

1998-1999  
BUDGET

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# Maintaining a Sound Tax System

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## Summary

This paper describes the additional measures to maintain a sound tax system contained in the 1998-1999 Budget Speech. It also discusses the results of the measures taken in this regard in recent years, mentioning in particular that the government has achieved its objectives. Accordingly, in three years, \$2.7 billion in revenue has been recovered thanks to measures taken to curb unreported work and tax evasion, including \$1.3 billion for 1997-1998 alone. They have already cut the tax losses associated with unreported activities in Québec by one quarter, and further reductions are expected. In this regard, the continuation of existing measures means that fewer and fewer individuals and companies will hide their activities or engage in practices to avoid paying their taxes. In addition, this Budget Speech introduces a series of measures to promote reporting of activities in the clothing sector and to ensure that workers benefit fully from reporting their tips.

# Maintaining a sound tax system

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## Introduction

This paper describes the additional measures designed to maintain a sound tax system contained in the 1998-1999 Budget Speech, and discusses the results of the measures taken in this regard over the last three years.

It also indicates that, in accordance with the recommendations of the 1996 Commission on Taxation and the Financing of Public Services, the government plans to place more emphasis on incentive and preventive measures to maintain a sound tax system. In this regard, new measures targeting certain sectors of activity will encourage more companies and individuals to abstain from unreported work and tax evasion.

The first section of the paper gives the results of the measures taken by the Québec government to maintain a sound tax system and discusses the progress made in reducing the size of the underground economy. It mentions in particular that over the last three years, these measures have helped recover \$2.7 billion. In addition, these efforts have reduced the size of the clandestine economy by almost one quarter.

The second section shows that this progress stems from more intensive audit and collection activities by the ministère du Revenu and the efforts made by other departments and agencies to reduce illegal activities and unreported work. It also concludes that the continuation of these measures should help reduce the number of individuals and companies that fail to report their activities.

Lastly, the third section describes the additional measures that will be implemented in 1998-1999 to curb unreported work in the clothing sector and ensure that workers benefit fully from reporting of tips.

## **1. MAINTAINING A SOUND TAX SYSTEM: OVERALL RESULTS AND GUIDELINES FOR THE FUTURE**

In recent years, particularly in the restaurant and hotel sector, events associated with unreported work and tax evasion have frequently made the headlines.

The Québec government is concerned by this issue and, since 1995, has announced a series of measures to reduce the tax losses associated with unreported work and tax evasion.

In its report, the Commission on Taxation and the Financing of Public Services indicated that the phenomenon of tax evasion was a central concern of ordinary citizens since it undermined the credibility of the tax system and encouraged organized crime. A paper prepared for the Commission<sup>1</sup> indicated that, based on data for 1994, the clandestine economy cost the Québec government some \$1.9 billion in annual tax losses.

This section describes the overall results of the measures the government has taken during the last three years to curb unreported work and tax evasion. It also includes a reassessment of the tax losses attributable to the clandestine economy for 1997, discusses the progress made and describes the guidelines for the future.

### **1.1 Objectives achieved: \$2.7 billion recovered**

Overall, the tax recovery objectives associated with the measures to curb the underground economy have been achieved. Over the last three years, these measures have led to the recovery of \$2.7 billion in supplementary revenue, including \$1.3 billion in fiscal 1997-1998. Without them, additional spending reductions or tax increases would have been required to achieve the government's deficit objectives.

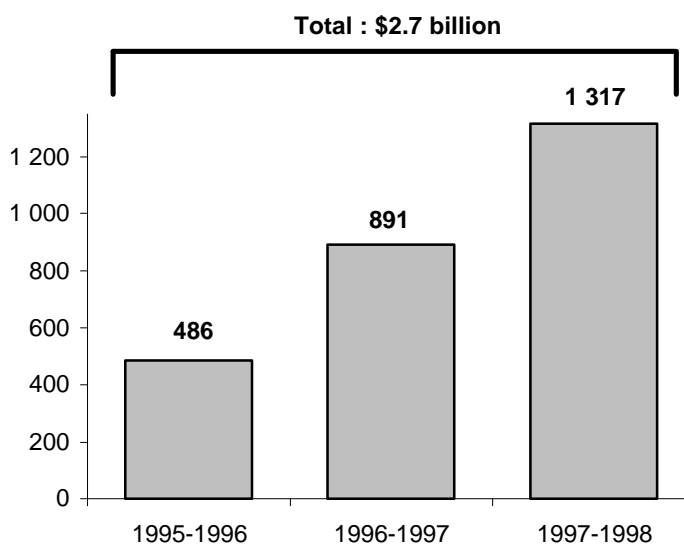
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<sup>1</sup> Commission on Taxation and the Financing of Public Services (1996). — *The Underground Economy, Unreported Work and Tax Evasion*. — Québec: Les Publications du Québec.



GRAPH 1

**YIELD OF MEASURES TAKEN TO CURB THE UNDERGROUND ECONOMY  
1995-1996 to 1997-1998**  
(in millions of dollars)



Of the \$2.7 billion in revenue recovered, 58.1% stems from the increased audit activities of the ministère du Revenu. The remaining 41.9% results from the efforts of other departments and agencies to curb unreported work in the construction industry and curb illegal activities such as the illegal trade in alcoholic beverages, the operation of illegal video lottery terminals and the activities of organized crime.

TABLE 1

**YIELD OF MEASURES BY TYPE OF ACTIVITY<sup>1</sup>****Total for 1995-1996 to 1997-1998**

(in millions of dollars)

	<b>Amount</b>	<b>Proportion %</b>
<b>Ministère du Revenu</b>		
— Audit activities	1 566	58.1
<b>Other departments and agencies</b>		
— Curb illegal activities	869	32.3
— Curb unreported work in construction	200	7.4
— Other measures	59	2.2
Sub-total	1 128	41.9
<b>TOTAL</b>	<b>2 694</b>	<b>100.0</b>

1 Preliminary results.

The positive effects of these measures go far beyond their yield which is used to achieve the government's financial objectives. By having each taxpayer pay his fair share of taxes, these actions reinforce taxpayer confidence, which is essential to the smooth operation of our institutions.

In addition, they improve the situation both of individuals and companies. Individuals, if they are workers, receive better social protection on their income such as the Québec Pension Plan and employment insurance. If they are consumers, their purchases are guaranteed and they have recourse if they feel they have been wronged. And as a result of these measures, companies are assured of doing business in a climate of fair competition that fosters job creation.

## 1.2 Significant reduction in the clandestine economy

On the basis of these results, it is estimated that clandestine activities have been reduced by one quarter.<sup>2</sup> Up to now, it has been estimated that the government's annual tax losses associated with these activities amounted to \$1.9 billion. This assessment has been updated for 1997 and indicates that, had nothing been done, the tax losses associated with the clandestine economy would have continued to rise, reaching \$2.1 billion.<sup>3</sup>

It is estimated that the annual tax losses associated with clandestine activities have been cut by \$509 million, or 23.8%, reducing them to \$1.6 billion. This assessment corresponds to legal economic activities of \$6.2 billion unreported to the tax authorities.<sup>4</sup>

TABLE 2

### ESTIMATE OF THE CLANDESTINE ECONOMY AND ASSOCIATED TAX LOSSES Québec 1994 and 1997 (in billions of dollars)

	Unreported activities		Tax losses	
	1994	1997	1994	1997
<b>In the absence of measures<sup>1</sup></b>	7.0	8.2	1.9	2.1
— Impact of measures	—	-2.0	—	-0.5
<b>After measures</b>	7.0	6.2	1.9	1.6
— Impact of measures in percentage	—	-23.8	—	-23.8

1 Clandestine economy and tax losses had nothing been done to curb the situation.

2 The clandestine economy consists of legal economic activities that are not reported to the tax authorities by corporations, self-employed workers or individuals who engage in them. It differs from the underground economy because it excludes all illegal economic activities, such as those related to prostitution and drugs. In addition, the clandestine economy does not include tax evasion associated with non-productive economic activities, such as the unauthorized use of certain credits or deductions, undeclared capital gains and undeclared income earned outside the country. For more details, see: Commission on Taxation and the Financing of Public Services (1996), *ibid*.

3 Estimate obtained by applying rates of evasion for 1994 to the spending in the most recent Québec economic accounts. For more details, see Addendum 1.

4 On this basis, the clandestine economy accounts for 3.3% of gross domestic product compared with 4.2% in 1994.

As Table 3 shows, the progress achieved is all the more significant given that in addition to the \$509 million arising from the reduction of the clandestine economy regarding 1997-1998, there is also additional revenue from other sources. A further \$249 million was recovered from unreported activities carried out prior to 1997-1998, \$340 million from the curbing of illegal activities, \$181 million from other tax audits and \$103 million in other revenue such as interest charges, penalties, fines, etc. In all, by maintaining the measures taken to date, the government recovers close to \$1.4 billion annually.

TABLE 3

**ANNUAL YIELD OF MEASURES BY SOURCE AND TYPE OF ACTIVITY<sup>1</sup>**

(in millions of dollars)

Type of activity	Source of revenue						
	Underground economy				Other tax audits <sup>2</sup>	Other revenue	TOTAL
	Reduction in unreported activities		Reduction in illegal activities	Total			
	Current year	Previous years <sup>3</sup>					
<b>Ministère du Revenu</b>							
— Audit activities	293	249	—	542	181	81	804
<b>Other departments and agencies</b>							
— Curb illegal activities	47	—	340	387	—	8	395
— Curb unreported work in construction	79	—	—	79	—	6	85
— Other measures	90	—	—	90	—	8	98
Sub-total	216	—	340	556	—	22	578
<b>TOTAL</b>	<b>509</b>	<b>249</b>	<b>340</b>	<b>1 098</b>	<b>181</b>	<b>103</b>	<b>1 382<sup>4</sup></b>

1 Preliminary results.

2 Includes revenue associated with non-productive economic activities such as the unauthorized use of a deduction or credit by a taxpayer, undeclared capital gains or undeclared income earned outside the country.

3 The tax audits of the ministère du Revenu may bear on the previous three years.

4 To better illustrate the progress achieved in reducing the size of the clandestine economy, this amount includes the financial impact over a full year of the measures concerning the reporting of tips, which became effective January 1, 1998. Accordingly, \$65 million has been added to the \$1 317 million shown in Graph 1 for fiscal 1997-1998.

## Tax losses reduced in all sectors of activity

Unreported activities have been reduced in all sectors, especially where they were most extensive, such as the food and lodging, and construction and renovation sectors.

In the food and lodging industry, the combined effect of measures to curb the illegal trade in alcoholic beverages, the additional audits by the ministère du Revenu and the measures taken to increase the reporting of tips have reduced tax losses associated with unreported activities by 25%. The reduction in the construction sector is 26.4% while the average for all other sectors is 21.1%.

TABLE 4

### TAX LOSSES ASSOCIATED WITH THE CLANDESTINE ECONOMY BY ACTIVITY SECTOR Québec 1997

Sector of activity	Tax losses before measures <sup>1</sup>		Impact of measures <sup>2</sup>		Tax losses in 1997		Change %
	Amount	Proportion	Amount	Proportion	Amount	Proportion	
	\$M	%	\$M	%	\$M	%	
Food and lodging	785	36.7	196	38.5	589	36.1	-25.0
Construction and renovation	515	24.1	136	26.7	379	23.2	-26.4
Automobile	210	9.8	29	5.7	181	11.1	-13.8
Clothing, textiles and jewelry	170	7.9	34	6.7	136	8.4	-20.0
Professional services	50	2.3	15	2.9	35	2.1	-30.0
Transportation	40	1.9	7	1.4	33	2.0	-17.5
Other sectors	370	17.3	92	18.1	278	17.1	-24.9
<b>TOTAL</b>	<b>2 140</b>	<b>100.0</b>	<b>509</b>	<b>100.0</b>	<b>1 631</b>	<b>100.0</b>	<b>-23.8</b>

1 Tax losses if no measures had been taken.

2 Preliminary results.

### **1.3 Encourage more taxpayers to declare their activities**

The approach used over the last three years has reduced the size of the underground economy and helped recover a significant portion of the associated tax losses. However, substantial progress can still be made. To do so, two approaches will be followed:

- continuation of the existing measures, notably in those sectors where unreported activities are more prevalent;
- the introduction of incentive measures to encourage more taxpayers to comply with the law.

The continuation of the measures taken over the last three years will help not only to preserve the gains made at the expense of the underground economy, but also to extend them. The wider range of audit and control activities will encourage more taxpayers to comply voluntarily with the law while, as indicated in the following section, some measures will achieve their full effect only gradually.

In addition, the new measures stipulated in the Budget Speech, as described in the third section of this paper, will encourage individuals and companies to report all their activities.

## 2. RESULTS OF THE MEASURES TAKEN SINCE THE FALL OF 1994

Over the last three years, the efforts to curb unreported work and tax evasion have focused mainly on:

- increasing the audit activities of the ministère du Revenu (MRQ);
- implementing specific measures by other departments and agencies.

Additional funding has been provided to enable the MRQ and other departments and agencies to intensify and improve their activities to combat the underground economy. The MRQ received \$80 million over the last year<sup>5</sup> while \$32 million has been granted to other departments and agencies.

The intensification of the MRQ's audit activities has helped generate more than half the total yield of the existing measures, i.e., \$1.6 billion of the \$2.7 billion in additional revenue.

*Note: The effects of the measures taken by the departments and agencies consist of three components:*

- **direct effects**, namely the revenue drawn mainly from taxes and fines which some taxpayers must pay as a result of audits, inspections or investigations;
- **recurring effects**, namely the taxes of the current year from taxpayers who comply with the law after having been found in violation in previous years;
- **incidental effects**, namely the taxes from taxpayers who have decided to comply voluntarily, either because of the increased risk of being caught or to avail themselves of the benefits associated with reporting their income.

*In this paper, all of these effects have been considered, with the exception of incidental effects of the audit activities of the ministère du Revenu. It will only be possible to estimate the latter with reasonable accuracy once detailed personal income tax and corporate income tax statistics are available for more recent years.<sup>6</sup>*

<sup>5</sup> The increase in additional funding for the MRQ has been gradual: almost \$20 million was granted in 1995-1996, \$30 million more in 1996-1997 and an additional \$30 million in 1997-1998 for a total of \$80 million.

<sup>6</sup> The most recent tax statistics concern taxation year 1995 for personal income tax and 1994 for corporate income tax.

TABLE 5

**YIELD OF MEASURES TAKEN TO CURB THE UNDERGROUND ECONOMY  
1995-1996 to 1997-1998**  
(in millions of dollars)

	1995-1996	1996-1997	1997-1998 <sup>1</sup>	TOTAL
<b>Ministère du Revenu</b>				
— Audit activities				
• Direct effects	241	446	677	1 364
• Recurring effects	22	53	127	202
<b>Sub-total</b>	<b>263</b>	<b>499</b>	<b>804<sup>2</sup></b>	<b>1 566</b>
<b>Other departments and agencies<sup>3</sup></b>				
— Curb illegal activities	178	296	395	869
— Curb unreported work in construction	45	70	85	200
— Other measures	0	26	33	59
<b>Sub-total</b>	<b>223</b>	<b>392</b>	<b>513</b>	<b>1 128</b>
<b>TOTAL</b>	<b>486</b>	<b>891</b>	<b>1 317</b>	<b>2 694</b>

1 Preliminary results.

2 Includes \$293 million to curb unreported activities for the current year, consisting of \$127 million in recurring effects and \$166 million in direct effects.

3 The revenue from measures taken by the other departments and agencies does not include the yield from audit activities of the ministère du Revenu arising from their actions, which is included in the results of the ministère du Revenu.

## 2.1 Increased activity by the ministère du Revenu

Because of its responsibility to enforce tax compliance and collect most of the government's own-source revenue (more than 85%), the ministère du Revenu du Québec (MRQ) is the key player in combating unreported work and tax evasion. Accordingly, it has received additional resources in recent years to:

- intensify and improve its audit activities;
- make taxpayers aware of the consequences of tax evasion;
- take corrective action where necessary to encourage tax compliance.



These measures have produced substantial results. Since fiscal 1993-1994, assessment revenue resulting from audit activities of the MRQ increased by almost 143%, from \$485 million to \$1 176 million for fiscal 1997-1998. This result stems from the combination of increased regular audit activities (\$14 million) and additional activities (\$677 million) arising from the supplemental resources granted to the department.

Accordingly, the revenue generated by audit activities now accounts for 4.0% of the \$29.1 billion collected by the MRQ, compared with 2.0% four years ago. This figure is more consistent with the level of intensity that must be maintained to prevent the proportion of individuals and companies engaging in tax evasion from rising too high. In this regard, the increase in audit activities has already had a substantial carry-over effect and is encouraging more taxpayers to voluntarily declare all their income. It is estimated that the recurring effects alone of these audits generated additional revenue of \$127 million in 1997-1998.

TABLE 6

**YIELD OF AUDIT ACTIVITIES OF THE MINISTÈRE DU REVENU<sup>1</sup>****1993-1994 to 1997-1998**

(in millions of dollars)

	Amounts recovered					Change	
	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998 <sup>2</sup>	97-98/93-94	
						\$M	%
<b>Audit activities</b>							
— Regular audits <sup>3</sup>	485	491	497	472	499	14	2.9
— Additional audits since the fall of 1994 <sup>4</sup>	—	126	241	446	677	677	—
<b>Sub-total</b>	<b>485</b>	<b>617</b>	<b>738</b>	<b>918</b>	<b>1 176</b>	<b>691</b>	<b>142.5</b>
<b>Total revenue collected by the MRQ</b>	24 745	25 306	26 965	27 250	29 131	4 386	17.7
<b>Audit activities as a % of total revenue</b>	2.0	2.4	2.7	3.4	4.0	—	—

1 Excluding the recurring effects shown in Table 5.

2 Preliminary results.

3 Resulting from the department's basic funding.

4 Resulting from the additional funding.

## Intensification and improvement of audit activities

To intensify its activity, the ministère du Revenu hired an additional 1 630 employees. They are distributed among its various branches and are essentially assigned to auditing, assessment and information processing.

In addition, the ministère du Revenu has improved its efforts to combat tax evasion by acquiring new resources, in particular:

- an administrative unit created specifically to combat tax evasion, the Bureau de lutte contre l'évasion fiscale;<sup>7</sup>
- acquisition of a data processing centre;
- more extensive exchange of information;
- new auditing methods;
- improving the information obtained from taxpayers.

These measures have made it possible to substantially increase the number of files analyzed. For instance, the number of files audited rose from 38 000 in 1993-1994 to more than 65 000 in 1997-1998.

In addition, the results will be even more significant once all the measures implemented are fully effective. The data processing centre is being installed this year and will be fully operational within a few months. This facility will be able to quickly access and process a large volume of data while maintaining confidentiality of information. Its full utilization will improve the department's actions.

Furthermore, new auditing methods have been tested in pilot projects over the past year. In particular, they allow an integrated audit of a taxpayer's file (taxes and source withholdings) or the detection of inconsistencies among data obtained from various taxpayers such as suppliers, intermediaries and customers. Once tested, they will be used on a larger scale, which will also help optimize the yield of audit activities.

Accordingly, over the next few years, the additional audit staff, together with more effective tools, will increase the department's auditing capacity. This will encourage more and more individuals and companies to declare all their activities, which should lead to the recovery of an even greater proportion of amounts that previously went uncollected.

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<sup>7</sup> The Bureau de lutte contre l'évasion fiscale, which consists of about 50 employees, is mandated to identify the sectors in which unreported work and tax evasion are most prevalent, and develop new auditing methods. It also coordinates measures to combat tax evasion for the ministère du Revenu. Creation of this unit is consistent with the recommendations of the Commission on Taxation and the Financing of Public Services.

### **Making taxpayers aware of the consequences of tax evasion**

When individuals believe unreported work and tax evasion are immoral, they are less inclined to engage in them. Education and sensitization of economic agents to the problems caused by unreported work and tax evasion can contribute to solving them, at least in part.

In addition, these activities will become less popular among consumers if they are more aware of the additional tax burden they must bear to offset the losses arising from clandestine economic activities.

For these reasons, the MRQ's plan for combating tax evasion includes a preventive section. To inform the public of the consequences of the clandestine economy, an awareness campaign was launched in the fall of 1996 (*"Under the table... never!"*). The campaign, which includes advertising messages, essentially seeks to remind the public that all people must assume their tax responsibilities to secure their future and avoid increasing the tax burden of future generations.

The results of a survey done in June 1997 show that 19% of people who have seen this advertising say it has already had an effect on their behaviour. These results are encouraging, considering that such an approach is designed especially for medium and long-term gains.

### **Make the corrections necessary to encourage tax compliance**

In some sectors where tax evasion is more pervasive, audits alone are not enough or are not a lasting solution. In these situations, changes are sometimes necessary to encourage the reporting of income.

The generalized under-reporting of income from tips, which used to be widespread in the restaurant and hotel sector, is a good example. To compensate for the fact that reported tips were not eligible for employment insurance, most employees earning tip income in this sector did not declare them to the tax authorities. To prevent the problem from persisting, the government implemented a series of measures which provide these employees with full social protection, notably employment insurance, and encourage the reporting of tips.

Over the next few years, emphasis will be placed on appropriate corrective measures in sectors where similar problems are identified.

## 2.2 Measures by other departments and agencies

To support the ministère du Revenu, other departments and agencies have intensified their actions in their respective fields, contributing to curb unreported work and tax evasion. In this way, the range of actions has been extended and the effectiveness of the steps taken improved.

For instance, the involvement of the Commission de la construction du Québec and the Régie du bâtiment du Québec has helped implement specific measures to curb unreported work in the construction industry. Similarly, the ministère de la Sécurité publique and police forces have intensified their operations to curb illegal activities and reduce their effects on unreported work and tax evasion.

To fund these measures, \$10 million in additional appropriations was granted for fiscal 1996-1997 and \$32 million for fiscal 1997-1998, the latter amount allocated from the budget provision "Collecting all the revenue owed to the government" of the ministère des Finances.<sup>8</sup>

During the last year, among other things, \$18 million was earmarked to combat illegal activities and \$9 million was set aside to curb unreported work in the construction industry. In all, these measures generated additional revenue of \$1.1 billion over the last three years, including \$513 million for fiscal 1997-1998.

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<sup>8</sup> This provision was set up in the 1997-1998 Budget Speech. The estimates are allocated to departments and agencies on the basis of specific projects, submitted to the ministère des Finances and the Conseil du trésor for approval, and designed to collect all the revenue owed to the government.

TABLE 7

**ESTIMATES ALLOCATED TO OTHER DEPARTMENTS AND AGENCIES  
1997-1998**  
(in millions of dollars)

Measures	Departments and agencies <sup>1</sup>	Estimates
<b>Curb illegal activities</b>		
— Curb the illegal trade in alcoholic beverages	MSP, MJQ, SQ, RACJ	11
— Combat organized crime	MSP, MJQ, SQ	7
Sub-total		18
<b>Curb unreported work in the construction industry</b>	CCQ, RBQ, MJQ	9
<b>Other measures</b>	MJQ, IGFI, CRSR	5
<b>Total</b>		<b>32</b>

1 Abbreviations: Ministère de la Sécurité publique (MSP), ministère de la Justice (MJQ), Sûreté du Québec (SQ), Régie des alcools, des courses et des jeux (RACJ), Commission de la construction du Québec (CCQ), Régie du bâtiment du Québec (RBQ), Inspector General of Financial Institutions (IGFI), and Centre de recouvrement en sécurité du revenu (CRSR).

### 2.2.1 Curb illegal activities

The illegal trade in alcoholic beverages, the operation of illegal video lottery terminals and the operations of criminal organizations make a substantial contribution to the growth of the clandestine economy since they provide fertile ground for unreported work and tax evasion.

For instance, buying alcoholic beverages on the illegal market, in addition to avoiding taxes on these products, can enable holders of liquor permits to more easily hide a portion of their sales from the tax authorities or to hire unreported workers. Similarly, illegal video lottery terminals enable some merchants to avoid taxation on the commissions and profits they earn from them. Finally, the activities of criminal organizations generate income that is not declared and on which tax is not collected.

For these reasons, specific measures have been taken to:

- curb the illegal trade in alcoholic beverages;
- curb the operation of illegal video lottery terminals;
- combat the activities of organized crime.

In addition to the positive effects in terms of public security, these measures have generated total revenue of \$395 million in fiscal 1997-1998.

TABLE 8

**YIELD OF MEASURES TO CURB ILLEGAL ACTIVITIES<sup>1</sup>**

**1997-1998**

(in millions of dollars)

Measures	Amount
Curb the illegal trade in alcoholic beverages	54
Curb the operation of illegal video lottery terminals	321
Curb the activities of organized crime	20
<b>Total</b>	<b>395</b>

1 Preliminary results.

### **Curb the illegal trade in alcoholic beverages**

The illegal trade in alcoholic beverages imperils the health of consumers, swells the coffers of organized crime and causes substantial tax losses for the government.

Accordingly, a large number of measures have been taken to reduce the supply of and demand for illegal alcoholic beverages. These initiatives involve:

- intensifying control and surveillance activities;
- imposing heavier penalties on violators.

To ensure that these measures are effective, the cooperation of the stakeholders concerned, namely the ministère de la Sécurité publique, police forces, the Régie des alcools, des courses et des jeux, the ministère de la Justice and the ministère du Revenu, has been enlisted.

It is estimated that for fiscal 1997-1998, the actions taken have generated \$54 million in revenue, in particular from:

- taxes collected as a result of higher sales by the Société des alcools du Québec (SAQ);
- fines imposed on violators and taxes arising from the reporting of higher sales by holders of liquor permits who have stopped purchasing illegal supplies.

TABLE 9

### YIELD OF MEASURES TO CURB THE ILLEGAL TRADE IN ALCOHOLIC BEVERAGES<sup>1</sup>

1997-1998

(in millions of dollars)

Sources of revenue	Amount
<b>Alcoholic beverages</b>	
— Tax revenue	13
— SAQ profits	25
Sub-total	38
<b>Other revenue<sup>2</sup></b>	16
<b>Total</b>	<b>54</b>

1 Preliminary results.

2 Including fines, court costs and taxes.

### Control and surveillance operations

The higher profits reported by the SAQ in recent years are partially attributable to a significant increase in the number of inspections of establishments operated by holders of liquor permits and the increase in operations designed to dismantle supply networks for illegal alcohol. These operations have eroded the demand for illegal products and considerably weakened the capacity of these networks to supply the clandestine market. The deterrent effect of these operations has been reinforced by the systematic transfer of cases of violation to the Régie des alcools, des courses et des jeux, the ministère de la Justice and the ministère du Revenu.

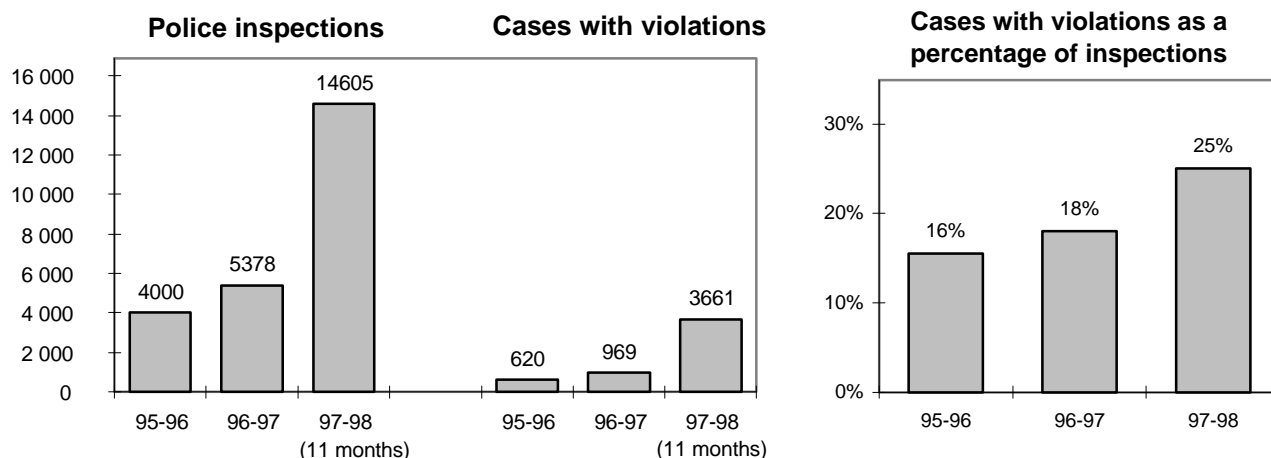
### Significant increase in police operations

To support the efforts of the Sûreté du Québec and the Service de police de la Communauté urbaine de Montréal to curb the illegal trade, more than 30 municipal police forces were specially mandated in 1997-1998 to participate in inspections. Accordingly, the number of inspections rose from 5 378 in 1996-1997 to more than 14 600 in 1997-1998.

Furthermore, to make these operations more effective, police forces have received special training in the enforcement of the *Act respecting liquor permits*<sup>9</sup> and the *Act respecting offences relating to alcoholic beverages*.<sup>10</sup> In addition, some establishments have been inspected more than once during the year. Accordingly, the percentage of liquor permit holders found in violation of the law has risen from 18% in 1996-1997 to 25% in 1997-1998.

GRAPH 2

#### ILLEGAL TRADE IN ALCOHOLIC BEVERAGES: POLICE INSPECTIONS AND VIOLATIONS UNCOVERED 1995-1996 to 1997-1998



Source: Ministère de la Sécurité publique.

Lastly, the number of investigations designed to dismantle illegal networks has risen appreciably, from 30 in 1996-1997 to more than 170 in 1997-1998. In this regard, during the past year, two large distilleries were dismantled, one in L'Ascension and the other in Namur, with a total annual potential output accounting for almost 15% of Québec's illegal market for spirits.

<sup>9</sup> This Act notably sets out the conditions for issue and operation of a liquor permit.

<sup>10</sup> This Act notably establishes the rules and obligations for possession, transportation and sale of alcoholic beverages in Québec.



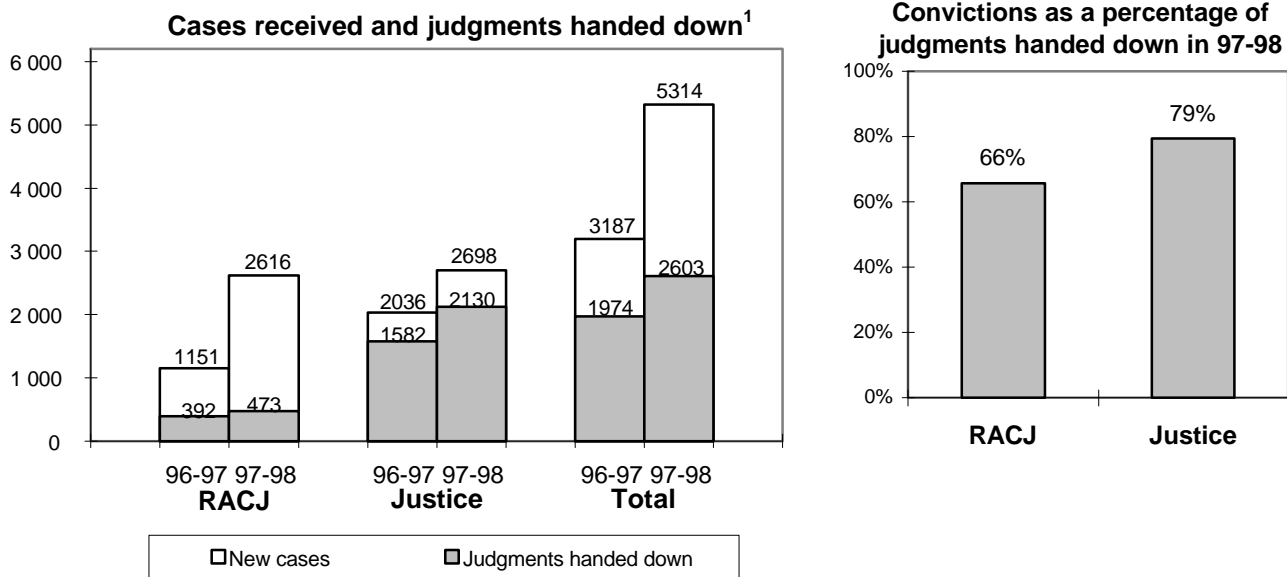
### Systematic transfer of cases of violation

Police operations have had added impact because of the systematic transfer and processing of cases of violation. During the first eleven months of 1997-1998:

- the ministère de la Justice and the Montréal Municipal Court received 2 698 new cases from police departments compared with 2 036 in 1996-1997 and, to date, have handed down, 2 130 judgments, including 1 691 convictions under the *Act respecting offences relating to alcoholic beverages*;
- the Régie des alcools, des courses et des jeux has received 2 616 new cases from police departments, compared with 1 151 in 1996-1997 and, to date, has handed down 473 decisions, including 280 liquor permit suspensions and 30 cancellations;
- the ministère du Revenu has received 1 328 additional files for audit compared with 970 for the entire period from April 1994 to March 1997.

GRAPH 3

#### ILLEGAL TRADE IN ALCOHOLIC BEVERAGES: PROCESSING OF CASES OF VIOLATION 1996-1997 to 1997-1998



Sources: Ministère de la Justice, Montréal Municipal Court and Régie des alcools, des courses et des jeux.

<sup>1</sup> The difference between the number of judgments and the number of files received is attributable to the cases waiting to be heard or whose processing has been postponed.

The vast majority of violations uncovered have resulted in sanctions. Accordingly, 66% of the decisions handed down by the Régie des alcools, des courses et des jeux have resulted in sanctions while the proportion is 79% for cases forwarded to the ministère de la Justice and to the Montréal Municipal Court.

### Harsher penalties

A number of amendments designed to toughen the *Act respecting liquor permits* and the *Act respecting offences relating to alcoholic beverages* have been adopted over the past three years. In particular, they aimed at:

- reducing the discrepancy between the profits that can be made from the illegal alcohol trade and the sanctions provided by the Acts;
- preventing offenders from getting away with their illegal activities by refining them (better ways of concealing illegal products, reduction of stocks of illegal products kept on the premises, etc.).

Also, to dissuade liquor permit holders from obtaining their alcohol from illegal sources, the minimum penalties provided by the *Act respecting liquor permits* have been increased. Now, suspension of liquor permits is mandatory in case of violation, for at least 60 days in the case of the sale of alcoholic beverages that are made with smuggled goods or goods manufactured illegally and for at least 30 days in the case of the sale of alcoholic beverages that are not labelled or marked by the Société des alcools du Québec or by the brewery, and on which the duties and taxes have not all been paid.<sup>11</sup>

In addition, the sanctions were made generally harsher, particularly the fines stipulated in the *Act respecting offences relating to alcoholic beverages*. These fines have more than doubled, and even tripled in some cases. For example, a person who is found in possession of illegal alcoholic beverages will be fined \$500 to \$1 000 for a first offence, \$1 000 to \$2 000 for a second offence and between \$2 000 and \$5 000 for further offences. Before, the fines were between \$175 and \$1 400, depending on the case.

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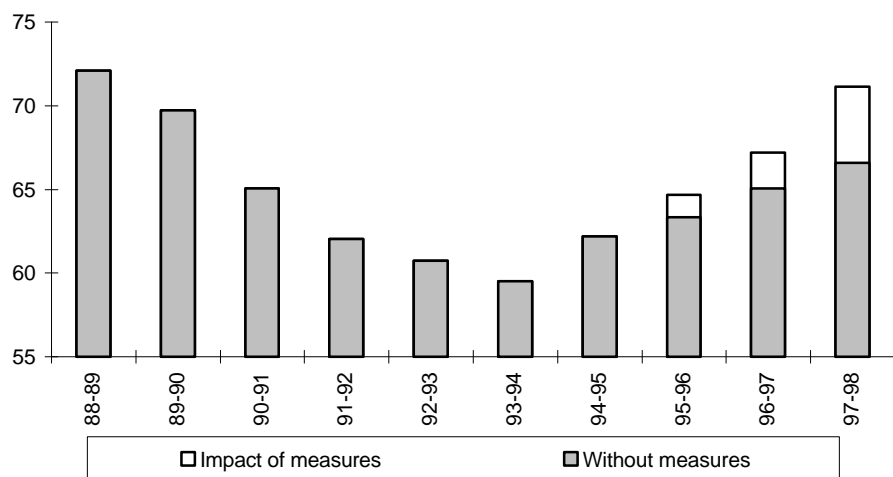
<sup>11</sup> Addendum 2 provides more details.

## Increase in declared activities

It is estimated that since 1994-1995, about half the increase in the volumes sold in Société des alcools du Québec stores has been attributable to measures taken to curb the illegal trade. On this basis, sales in 1997-1998 are expected to be 71 million litres rather than the 67 million in the absence of measures. Also, the tax losses associated with illegal trade in alcoholic beverages were reduced by 22%, for a recovery of \$38 million. The tax losses are now estimated at \$135 million, as opposed to \$173 million had these measures not been taken.

GRAPH 4

### SALES IN SOCIÉTÉ DES ALCOOLS DU QUÉBEC STORES<sup>1</sup> 1988-1989 to 1997-1998 (in millions of litres)



Sources: Société des alcools du Québec and ministère des Finances du Québec.

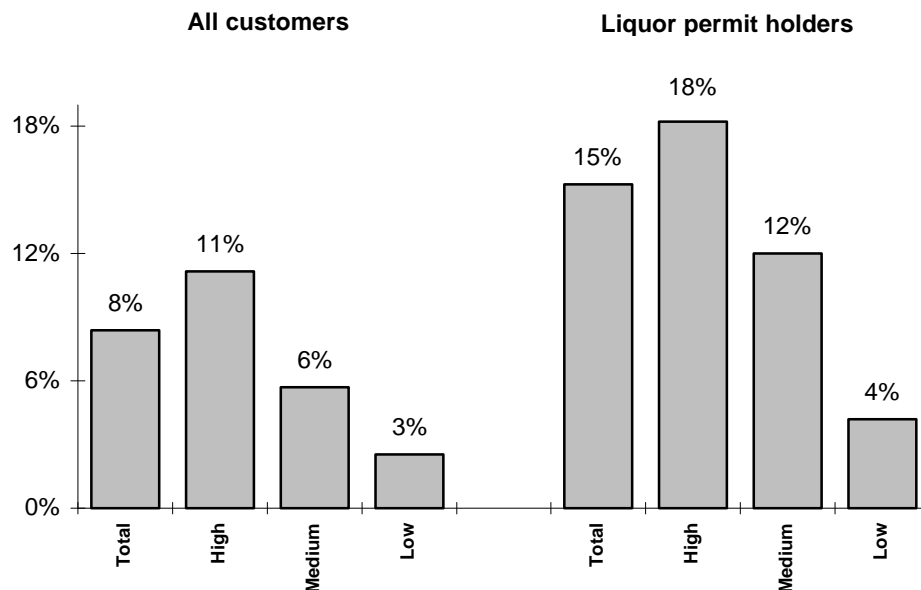
<sup>1</sup> Sales to consumers and establishments with a liquor permit, excluding grocery store sales. Preliminary results for 1997-1998.

This recovery stems largely from additional sales to liquor permit holders. Since 1994-1995, these sales have grown more quickly (15%) than the SAQ's sales in its stores and in grocery stores (8%). This result is attributable to a large extent to measures taken to persuade permit holders to stop obtaining supplies from illegal sources.

In addition, the increase in sales has been more marked in regions where police operations were more numerous and sustained in recent years. In these regions, sales rose 11% for all customers and 18% for liquor permit holders. By comparison, in regions where police activities were less intense, total sales to all customers rose 3% and those to liquor permit holders, 4%.

GRAPH 5

**GROWTH IN VOLUME SOLD BY THE SAQ BY INTENSITY OF POLICE OPERATIONS BY REGION**  
**1997-1998 compared with 1994-1995**  
 (as a percentage)



Sources: Société des alcools du Québec and ministère des Finances.

Total: All administrative regions in Québec.  
 High intensity: Montréal, Laval, Lanaudière, Laurentides, Saguenay-Lac-St-Jean and Estrie.  
 Medium intensity: Québec, Mauricie-Bois-Francs, Chaudières-Appalaches and Montérégie.  
 Low intensity: Bas-St-Laurent, Gaspésie, Outaouais, Abitibi-Témiscamingue, Côte-Nord and Nord du Québec.

### **Curb illegal video lottery terminal operations**

The shutting down of illegal video lottery terminals has had a major impact on the scope of illegal activities. Whereas more than 30 000 illegal terminals were in use throughout Québec at the beginning of the decade, they have now been practically eliminated.

These results have been achieved because the necessary steps were taken to control these activities and enable the recovery of revenue which, in part, was swelling the coffers of organized crime. To do so, measures were taken to:

- withdraw illegal terminals from the market;
- enable the Société des loteries vidéo du Québec to install a legal network.

Accordingly, since 1994-1995, police forces have seized more than 14 000 illegal video lottery terminals, including more than 300 last year.<sup>12</sup> These operations have made it easier to gradually introduce the legal video lottery network,<sup>13</sup> with the number of terminals in operation rising from 6 800 in 1994 to more than 15 000 last year.

For fiscal 1997-1998, these measures have helped generate revenue totaling \$321 million, including \$291 million from the profits of the Société des loteries vidéo du Québec and \$30 million from income tax collected on commissions paid to operators.

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12 Illegal terminals voluntarily withdrawn by operators before police operations account for the difference between the number of illegal terminals previously operated and the number seized.

13 The *Act respecting lotteries, publicity contests and amusement machines* stipulates that, with the exception of government-run casinos, all video lottery terminals must be exclusively operated in bars, brasseries and taverns which have a valid permit issued by the RACJ. In addition, these terminals must belong to the Société des loteries vidéo du Québec and be linked to its video lottery system control main computer.

TABLE 10

**YIELD OF MEASURES TO CURB THE OPERATION OF  
ILLEGAL VIDEO LOTTERY TERMINALS  
1994-1995 to 1997-1998**

	94-95	95-96	96-97	97-98 <sup>1</sup>	Total
<b>Police inspections</b>					
— Number of illegal machines seized	4 800	8 000	750	321	13 871
<b>Legal video lottery network</b>					
— Number of terminals in operation	6 809	14 644	15 065	15 200	—
— Number of sites in operation	2 663	4 242	4 370	4 200	—
— Net profits of the Société des loteries vidéo du Québec	18	140	243	291	692
— Income tax on commissions to retailers	3	17	25	30	75

1 Preliminary results.

### Combat organized crime activities

Criminal organizations, by their very nature, encourage the spread of illegal activities. Consequently, additional actions have been undertaken to weaken these organizations and their influence on unreported work and tax evasion.

These actions consist mainly in:

- additional police operations to dismantle their networks and prevent them from laundering the income derived from criminal activities such as the sale of narcotics;
- a team of prosecutors specialized in fighting organized crime.

Police activities, conducted under memoranda of agreement with the Régie des alcools, des courses et des jeux, have led to the closing of many establishments operated by criminal organizations to launder funds and distribute illicit products (narcotics, contraband alcohol and tobacco, etc.). Over the last year, some 65 establishments have been closed including almost 50 in the Québec City region as a result of actions by the GRICO squad. These closures have benefited lawful operators, who have notably been able to increase their sales of alcoholic beverages.

In addition, police efforts, together with those of prosecutors charged with proceeding with the confiscation of income generated by criminal activities, have recovered \$7 million from criminal organizations and led to the confiscation of buildings worth \$12 million. In all, these actions have helped recover \$20 million for fiscal 1997-1998.

TABLE 11

**YIELD OF MEASURES TO COMBAT ORGANIZED  
CRIME ACTIVITIES<sup>1</sup>**

**1997-1998**

(in millions of dollars)

Sources of revenue	Amount
<b>Confiscated property</b>	
— Disposed of	7
— Held	12
Sub-total	19
<b>Other revenue</b>	1
<b>Total</b>	<b>20</b>

<sup>1</sup> Preliminary results.

### On-going measures

While these initiatives have helped to significantly reduce the scope of illegal activities, criminal organizations still have substantial resources and the illegal trade in alcoholic beverages has not been eliminated.

During the coming year, on-going police measures together with harsher penalties should prompt many liquor permit holders to regularize their situation. Moreover, additional efforts will be made to better inform liquor permit holders and consumers of the rules that apply to the trade in alcoholic beverages.

Lastly, the operations carried out by the team of prosecutors charged with proceeding with the confiscation of income generated by criminal activities will be intensified to apply more pressure on criminal organizations and further reduce the possibility of laundering their funds.

## 2.2.2 Curb unreported work in the construction industry

The construction industry is one of the sectors most affected by unreported work and tax evasion. To curb this phenomenon, a series of measures have been taken over the past three years. They involve:

- increasing and improving controls;
- harsher penalties;
- making industry partners aware of the consequences of unreported work.

All in all, for fiscal 1997-1998, these measures have led to the recovery of \$85 million in revenue notably because of the increased hours of work reported to the Commission de la construction du Québec. They have also contributed to restoring fair competition among contractors, leading to significant positive effects on the overall operation of the industry.

These measures required the participation of many departments and agencies including the Commission de la construction du Québec, the Régie du bâtiment du Québec, the ministère des Affaires municipales and the ministère du Revenu.

TABLE 12

### YIELD OF MEASURES TO CURB UNREPORTED WORK IN THE CONSTRUCTION INDUSTRY<sup>1</sup>

1997-1998

(in millions of dollars)

Sources of revenue	Amount
<b>Increase in reported activities</b>	
— Personal and corporate income tax	51
— Health services fund contributions	11
— Québec sales tax	17
Sub-total	79
<b>Other revenue<sup>2</sup></b>	6
<b>Total</b>	<b>85</b>

1 Preliminary results.

2 Includes fines, penalties and other revenue from the issuing of contractor's licences.



## Increased and improved controls

The additional resources allocated to inspection and investigation have substantially raised the profile of the Commission de la construction du Québec (CCQ) and the Régie du bâtiment du Québec (RBQ) in the field, thus helping to encourage contractors and workers to comply with the rules that apply in the sector.

Since 1994, the CCQ has more than doubled the number of inspectors on construction sites, from 45 to 100 in 1997. An additional 59 employees have been hired to audit the books<sup>14</sup> and process supplementary information from site inspections. Meanwhile, the RBQ has set up a specialized team of 23 investigators to combat unreported work. This team became operational in February 1997 and has concentrated its activities in the residential renovation and self-help housing sectors, where unreported work is most prevalent.

The two agencies have also improved their control mechanisms to more effectively target their inspection and investigation activities. This improvement stems from the use of information taken from municipal building permits and site opening notices<sup>15</sup> as well as the development of certain computer tools, such as the CCQ's registry of construction sites and the RBQ's registry of contractors, which enable preventive action to be taken by identifying likely candidates for unreported work from the outset.<sup>16</sup>

As a result of these actions:

- the number of sites visited by CCQ inspectors rose 60% between 1994 and 1997, leading to a substantial increase of almost 9 000 in the number of criminal cases transferred to the ministère de la Justice. In addition, audits of company books have risen 25% while the annual amount of fines has increased by more than \$2 million over the same period;
- RBQ inspectors and investigators have increased the annual number of site visits by more than 27 000, leading to a rise of close to 4 000 in the annual number of criminal cases;

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14 Audits of contractors' books and accounting records.

15 Since June 1995, municipalities have been required to provide the RBQ with a form with information on single detached dwelling housing starts.

16 The site register contains information on contracts and employers operating on construction sites. It allows the CCQ to more effectively monitor the progress of work and more quickly detect abnormal situations. The RBQ's register of contractors contains any information useful for analyzing the renewal of a contractor's licence, notably the names of the company's contact persons.

- specific measures have been taken in the self-help housing sector, which is particularly prone to unreported work.<sup>17</sup> More than 80% of the self-help housing sites identified, i.e. 3 600, were visited by RBQ investigators in 1997, in addition to the 1 447 visited by the CCQ. Infractions were noted on 29% of the sites visited by the RBQ while visits by the CCQ uncovered more than 1 300 infractions.

TABLE 13

**RESULTS OF CCQ AND RBQ CONTROL ACTIVITIES  
1994 and 1997**

	CCQ				RBQ			
	1994	1997	Change		1994-1995	1997-1998	Change	
			Nb.	%			Nb.	%
Sites visited	25 225	40 424	15 199	60.3	9 684	37 022	27 338	282.3
Licences checked <sup>1</sup>	2 685	2 390	-295	-11.0	12 253	34 564	22 311	182.1
Audits of books	6 172 <sup>2</sup>	7 725	1 553	25.2	n.a.	n.a.	n.a.	n.a.
Recommendations to lay charges	7 802	16 519	8 717	111.7	1 309	5 139	3 830	292.6
Amount of fines (\$000)	1 652	3 881	2 229	134.9	1 040	3 661	2 621	252.0

1 CCQ figures indicate the number of violation notices associated with failure to hold a licence, while those of the RBQ indicate the number of licence checks by the agency.

2 Number in 1995.

## Harsher penalties

The CCQ and the RBQ have amended their founding legislation to add increased deterrent powers to more effectively combat unreported work and encourage stakeholders to comply with the applicable rules in the construction industry.

17 An individual is allowed to build a residence for his personal use and that of his family or to sub-contract the said construction work. However, to circumvent the obligation to hold a building contractor's licence or avoid paying the taxes associated with a construction project, some individuals repeatedly and continuously build houses and falsely claim that they are intended for their own use whereas they are intended for another person. In other cases, some claim they are self-help housing builders whereas, in fact, they do business with individuals who act as contractors without satisfying the attendant obligations.

### **Suspension of work and claims based on an estimate of unreported hours**

The *Act respecting labour relations, vocational training and manpower management in the construction industry* (bill R-20) was amended to enable the CCQ, after hearing the parties, to suspend work on the site of a contractor or sub-contractor who systematically refuses to comply with certain orders. This power has a substantial deterrent effect. While it is frequently invoked (about 300 times a month), it is rarely applied, since virtually all contractors in violation (99.9%) decide to comply rather than face an executory order to suspend work.

Bill R-20 was also amended to authorize the CCQ to produce claims based on an estimate of unreported hours in the case of a contractor who refuses, after repeated notices, to provide his monthly report and comply with the CCQ's requests for information. Virtually all contractors have responded to the CCQ's requests.

### **Suspension of the licence issued by the RBQ**

The *Building Act* was amended to enable the RBQ to suspend the licence of a contractor whose construction work has been suspended more than once by the CCQ.

### **Tightening-up of rules for awarding public contracts for construction**

Last December, the government passed amendments to the *Building Act* and to the *Act respecting labour relations, vocational training and manpower management in the construction industry* to implement new rules for awarding public contracts for construction. A draft regulation to be submitted shortly will stipulate that, henceforth, a contractor who is found to engage in unreported work will be barred from obtaining a public contract for construction for a period of two years.

### **Making the industry aware of the consequences of unreported work**

To make the industry aware of the consequences of unreported work, an information campaign was carried out by the CCQ with "Plein le casque du travail au noir" as theme. In addition, regional concerted action committees were organized to encourage contractors and workers to come up with other solutions to the unreported work problem.

The RBQ has made consumers aware of the negative consequences of unreported work in renovation and self-help housing.

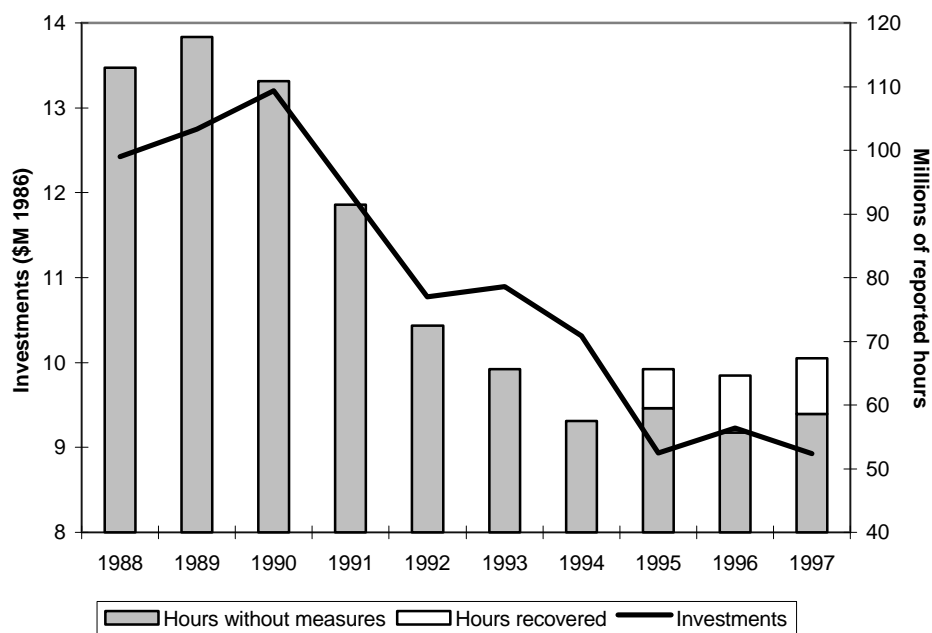
## Increase in reported economic activity

Numerous indicators show that the action taken over the last three years to curb unreported work has contributed to increasing reported economic activity in the construction industry.

In particular, a greater proportion of hours worked is reported. While capital spending in construction expressed in constant dollars fell almost continuously between 1990 and 1997, hours reported to the CCQ, which had been in decline until 1994, have since risen. The number of hours reported to the CCQ per \$1 million of investment rose from 6 027 in 1993 to 7 445 in 1997, an increase of almost 25%. It is estimated that had nothing been done to curb unreported work, the number of reported hours would have been almost nine million less in 1997.

GRAPH 6

**HOURS OF WORK REPORTED TO THE COMMISSION DE LA CONSTRUCTION DU QUÉBEC AND INVESTMENTS IN CONSTANT DOLLARS<sup>1</sup>**  
1988 to 1997



Sources: Commission de la construction du Québec and Bureau de la statistique du Québec.

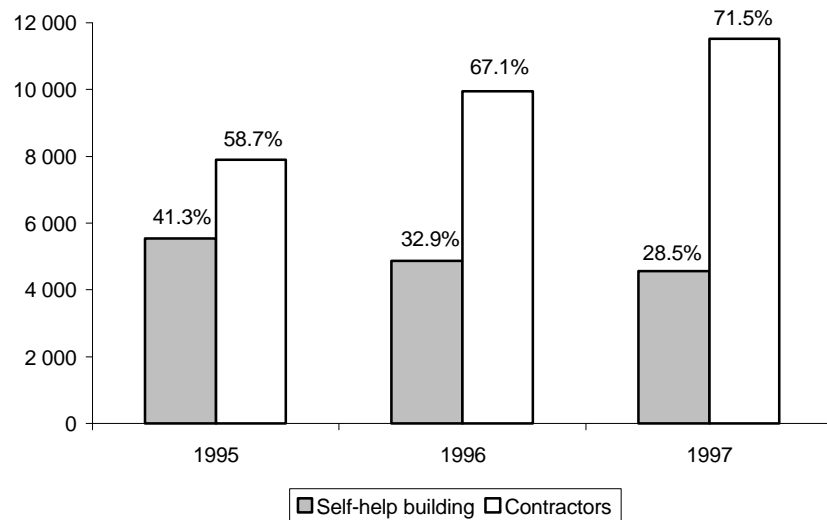
<sup>1</sup> Capital spending in residential and non-residential construction, excluding residential renovation, spending on machinery and equipment, and real estate commissions.

In addition, the measures taken may have contributed to an appreciable decline in the number of self-help housing builders operating for speculative purposes or doing business with individuals who flout the rules.

The number of houses built by self-help housing builders has fallen considerably in spite of an increase in housing starts. The share of single detached dwellings built by self-help housing builders fell from 41.3% in 1995 to 28.5% in 1997. This trend is common to almost all Québec's regions.

GRAPH 7

**SINGLE DETACHED HOUSING STARTS  
1995 to 1997**



Sources: Régie du bâtiment du Québec and Canada Housing and Mortgage Corporation.

Other indicators confirm the upward trend in reported construction work:

- the number of plumbing projects reported to the RBQ has risen by 54% since 1995-1996, whereas it had been in constant decline since 1991-1992;
- the number of hours of work reported per dwelling built has risen 10% since 1994, from 360 to 394 in 1997;
- lastly, as shown in Table 13, in spite of the increase in the number of sites visited by the CCQ, infractions associated with the contractor's failing to have a licence have fallen 11%, which seems to indicate that contractors are more inclined to observe this rule.

### **On-going measures**

Overall, the results obtained from efforts to curb unreported work and tax evasion in the construction industry are encouraging and justify the continuation of measures taken for this purpose. Moreover, additional efforts will have to be taken, particularly in the residential construction and renovation sectors, where these problems are still most prevalent.

### **3. ADDITIONAL MEASURES IN 1998-1999**

To further reduce tax losses associated with the underground economy, the Budget Speech stipulates that the chief measures already in place will be maintained. Accordingly, the additional funding granted in 1997-1998 to the ministère du Revenu will be renewed in 1998-1999. The funding granted to other departments and agencies will be renewed and increased by \$7 million.

Furthermore, the Budget Speech introduces additional measures to reduce unreported work in the clothing sector and to ensure that all workers in the hotel and restaurant industry receive the benefits arising from reporting their tip income. Lastly, measures will be taken to improve the collection of the government's revenue.

#### **3.1 New refundable tax credit for job creation in the clothing industry**

To reduce unreported work in the clothing sector and provide improved social protection for its many workers, a refundable tax credit will be offered until the end of 2001, i.e. for more than three years, regarding new jobs created in this industry.

##### **Some companies use unreported work to become more competitive**

The clothing industry is the largest manufacturing employer in Québec. While it accounts for 4.3% of production, it employs 11% of all production workers, i.e. almost 37 000.<sup>18</sup>

Moreover, the industry is faced with major structural changes stemming from, among other things, increased foreign competition and market globalization. The result has been a loss of almost 22 000 jobs since 1988.

While some companies have succeeded in repositioning and restructuring themselves to compete with countries where wages are lower, others are trying to become more competitive by hiring unreported workers paid "under the table" at lower rates than those negotiated and by failing to collect all the taxes applicable on the goods and services they produce.

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18 Statistics Canada's annual survey of manufacturing industries for 1995, catalogue 31-203.

For employers, hiring unreported workers reduces their payroll, the applicable employer contributions and even allows them to evade taxes by hiding part of their sales figure. For the employees, unreported work allows them to avoid paying their income tax and, in some cases, to illegally receive assistance-of-last-resort benefits or employment insurance benefits. Including unreported wages and profits, this situation leads to annual tax losses of about \$150 million for the government.

### **Unreported employment and production**

Unreported work and tax evasion have risen substantially in the clothing industry and may now account for the equivalent of about 20% of reported production.

While the methods used to measure the phenomenon are still approximate, because of the difficulty in observing it directly, cross-checking of basic economic data indicates that purchases of products made in Québec exceed reported production.<sup>19</sup>

Accordingly, it is estimated that a significant portion of jobs lost since 1988 has been accompanied by a considerable increase in the number of unreported workers, which estimates place at 13 000 in this industry.

### **Negative consequences for companies and workers**

In addition to causing significant revenue losses for the government, unreported work has negative consequences on the clothing industry.

Companies that turn to unreported work obtain contracts unfairly, to the detriment of those that observe the law. This limits their growth and impedes investment in capital and manpower training needed to compete effectively.

Furthermore, unreported work is often associated with worker exploitation. Unlike other sectors, unreported workers in the clothing sector must often work under conditions that do not meet labour standards, and they have no social protection.

### **Refundable payroll tax credit**

To enable companies that observe the law to compete more effectively, they will be granted temporary assistance. This assistance will be provided as a refundable tax credit, equal to 20% of payroll for new production workers. The credit will apply until the end of 2001.

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<sup>19</sup> Addendum 1 provides more details.



Accordingly, for an employer who hires a worker in 1998, the credit will be available for the current year and for the three years following hiring, as long as the job is maintained. For hires in 1999, the credit may be claimed for three years, 1999, 2000 and 2001, while for hires in 2000 and 2001, it may be claimed for a period of two years and one year respectively.

To summarize, the credit:

- will be available to employers the bulk of whose production consists of clothing or footwear;
- will not apply to overtime, benefits or commissions paid to employees;
- will afford the same benefit to companies, regardless of the number of hours and weeks worked by the new employees during a year. As a result, it will reflect the potentially significant fluctuations in production in this sector, which can be concentrated in short periods.

The application details of the payroll tax credit are described in detail in the Additional Information of this Budget Speech.

### **Substantial reduction in hiring costs for many years**

Employers' hiring costs in the clothing sector will be reduced substantially. The reduction will be equivalent to about \$3 900 per job on an annual basis and may amount to more than \$13 550 per job if, for instance, the job is created by July 1 and maintained thereafter.

TABLE 14

**IMPACT OF THE TAX CREDIT ON THE COST OF HIRING A WORKER  
ASSIGNED TO CLOTHING PRODUCTION**  
(in dollars)

	Full year	July 1, 1998 to December 31, 2001
<b>Wages paid to new worker<sup>1</sup></b>	19 355	67 743
<b>Payroll taxes<sup>2</sup></b>	2 787	9 755
<b>Wage costs associated with hiring the new worker</b>	22 142	77 498
<b>Credit of 20 % on wages paid to the worker</b>	<b>3 871</b>	<b>13 549</b>

1 Average wages in the women's clothing sector of \$10.06 an hour (September 1997); 37 hours a week; 52 weeks a year.

2 Employer contributions to the HSF (4.26%), the Commission de la santé et de la sécurité du travail (3.08%), the Commission des normes du travail (0.08%), the Régie des rentes du Québec (3.2%) and for employment insurance (3.78%). The contribution rate for the Commission de la santé et de la sécurité du travail corresponds to the general rate in the clothing and accessories manufacturing sector.

By significantly reducing the difference between the costs of hiring on the clandestine and the legitimate markets, the assistance provided will foster the creation of reported jobs. It will help companies hiring new workers to be more competitive as against those which make use of unreported work. It should also encourage many companies with clandestine operations to declare their activities and thus allow their employees to benefit from better working conditions and full social protection.

### Revision of decrees in the clothing industry

For the next few years, the refundable tax credit for job creation will help companies in the clothing industry to become more competitive. However, in view of the temporary nature of the credit, more long-term solutions are needed to maintain healthy competition in the industry, help it to remain competitive and protect jobs.

In this regard, some industry partners have approached the government with a view to reviewing the decrees in force, namely the decrees in the women's clothing, men's clothing, men's and boys' shirt-making and leather glove sector. All industry partners acknowledge the importance of the problem of unreported work and want to eliminate it. They also agree on the need to review the system to make work organization and production as flexible and efficient as possible.

For example, merging the four decrees into one should resolve problems associated with dual coverage and encroachment of one decree compared with another. However, it seems clear that more action will be required to deal effectively with this issue, in particular to improve manpower training, make the sector more competitive, intensify efforts to curb unreported work and increase our exports to other countries.

The Québec Minister of Labour has received a mandate to have a new regulatory framework passed by the end of the year, for gradual implementation beginning in 1999. The suggested revision of decrees being carried out by the ministère du Travail, together with the new tax credit, is an auspicious occasion for industry partners to develop more effective tools to instill new vigor into this sector while continuing to protect its workers. The government invites the partners to participate with an open mind and good faith to secure the future of the clothing industry.

### **Financial impact**

The tax credit is expected to cost \$20 million annually. However, it will be offset by higher tax receipts resulting notably from an increase in reported activities and a reduction in unreported jobs. Consequently, this measure will have no impact on the government's budget framework.

## **3.2 Ensure workers receive full benefit from reporting their tips**

To ensure workers receive full benefit from reporting tips, the Commission des normes du travail will intensify its inspection activity in the restaurant and hotel sector.

### **Full social protection for tip-earning employees**

Since January 1, 1998, new provisions on the reporting of tip income have been in effect in the restaurant and hotel sector. These provisions are notably designed to ensure that employees earning tips receive full social protection on all their income, including the tips they declare. Accordingly, they can now receive greater benefits under employment insurance and the Québec Pension Plan, larger indemnities in the event of an industrial or traffic accident, as well as better vacation pay and indemnities for paid leave.

Since these provisions cover more than 80 000 employees and almost 20 000 employers, adjustments must still be made in some establishments. In some places, lack of information or bad faith, on the part of the employer or the employees, leads to irregularities. For instance, some employees receive no remuneration other than their tips and others only declare an amount decided in advance by their employer.

In addition to penalizing workers, this situation creates unfair competition with employers who comply with labour standards and satisfy all their social and tax obligations. Accordingly, measures must be taken to ensure that the new rules are understood and observed.

### **More inspections by the Commission des normes du travail in restaurants and bars**

The Budget Speech stipulates that the Commission des normes du travail (CNT) will intensify its inspection activity in restaurants and bars. The CNT, as the agency responsible for enforcing labour standards, has the expertise necessary to undertake preventive and incentive action to improve the situation.

The *Act respecting labour standards* sets the pay structure for workers, employee working conditions (paid holidays, paid annual vacation, etc.) and the basic responsibilities of employers (keeping of registers, pay statements, etc.). Accordingly, by seeing that employers comply with the *Act respecting labour standards*, the CNT will help ensure that employees are paid the various benefits and indemnities they are entitled to.

The Commission already has a team that oversees the enforcement of these standards in all sectors of activity. As of fiscal 1998-1999, it will carry out more inspections in the restaurant and hotel sector, reaching 10% of employers annually. The goals of these inspections include:

- verifying, on site, that employers and employees are complying with the new measures;
- ensuring that the information contained in the registers and pay statements is adequate;
- encouraging employers, if necessary, to act quickly to correct situations of non-compliance;
- imposing the sanctions stipulated in the *Act respecting labour standards* on employers who fail to correct their situation.

In addition to ensuring that workers benefit fully from the advantages associated with reporting their tip income, these measures will encourage employers to comply with labour standards and will foster fair competition within this industry.

### **3.3 Optimize collection of government revenue**

To treat all taxpayers fairly, the departments and agencies involved in recovery activities must ensure that all government debts are collected.

Consequently, specific actions will be taken to enable the key departments and agencies involved in recovery activities, namely the Centre de perception fiscale, the ministère de la Justice, the ministère de l'Éducation and the Centre de recouvrement en sécurité du revenu, to more effectively collect their debts and prevent a sharp increase in accounts receivable.

#### **Intensify recovery activities**

In the short term, these departments and agencies will receive additional funding to enable them to increase the number of employees assigned to debt recovery and become more effective in this activity.

#### **More effective recovery services**

In addition, to optimize debt collection, the operations of debt recovery services will be reviewed and measures taken to make their operations more effective. In this regard, new methods to facilitate the collection of debts will be implemented, in particular concerning the automation of management of information on debtors. In addition, economies of scale may be achieved by consolidating or pooling certain recovery operations, notably those concerning the whereabouts of debtors and the assessment of their ability to pay.

## CONCLUSION

The measures taken over the last three years against unreported work and tax evasion have resulted in the recovery of substantial amounts for the government and cut the tax losses associated with the clandestine economy by almost one quarter. Without them, additional reductions in program spending or tax increases would have been needed to achieve the government's deficit objectives.

Still, the situation remains sufficiently serious for the efforts that have been made to be maintained not only to safeguard the progress achieved against the underground economy, but also to extend it.

Accordingly, the government intends to not only continue its action, but make greater use of incentive and preventive measures to maintain a sound tax system. In particular, to reduce unreported work in the clothing sector, the Budget Speech announces a tax credit for new jobs created in this industry and a revision of the decrees that apply in it.

Overall, these measures will help provide better protection for workers and consumers, while enabling companies to operate in a context of fair competition that fosters job creation.

## **MAINTAINING A SOUND TAX SYSTEM**

### **ADDENDA**

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#### **ADDENDUM 1**

Tax losses associated with the clandestine economy in Québec for 1997

#### **ADDENDUM 2**

Illegal trade in alcoholic beverages: minimum length of liquor permit suspension in case of infraction

## ADDENDUM

### 1. Tax losses associated with the clandestine economy in Québec for 1997

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The preparatory work for the Commission on Taxation and the Financing of Public Services included a paper published on the underground economy, unreported work and tax evasion in Québec. Using data for 1994, the tax losses associated with the clandestine economy were assessed at \$1.9 billion for the Québec government.<sup>1</sup>

Recent work to reassess the extent of tax losses in certain sectors, as well as information obtained in recent years, generally support this estimate. Moreover, an analysis of data from some sectors shows that the tax losses are higher than had been estimated. In particular, in the clothing sector, annual tax losses in the absence of any measures would have reached \$150 million, while in the taxi industry and the professional services sector, they would have been \$34 million and \$50 million respectively.

On this basis, the tax losses associated with the clandestine economy have been reassessed for 1997. This new estimate was carried out in two stages. First, the results for 1994 were extrapolated to 1997, ignoring the impact of measures taken in recent years to curb unreported work and tax evasion. To do so, the evasion rates that had been calculated for 1994, adjusted to reflect revisions in the clothing, taxi and professional services sectors, were applied to the expenditures of the most recent Québec economic accounts. Lastly, the tax losses for 1997 were obtained by removing the impact of measures taken over the last three years from the new estimate.

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<sup>1</sup> The clandestine economy consists of unreported legal economic activities by corporations, self-employed workers or individuals who engage in them. It differs from the underground economy because it excludes all illegal economic activities, such as those related to prostitution and drugs. In addition, the clandestine economy does not include tax evasion associated with non-productive economic activities such as the unauthorized use of certain credits or deductions, undeclared income earned outside the country and undeclared capital gains.



TABLE A.1.1

**TAX LOSSES ASSOCIATED WITH THE CLANDESTINE ECONOMY  
BY SECTOR OF ACTIVITY IN THE ABSENCE OF MEASURES  
Québec 1994 and 1997**  
(in millions of dollars)

Sector of activity	1994	1997	Difference
Food and lodging	745	785	40
Construction and renovation	500	515	15
Automobile	200	210	10
Clothing, textiles and jewelry	57	170	113
Professional services	22	50	28
Transportation	15	40	25
Other sectors	347	370	23
<b>TOTAL</b>	<b>1 885</b>	<b>2 140</b>	<b>255</b>

## Clothing

The tax losses attributable to the clothing sector are much greater than the initial estimate, i.e. \$150 million for 1997, compared with \$39 million in the preceding study.

Changes in the major supply and demand indicators suggest that, to reduce their costs and improve their profitability, some companies hide part of their activities. While demand for Québec clothing<sup>2</sup> rose by about 17% between 1987 and 1995, the value of shipments declared by Québec manufacturers<sup>3</sup> grew by only 3%. On this basis, it is estimated that the value of undeclared deliveries was about \$800 million in 1996, or about 20% of the sector's declared production. In addition, the number of unreported workers in the sector is estimated at 13 000.<sup>4</sup>

2 Demand for clothing produced in Québec includes spending by Québec and Canadian consumers on Québec clothing, net of margins, transportation expenses and indirect taxes, to which Québec exports are added.

3 Manufacturing shipments taken from Statistics Canada's Survey of Manufacturers (catalogue 31-203).

4 The number of unreported workers in the clothing sector is expressed in full-time equivalents. In fact, the number of unreported workers could be greater than 13 000, since many work in the clandestine economy on a casual basis.

In addition, even when production is reported, some companies hide part of their workforce to avoid payment of payroll taxes and claim false sales tax refunds on their inputs.

### **Transportation**

This sector includes the taxi industry where unreported activities cause substantial tax losses. The preliminary results of ministère du Revenu audit programs show that many taxpayers in this sector hide a significant portion of their operating income. In addition, the industry has a large proportion of unreported workers.

On this basis, the estimate of tax losses for 1994 in this sector has been revised upward by \$24 million, and now stands at \$33 million for 1997.

### **Professional services**

Tax losses in the professional services sector have been adjusted upward by \$28 million between 1994 and 1997. This adjustment stems from the fact that recoveries by the ministère du Revenu in this sector have been much greater than expected.

## ADDENDUM

### 2. Illegal trade in alcoholic beverages: minimum length of liquor permit suspension in case of infraction

TABLE A.1.2

**MINIMUM LENGTH OF LIQUOR PERMIT SUSPENSION FOR INFRACTIONS  
RELATING TO THE ILLEGAL TRADE IN ALCOHOLIC BEVERAGES**  
(in force since February 4, 1998)

Source of alcoholic beverages seized	Quantity of alcoholic beverages seized (in litres)				
	Less than 5	5 to 10 exclus.	10 to 15 exclus.	15 to 20 exclus.	20 or more
Legal supplier but unstamped products <sup>1</sup>	30	35	40	45	50 or more <sup>3</sup>
Illegal supplier <sup>2</sup>	60	70	80	90	100 or more <sup>3</sup>

1 Alcoholic beverages without the identification of the Société des alcools du Québec, brewers or the Régie des alcools, des courses et des jeux.

2 Contraband or illegally produced alcoholic beverages.

3 If the seizure is greater than 20 litres, an additional day of suspension is imposed for each litre seized. When a decision by the Régie des alcools, des courses et des jeux produces a suspension of more than 180 days, the liquor permit is cancelled.