NATIONAL AUDIT OFFICE

OF THE REPUBLIC OF LITHUANIA

PUBLIC AUDIT REPORT
TAX INCENTIVES

7 June 2013, No. VA-P-60-3-7
Vilnius

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Full audit report in Lithuanian is available on the website
of the National Audit Office: www.vkontrole.lt

SUMMARY

By offering tax incentives, the state foregoes a portion of its revenue. An explanatory note following the reports on the execution of the state budget sets out state budget revenue losses due to the application of the main tax incentives.

In its Programme for 2012-2016, the sixteenth Government provided for a reform of the tax system. One of the objectives of the reform is to apply only socially relevant and targeted tax incentives for business and the public. Also, only economically justified tax incentives intended to encourage economic development and to achieve specific goals significant for the public should be provided for[1].

Lithuanian tax experts point out that tax exemptions are in fact budget expenditures – only less transparent because they are "almost invisible". Incentives should be very "narrow" and easily explainable as to their appropriateness, and the state should monitor the application of incentives and flexibly respond to changes in the economic environment[2].

International practice emphasises the necessity to monitor the application of tax incentives and the importance of publicity. It is recommended to assess tax incentives in view of their purpose, impact on business, society and budget revenues. It is important that politicians responsible for decision making receive as detailed information on the effects of tax incentives as possible to be able to make justified decisions on their further appropriateness.

The audit objective was to assess effectiveness of the monitoring of the application of tax incentives:

- Is it possible to determine the impact of tax incentives according to their purpose?
- Are budget revenue losses incurred due to the application of tax incentives assessed?
- Is information about budget revenue losses incurred due to the application of tax incentives made available to the public?
- Are tax incentive applied in a proper way[3]?

The implementation of the state policy in the financial field is formed, organised, coordinated and controlled by the Ministry of Finance. The main body responsible for the administration of tax incentives is the State Tax Inspectorate[4].

The audit conclusions were formulated upon assessment of the conclusions provided in the study Managing the Effects of Tax Expenditures on National Budgets prepared by the World Bank, guidelines provided in the Manual on Fiscal Transparency prepared by the International Monetary Fund, Best Practice Guidelines for Tax Expenditures prepared by the Organisation for Economic Cooperation and Development, upon evaluation of foreign experience and analysis of 2009-2011 data on the application of tax incentives.

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[1] Approved by Resolution No. XII-51 of the Seimas of the Republic of Lithuania of 13 December 2012.
[2] I.Šimonytė: tax incentives to be reviewed. [Accessed on 21 March 2013] Internet access: http://verslas.delfi.lt/verslas/isimonyte-bus-perziurimos-mokesciu-lengvatos.d?id=42376391#ixzz2PwqIuvU5. Maybe they really do know "how"?! [Accessed on 12 December 2012] Internet access: http://www.lrytas.lt/-13540061001353577600-varge-gal-jie-tikrai-%C5%BEino-kaip.htm. Muck-up regarding tax incentives [Accessed on 21 December 2012] Internet access: http://laikrastis.verslozinios.lt/index.php?act=mprasa&sub=article&id=54118.
[3] The auditors followed the assumption that tax incentives are applied properly when they are used by the entities which are entitled to the incentives and that they are applied to the due object.
[4] Law of the Republic of Lithuania on Tax Administration, 13 April 2004 No IX-2112 (current version of 22 December 2011 No. XI-1875), Art. 15-16.

The audit was conducted on the assumption that the audited and other entities provided comprehensive and objective information and copies of the documents correspond to the originals.

The audit conclusions and recommendations provided below were drawn upon assessment of the audit findings.

Audit conclusions

In the opinion of foreign experts, tax incentives should be regarded as budget expenditures. Failure to assess effects of tax incentives on the national revenues and to make this information available to the public may result in absence of fiscal transparency. Therefore, it is necessary to carry out monitoring of the application of tax incentives. International practice guidelines for the monitoring of the application of tax incentives, namely, to clearly define the purpose of incentives, to assess budget revenue losses due to their application, and to make these losses public, have not been implemented in Lithuania to a required extent.

1. General purposes of 70 tax incentives assessed during the audit (out of 215) may be traced in the text of documents accompanying draft legislation and no purpose is specified for 27 tax incentives. In case only general purposes of tax incentives are provided or no purposes are indicated, if no criteria to assess the achievement of the purpose of tax incentives are defined, it is difficult to determine whether the purpose has been achieved and whether the expected benefits have been obtained.

2. A term is set for the application of 4 tax incentives out of 215. When tax incentives are used for market regulation as measures of impact on business and the public and no application term is indicated, in the long run they can become market distorting measures, because they were adopted under different economic conditions.

3. Not all available information about the effects of tax incentives on budget revenues is provided to the Seimas, Government and the public.

3.1. The Ministry of Finance, the State Tax Inspectorate and the State Patent Bureau have data on the loss of budget revenues due to the application of 52 tax incentives (out of 215), the amount of which totalled LTL 1808 million in 2009, LTL 1882 million in 2010, and LTL 2101 million in 2011. State budget execution reports show the loss of budget revenues due to the application of 10 tax incentives: LTL 979 million in 2009, LTL 713 million in 2010, and LTL 918 million in 2011. Publicly available revenue losses due to the application of tax incentives are twice smaller than the actual figures.

3.2. The auditors additionally calculated potential revenue losses due to the application of eight income tax incentives: LTL 97 million in 2009, LTL 153 million in 2010, LTL 191 million in 2011. Lt. Budget revenue losses as a result of tax incentives may be even bigger.

4. As from 2004, extended assessment of impacts of draft decisions has been regulated in relevant legislation; however, no such assessment has been conducted when setting new tax incentives or modifying their content. Monitoring of regulatory acts, which should have been performed since 2009, was carried out only in respect of one tax incentive (out of 215). Consequently, it may be difficult to assess the appropriateness of the application of tax incentives and to address problems related to the application of tax incentives in due time.

5. In 2009 tax incentives were used 3 319 thousand times, in 2010 – 3 025 thousand times, and in 2011 – 2 926 thousand times[5]. In some cases, improper application of the rules on tax incentives due to vague definitions of tax incentives, their objects and conditions complicates the work of the State Tax Inspectorate and increases the risk of unfair taxation.

Audit recommendations

To the Government of the Republic of Lithuania:

1. With a view to assessing the appropriateness and effects of tax incentives, to approve a monitoring procedure for the application of tax incentives, which should:

- provide for the incentives subject to monitoring and monitoring frequency;
- provide for the criteria to be followed when assessing the effects of incentives and their benefit for the public, business and budget revenues;
- establish competence and responsibilities of individual entities;
- provide for publicity of monitoring results.

To the Ministry of Finance of the Republic of Lithuania:

1. To publish annual information on budget revenue losses due to the application of tax incentives.

A recommendations implementation plan is provide in Annex 2 of the Report.

[5] One person may be entitled to several different tax incentives. In such case the same person can be included in the total number of the beneficiaries of tax incentives several times.