Executive summary of the public audit report

SYSTEM FOR SELECTION OF TAXPAYERS TO BE INSPECTED BY THE STATE TAX INSPECTORATE UNDER THE MINISTRY OF FINANCE OF THE REPUBLIC OF LITHUANIA

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ABBREVIATIONS AND DEFINITIONS

ABBREVIATIONS

Audit IS - the audit information system of the State Tax Inspectorate.

CSTIs - County State Tax Inspectorates.

STI under the FM – the State Tax Inspectorate under the Ministry of Finance of the Republic of Lithuania.

STI – the STI under the FM and CSTIs.

IT - a complex or subject-based inspection of a taxpayer.

TI – a tax investigation.

OI – an operational inspection.

IEFA – an investigation of economic and financial activities.

RASS - the risk analysis and selection subsystem of the Audit IS.

Consolidated action plan - the STI's consolidated plan of the measures aimed to ensure the enforcement of the tax duties of taxpayers and the collection of taxes.

DEFINITIONS

Selection criterion – a logical condition the satisfaction of which helps to distinguish a subject of selection from the other subjects for a possible control procedure.

Control procedure - a complex or subject-based inspection of a taxpayer, a tax investigation or an operative inspection.

Taxpayer - a person having an obligation under the tax law to pay taxes[1].

Tax inspection – an inspection conducted by the tax administrator in respect of the taxpayer to control the taxpayer's compliance with the requirements prescribed by tax laws in the fields of calculation, declaration and payment of taxes and, in the cases prescribed by law, in other fields as well[2].

Tax investigation - monitoring the tax payer's activities by the tax administrator, which includes an analysis of tax returns, customs declarations, documents and any other information available about the tax payer as well as visiting taxpayers, controlling their activities with a view of identifying and eliminating any deficiencies and contradictions in respect of the calculation, declaration and payment of taxes[3].

[1] Law on Tax Administration of the Republic of Lithuania, 13/04/2004, No. IX-2112, Article 2 Part 17.

[2] Ibid, Article 2 Part 23.

[3] Ibid, Article 2 Part 24.

Operational inspection – the inspection of the performance of specific obligations by a taxpayer in the fields of accounting, tax declaration, tax payment, registration as a taxpayer, etc., provided for by laws and their accompanying legal acts[4].

Risk - the probability that an event will adversely affect the achievement of the objectives.

Risk analysis - an automated RASS procedure of the application of risk identification rules, during which the risk score is calculated for the analysed subject in accordance with the risk establishment rules, the data discrepancies are established as well as the level of the risk, the taxes the risks are associated with, the recommended control procedure and the recommended qualification of the public servant or employee of the State tax Inspectorate employed under an employment contract and receiving a salary from the state budget of the Republic of Lithuania, capable to execute the control of the taxpayer.

Risk sign – an attribute, data or index of a taxpayer, indicating improper or potentially improper execution of the tax duties.

Risk rule – a rule for establishing the risk of a taxpayer used by the Audit IS that includes the taxpayer's attributes (data, rates), logical operators and the values of the taxpayers attributes.

Risk scores (points) – a quantitative risk assessment of a taxpayer executed in accordance with the risk rules.

Investigation of economic and financial activities – an inspection of the economic and financial activities of economic entities, carried out by the specialists in the cases established by law (investigation of a subject), and the collection of the required data on accounting management, financial reporting, tax calculation, fairness and of reasonableness of payment, etc., in order to determine the circumstances significant to reveal and investigate a criminal activity or other violations of law[5].

[4] Law on Tax Administration of the Republic of Lithuania, 13/04/2004, No. IX-2112, Article 115 Paragraph 3.

[5] Regulations of Investigations of Economic and Financial Activities Executed by the Specialists of the Financial Crime Investigation Service under the Ministry of the Interior approved by the Order No. V-73 of 12/08/2010 of the Director of the Financial Crime Investigation Service under the Ministry of the Interior, Point 3.

SUMMARY

The establishment of an effective risk-assessment-based system for selection of taxpayers to be inspected poses a considerable challenge to tax authorities. Risk assessment and the prioritization of activities contribute to efficient and effective public administration. The Institution-owned limited resources intended for monitoring are used most efficiently when they are directed to the most important and the most risky fields of monitoring.

The actions of the tax administrator, aimed at ensuring the proper discharge of tax duties, should first be directed to the reduction of the risks that have the greatest impact on public revenue collection as well as to the respective taxpayers and their groups/segments whose actions carry the highest potential risk of tax avoidance.

The relevance of the topic to the public had prompted the National Audit Office to carry out an audit of the system for selection of taxpayers to be inspected by the STI.

The objective of the audit was to assess whether the system for selection of taxpayers to be inspected, applied by the STI under the MF, is truly effective.

During the audit, we have assessed:

- Whether the risk rules are laid down in a way they could be used to assess the riskiness of all taxpayers;
- Whether the taxpayer selection process ensures that the riskiest taxpayers are selected for the control actions.

The audit was carried out at the State Tax Inspectorate under the Ministry of Finance. The audited period – the years of 2012-2014. When assessing the development of the plans of taxpayers to be inspected and the effectiveness of the control actions, the data of 2015 was also used.

As part of the taxpayers' control function, the STI carries out the selection of taxpayers to be inspected. Taking into account this selection, plans of taxpayers to be inspected are drawn. The current selection process applied by the STI is essentially advanced, however, it does have some drawbacks. We found that about 60 percent of the control actions provided for in the plans of taxpayers to be inspected are composed of control actions taken in respect to the taxpayers selected with the use of selection measures of the STI and analysis, and about 40 percent of the control actions are included in the plans for other reasons: collection of opposing information, fulfilment of the tasks of law enforcement authorities, examination of the information received from other authorities, etc. The effectiveness[6] of the control actions provided for in the plans of taxpayers to be inspected, included by the method of selection, is more than 50 percent. Besides, the STI fails to ensure timely commencement of the control actions foreseen in the plans of taxpayer to be inspected well enough.

The selection of taxpayers, carried out by the means of the Audit IS, also requires improvements. Due to the constantly changing data of taxpayers, it is not possible to restore the exact initial lists of taxpayers compiled after the assessment of the riskiness of taxpayers. In addition, as the expert assessment procedures lack clarity, the assessment of

[6] A control action which results in identification of inconsistencies additional calculations of taxes as efficient..

the selected taxpayers contains the features of subjectivity and depends on the professional competence, experience and knowledge of the STI specialist performing the assessment.

Having assessed the evidence collected during the audit, we hereby present our conclusions and recommendations the proper implementation of which would contribute to a more progressive system for selection of taxpayers to be inspected applied by the STI and ensure more transparent and objective execution of the selection, which in turn would have a direct impact on budget revenue collection.

CONCLUSIONS

1. When preparing a plan of taxpayers to be inspected, for the purpose of control actions the STI includes about 60 percent of taxpayers selected by means of selection and analysis in the plan, while 40 percent of the included taxpayers are included for reasons other than the result of selection. One of the methods of selection of taxpayers to be inspected is the Audit IS, which is specially adapted for the selection of taxpayers. The efficiency of the selection control actions of this system amounted to 53 percent during the audited period, however, an average of only 6 percent of taxpayers included in the plans are selected for inspections every month using the Audit IS. Thus, STI is not exploiting the possibilities provided by this system well enough (Chapters 1, 3).
2. The selection of taxpayers to be inspected (except for the excise duty payers) and the submissions for further actions by the control units is carried out, monitored and controlled by the Excise Duty Administration Department. The exclusive function of the selection of excise duty payers to be inspected and the undifferentiated functions of the selection and control of excise duty payers may affect the objectivity of the selection (Subsection 1.1).
3. During the selection of taxpayers to be inspected, the relevant data of taxpayers, selection filters and their sequence are employed. A quarter of the control operations of taxpayers to be inspected, included in the plan of taxpayers to be inspected, are commenced with a delay. In some cases, this has an impact on the effectiveness of the operations of control of the payers of these duties (Subsection 1.2).
4. The Audit IS provides only the traceability of the applied selection criteria, filters and their sequence. However, it is not possible to restore the exact initial list of the taxpayers to be inspected selected to the plans, which is prepared by the Audit IS applying the selection criteria, filters and their sequences. Therefore, it is impossible to accurately determine whether the riskiest taxpayers were included to the plans of taxpayers to be inspected during a specific previous period. This affects the objectivity of the selection of taxpayers to be inspected carried out (Subsection 2.1).
5. One of the procedures of the phases of the selection for inspection carried out by the Audit IS is an expert assessment, during which the STI specialists assess and select individual taxpayers from the list of taxpayers (selected by the means of the Audit IS)

for further actions. This procedure has not been described in detail – no detailed criteria required for the execution of an expert assessment have been determined. Therefore, such an assessment and selection take on some features of subjectivity and depend on the professional competence, knowledge and other human factors of the STI specialist executing the assessment. Due to non-determined comprehensive requirements for the execution of expert assessment, the objectivity of the selection is not guaranteed (Subsection 2.2).

6. The striving of the STI to assess the effectiveness of the Audit IS is a good practice, however, the assessment of the selection process carried out has some drawbacks: no criteria for assessing the coefficient values of the assessment of effectiveness of the risk rules are set; no risk rules, the calculation of whose efficiency coefficients lacks some features, are determined; the task group on risk rules management has not considered and has not changed (except for the replacement of the litas by the euro) the seven risk rules, recommended for review due to their incapability to achieve effectiveness; not all established indicators to be used for the assessment of the performance of the selection process are being calculated. Therefore, the risk rules performance assessment, carried out by the STI, is only partially in line with the prescribed methodology, and the insufficient attention to the assessment results does not encourage the improvement of the risk rules (Section 4).

RECOMMENDATIONS

To the State Tax Inspectorate under the Ministry of Finance

1. In order to achieve a more effective process of selection of taxpayers to be inspected, the measures should be established while selecting taxpayers for the inspection plans, aimed at a more active use of the Audit IS specially adapted for the selection of taxpayers (Conclusion 1).
2. In order to ensure that the selection of all taxpayers to be inspected is carried out objectively and in accordance with the same principles, it is appropriate to distinguish the function of the selection of excise duty payers and their inclusion in the plans of excise duty payers from the function of monitoring and control of these payers and transfer the execution of the selection of excise duty payers to be inspected to the Selection and Audit Support Department (Conclusion 2).
3. In order to ensure a more transparent and objective process of selection of taxpayers to be inspected, it is appropriate:
   3.1. To ensure the traceability of the initial lists of taxpayers compiled by the means of the Audit IS (Conclusion 4);
   3.2. To ensure that the expert assessment of the selection process, executed by the means of the Audit IS, would be based on specific assessment criteria (Conclusion 5).

4. In order to make the assessment of the effectiveness of the taxpayer selection process carried out by the STI appropriate and useful, to improve the selection process performance assessment: to establish the assessment criteria for the values of the coefficients of the assessment of the effectiveness of the risk rules; to establish the procedure of the assessment of the risk rules, the calculation of the efficiency coefficient

of which lacks some features; to establish the reasonable period for the assessment of the effectiveness of the risk rules and the scope of the assessed risk rules (Conclusion 6).

The measures for implementation of the recommendations as well as the deadlines are provided for in Annex 2 to the present Report "Recommendation Implementation Plan".

Changes that occurred during the audit

On 23 December 2015, the regulations of selection of taxpayers for the control and monitoring procedures were amended. The changes and their implementation will help to ensure timely execution of the actions of control of taxpayers provided for in the plans of taxpayers to be inspected. These changes will have a positive impact on eliminating the drawbacks identified in Conclusion 3.