# Chapter 3
# Department of Finance
# Tax Expenditure Programs

## Contents

# Department of Finance Tax Expenditure Programs

## Background

**3.1** We typically associate government programs with the expenditure budget. But not all government programs are offered in this manner. Governments are also offering programs using various tax revenues. Ever since the introduction of personal income tax, there have been deductions and exclusion programs that have reduced the tax revenue.

**3.2** These programs have the effect of reducing taxes paid by certain taxpayers and, as such, reducing the tax revenues otherwise due to the Province. These types of programs are commonly referred to as *tax expenditures*.

**3.3** There is no universally accepted definition of tax expenditures, although there appears to be general agreement on the concept. The Department of Finance of Canada has defined tax expenditures as follows.

> *Tax expenditures are foregone tax revenues, due to special exemptions, deductions, rate reductions, rebates, credits and deferrals that reduce the amount of tax that would otherwise be payable.*

**3.4** Tax expenditures can be viewed as providing financial assistance to certain groups of taxpayers or as providing economic incentives that encourage specific taxpayer behaviour.

**3.5** Some examples of provincial tax expenditure programs and the benefits to the affected taxpayers are identified in Exhibit 3.1.

**3.6** Tax expenditures affect the financial position of the Province in the same way as direct spending programs. A dollar in forgone revenue has the same impact on the Province's surplus or deficit as a one-dollar increase in direct expenditure. We believe that tax expenditure programs can have economic effects that are identical to government direct spending programs. In some situations, tax expenditures can be viewed as an alternative to direct expenditures.

*Exhibit 3.1*
*Examples of provincial tax expenditure programs*

| Tax | Program | Benefits to affected taxpayers |
|---|---|---|
| Personal income tax | New Brunswick low income seniors' tax benefit | $100 per year for seniors in receipt of either a Guaranteed Income Supplement, Allowance for Survivor or Extended Spouse's Allowance |
| Gasoline and motive fuel tax | Exemptions for aquaculturists, farmers, fishermen and silviculturists | Provides for point of sale tax exemptions on motive fuel and refund of tax on both gasoline and motive fuel |
| Real property tax | Assessment reduction program | Partial exemptions for qualifying properties owned by charitable and qualifying non-profit organizations |
| Personal income tax | Political contributions tax credit | Maximum $500 tax credit<br>• 75% of the first $200 of contributions<br>• 50% of the next $350 of contributions<br>• 33.33% of the next $525 of contributions |
| Corporate income tax | Labour incentive film tax credit | For corporations whose principle business is the production of films, a tax credit equal to a maximum of 40% of eligible salaries paid to New Brunswick residents. Wages in excess of 50% of the total costs of production are not eligible for consideration. |

**3.7** However, tax expenditure programs and direct expenditure programs are not presented to the Legislative Assembly in the same way in the annual budget approval process. As well, there is currently no information available publicly on the cost of the tax expenditure programs offered by the Province. There is no means of knowing whether these programs are achieving what they set out to accomplish. It is possible that a program could have achieved its purpose and is no longer a useful program for taxpayers.

## Scope

**3.8** Because of the number of tax expenditure programs, and the accountability issues surrounding them, we decided to focus our attention on this area.

**3.9** Our objective for this project was as follows:

*To examine and assess the processes of approving, monitoring, evaluating and reporting provincial tax expenditure programs.*

**3.10** We developed four audit criteria to use as the basis or standard for our audit. These were discussed with the Department of Finance and it was agreed that they were reasonable.

**3.11** We reviewed in detail a sample of four representative tax expenditure programs to examine the government process from the perspective of the four audit criteria.

**3.12** The following are the four programs reviewed:

| Tax | Program | Benefits to affected taxpayers |
|---|---|---|
| Gasoline and motive fuel tax | Tax exemptions on motive fuels for various classes of consumers | Provides for point of sale tax exemptions on motive fuel and refund of tax on both gasoline and motive fuel |
| Real property tax | Assessment reduction program | Partial exemptions for qualifying properties owned by charitable and qualifying non-profit organizations |
| Real property tax | Farm land identification program | Allows for the deferral of real property tax on registered farm land and real property |
| Personal income tax | Labour sponsored venture capital tax credit | Taxpayers who purchase shares of prescribed New Brunswick labour sponsored venture capital corporations are eligible for a 15% non-refundable provincial tax credit up to a maximum credit of $750 |

**3.13** We obtained audit evidence by reviewing documentation, conducting interviews and performing compliance testing of various departmental processes. We compared audit evidence against audit criteria to develop findings, recommendations and conclusions. We also reviewed practices in jurisdictions outside of New Brunswick.

**3.14** The majority of the work we conducted was in the Department of Finance. Given the broad nature of the responsibilities of the Department and its role in the taxation revenue programs, we concluded that such an audit focus was appropriate.

## Results in brief

**3.15 Tax expenditure programs are not subject to the same stringent scrutiny of the Legislative Assembly that is applied during the process of approving the yearly expenditure budget. The Legislative Assembly approves the establishment of these programs, but does not receive sufficient information on a regular basis to assess their continuing relevance and value.**

**3.16 The tax expenditure programs we examined did not have measurable objectives that would indicate what the program was expected to achieve.**

**3.17 There is no formal process in place to guide the monitoring and evaluation of tax expenditure programs.**

**3.18 There is no public reporting on the effectiveness of tax expenditure programs.**

## Approval of tax expenditure programs

**3.19** Our first criterion was:

*Tax expenditure programs should be properly approved.*

**3.20** Under long-established practice in the Province of New Brunswick, the Legislative Assembly is required to provide its prior approval for all expenditures of public money. It does this through appropriation acts. These acts are the major legislative control over government expenditures.

**3.21** The approval process for tax expenditure programs is not the same.

**3.22** The process required for the initial approval of a tax expenditure program appears to be quite rigorous. It involves enacting (or changing) legislation. This requires the sponsoring department to complete a Memorandum to the Executive Council using the procedures set out in the Procedures Manual for Executive Council Documents. The procedures require the completion of a policy analysis, which according to the manual is to include:

- why the proposal for the new or amending act is being made;
- what is being proposed;
- how the objectives will be accomplished;
- advantages and disadvantages of the proposal; and
- a description of the enforcement methods.

**3.23** The above procedures appear reasonable. However we are unable to confirm that they are performed because we have been refused access to all Executive Council documents.

**3.24** Senior Department of Finance staff advised us that revenue programs, including tax expenditure programs, cannot be created or changed without supporting statutory authority.

**3.25** Although we could not directly examine the approval process in support of the decision to create the tax expenditure programs, we were able to locate the legislative authority for all four of the programs we selected for review. While this satisfied us that appropriate approval had been given, we were concerned over the supporting information given to the Legislative Assembly. While we were informed that cost estimates underlying the foregone revenue are often received by the Legislative Assembly, there is no requirement that this information be made available at the time of approval. Another cost that should be reported, if it is significant, is the cost to administer the program.

**3.26** Each year the Main Estimates set out the estimated revenue amounts for the year. Although the revenue may be discussed, the legislators do not vote upon these amounts at budget time. Unless there is a requirement in the supporting legislation, tax expenditure programs are not subject to the same stringent scrutiny of the Legislative Assembly that is applied during the process of approving the yearly expenditure budget.

**3.27** Other jurisdictions have found that tax expenditure programs are subject to less budget scrutiny than direct expenditures. Funds spent through tax reductions are often insulated from competition with other spending priorities. Delivering programs using tax revenues can hinder the government's ability to assess accurately the value of such programs relative to other needs. And not treating tax expenditure programs in the same manner as direct expenditures can obstruct the formulation of a co-ordinated and consistent budget plan.

**3.28** Other jurisdictions have also found that once a program has been approved as part of the tax system, its ongoing relevance may never be challenged. The process of curbing tax expenditures programs is more difficult than for direct expenditures, in many cases, because the necessary financial information is not available to prompt and support the appropriate action.

***Recommendations***

**3.29 Government should provide financial information to the Legislative Assembly at the time when legislative approval is sought for a tax expenditure program.**

**3.30 Government should prepare information for the Legislative Assembly that would facilitate its scrutiny of tax expenditure programs on a regular basis.**

***Departmental response***

**3.31** *While there is no formal process that specifically states that financial information must be provided, financial information is always available when tax measures are introduced in the legislature and is almost always provided. There are mechanisms whereby cost projections are provided during the legislative process such as the introductory statement, at second reading or at the Committee of the Whole stage. However, the manner in which this information is provided is a decision of government. The Department has no jurisdiction in dictating what information is to be provided to the Legislative Assembly or when.*

**3.32** *The Department agrees in principle that more information should be provided on those tax expenditures that are most similar to expenditure programs. However, we would like to point out that the monitoring, evaluation and reporting of such programs requires resources and time. Therefore, the establishment of a reporting process should strike a reasonable balance between the costs and the benefits of conducting such evaluations.*

***Conclusion***

**3.33** Based on the representations made by the Department of Finance and results of the audit sample, we conclude that this criterion has been met. However, always providing cost projections to the Legislative

Assembly at the time of the initial approval of the programs would improve the approval process. And accountability would be strengthened if there were a means of approving the continuation of tax expenditure programs, following their initial implementation.

## Objectives of tax expenditure programs

**3.34** Our second criterion was:

*Tax expenditure programs should have measurable objectives.*

**3.35** There are a number of considerations when one is establishing a program. One of the most fundamental of these considerations is establishing measurable program objectives. The program objectives guide the program activity and are the reference point for dealing with challenges and changes to the program as it evolves. The objectives must be stated in terms that allow the comparison of actual results to the intended results, and they must facilitate a useful measurement of the performance of the program.

**3.36** Full accountability for performance requires those responsible for delivering government programs to be aware of what measurable objectives they are expected to achieve.

**3.37** As previously discussed, the Procedures Manual for Executive Council Documents requires the establishment of program objectives. The manual requires a description of the objectives and how they will be accomplished. We inquired about the existence of any provincial or departmental policy that outlines a requirement for tax expenditure programs to publicly disclose measurable program objectives (or expected outcomes). Senior Department of Finance staff advised us that there is no such policy.

**3.38** We reviewed available documentation and supporting legislation for four tax expenditure programs in an attempt to identify any measurable objectives.

**3.39** We found that in all four cases there is responsibility assigned for the delivery of the program. There are also eligibility criteria established to qualify for the tax expenditure programs. However, there are no clearly documented, measurable objectives that would indicate what the program was expected to achieve.

**3.40** For example, the Department of Agriculture, Fisheries and Aquaculture is responsible for delivering the Farm Land Identification Program. Based on discussions with departmental staff, we were able to identify that the purpose is to maintain agriculture land for agricultural use, and to prevent encroachment on agricultural land by urban and residential development. While we were encouraged to see that staff is aware of the thrust of the program, measurable objectives were not formally established. For example, the program could have an objective related to the percentage of farm land that is registered in the Province, or an objective of increasing the percentage of farm land area in the Province as compared to total land area.

**3.41** In the absence of measurable objectives, we believe that program administrators and legislators are not receiving sufficient information to allow them to develop a complete understanding of what to expect from the program.

***Recommendation***

**3.42 Government should establish measurable objectives for all tax expenditure programs.**

***Departmental response***

**3.43** *The Department agrees with this recommendation to the extent that program objectives are measurable and that the measurement can be conducted at a reasonable cost, such as in the case of the New Brunswick Film Tax Credit. However, for some programs, establishing measurable objectives and measuring the performance of the program are not easily quantifiable and may not be cost effective. In addition, most tax programs are easily measured using administrative objectives, but policy results are more difficult to quantify.*

***Conclusion***

**3.44** The criterion has not been met. There is no requirement that tax expenditure programs have measurable objectives, and we found that measurable objectives are not clearly documented for the programs examined.

## Monitoring and evaluating tax expenditure programs

**3.45** Our third criterion was:

> *Tax expenditure programs should be properly monitored and evaluated.*

**3.46** In identifying the existing monitoring and evaluation processes we noted the following:

- There is no government definition of a tax expenditure program. It is necessary to define what is meant by the term, to ensure there is a clear understanding by administrators, legislators and taxpayers.
- The cost of the tax expenditure programs in terms of foregone revenue is not normally established. Knowledge of the ongoing costs of a program in terms of both its administration cost and its impact on tax revenue is an important factor in its monitoring and evaluation.
- There is an absence of documented government policies and procedures that address the management of tax expenditure programs, specifically in the areas of monitoring and evaluating.
- There is no central body within government or within the Department of Finance to ensure monitoring and evaluation procedures are properly performed for all tax expenditure programs. The Department of Finance stated that they monitor and evaluate tax

expenditure programs for which they are responsible, but they do not have a formal program in place.

## Monitoring process

**3.47** Receiving information on performance on a regular basis gives the opportunity to take action where performance has not met expectations. To reach a decision on whether programs are properly monitored, we asked a number of questions for each of the four programs that we tested.

***Is it clear who has the responsibility to ensure beneficiaries qualify for the program?***

**3.48** We found that although there are no documented monitoring procedures, staff assigned to deliver the tax expenditure programs are taking steps to ensure that the beneficiaries of the program continue to qualify. For example, under the Labour Sponsored Venture Capital Program (LSVC) there are six individual LSVC funds. An individual within the Department of Finance has been assigned the responsibility to ensure that each of the funds continues to qualify under the program.

***Is there a systematic review of whether progress has been made towards meeting measurable objectives?***

**3.49** We did not find any evidence of performance indicators being used or reports being produced to effectively monitor the programs we reviewed. It was not clear, in any of the four programs we reviewed, if anybody was responsible for monitoring the program for the purpose of comparing results against objectives.

**3.50** For instance, under the Gasoline and Motive Fuel tax there are certain exemptions on both gasoline and motive fuel, for specified classes of consumers. The Department of Finance administers these exemptions and refunds. There are no reports being produced that measure the value of the exemptions to each exempted class of consumers (aquaculturists, farmers, fishermen, wood producers, vessel operators, etc).

***Is there a process in place to estimate the foregone revenue and the administrative costs of the program and to compare these estimates to actual results?***

**3.51** In only one case of the four programs reviewed were yearly estimates made of the impact that these individual programs would have on the provincial tax revenue. The administration costs were projected or measured in only one of the four programs.

**3.52** In all four cases the department responsible assured us that they were capable of determining the actual amount of foregone revenue for each tax expenditure program, however it is not routinely calculated. In no cases are projections of the costs of foregone revenue made for the year nor was a comparison made between actual and projected foregone revenues.

**3.53** As an example, Service New Brunswick (SNB) is responsible to administer the assessment reduction program under the *Real Property Tax Act*. An individual employed with SNB carries out the responsibilities on a part time basis. The costs of administering the program are neither projected nor measured. The amount of the foregone revenues is not projected. The actual revenue foregone is not calculated although sufficient information appears to be available to produce such information.

## Evaluation process

**3.54** One of the keys to the successful management of any program is the use of an appropriate evaluation process. The evaluation process should act as a means of ensuring that each tax expenditure program continues to perform at an acceptable level.

**3.55** The Department of Finance confirmed that there is no documented evaluation process in place for any of the tax expenditure programs that they administer. They stated that an informal evaluation is performed on some of the tax expenditure programs for which they are responsible.

**3.56** There are a number of important questions that should be asked in evaluating government programs, including tax expenditure programs.

- Is the program designed to serve an important public purpose?
- Is the program actually helping to achieve its goals?
- Are the benefits fairly distributed to those who need or deserve the assistance?
- Is the program well administered?
- Are there other programs in existence that would mean this particular program is not required?
- Is the level of service provided by the program satisfactory?
- Are there adequate documented sources of information available that the decision-makers can draw upon to complete an evaluation?
- Is there a clear process to renew the program?
- Why does the program continue to exist?
- Is program performance acceptable in view of the objectives?

**3.57** The Department of Finance did not have a documented program evaluation process in place. As well there was no recent program evaluation performed for the four programs that we reviewed. As a result we did not attempt to obtain answers to these types of questions.

### *Recommendations*

**3.58 Government should clearly identify its criteria for defining tax expenditure programs.**

**3.59 Government should commit to a process of regularly monitoring and evaluating the tax expenditure programs.**

***Departmental response***

**3.60** *The Department acknowledges that establishing criteria for a tax expenditure definition is a necessary first step in order to determine which programs are true tax expenditure programs to ensure there is a clear understanding between administrators, decision-makers and the public. There is not a common definition across jurisdictions and it is important that Government determines what is important and significant to New Brunswick.*

**3.61** *Various aspects of the tax system are reviewed on an ongoing basis, including tax concessions. These reviews are conducted with the objective of continued improvement to the fairness, transparency and efficiency of the tax system and to meet the priorities of government. The on-going monitoring and evaluation of all tax programs is an essential component of tax policy work. It would be inaccurate to assume that the monitoring and evaluation of tax expenditure programs is not done because there are no formal processes in place, or because the results are not made public.*

***Conclusion***

**3.62** Since there are no formalized procedures to guide the monitoring and evaluation of tax expenditures, and there are no organized and consistent approaches being followed in this regard, this criterion was not met.

## Reporting on effectiveness

**3.63** Our fourth criterion was:

> *The effectiveness of the tax expenditure programs should be reported publicly.*

**3.64** A requirement of a sound accountability process is the appropriate reporting of results in comparison with the planned targets or standards.

**3.65** Government's policy on annual reports states:

> *To the degree possible, departments and agencies should give a clear account of goals, objectives and performance indicators. The report should show the extent to which a program continues to be relevant, how well the organization performed in achieving its plans and how well a program was accepted by its client groups.*

**3.66** It is our view that tax expenditure programs should be subject to the same reporting requirements as other government programs.

**3.67** Our review of the four tax expenditure programs found that there is no public reporting on the effectiveness of the programs. For example the Labour Sponsored Venture Capital tax credit was introduced in 1993 effective for the 1993 to 1997 taxation years. In

1998, the *Income Tax Act* was amended to allow for the extension of the program by regulation on an annual basis. The effectiveness of this program has not been publicly reported. The need for public reporting is particularly critical for tax expenditure programs because the full costs of such programs is not placed before the Legislative Assembly for approval on an annual basis, as is the case for direct expenditures. Nor are the results reported at the end of each year in the Public Accounts, as is the case for direct expenditures.

***Tax expenditures reporting outside of New Brunswick***

**3.68** We reviewed practices followed by governments outside New Brunswick. We found that a number of other Canadian jurisdictions have implemented reporting on tax expenditure programs, although most restrict themselves to reporting estimates of the tax revenues foregone.

**3.69** For example, British Columbia publishes estimates of tax expenditure programs. It is published with their budget documentation, and it is called a “Tax Expenditures” report. As well as defining tax expenditures and their role, the report estimates the cost of each tax expenditure program. The report also addresses the criteria that British Columbia uses to choose features of the tax system that should be reported as tax expenditures. The 2000 report stated: “the emphasis is on tax reductions, exemptions and refunds that are close equivalents to spending programs. … By implication, the list does not include tax measures designed to meet broad tax policy objectives such as improving fairness in the tax system, or measures designed to simplify the administration of the tax.”

**3.70** The Government of Canada and the Province of Saskatchewan also publish documents which estimate the value of individual tax expenditures. In the United States thirty-seven of the fifty states publish tax expenditure budget reports.

**3.71** Our research indicated that one of the most advanced jurisdictions for managing tax expenditures is the state of Oregon. They not only estimate tax expenditures, they also produce a report which evaluates individual tax expenditure programs.

**3.72** The Oregon philosophy is to manage tax expenditures in a similar manner to direct expenditures “because they (tax expenditures) provide special benefits to favoured individuals or businesses, and thus result in higher tax rates for all individuals…”. The state prepares a biennial report on tax expenditures that allows the public and policy makers to identify and analyze tax expenditures and to periodically make criteria-based decisions on whether the tax expenditures should be continued. The report allows tax expenditures to be debated in conjunction with direct expenditure budgets. The result is the elimination of inefficient and inappropriate tax expenditures and a greater accountability by government.

***Recommendation***

**3.73 Government should report publicly on the effectiveness of tax expenditure programs. This reporting should be consistent with the Province's annual report policy, particularly with respect to addressing the programs' continuing relevancy and the achievement of planned performance.**

***Departmental response***

**3.74** *The Department agrees with the principle underlying this recommendation and feels that it may be appropriate for those tax expenditures that are most similar to direct expenditures. However, reviewing the effectiveness of all tax expenditure programs and reporting annually may not be cost effective. The provision of public estimates and analysis on an annual basis would require significant additional resources.*

***Conclusion***

**3.75** The criterion was not met. The effectiveness of tax expenditure programs is not reported publicly.