

**AUDIT
OF
GRANTS IN LIEU OF TAXES**

July 2000

Audit Division (SIV)

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Executive Summary

The Internal Audit Division (SIV) undertook, in the fall and winter of 1999, an audit of Grants in Lieu of Taxes (GILT) as part of its review of Departmental Grants and Contributions.

DFAIT pays approximately \$ 6 million per year in GILT to municipalities where the Diplomatic or Consular properties of foreign governments enjoy immunity from municipal property taxes in Canada. The United Nations, Criminal and Treaty Law Division (JLA) administers the Memorandum of Understanding (MOU) on behalf of the Department. Diplomatic Corps Services (XDC) determines the eligibility of diplomatic properties.

A MOU exists between DFAIT and the Real Estate Services Division of Public Works and Government Services Canada (PWGSC) which establishes responsibilities and procedures governing the provision of service related to the payment of GILT. PWGSC charges an administration fee of \$33,000 per year for the provision of these services.

The determination of the amount of municipal taxes owing on a diplomatic property is made up of three elements: the identification of an eligible property, the assessed value of that property and the mill rate. Through the course of the audit, the following were noted:

- JLA and XDC are unable to provide a comprehensive list of the properties which are entitled to the GILT. Based on our review, up to \$58,000 may be paid annually for properties which may not be entitled to GILT. However, XDC has now committed to establishing and maintaining a list of properties eligible for the tax exemption.
- JLA has not requested that PWGSC challenge the assessed value of the properties. Consequently, the values used in the determination of taxes may not be appropriate. It was determined that neither DFAIT nor PWGSC have the legal right to challenge property values as the Government of Canada does not own or lease the properties in question. However, PWGSC is developing a risk assessment to determine the costs of re-evaluating the assessments in light of its anticipated benefits. Also, a revised MOU, which will accurately reflect the rights and responsibilities of both parties, is currently being developed.
- Verification of the factoring of the mill rate is done by PWGSC and is included in the \$33,000 administrative fee.

As a result of the audit, discussion between JLA and XDC are underway to determine whether responsibility for the administration of GILT should continue to be housed within JLA or whether it would be better suited in XDC.

Scope and Objectives

The Internal Audit Division (SIV) has undertaken an audit of the GILT as part of its review of Departmental Grants and Contributions. The scope of the audit focussed on the management of GILT within the Department and involved interviews and file reviews conducted to gain an understanding of the processes and controls used by the Department in the management of GILT.

Overview of Grants in Lieu of Taxes

Under the Vienna Convention on Diplomatic and Consular Relations and agreements with international organizations, Canada is obligated to exempt certain properties from taxation. These are provincial and municipal taxes. The loss of tax revenue is essentially a cost of carrying Canada's international relations. Therefore, the Government of Canada provides provincial and municipal governments with grants equivalent to the taxes that they would have otherwise collected in the same way that it pays them grants in lieu of taxes on federal government owned properties.

An MOU exists between DFAIT and the Real Estate Services Division of PWGSC which establishes responsibilities and procedures governing the provision of services related to the payment of grants in lieu of real property and frontage or area taxes with respect to diplomatic property. The MOU is reviewed annually and DFAIT pays an administrative fee of \$33,000 annually to PWGSC for these services.

In DFAIT, JLA administers the MOU on Grants in Lieu of Taxes on behalf of the Department. XDC of the Office of the Protocol identifies the diplomatic properties that may be eligible for an exemption from property taxes and provides all necessary information to JLA. When eligibility for an exemption is not clear, JLA makes the necessary determination. Information on additions and deletions to the list of exempt properties is then forwarded on to PWGSC.

Under current arrangements, tax bills for exempt diplomatic properties are sent by the municipal taxing authorities to PWGSC, Real Estate Services. PWGSC then recalculates the taxes using the municipalities' valuation of the properties and the assessment rates and pays the grants from funds provided by DFAIT. The tax summary assessment is forwarded to JLA twice a year, usually via an interim assessment in August and the final assessment in December/January. JLA reviews the summary assessments and authorises payment.

The GILT paid over the last three years is as follows:

Grants in Lieu of Taxes by Fiscal Year

	Grant	Administrative fee
1997/98	\$ 6,052,000	\$ 33,000
1998/99	5,761,524	33,000
1999/00	6,889,000*	33,000

*Estimated

Observations by Area

The determination of the amount of municipal taxes owing on a diplomatic property is made up of three elements: the identification of an eligible property, the assessed value of that property and the mill rate.

Identification of Eligible Properties

The MOU between DFAIT and PWGSC states that DFAIT agrees to “*identify diplomatic property eligible for grants, and provide all necessary information bearing on such eligibility, including, but not limited to, dates of acquisition and disposal, dates of demolition and new construction, use and occupancy of the property and proportions of the property in different use.*”

Responsibility for the identification of eligible properties lies with XDC. When a foreign government wishes to purchase or dispose of an Official Residence or a Chancery, permission must be granted from the Government of Canada. The foreign government sends a request to XDC, who after vetting it through several Departmental Bureaux,

issues a note to the foreign government authorizing the purchase of a diplomatic mission, an Official Residence, a Consular post or a residence of a Consul General. These properties are eligible for GILT. This information is then passed by XDC to the Authentication and Service of Documents Section (JLAC), who forward the information on to PWGSC. While PWGSC has a list of properties for which it pays GILT, prior to this audit, it had been some time since a listing had been provided to either XDC or JLA.

At the time of the audit, neither JLA nor XDC maintained a comprehensive list of properties for which GILT should be paid. XDC is also responsible for providing information to PWGSC on use of occupancy of a property and on proportions of property in different use. In this area as well, the XDC files were found to be incomplete.

On February 14, 2000, XDC committed to the implementation of a number of administrative procedures aimed at ensuring the accurate identification of properties eligible for the tax exemption. These procedures include:

- the modification of its Diplomatic Registration System to include an indication of the exempt status of a property and the date of ownership;
- the establishment of verification procedures with PWGSC;
- the development of specific instructions to foreign Missions outlining the conditions for eligibility for the tax exemption; and
- the development of new procedures in cases of non-compliance by a foreign government.

Recommendations for XDC:

- 1. Proceed with a reconciliation of the list of properties provided by PWGSC for which DFAIT is paying GILT to a departmental list of properties eligible for GILT.**
- 2. Where applicable, provide updated information to PWGSC on the use and occupancy of the property and proportions of the property in ineligible use.**

XDC Responses:

- 1. XDC is modifying its Diplomatic Registration System to capture the properties eligible for the exemption. The reconciliation of these**

properties with the list provided by PWGSC will be completed by September 2000.

- 2. Updated information on the use and occupancy of properties and the proportions of the properties in ineligible use will be provided to PWGSC by September 2000.**

Assessed Value of the Diplomatic Properties

The MOU states that PWGSC agrees to: *“verify all physical and legal attributes bearing on the valuation of diplomatic property, and using appropriate assessment principles and practices, establish a property value for each property.”*

It is PWGSC’s interpretation of this section in the MOU that its responsibility is to not establish a property value using valuation principles but rather to simply confirm the current assessed value of the property with the municipality. It is an administrative verification to ensure the matching of properties and values with the municipality.

Recommendation for JLA:

- 3. Review the MOU with PWGSC to ensure that it accurately defines the responsibility of PWGSC with respect to the valuation of properties.**

JLA Response:

- 3. PWGSC and DFAIT are in the process of drafting a new MOU which will accurately reflect the responsibilities of both parties. The MOU is expected to be finalized by June 2000.**

While the Municipal Grants Acts provides for a review of the amount assessed at any given time, PWGSC has not conducted nor has been instructed to conduct any valuation reviews. In fact, some reviews of property valuations date back to the 1940's.

In July 1998, as part of discussions surrounding the annual MOU signing, the possibility of a risk assessment approach to the identification of properties for valuation review was raised. This approach consisted of identifying up to 10 high value properties per year for revaluation. PWGSC suggested that the administrative fee would have to be increased by \$5,000 to \$38,000 as a result of the additional duties that valuation reviews entail. JLA opted to forgo a review of the assessed values in order to minimize administrative costs.

In 1998, the Ontario Government completed a reassessment of all property values. The resulting increases on applicable properties have been phased in over three years.

While a review of the valuation of federal commercial properties may not be indicated because of the agreed upon cap of 40 percent in increased assessed value, no such cap exists with respect to residential properties which account for 61 percent of the properties subject to GILT.

Properties by Location
(1999/00 fiscal year)

Provinces *	Properties			Grant \$
	Total	Commercial	Residential	
Ontario	210	79	131	6,666,800
B.C.	17	9	8	184,500
Alberta	4	3	1	22,400
Nova Scotia	1	0	1	5,000
TOTAL	232	91	141	6,878,700

* Saskatchewan, Manitoba, New Brunswick, P.E.I, and Newfoundland do not have properties eligible for the tax exemption. Quebec has several properties that are eligible for the tax exemption. However, municipal taxation falls under provincial jurisdiction and the Province of Quebec has opted to provide the Grants in Lieu of taxes itself.

In light of the fact that 90 percent of the properties eligible for GILT representing 97 percent of the total value of the GILT are located in Ontario and in light of the Province of Ontario's recent move to market value assessment of properties, a review of the assessed values of properties located in Ontario would be timely.

Recommendations for JLA:

4. **Instruct PWGSC to proceed with a review of the assessed value of a sample of high value properties.**
5. **Following the results of the review, assess cost effectiveness of instituting cyclical reviews of assessed values of selected properties**

JLA Responses:

- 4. PWGSC is currently developing a risk assessment for the reassessment of properties. The risk assessment will outline the expected costs versus the anticipated benefits.**
- 5. JLA will determine the need for cyclical reviews of assessed values of selected properties upon completion of the PWGSC risk assessment.**

The MOU further outlines DFAIT's responsibilities relating to property assessments. They include:

- obtaining from owners of diplomatic property data necessary to establish its property value and provide to PWGSC;
- arranging for physical inspections of properties by PWGSC, when required, for valuation purposes; and,
- designating officers of DFAIT responsible for information on eligibility and valuation of diplomatic property.

Interviews with PWGSC and file review indicate that very little information on property valuation is passed on to PWGSC, that very few properties (approximately five or six in the last three years) are inspected for valuation purposes and that PWGSC is unaware of the existence of a DFAIT officer responsible for the provision of valuation information.

Recommendations for JLA:

- 6. Establish specific procedures with PWGSC to ensure that relevant data is provided and to ensure the appropriate physical inspections are undertaken, where possible.**
- 7. Identify a DFAIT officer responsible for the provision of information relating to the valuation of diplomatic properties.**

JLA Responses:

- 6. JLA has determined that there is no right under law for PWGSC to proceed with physical inspections of exempt properties as set out in the original MOU. The MOU is currently under revision and will reflect this. Other information will be provided to PWGSC as requested on a basis to be determined as part of the current risk assessment process.**

7. The revised MOU will identify a DFAIT officer responsible for the provision of information relating to the valuation of diplomatic properties.

Factoring of the Mill Rate

PWGSC reviews the municipal taxes which are assessed against each property using the appropriate mill rate and ensures that the calculations have been done correctly. PWGSC has in the past challenged the municipal calculation of the assessments but not the assessed value of the property. If municipal assessment differs, discrepancies are usually the result of an administrative error and are readily corrected. PWGSC is effectively discharging its responsibility in this regard.

GILT Payment

JLA's authorization of the payment of the GILT is based solely on the summary invoice provided by PWGSC. Neither, JLA nor XDC receives a detailed list of municipal taxes by property. Verification of eligible properties had not been done nor had attempts been made to verify and determine, if need be, the appropriate assessed values of diplomatic properties.

Discussions are also underway between JLA and XDC to determine whether the responsibility for the administration of GILT should continue to reside with JLA or whether XDC would be a more appropriate home.