## 2.16 Gasoline Tax

### Introduction

The Tax Administration Branch of the Department of Finance is responsible for administering the Gasoline Tax program as stipulated in the *Gasoline Tax Act.* Taxes are charged and collected on all gasoline at a rate ranging from 0.7 to 16.5 cents per litre, depending on the grade of fuel used. In the *Act*, gasoline is defined as any and all liquids capable of being used for the purpose of generating power in an internal combustion engine. Figure 1 shows the various types of gasoline and the related Provincial gasoline tax per litre.

**Figure 1**

**Gasoline Tax Rates**

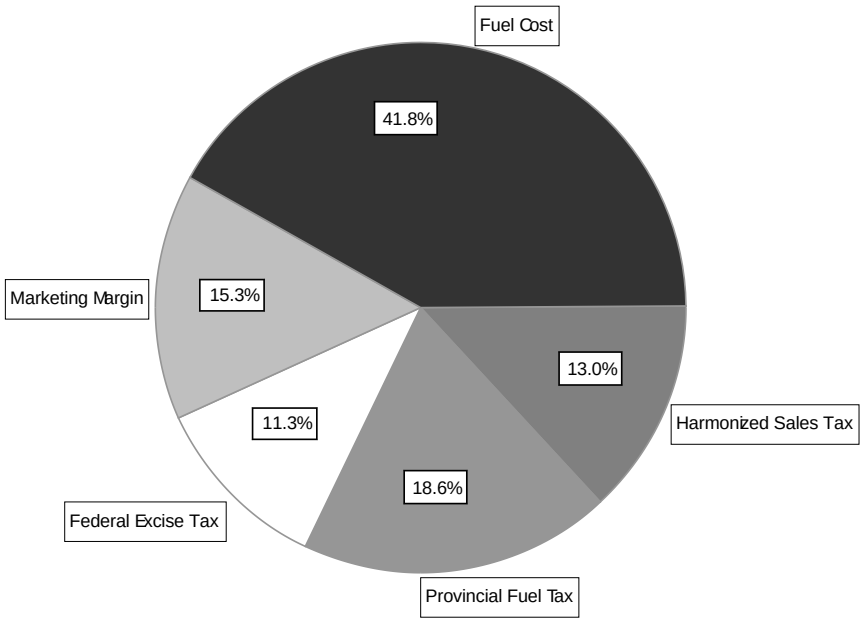
| Type | Consumer Tax ( Cents/Litre) |
|---|---|
| Gasoline | 16.5 |
| Diesel | 16.5 |
| Auto Propane | 7.5 |
| Marine fuel | 3.5 |
| Aviation fuel | 0.7 |

Source: *Gasoline Tax Act*

The price the consumers pay for gasoline is comprised of the fuel cost, a marketing margin (wholesaler and retailer), Provincial gasoline tax, Federal excise tax and HST. The price of a litre of regular unleaded self-serve gasoline in the Avalon Peninsula zone at 31 March 2004 was 88.5¢. Figure 2 shows the cost components of the litre of gasoline.

**Figure 2**

**Cost Components of a Litre of Regular Unleaded Self-Serve Gasoline on the Avalon Peninsula 31 March 2004**




Source: Public Utilities Board

Therefore, of a total cost per litre of 88.5¢, the Province's share is 22.7¢, the Federal share is 15.3¢, fuel cost is 37.0¢ and company profits total 13.5¢.

Revenues from gasoline tax for the year ended 31 March 2004 totalled $136 million and represented 7.1% of the Province's taxation revenue and 3.6% of the Province's total revenue from all sources.

Only two types of fuel may be used without paying tax - gasoline-grade fuel or diesel. All other gasoline sales are taxed at the specified rate. While diesel fuel may be purchased tax free at the pump if a purchaser has an exemption permit from the Department of Finance, the tax on gasoline-grade fuel is paid at the pump and the purchaser has to request a rebate from the Department. As at 31 March 2004, there were 2,726 registered permit holders eligible to purchase tax-exempt diesel. In both instances, the fuel must be consumed for specified purposes (fishing, farming, logging, manufacturing and processing, transportation by boat,

locomotives, generation of electricity, household fuels and natives on reserves) in order to qualify as tax-exempt. Because tax-exempt diesel fuel is available only at a separate pump, it is able to be dyed which acts as a deterrent for consumers to use it for other than specified purposes.

The *Act* states that every wholesaler and retailer must be registered and receive a licence to sell gasoline in the Province, and must submit monthly returns. As of March 2004, there were a total of 16 wholesalers comprised of 12 which sold to retailers and 4 which used gasoline for their own purposes (referred to as self-assessors), and 297 retailers. Information on the wholesalers and retailers are recorded in the Tax Audit Management System (TAMS) at the Department of Finance.

The tax is collected by the wholesalers and is required to be remitted to the Province by the 20th of the month after the tax is collected. Each wholesaler determines the amount of tax due to the Province through the filing of a generic monthly return which contains details of imports, exports and opening and closing inventories of all grades of fuel. Retailers obtain fuel from the wholesalers and sell fuel to retail purchasers, who either pay tax on their purchase or have a permit to purchase tax-exempt fuel. Retailers must file a return (Schedule F) for all sales of tax-exempt fuel to retail purchasers (consumers) with a valid permit.

## Scope and Objectives

We completed our review of the Gasoline Tax component of the Tax Administration Branch of the Department of Finance in March 2004. The objectives of our review were to determine if the Department has adequate systems and practices in place to ensure that all licencees and purchasers are in compliance with the *Gasoline Tax Act* and in particular to determine whether:

- all potential gasoline tax licencees are identified and registered;
- all licencees have remitted monthly returns and tax amounts on a timely basis;
- monthly returns are adequately monitored; and
- audits are conducted and issues arising from audits or monthly reviews are investigated and/or followed up on a timely basis.

## 2.16 Gasoline Tax

### Conclusion

The Gasoline Tax program applies to wholesalers, retailers and consumers. Therefore, the Department is required to identify, monitor and audit each group to ensure that there is compliance with the *Gasoline Tax Act* and *Regulations*. We found weaknesses in how the Department performs its identification, monitoring and audit activities.

*Wholesalers*

There are 16 registered wholesalers in the Province who account for all of the gasoline tax revenue collected and remitted to the Province. The *Act* requires wholesalers to be licensed if they sell fuel to retailers. We found that the Department does not always review monthly generic returns submitted by wholesalers and does not follow up on issues on a timely basis. Furthermore, the Department has only conducted one audit on 2 of the 16 wholesalers over the last five years.

*Retailers*

The Department does not do a good job in identifying unregistered retailers, and monitoring and auditing retailers. There are 297 retailers in the Province who are required by the *Act* to be licensed to sell fuel to consumers. Departmental officials indicate that 212 of these retailers are licensed to sell tax-exempt diesel fuel to permit holders. In particular we found:

- In 2001, the Department conducted its only review of retailer registration and identified 197 unregistered retailers. Before this, the Department had only identified 100 registered retailers. The Department has not conducted a review of retailers and their registration since 2001 to identify unregistered retailers.

- The Department does not follow up on issues identified in monthly exemption reports such as:

    - Retailers not submitting the required monthly forms. As at 31 March 2004, there were 13 monthly returns not submitted relating to 12 retailers. Of these 13 returns, 7 were outstanding for more than 12 months.

- Permit information from monthly reports not matching the Department's system. As at 31 March 2004, there were 2,726 registered permit holders eligible to purchase tax-exempt diesel and a Departmental report at that time indicated that the information on approximately 400 consumers from 85 different retailers did not match the Department's system. These 400 consumers purchased a total of 15.4 million litres of tax-exempt diesel (3 million litres of dyed diesel and 12.4 million litres of marine diesel).

- The Department does not regularly perform audits on retailers as evidenced by the fact that only one audit on 9 of the 212 retailers registered to sell marked diesel in the Province was performed in the past five years.

*Consumers*

Some consumers are using tax-exempt diesel fuel for purposes other than provided for under the *Act*. For example, between April 2003 and March 2004, the Department conducted 372 random checks of vehicles throughout the Province and found 66 instances where consumers were using tax-exempt diesel fuel for inappropriate purposes.

The Department does not regularly perform audits of consumers as evidenced by the fact that only 71 audits were performed in the last five years. Thirty-four of these audits resulted in tax assessments ranging from $471 to $102,386, with total tax assessed of $578,870. Therefore, the audits show that consumers are using tax-exempt diesel fuel for purposes other than provided for under *Act* and significant tax recoveries are available.

*Reporting*

The Department has not done a good job in documenting its program objectives and performance indicators. Furthermore, the Department does not have an annual operational plan to focus its identification, monitoring and audit activities towards meeting its objectives.

## 2.16 Gasoline Tax

## Findings and Recommendations

### Wholesalers

### 1. Identification and Registration

There are 16 registered wholesalers in the Province who account for all of the gasoline tax revenue collected and remitted to the Province. The *Act* requires wholesalers to be licensed if they sell fuel to retailers. Licensing is also necessary so that the Department will receive the information it requires to account for the volume of fuel sold and ensure that the appropriate amount of tax is remitted by the wholesalers. For the 12 wholesalers who sell fuel to retailers, there is an annual registration fee based on their sales volume.

The Department indicated that it was confident that all collectors of fuel tax had been identified and, therefore, it does not make any effort to identify unlicensed wholesalers.

We reviewed registration files for 4 of the 16 wholesalers and found 1 where, although the registration fee had been paid each year, the wholesaler did not sign its application for either 2000 or 2001.

### 2. Monitoring

Monitoring consists of a review of documentation submitted by wholesalers and audit work that the Department performs on wholesalers. We found the following:

#### (a) Review of Monthly Returns

The wholesalers are required by the *Act* to remit monthly returns. The generic monthly return is a document that was developed at a national level by the Canadian Fuel Tax Council and is standard across the country for all wholesalers. It is used to record sales, imports, exports, and consumption of all fuel types within the Province. It is received by the Department, entered into TAMS, and checked for mathematical accuracy. The Department has a checklist to determine whether all required documents are included with the return. By reviewing the monthly returns, the Department can assess whether the appropriate level of tax is submitted.

We examined a sample of 4 wholesalers' monthly returns and the Department's checklists for a period of two years in order to determine whether the wholesalers were providing all of the documents required to be submitted with the monthly return. We found the following:

- While most returns and documents were filed, the Department did not always complete its checklists and issues identified were not followed up on a timely basis. For example, there were significant time lags ranging from one to seven months between receipt of the return and the completion of the checklist. Furthermore, although one wholesaler had five monthly returns where information was noted as missing, there was no evidence of follow-up.

- Not all required procedures on monthly checklists were performed (five monthly checklists for one wholesaler, four for another, and two for a third).

- Monthly checklists and monthly returns could not always be located (two monthly checklists and one monthly return for one wholesaler, two monthly checklists for another, and four monthly checklists and one monthly return for a third).

- Monthly checklists were sometimes attached to the monthly returns but were not always completed (eight months for one wholesaler and six months for another). In these instances, the taxes were received from the wholesaler and the $100 penalty was imposed for failing to file the return on time.

**(b) Audit**

The audit of a wholesaler includes a review of the purchases, sales, and changes in inventory levels of all grades of gasoline, usually over a three-year period. The purpose of the audit is to assess compliance with the *Act* by the wholesaler and to obtain information on retailers for later use. The audit provides an assessment of whether the amount of tax remitted by the wholesaler is correct, whether there are any unregistered retailers and whether retailers' purchases may warrant further investigation.

Our review indicated that the Department has only conducted one audit on 2 of the 16 wholesalers over the last five years. We found the following:

- Only one of the audits was performed at the wholesaler's premises, the other was a desk audit whereby all the records were requested from the client and sent to the Department for review. Departmental officials indicated that 13 of the 16 wholesalers are located outside the Province; therefore, most audit work performed would be desk audits.

- The desk audit resulted in a nil assessment while the on-site audit is still ongoing.

- The Department does not have a standard audit program to assist auditors in performing their work.

Neither of the audit files contained evidence of review by a manager.

**Retailers**

**1. Identification and Registration**

There are 297 retailers in the Province who are required by the *Act* to be licensed to sell fuel to consumers. Departmental officials indicate that 212 of these retailers are licensed to sell tax-exempt diesel fuel to permit holders. Since 1992, retailers are not required to renew their licence on an annual basis; instead, the licence remains in effect until the retailer ceases operations.

Our review indicated that, in 2001, the Department conducted a review of retailer registration and identified 197 unregistered retailers. As a result, before this, the Department did not have the information necessary to determine whether tax-exempt fuel sales were made to valid permit holders. Prior to 2001, the Department did not actively search for retailers of taxable fuel products to ensure that they were registered. Furthermore, no review for unregistered retailers has been performed since 2001.

## 2. Monitoring and Audit

Monitoring consists of a review of documentation submitted by retailers and audit work that the Department performs on retailers. We found the following:

### (a) Review of Monthly Returns

Retailers are required to submit a monthly return (Schedule F) indicating the volume of tax-exempt diesel sold and to whom it was sold (i.e. name and permit number). This information is entered into the TAMS. As at 31 March 2004, there were 2,726 registered permit holders eligible to purchase tax-exempt diesel. The Department reviews the monthly returns to determine whether retailers are complying with the *Act* with regards to selling tax-exempt diesel and to obtain information about fuel purchases by permit holders for later use.

The TAMS produces a number of exemption reports which the Department can review to determine whether retailers are complying with the *Act*, i.e., filing the reports on time and selling tax-exempt diesel only to registered permit holders. In this way, the Department can assess the loss of potential tax revenue from diesel sales and use the information to follow-up on certain permit holders. We reviewed a sample of three monthly exemption reports from TAMS relating to Schedule F and identified the following:

- Report A0051 is a list of how many Schedule F reports are outstanding at month end and for how long they have been outstanding. As this report showed, as at 31 March 2004, not all monthly Schedule F returns had been submitted. The report indicated that there were 13 Schedule F returns not submitted relating to 12 retailers. Of these 13 returns, 7 were outstanding for more than 12 months.

- Report A0011 is a list of retailers who have outstanding Schedule F reports and also have a balance owing to the Department for such items as late filing penalties, prior tax assessments and interest charges. The report showed that, as at 31 March 2004, there were five retailers with outstanding Schedule F reports who collectively owed $700.

- Report A0120 is a list of instances where a permit number or name reported for a sale of tax-exempt fuel on a Schedule F does not match to the registered permit holder in the TAMS. The report showed that during June 2003, 12 retailers submitted incorrect information on 69 different consumers who purchased tax-exempt diesel. Upon further review, we found that 8 of these 69 consumers did have a valid permit and, therefore, should not have been in the exception report. Retailers are granted a period of 30 days to either provide the missing or incorrect information to the Department, or pay the tax on the sale to non-permit holders.

  We again reviewed report A0120 in March 2004 and found that 44 of the 69 consumers whose permit information did not match TAMS in June 2003 were still being highlighted as not matching the system in March 2004.

  Furthermore, this report at March 2004 identified approximately 400 consumers from 85 different retailers whose permit information did not match TAMS and purchased a total of 15.4 million litres of tax-exempt diesel (3 million litres of dyed diesel and 12.4 million litres of marine diesel).

The Department has not followed up on any of these issues identified in the monthly exemption reports.

**(b) Audit**

The audit of a retailer includes a review of the retailers' fuel sales, usually over a three-year period. The purpose of the audit is to assess compliance with the *Act* by the retailer and to obtain information on consumers for later use. The Department has a basic checklist for auditors to use when performing audits. There were 297 retailers in the TAMS at 31 March 2004, 212 of which were registered to sell marked diesel. Our review indicated that:

- The Department performed only one audit on 9 of the 212 retailers registered to sell marked diesel in the Province in the past five years. Three of these audits resulted in tax assessments ranging from $490 to $26,113, for a total of $36,092 in tax assessments.

- The Department's audit checklist is not completed for all audits. Furthermore, the Department does not have a standard audit program to assist auditors in performing their work.

**Consumers**

There is a risk that a consumer will acquire tax-exempt diesel fuel for purposes other than provided for under the *Act*. Tax-exempt diesel fuel, therefore, is marked with a dye as a deterrent to consumers in that its use for inappropriate purposes can be detected by inspection. The Department conducts two types of inspections - random vehicle checks and consumer audits.

*Random Vehicle Checks*

Random vehicle checks prior to December 2002 could only be conducted with a search warrant. However, effective December 2002, the Department was authorized under the *Act* to conduct a random check of fuel in vehicles to determine if a consumer is using tax-exempt diesel for inappropriate purposes.

Between April 2003 and March 2004, the Department conducted 372 random checks of vehicles throughout the Province to determine if consumers were using tax-exempt diesel fuel for inappropriate purposes. As a result of these checks, the Department found 66 instances where consumers were using tax-exempt diesel for inappropriate purposes. Some of these inspections resulted in audits of the consumers, some consumers were issued warning letters, and court action was initiated against other consumers.

*Consumer Audits*

Consumer audits are usually performed as a result of information from a Schedule F review or as a result of findings from a random inspection. The Department has a basic checklist for auditors to use when performing these audits. Our review indicated that:

- The Department has completed only 71 consumer audits in the last five years. Thirty-four of these audits resulted in tax assessments ranging from $471 to $102,386, with a total tax assessed of $578,870. Collection activities are in progress with these outstanding balances; however, we do note that the Department had to enter into an arrangement with the consumer who was assessed $102,386 to retire this debt over time and another consumer who was assessed $52,367 has not paid the account. Of

the 71 audits completed, 17 audits related to consumers who held permits to purchase tax-exempt diesel. The remaining 54 consumer audits were completed on consumers who did not have a permit to purchase tax-exempt diesel.

- The Department has completed only 17 audits relating to the 2,726 registered permit holders eligible to purchase tax-exempt diesel fuel. Other than permit holders identified from either Schedule F reviews or random inspections, the Department does not regularly schedule consumer audits.

- The Department's audit checklist is not completed for all audits. Furthermore, the Department does not have a standard audit program to assist auditors in performing their work.

Departmental officials indicated that, as of 31 March 2004, they had not pursued prosecution of any of the consumers found to be in contravention of the *Act* identified during random checks.

**Planning and Reporting**

The Department developed checklists specific to each of the programs - wholesaler, retailer and retail purchaser - to ensure that minimum audit procedures are completed, adequately planned and properly executed. The Department began to use the checklists for retailers and consumers in October 2001; however, the checklist for the wholesaler audit has not been put into use by the Department. Department officials indicated that, although the wholesaler checklist was not useful in its current format, a new checklist has not been developed.

Of the 18 audit files we reviewed for retailers and retail purchasers, 11 of these files related to an audit period after October 2001 and therefore a checklist should have been completed. However, for 4 files there was no checklist, while the remaining 7 had checklists which were incomplete.

In a report to the Department in 1995, we commented on planning and reporting activities of the Department. We noted that the establishment of major program objectives for the Tax Administration Branch activities and performance indicators against which progress towards these objectives can be measured would assist the Department in developing operational plans for the administration of the *Gasoline Tax Act*. We also noted that these objectives would assist in subsequent review of the Tax Administration Branch activities to determine whether specific objectives have been met. We recommended that the Department determine objectives for the Gasoline Tax program, establish performance indicators, and implement an operational plan.

The Department has indicated that they have only developed program objectives such as the number and type of audits they plan to conduct, and that only limited performance indicators have been established such as the number of inspections completed for the retailer and consumer programs. Therefore, the Department has not done a good job in documenting its program objectives and performance indicators. Furthermore, the Department does not have an annual operational plan to focus its identification, monitoring and audit activities towards meeting its objectives.

**Recommendations**

*The Department should:*

- *review monthly generic returns submitted by wholesalers and follow up on issues on a timely basis;*
- *conduct regular reviews to identify unregistered retailers;*
- *ensure that retailers submit the required monthly returns;*
- *follow up on issues identified in monthly exemption reports;*
- *perform more frequent audits on retailers;*
- *continue with its random vehicle checks and perform more frequent audits on consumers; and*
- *document its program objectives and performance indicators, and prepare an annual operational plan.*

**Department's Response**

I reference the seven (7) recommendations included within your report and reply to each as follows:

*1) The Department should review monthly generic returns submitted by wholesalers and follow up on issues on a timely basis.*

*The Department does perform reviews on a regular basis. Staff turnover has interrupted the timeliness of such reviews, however, this area will be re-addressed.*

*2) The Department should conduct regular reviews to identify unregistered retailers.*

*The Department's position is that regular reviews, such as that conducted by the Department in 2001, are not required. Timely review of the wholesaler accountability return and the retailer schedule 'F' return ensures registration on an ongoing basis.*

*3) The Department should ensure that retailers submit the required monthly returns.*

*Monthly delinquency reports are generated by the Tax Administration Management System listing outstanding returns for all tax programs. These reports are then assigned to Collectors and worked based on their priority (estimated dollar amount). Since the Schedule 'F' return is an information report with no actual tax dollars due, they are not assigned a high priority in the prioritization model.*

*The Department will revise its compliance procedures relating to Gasoline Retailer returns to ensure this prioritization issue is addressed.*

*4) The Department should follow up on issues identified in monthly exception reports.*

*As noted under recommendation 1, the Department does follow up on monthly exception reports. Staff turnover has interrupted the timeliness of these follow ups. This is being addressed.*

*5) The Department should perform more frequent audits on retailers.*

*The Department has a limited number of resources available to allocate to each tax program and to allocate to each type of audit within a program (ie. wholesaler, retailer or consumer level within the Gasoline Tax program). Consequently, these resources are allocated to where the Department determines it can have the most impact. To date, the resources have been allocated primarily to audit at the consumer level, since experience has indicated that the largest dollar return and largest area of risk for tax loss is at this level.*

*6) The Department should continue with its random vehicle checks and perform more frequent audits on consumers.*

*The Department has been performing random inspections of equipment since the legislative change of December 2002. Funding has recently been provided to hire four (4) temporary Gasoline and Tobacco Tax*

*Inspectors to further enhance this program. The Department has recognized this area as having a major impact upon ensuring compliance under the* Gasoline Tax Act.

*In relation to the recommendation of performing more frequent audits on consumers, it has been the experience of the Department that consumer audits only result in assessment where a dyed fuel sample has already been obtained through the inspection program or some other viable "lead" exists. Random audits of consumers is ineffective. All positive fuel samples are reviewed by the Tax Audit Manager and audits assigned for follow up by audit staff.*

*7) The Department should document its program objectives and performance indicators and prepare an annual operational plan.*

*The Department regularly measures performance statistics for its audit and inspection programs. Such measures include number of audits performed, hours and dollar results of the audits, number of inspections performed, number of "positive samples obtained" and number of successful prosecutions.*

*Each Manager is responsible for his/her program area and reviews such measures when deciding how to allocate staff to program areas requiring more or less attention.*

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