberta about sharing experiences and approaches to collections.

Furthermore, the department recently updated its information system to assess the risk of collectability of tax files based on various factors such as payment history and amount outstanding. The information system assigns files a low-, medium- and high-risk ranking. There is no guidance for tax compliance officers to prioritize files for collection action. Compliance officers do not consistently use the risk levels for prioritizing their workload, but instead determine collection priority on a case-by-case basis, using their own judgment. This approach results in inconsistent practices. While this may be appropriate given the nature of the files, clearly defining the expectations regarding how these risk levels should be used will help tax compliance officers to prioritize files.

Training—Compliance officers receive three months of training when they start work. The training focuses on how to use TRA's computer systems to manage the files assigned to them, how to obtain information for collection actions, for example by searching for assets. It also covers how to do certain basic collection actions. Senior compliance officers assist new staff during this time. Staff also consults with each other continuously about how to deal with collection files.

While TRA has provided some ad hoc training to compliance officers, it does not have a comprehensive training program for continuous learning and staff development. Considering that tax collection is a complex subject, there is scope for continuous learning; management should consider regular courses and training on new trends and best practices.

Implications and risks if recommendation not implemented

Without documented policies, procedures and adequate training, compliance officers will not execute their duties the same way, leading to TRA treating taxpayers inconsistently. Opportunities to collect taxes may be lost when compliance officers do not have clear policies, procedures and training.

Performance measures and reporting

Background

To demonstrate that TRA is achieving its results in a cost-effective and efficient way, it must have sufficient performance measures and targets to evaluate, assess and report the performance of collections. This includes external measures to demonstrate accountability for the results achieved, as well as more detailed internal measures to manage resources toward achieving the desired results. These serve as communication, motivational and decision making tools. When there are significant variances from targets, management needs to explain what factors, including external factors, impacted results. When targets are not met, management needs to adjust and develop cost-effective strategies to achieve the desired results.

RECOMMENDATION 7: DEVELOP INTERNAL AND EXTERNAL PERFORMANCE MEASURES AND TARGETS

We recommend that the Department of Treasury Board and Finance develop comprehensive performance measures and targets for tax collections and determine which to report publicly.

Criteria: the standards we used for our audit

The department should evaluate and report whether the tax collection program is achieving its goals and objectives. This includes measuring and reporting the cost of tax collections and publicly reporting the results of its collection activities.

Our audit findings

KEY FINDINGS

- The department lacks adequate performance measures to evaluate collection activities.
- Results based budgeting analysis on the benefit of Alberta administering its corporate taxes omitted write-off costs for uncollectable accounts.

Performance measures and reporting—TRA aims to collect $100 million of outstanding taxes annually through collection activities. The department improved the disclosures in its financial statements by providing an aging of the outstanding corporate income taxes assessed and the amount under objection. It also reports the amounts written off during the year, as the *Financial Administration Act*[4] requires.

However, the department has not established adequate performance measures and targets to monitor and assess the timeliness and effectiveness of its collections efforts. The department also does not report publicly on the success of its collection activities.

An international tax benchmarking study[5] involving ten countries, including Canada, highlighted eight measures to assess the timeliness and efficiency of debt collection. For example, the CRA reports in its annual report to parliament a comprehensive set of performance measures, targets, results and analysis of its programs, including collection activities. The CRA aims to have less than 18 per cent of the outstanding balance it can pursue, being older than five years. Its actual result for 2013 was 14.4 per cent. TRA does not have these type of measures.

The department also reported in its result based budgeting analysis that the benefit to the province of administering its own corporate tax collection system was $457 million in penalties and interest from 2009 to 2012. However, the department bears the cost of write-offs but omitted this from its evaluation. During that time, the department did not focus their resources and efforts to write-off accounts, resulting in a very small number of files and value of write-offs. This also resulted in a large backlog of files that it had identified for write-off but did not. During the last two years, the department started to focus on write-offs and wrote off $108 million. At March 31, 2014, it also estimated that it might be unable to collect a further $378 million.

Staff workload measures—TRA expects each compliance officer to close 79 files per month. Supervisors monitor this regularly to allocate new files to compliance officers. They also consider the time that certain files remain outstanding and work with compliance officers to resolve any long outstanding files.

Staff close on average 102 files per month; one staff member closes 207 files on average per month. Management has not documented its evaluation, reasons and risks for not updating the expectation for compliance officers to close 79 files per month.

Implications and risks if recommendation not implemented

Without comprehensive measures and targets and public reporting, the department cannot demonstrate that its collection program is efficient and effective. In addition, management and staff may not be held accountable for results.

[4] Section 23
[5] http://www.hmrc.gov.uk/research/benchmarking.pdf

Management information and monitoring

Background

TRA uses a number of collection activities such as sending letters, making phone calls and taking various enforcement actions such as registering liens, garnisheeing outstanding taxes from corporations' bank accounts or other sources according to the *Alberta Corporate Tax Act*. To be effective, management should monitor and analyze the status of collection files and the results of its collection activities, so they can focus on actions with the best results or develop alternate strategies for actions that are less effective. Focusing resources on the highest risk and value amounts must be balanced with avoiding the perception that compliance is not required for lower risk and value files.

RECOMMENDATION 8: IMPROVE MANAGEMENT INFORMATION AND ANALYZE DATA PERIODICALLY

We recommend that the Department of Treasury Board and Finance:

- update its management reports to include additional information on the status of tax collection files and the success of its various collection activities
- periodically analyze the characteristics of the corporate taxes outstanding to identify potential changes to legislation, policies and collections strategies
- deal with the backlog of files submitted for write-off and low value accounts

Criteria: the standards we used for our audit

The department should evaluate and report whether the collection program is achieving its goals and objectives. This includes:

- reporting on the state and general collectability of overdue taxes, including amounts written off, forgiven or otherwise adjusted
- evaluating the results to identify lessons learned to improve future collection strategies and activities
- having appropriate information technology systems and management information to support the collection process

Our audit findings

KEY FINDINGS

- Management reviews a monthly report on collections, but the report lacks key information to monitor collection activities.
- TRA does not analyze receivables sufficiently to identify potential trends.
- Information systems need improvement to track the status of collection activities.

TRA management reviews a monthly report that includes information on the total number and value of outstanding assessments based on tax year-ends, how long they have been outstanding, value in objections, assigned to compliance officers and unassigned items. The report also includes the number of new tax assessments with outstanding taxes opened during the month, expected future assessments and closed through collection and write-offs.

Management does not periodically analyze the collection inventory to identify potential trends and issues that will help identify potential changes required to policies and collection activities. They can also improve the reports. Examples of key summary level information for reports or analysis are:

- how much is collected through each collection activity. The report shows how much TRA collected in total but this information is not broken down by collection action. Resources are limited, and management wants to maximize the return on investment. By knowing which collection action brings the highest returns, management can focus their attention on actions with the best results or identify possible changes to legislation, policies, procedures and training for collection actions that may not be effective.
- grouping of outstanding amounts and number of files—At March 31, 2014, compliance officers could pursue 45,594 files, of which 29,351 files (64 per cent) were for amounts smaller than $1,000. A total of 7,395 files were for balances where the taxpayer paid the taxes due but not any interest and penalties. The department has not evaluated the potential to use the Department of Service Alberta's crown debt collections or other third party collection agencies to collect the high volume of accounts with low balances. While small value amounts may be uneconomical to collect, without the information management may conclude more resources are required to deal with the increasing workload.
- collection activity status such as agreement to pay, liens, request to pay or various legal actions for assigned files—Different collection activities require different approaches, resources and skills. For example, TRA does not track how many files have an agreement from taxpayers to pay their taxes. This information will allow management to determine whether the terms compliance officers agree to are complying with TRA policies, whether taxpayers are adhering to agreements, and, if not, that compliance officers are taking appropriate and timely action.
- risk level of assigned and unassigned files to determine if resources are appropriately allocated to where the return is the greatest—For example, 416 high-risk files have not been assigned to collection officers, but the reasons and length they have been unassigned is not reported.
- number of corporations that owe taxes—Staff workloads are based on a corporation, irrespective whether the corporation owes taxes related to one or multiple tax year-ends. The reports include summary information based on the number of tax year-ends but not unique corporations. Management may not identify the appropriate resource needs without the information. At March 31, 2014, 45,594 corporations owed taxes related to 59,541 tax-year-ends.
- number and value of files submitted for write-off and how long files are awaiting a senior compliance officer or group lead review—There were 2,498 files related to 5,069 tax year-ends totaling $121 million at March 31, 2014, awaiting a senior compliance officer and supervisor's review. Some files took up to 10 years to write off after it was initially submitted for write-off. Some files have been outstanding for 25 years since TRA issued the assessment or reassessment.

Implications and risks if recommendation not implemented

Without relevant management information and analysis, the department may not use its resources and available collection tools in an effective and efficient manner, and it may not identify alternative strategies to deal with outstanding taxes and non-compliance.