

## **AUDIT REPORT**

Riga

January 9, 2008  
4/2007

No. 5.1-2-

### **On Administration of Enterprise Income Tax Relief**

#### **Legal Justification of the Audit**

1. The legality audit on administration of Enterprise Income Tax relief was conducted according to the Section 2 of the Law on the State Audit Office and audit assignment of the State Audit Office 1<sup>st</sup> Audit Department No.5.1-2-4/2007 of March 5, 2007.
2. The audit was conducted by Senior State Auditors Iveta Martuzāne, Īva Šaicāne, Liene Upeniece (until September 3, 2007), Sandijs Māliņš (until September 3, 2007), State Auditor Ilze Ozola, and State Auditor - Lawyer Oskars Erdmanis.

#### **Audit Objective**

3. The objective of the audit is to gain assurance that institution subordinated to the Minister for Finance – the State Revenue Service provides administration of Enterprise Income Tax relief in accordance with the regulatory enactments in force:
  - 3.1. To verify if control over justified application of Enterprise Income Tax relief is provided and organized;
  - 3.2. To verify if tax amounts forgone the State budget as a result of application of tax relief specified by legal enactments, are accounted and reported;
4. To verify if the Ministry of Finance provides development and implementation of tax policy regarding Enterprise Income Tax relief and if tax relief efficiency and benefit to the public is assessed.

#### **Accountability of the State Audit Office Auditors**

5. Auditors of the State Audit Office are responsible for the audit report, which is based on the audit evidence obtained in the audit.

#### **Accountability of the Audited Entity**

6. The Ministry of Finance and institution subordinated to the Minister for Finance – the State Revenue Service are responsible for compliance with the regulatory enactments and truthfulness of the information provided to the auditors.

## Scope of the Audit

7. The audit is conducted in accordance with international auditing standards recognized in the Republic of Latvia. The audit was planned and performed to obtain reasonable assurance on administration of Enterprise Income Tax relief. Administration includes supervision, control and accounting of Enterprise Income Tax relief calculation and payment accuracy and accuracy of tax rebate application, as well as other activities related to determination, granting and cancellation of tax relief.
8. The audit was conducted within the framework of integrated parallel audit (hereinafter – parallel audit) of EUROSAI 2<sup>nd</sup> sub-group<sup>1</sup> on administration of Enterprise Income Tax relief. The scope of the audit and audited issues are adapted to the objectives and audited issues of the parallel audit.
9. Within the framework of the audit:
  - 9.1. Interviews regarding administration system of Enterprise Income Tax relief were conducted at the Ministry of Finance, the State Revenue Service, the State Regional Development Agency, Free Port Authorities and Special Economic Zone Authorities;
  - 9.2. Inspections were carried out on administration of Enterprise Income Tax relief in 2005 and 2006, including:
    - 9.2.1. Compliance of activity of the audited entity – the Ministry of Finance regarding introduction and supervision of Enterprise Income Tax relief, with the regulatory enactments;
    - 9.2.2. Compliance of activity of the audited entity – the State Revenue Service regarding administration of Enterprise Income Tax relief, with the regulatory enactments, as well as cooperation of the State Revenue Service with other institutions involved with administration of Enterprise Income Tax relief.
  - 9.3. Information was acquired regarding activities of institutions involved with administration of Enterprise Income Tax relief:
    - 9.3.1. Activity of the State Regional Development Agency, accepting applications from companies, registered in regions requiring special assistance, to evaluate compliance of company's activity development project with development programme of region requiring special assistance, and to prepare the decision regarding what in particular gives them the right to apply Enterprise Income Tax relief after the decision is taken by National Regional Development Council;
    - 9.3.2. Activity of Free Port Authorities and Special Economic Zone Authorities, granting special status to a tax payer, which operates in a special economic zone or in a free port territory, thus obtaining the right to apply Enterprise Income Tax relief in accordance with the amount of investments made.

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<sup>1</sup> EUROSAI (European Organization of Supreme Audit Institutions where the State Audit Office of the Republic of Latvia is a member) 2<sup>nd</sup> sub-group has been established to perform integrated parallel audit "On Administration of Enterprise Income Tax Relief".

10. The following institutions and structural units were included in the scope of the audit:
- 10.1. Tax Policy Department State Aid Control Department of the Ministry of Finance;
  - 10.2. National Customs Board of the State Revenue Service and four territorial offices (Ziemeļu District Division of Rīga Regional Office, Rēzekne Division of Latgale Regional Office, Ventspils and Liepāja Divisions of Kurzeme Regional Office).
11. The audit provided sufficient and according audit evidence for drawing up the audit report.

## Summary

12. The following discrepancies were disclosed in the activity of the Ministry of Finance, providing development and implementation of tax policy, and in the activity of the State Revenue Service, providing administration of Enterprise Income Tax relief:
- 12.1. Although the Ministry of Finance is responsible for development of fiscal policy and State budget, the regulatory enactments do not provide for the Ministry to establish performance indicators targeted at achievement of certain relief goals and unified their achievement supervision mechanism regarding Enterprise Income Tax relief. Thus the benefit of the public and anticipated economical or social gain from implementation of Enterprise Income Tax relief policy;
  - 12.2. Although the Ministry of Finance shall inform the public on sector policy and activity of subordinated institutions; however, as regulatory enactments do not provide for the Ministry of Finance to aggregate, analyze and publish information regarding benefit to companies applying Enterprise Income Tax relief and benefit to the public in general, there is a risk that the public does not have sufficient understanding of the essence and meaning of the State implemented tax policy (including Enterprise Income Tax relief).
  - 12.3. The Ministry of Finance has planned introducing new Enterprise Income Tax relief by amending regulatory enactment<sup>2</sup>; however, the regulatory enactment<sup>3</sup> specifying Enterprise Income Tax declaration form, which does not provide for display of information on Enterprise Income Tax relief applied by tax payer acquiring or establishing new production technology equipment, has not been amended in due time. Consequently, the State Revenue Service has not been able to provide timely and absolute control over accuracy of relief application and calculation. Thus the State Revenue Service has not provided comprehensive implementation of duties specified by the regulatory enactment<sup>4</sup>. New regulatory

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<sup>2</sup> Section 13, Paragraphs 1<sup>1</sup>,1<sup>2</sup>,1<sup>3</sup>,1<sup>4</sup> of the Law “On Enterprise Income Tax”.

<sup>3</sup> Cabinet Regulation No.927 of 6 December 2005 “Regulations Regarding the Declaration of Enterprise Income Tax for a Taxation Year and the Procedures for the Completion Thereof”.

<sup>4</sup> Section 18, Clauses 1-2 of the Law “On Taxes and Fees”.

enactment<sup>5</sup>, improving Enterprise Income Tax declaration form for taxation year, came into force only on December 15, 2007.

- 12.4. In accordance with the requirements of regulatory enactment<sup>6</sup>, the State Revenue Service on a yearly basis shall prepare information for the Ministry of Finance regarding tax amounts forgone as a result of application of tax relief specified by legal enactments; however, the State Revenue Service does not aggregate information regarding tax amounts forgone as a result of application of Enterprise Income Tax relief, resulting from tax payer activities in regions requiring special assistance, acquiring or establishing new production technology equipment;
- 12.5. As the State Revenue Service and institutions (the State Regional Development Agency, Free Port and Special Economic Zone Authorities), indirectly involved with administration of Enterprise Income Tax, do not have sufficient cooperation and information exchange, there is a risk that quality control and supervision of the respective field is not provided.
- 12.6. The risks may be identified and examined within the framework of various tax administration processes, including data quality inspections of Enterprise Income Tax declarations, data validity evaluation processes, thematic inspections and tax audits. Taking into account available resources and principles of sound management, the State Revenue Service performs Enterprise Income Tax audits, inspecting not more than 1% of tax payers per year.

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<sup>5</sup> Cabinet Regulation No.852 of 11 December 2007 “Regulations Regarding the Declaration of Enterprise Income Tax for a Taxation Year and Advance Payment Calculation and the Procedures for the Completion Thereof”.

<sup>6</sup> Section 3, Paragraph three of the Law “On Budget and Financial Management”.