Organisation of tax audits

Audit report No. OSI-2-6/06/33 of 30 May 2006

Summary

Tax revenue accounts for the bulk of the revenues of the state budget – the 45.9 billion Estonian kroons of tax revenue which accrued in 2005 amounted to over 80% of the budget funds of the state. The only collector of the state taxes in Estonia is the Tax and Customs Board and it is very important that stable accrual of taxes be ensured by its activities.

In 2004 the Tax Board and the Customs Board were merged and after that a number of changes have been made in the structure of the institution. By today the priorities of the Tax and Customs Board are client-centeredness and promotion of voluntary payment of taxes. The tax audit, which constitutes the object of the audit, is one of the core activities of tax administration, which directly increases accrual of taxes and improves the overall tax behaviour.

To set goals and monitor achievement thereof the Tax and Customs Board has introduced a planning system, which binds the strategic goals to the day-to-day work. All fields of activity and structural units have been involved in planning and reporting and therefore the same plan is a tool for the top executives as well as officers of divisions. **According to the State Audit Office, the overall planning of audits has improved the overview of the targets and results of audits.**

Subsection 10 (3) of the Taxation Act obligates the tax authority to organise the procedure as simply, quickly and effectively as possible, preventing excessive costs and inconveniences. Frequent exceeding of the deadlines of tax audits and audits of single cases and poor performance of the audits show that the procedures are not always organised with sufficient speed and effectiveness.

According to the State Audit Office, the organisation of tax audits can be improved in various areas. First, the analysis criteria used upon selection of the objects of tax audits are relatively general, as a result of which the effectiveness of the audits has suffered. Comparison of the tax amount of one person with the average of the general tax amount does not take the specifics of various business sectors and areas sufficiently into account. The data currently gathered on taxable persons does not always allow for conducting the analyses necessary for detection of tax risks (e.g. differentiating between the primary and ancillary activities of taxable persons, identification of the actual place of business of persons, differentiating between part-time and full-time employees).

The second reason for the poor performance of the object selection lies in the insufficient exchange of information between audit authorities and other authorities as well as in poor preliminary analysis of the object in regional authorities. Upon auditing it became evident that regional tax authorities do not always understand the criteria on the basis of which the central authority had the objects audited or the tax risks that had to be kept in mind upon auditing. The division of work and responsibility between the central institution and regional information authorities has not been clearly regulated.

Third, according to the State Audit Office the performance of tax audits could be improved by better planning of each specific audit and uniform documentation of the process of audits. Upon auditing it became evident that audit planning has been poorly recorded in many cases and there is no overview of the audit operations that have been made. In comparison with the remaining audits the poorly planned audits usually lasted over two months longer on average.

Main proposals to the Director General of the Tax and Customs Board

- To ensure the reliability and sufficiency of the data serving as the basis for the risk analysis and object selection. The data serving as the basis for the analysis must be adequate and reflect all the tax risks pertaining to the activities of the taxpayer.
- The information department of the central institution should systematically improve and update the analysis of tax risks and criteria of selection of tax audit objects. The analysis of tax risks must cover all sectors of the economy, take into account the specifics of the areas and serve as a basis for the selection of the directions and priorities of tax audits. The selection criteria must take the decisions and reasons of the audit department regarding the final tax audit list and the results of finished audits into account.

- Regional centres should conduct a preliminary analysis of all the persons found on the basis of the risk analyses and record each decision regarding auditing or not auditing a person along with the reasons.
- To ensure documentation of planning and conducting audits and harmonisation of the principles and organisation of documentation. Uniform work organisation and sufficient documentation of operations are the prerequisites for quality control.
- To introduce systematic quality control over the process and results of tax audits. First of all, systematic control over planning the work of tax auditors, audit operations conducted and documentation of results must be ensured by the heads of the tax authorities.

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The reply of the Director General of the Tax and Customs Board to the proposals of the State Audit Office has been annexed to the audit report.

In his letter the Director General of the Tax and Customs Board agreed with the proposals of the State Audit Office and described the activities conducted and planned for implementation of the proposals.

Ines Metsalu
Chief Auditor
Audit Department I