

STATE OF NEVADA
LEGISLATIVE COUNSEL BUREAU

LEGISLATIVE BUILDING
401 S. CARSON STREET
CARSON CITY, NEVADA 89701-4747
Fax No.: (775) 684-6600



LEGISLATIVE COMMISSION (775) 684-6800
BARBARA E. BUCKLEY, *Assemblywoman, Chair*
Lorne J. Malkiewich, *Director, Secretary*

INTERIM FINANCE COMMITTEE (775) 684-6821
WILLIAM J. RAGGIO, *Senator, Chairman*
Gary L. Ghiggeri, *Fiscal Analyst*
Mark W. Stevens, *Fiscal Analyst*

LORNE J. MALKIEWICH, *Director*
(775) 684-6800

PAUL V. TOWNSEND, *Legislative Auditor* (775) 684-6815
DONALD O. WILLIAMS, *Research Director* (775) 684-6825
BRENDA J. ERDOES, *Legislative Counsel* (775) 684-6830

Legislative Commission
Legislative Building
Carson City, Nevada

We have completed an audit of the Department of Taxation. This audit is part of the ongoing program of the Legislative Auditor as authorized by the Legislative Commission. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions. The results of our audit, including findings, conclusions, recommendations, and the Department's response, are presented in this report.

We wish to express our appreciation to the management and staff of the Department of Taxation for their assistance during the audit.

Respectfully presented,

A handwritten signature in black ink, appearing to read "Paul V. Townsend".

Paul V. Townsend, CPA
Legislative Auditor

September 6, 2006
Carson City, Nevada

STATE OF NEVADA
DEPARTMENT OF TAXATION

AUDIT REPORT

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EXECUTIVE SUMMARY

DEPARTMENT OF TAXATION

Background

The Department of Taxation (Department) was established by Chapter 748 of the 1975 Nevada Statutes. Established in 1913, the Nevada Tax Commission is the head of the Department and exercises general supervision and control over the Department's activities.

The Department is responsible for the general supervision and control over the State's revenue system. The Department collects 16 taxes and fees including statewide sales and use tax, estate taxes, net proceeds of minerals tax and property tax on interstate and inter-county companies, excise taxes and fees on liquor, cigarettes, other tobacco products, lodging taxes, insurance premium tax, tire tax, and government services fees. Pursuant to the Legislature's 20th Special Session, new taxes effective in fiscal year 2004 included the bank excise tax, business license fee, live entertainment tax, modified business tax, and real property transfer tax. The revenue collected by the Department provides funding to all levels of government including school districts, cities, counties and the State. Revenue for these taxes exceeded \$4 billion in fiscal year 2005.

The Department's main funding comes from general fund appropriations and contingency fund allocations. The Department's expenditures equaled \$31.5 million in fiscal year 2005.

Purpose

The purpose of this audit was to determine if the Department implemented procedures to ensure the insurance premium tax and the real property transfer tax are collected accurately, equitably, and in accordance with all applicable laws and regulations. Our audit included insurance premium tax and real property transfer tax

EXECUTIVE SUMMARY

DEPARTMENT OF TAXATION

activities during the fiscal year ended June 30, 2005. In certain instances we obtained insurance premium tax returns for years prior to those submitted in 2005.

Results in Brief

Current processes and controls utilized by the Department for the administration of the insurance premium tax and the real property transfer tax (RPTT) do not ensure these taxes are collected accurately, equitably, and in accordance with all applicable laws and regulations. Specifically, the Department's desk audit process is deficient, controls are weak, and all information to properly administer the insurance premium tax has not been gathered. This resulted in the Department failing to collect approximately \$16 million in taxes for tax years 2000 to 2004 and allowing \$1.1 million to be inappropriately refunded or lost due to the statute of limitations. Since the insurance premium tax is the third largest tax the Department collects, proper administration and understanding of the tax is essential to ensuring all amounts are appropriately collected. Further, the Department has not developed guidelines to ensure counties administer the RPTT consistently and equitably and the Department does not have formal processes and procedures for auditing the RPTT. The State receives the largest portion of the RPTT, making proper oversight of the tax crucial to ensuring fairness to taxpayers.

Principal Findings

- Errors in reporting taxable annuities resulted in nearly \$11 million not being collected by the Department since the 2000 reporting year. Problems occurred because the Department does not have reference guides to know whether taxpayers are reporting properly, forms and instructions are inadequate and confusing, and procedures are not sufficient to ensure inaccurate information is corrected. (page 14)

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- Total gross premiums on returns did not always contain all taxable amounts. At least \$5 million in taxes went uncollected for tax reporting years 2000 to 2004 because the Department failed to properly reconcile amounts reported on tax returns to supporting documentation. Further, penalties were not always imposed when they should have been, and the Department assessed interest for the entire month instead of a fraction of a month as required by statute. (page 16)
- Current tax reporting forms and instructions provided by the Department do not request companies to provide necessary and detailed information to ensure reported amounts are accurate. As a result, we could not determine reported amounts were appropriate and accurate. (page 19)
- Inadequate controls over other insurance premium tax administration allowed \$1.1 million to be inappropriately refunded or forfeited by the Department. The incomplete review of refunds allowed \$465,000 to be returned to a company inappropriately. Further, failure to issue memorandums for incomplete payment and penalty and interest assessments resulted in a loss of \$566,000. Finally, erroneous credits allowed \$137,000 more to be returned to insurers than they were due. In part, these problems occurred because the Department assumes all information provided to it is correct and does not use all available information to determine appropriateness and accuracy. (page 20)
- The Department has not developed comprehensive guidelines for counties to follow for granting exemptions and retaining supporting documentation when collecting the real property transfer tax. As a result, exemptions requiring supporting documentation vary by county. In addition, two counties have reached contradictory conclusions regarding one exemption meaning some taxpayers are paying taxes while others are not. (page 27)

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- Formal processes and procedures for auditing Nevada counties regarding the administration of the real property transfer tax have not been developed. Specifically, the Department has not determined the timing and frequency that each county will be audited. Further, the Department has not developed procedures for determining sample sizes and selection methodology to maximize time and resources. (page 29)
- The Department requires monthly reports from each county detailing the real property transfer tax activity for the period. During fiscal year 2005 and prior, the Department did not compare these reports to amounts transferred to the State Controller. Had the Department compared the two, it would have discovered several reporting errors. (page 30)

Recommendations

This report contains 14 recommendations to improve controls over the Department's administration of insurance premium and real property transfer taxes. Specifically, we recommended that policies and procedures should be developed over the administration of both taxes. Additionally, we made seven recommendations to improve, develop, modify, and correct several aspects of its administration of the insurance premium tax and the real property transfer tax. We also made three recommendations to correct areas that do not comply with statutory requirements. (page 42)

Agency Response

The Department, in its response to our report, accepted all 14 recommendations. (page 38)

Introduction

Background

The Department of Taxation (Department) is responsible for the general supervision and control over the State's revenue system. The revenue collected by the Department provides funding to all levels of government including school districts, cities, counties, and the State. The mission of the Department is to provide fair, efficient, and effective administration of tax programs for the State of Nevada in accordance with applicable statutes, regulations, and policies. The Department's goals include:

- Ensure the stable administration of tax statutes.
- Improve compliance through education, information, and enforcement.
- Cooperate with other agencies and entities to better serve taxpayers.
- Provide improved and more efficient service.
- Promote the fair and equitable treatment of taxpayers.
- Enhance workforce proficiency through training and communication.
- Improve tax administration through new technology.

The Department was established by Chapter 748, Statutes of Nevada, 1975. The chief administrative officer of the Department, the Executive Director, is appointed by the Governor. Established in 1913, the Nevada Tax Commission (Commission) is the head of the Department and exercises general supervision and control over the Department's activities. Actions by the Department may be appealed to the Commission as provided by law. The Commission may review all decisions of the Department and may reverse, affirm, or modify them.

The Department interacts with the Commission, two boards, and one committee. Exhibit 1 shows each entity, number of members, member appointing authority, and interaction with the Department.

**Department of Taxation
Boards, Commissions, Committees**

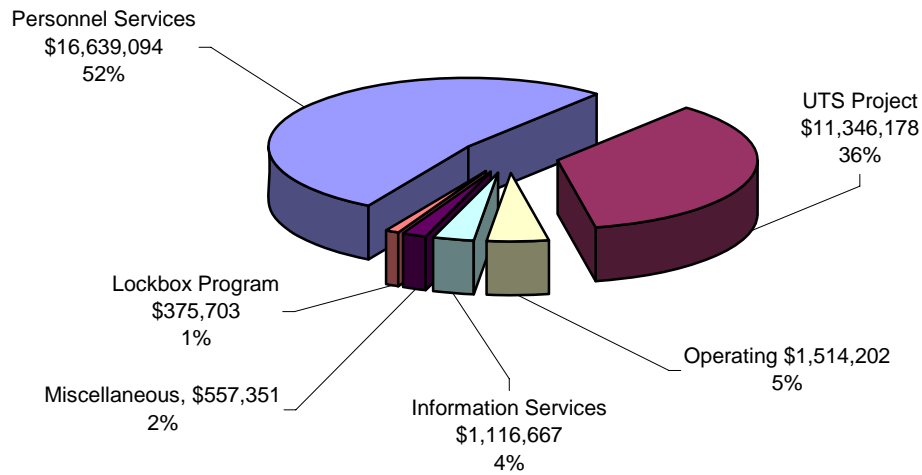
<i>Entity</i>	<i>Number of Members</i>	<i>Member Appointing Authority</i>	<i>Department Interaction</i>
Nevada Tax Commission	8 members	All members are appointed by the Governor for 4-year terms.	The Commission is the head of the Department and exercises general supervision and control over its activities.
State Board of Equalization	5 members	All members are appointed by the Governor for 4-year terms.	The Board hears and acts on appeals from the actions of various county boards of equalization and from valuations set by the Nevada Tax Commission.
Committee on Local Government Finance	11 members	3 members appointed by the League of Cities. 3 members appointed by the Nevada Association of Counties. 3 members appointed by the Nevada School Trustees Association. 2 members appointed by the Nevada State Board of Accountancy. Members serve 3-year terms.	The Committee advises the Department regarding regulations, procedures, and forms for compliance with the Local Government Budget Act, NRS 354.570 through 354.626.
Property Appraiser Certification Board	6 members	3 members appointed by the Association of County Assessors. 3 members appointed by the Nevada Tax Commission. Members terms are not specified.	The Board advises the Department on matters pertaining to certification and continuing education of appraisers.

Source: Department of Taxation's Annual Report fiscal year 2004-2005.

The Department maintains five offices consisting of its headquarters located in Carson City, district offices in Las Vegas and Reno, a satellite office in Henderson, and a taxpayer assistance office in Elko. As of July 2005, the Department had 346 authorized positions.

The Department's main funding comes from general fund appropriations and contingency fund allocations. The Department's expenditures were about \$31.5 million in fiscal year 2005. The majority of expenditures were associated with personnel services and the implementation of the Unified Tax System (UTS) project. Exhibit 2 shows the Department's expenditures by type for the fiscal year ended June 30, 2005.

**Expenditures by Type
Fiscal Year 2005**



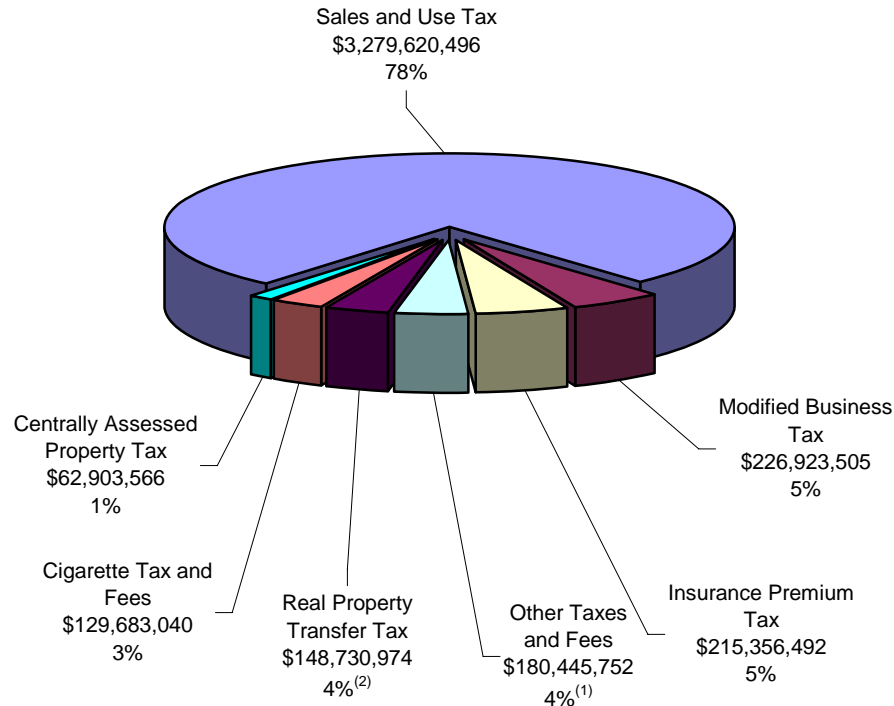
Source: State Accounting System; budget account 2361, fiscal year 2005.

Note: Miscellaneous expenses include travel, demographic surveys, cigarette stamps, attorney general cost allocation, out of state audit, training, and purchasing.

The Department collects 16 taxes and fees including statewide sales and use tax, estate taxes, net proceeds of minerals tax and property tax on interstate and inter-county companies, excise taxes and fees on liquor, cigarettes, other tobacco products, lodging taxes, insurance premium tax, tire tax, and government services fee. Pursuant to Senate Bill 8 of the Legislature's 20th Special Session, new taxes effective in fiscal year 2004 included the bank excise tax, business license fee, live entertainment tax, modified business tax, and real property transfer tax.

The Department collected and distributed about \$4.2 billion in taxes and fees in fiscal year 2005; an increase of about 45% over fiscal year 2003. Exhibit 3 shows the revenue collected by significant tax source for fiscal year 2005 and Appendix C details fees and taxes collected from fiscal years 2003 to 2005.

**Revenue by Tax Source
Fiscal Year 2005**



Source: Department of Taxation's Annual Report fiscal year 2004-2005.

(1) Other taxes and fees include net proceeds of minerals, intoxicating beverages, estate, lodging, live entertainment, other tobacco products, bank excise, and tire taxes. Also included are fees for government services, business licenses, and the business tax and fees.

(2) Real property transfer tax as shown reflects only the portion deposited to the General Fund. This amount equals \$1.30 for each \$500 of valuation. Another \$0.10 is deposited directly to low income housing and \$0.55 is transferred back to the respective county. Churchill, Clark, and Washoe counties have additional assessments on transfers of real property.

Insurance Premium Tax

The insurance premium tax was originally enacted in 1933 and is authorized by NRS 680B. The tax is imposed for the privilege of transacting business in the State. It is assessed at a rate of 3.5% on net direct premiums and net direct considerations written. Premiums and considerations are policy, membership and other fees and assessments for insurance, bail or annuity contracts received on account of policies and contracts covering property or risks. Insurers are allowed certain deductions and credits against the tax, including:

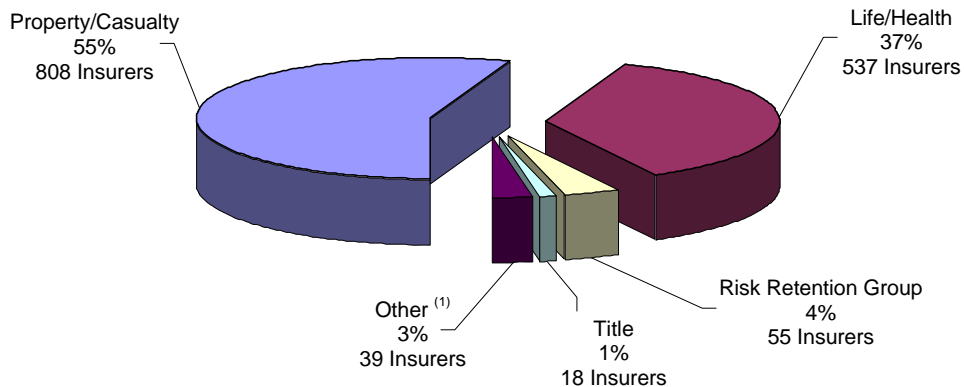
- Premiums paid with funds from a pension, annuity, or profit-sharing plan exempted per Internal Revenue Service codes 401, 403, 404, 408, 457, or 501.
- Returned premiums.

- Dividends, savings, and unabsorbed premium deposits returned to policyholders in cash or credited to their accounts.
- Industrial insurers who pay assessments to the Division of Industrial Relations.
- Insurers who pay assessments to the Nevada Insurance Guaranty Association and the Nevada Life and Health Insurance Guaranty Association.
- Insurers who maintain a home or regional office in Nevada.

Collections of insurance premium taxes totaled \$215 million in fiscal year 2005; an increase of 11% from fiscal year 2004. Insurance premium tax revenues are deposited in the state's General Fund. The Department's records indicate 1,457 insurance entities submitted an annual return for reporting year 2004. Annual returns are submitted for the calendar year with quarterly returns required when annual liabilities exceed \$2,000. Exhibit 4 shows the number of insurers submitting insurance premium tax annual returns by the type of license they hold.

Exhibit 4

**Insurers by License Type
Reporting Year 2004**



Source: Department insurance premium tax database.

⁽¹⁾ Other consists of Home Protection, Health Maintenance Organizations, Dental Care, Premium Finance, Prepaid Ltd. Health Service Organizations, Non-Profit Medical Service Organizations, Fraternal, Motor Club, and Rate Service Organizations.

Real Property Transfer Tax

The real property transfer tax (RPTT) is governed by NRS 375 and has been assessed by counties on transfers of real property since 1968. The recorder in each county is responsible for the computation and collection of RPTT before acceptance of

the deed for recordation. Exemptions to the real property transfer tax are allowed by NRS 375.090 if specific criteria are met. Exemptions in effect during fiscal year 2005 are detailed in Appendix D.

In October 2003, the Department became responsible for the fair and equitable administration of the RPTT with the passage of SB 8 of the 20th Special Session of the Nevada Legislature. The Department attempts to accomplish this responsibility by performing audits to ensure the tax is collected fairly and equitably and in compliance with statute. Audits consist of on-site inspections, individual interviews, and a review of deeds and other title documents to determine whether the transfer of real property was a taxable event.

The rate assessed for remittance to the state's General Fund is \$1.30 per each \$500 of value. Counties whose population is less than 400,000 assess an additional \$0.65 per \$500 of value. Clark County imposes an additional \$1.25 per \$500 in value. Further, Washoe County and Churchill County assess another \$0.10 per \$500 of value. Exhibit 5 shows RPTT rates by component levied and county.

Exhibit 5

**RPTT Tax Rates
by Component and County**

County	Component Type	Effective Date	Rate (per \$500)	Total Rate (per \$500)
Churchill	Consolidated Tax	01/01/1968	\$0.55	\$2.05
	Low Income Housing	07/01/1991	0.10	
	Local Government Tax Act	07/01/1991	0.10	
	State General Fund	10/01/2003	1.30	
Clark	Consolidated Tax	01/01/1968	\$0.55	\$2.55
	Low Income Housing	07/01/1991	0.10	
	School District	08/01/1997	0.60	
	State General Fund	10/01/2003	1.30	
Washoe	Consolidated Tax	01/01/1968	\$0.55	\$2.05
	Low Income Housing	07/01/1991	0.10	
	Local Government Tax Act	07/01/1991	0.10	
	State General Fund	10/01/2003	1.30	
All Other Counties	Consolidated Tax	01/01/1968	\$0.55	\$1.95
	Low Income Housing	07/01/1991	0.10	
	State General Fund	10/01/2003	1.30	

Source: Department of Taxation Real Property Transfer Tax Reporting Guide.

Collections of real property transfer tax transferred to the State for general fund purposes totaled \$149 million for fiscal year 2005. Total collections including state,

county, and special assessments for fiscal year 2005 equaled \$277 million. Exhibit 6 shows the total amount of RPTT collected by each county in fiscal year 2005.

Exhibit 6

**RPTT Collected by County
Fiscal Year 2005**

County	RPTT Collected	Percentage of Total
Clark	\$228,738,537	82.42%
Washoe	31,430,655	11.33%
Douglas	5,138,732	1.85%
Lyon	3,904,631	1.41%
Nye	2,914,104	1.05%
Carson City	2,078,341	0.75%
Elko	940,655	0.34%
Churchill	926,228	0.33%
Storey	388,315	0.14%
Humboldt	337,727	0.12%
Lincoln	288,512	0.10%
White Pine	137,518	0.05%
Pershing	136,533	0.05%
Lander	65,388	0.02%
Mineral	47,771	0.02%
Eureka	26,634	0.01%
Esmeralda	23,848	0.01%
Total Collections	\$277,524,129	100%

Source: Reports submitted monthly to the Department by county recorders.

Scope and Objective

This audit is part of the ongoing program of the Legislative Auditor as authorized by the Legislative Commission, and was made pursuant to the provisions of NRS 218.737 to 218.893. The Legislative Auditor conducts audits as part of the Legislature’s oversight responsibility for public programs. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

This audit included a review of the insurance premium tax and the real property transfer tax. The scope of our detailed testing focused on the fiscal year ended June 30, 2005. In certain instances we obtained insurance premium tax returns for years prior to those submitted during 2005. The objective of our audit was to determine

if the Department implemented procedures to ensure the insurance premium tax and real property transfer tax were collected accurately, equitably, and in accordance with all applicable laws and regulations.

Findings and Recommendations

Current processes and controls utilized by the Department for the administration of the insurance premium tax and the real property transfer tax (RPTT) do not ensure these taxes are collected accurately, equitably, and in accordance with all applicable laws and regulations. Specifically, the Department's desk audit process is deficient, controls are weak, and all information to properly administer the insurance premium tax has not been gathered. This resulted in the Department failing to collect approximately \$16 million in taxes for tax years 2000 to 2004 and allowing \$1.1 million to be inappropriately refunded or lost due to the statute of limitations. Since the insurance premium tax is the third largest tax the Department collects, proper administration and understanding of the tax is essential to ensuring all amounts are appropriately collected. Further, the Department has not developed guidelines to ensure counties administer the RPTT consistently and equitably and the Department does not have formal processes and procedures for auditing the RPTT. The State receives the largest portion of the RPTT making proper oversight of the tax crucial to ensuring fairness to taxpayers.

Significant Improvements Needed to Ensure Insurance Premium Taxes Are Properly Collected

The Department needs to improve its oversight of insurance premium taxes. In total, the Department failed to collect approximately \$16 million in taxes for tax years 2000 to 2004. In addition, control deficiencies allowed another \$1.1 million to be inappropriately refunded or lost due to the statute of limitations. Problems occurred because the Department's desk audit process was deficient, controls are weak, and all information to properly administer the tax has not been gathered. Because the insurance premium tax is the third largest tax the state collects, proper administration and understanding of the tax is essential to ensuring all amounts are appropriately collected.

Department Desk Audits Fail to Identify Errors

The Department's current process for reviewing insurance premium tax quarterly and annual returns is inadequate. Of the 57 annual returns we reviewed, 49 returns

had at least one error on them. Further, taxes were calculated incorrectly on 14 of the returns resulting in millions of dollars of uncollected and lost taxes. The most significant problems occurred because the reporting of annuity products is complicated. Errors are compounded by confusing and inadequate forms and instructions. Further, the Department failed to properly review the industrial insurance returns for reporting years 2003 or 2004. Many problems noted on insurance premium tax returns can be mitigated through the development of detailed policies and procedures, proper reference material, and revisions to current tax forms.

Annuity Reporting Problematic

Errors in reporting annuities resulted in nearly \$11 million not being collected by the Department since the 2000 reporting year. The largest inaccuracies occurred on two returns; however, nearly all of the returns reporting annuities were incorrect. Problems occurred because the Department does not have reference guides to know whether taxpayers are reporting properly, forms and instructions are inadequate and confusing, and procedures are not sufficient to ensure inaccurate returns are corrected.

An annuity is an arrangement whereby an individual (annuitant) is guaranteed to receive a series of stipulated amounts commencing either immediately or at some future date. Money accepted by a life insurer for the accumulation and the eventual purchase of an annuity may be taxed by one of two alternatives. Companies may elect to pay tax on annuity premiums on a “front-end” or “back-end” basis. For “front-end” taxpayers, premiums are reported and taxed at the time premiums are paid by the annuitant for the purchase of an annuity. “Back-end” taxpayers defer taxes on the premiums until the policy is annuitized and the policyholder begins to receive benefits. If taxed under this method, taxes are due on both the premiums paid by the annuitant and any interest or dividends credited to their account. Life and health companies signified their election on the return filed in 1971 or the first calendar year they transacted business in the state, whichever came later. Changes to the original reporting election must be approved by the consent of the Insurance Commissioner.

The Department does not verify if companies are reporting annuity premiums consistent with their election. As a result, some companies have changed their reporting method for tax purposes without approval from the Insurance Commissioner.

In one instance, a company changed their method of reporting annuity premiums from the “front-end” to the “back-end” method in 2002 even though the Insurance Commissioner never approved this change. As a result, the company inappropriately deferred approximately \$110 million in annuity premiums for years 2002 to 2004. Taxes due for the three combined years is about \$4 million, of which, \$1 million is not recoverable due to the statute of limitations. Generally, the statute of limitations gives the Department 3 years to notify companies of errors or deficiencies made on tax returns that result in additional amounts owed the state.

Even though the Department receives notification from the Division of Insurance regarding approved election changes, it does not retain the documentation in an easily accessible format. Without a reference of each company’s election, the Department cannot adequately review annual insurance premium tax returns reporting annuity premiums. An annuity reference can assist the State in ensuring that companies do not inappropriately defer or avoid taxes by requesting multiple changes to their annuity reporting election.

In addition, nearly all of the schedules examined regarding annuity reporting were wrong. Fourteen companies reported annuity products on their tax returns. Of those, nine of the annuity schedules were incorrect. Companies did not report amounts they should have, completed the schedules incorrectly, included inappropriate amounts, and deducted items inappropriately. For example, one company excluded over \$46 million in annuity premiums as nontaxable on the annuity schedule for reporting year 2004 and \$195 million since reporting year 2000. Amounts were excluded because of product classification changes instigated by the National Association of Insurance Commissioners in the year 2000. However, statutes allow an exclusion of annuity premiums only if they are issued from a pension or profit sharing plan that is exempt from taxation by certain codes of the Internal Revenue Service. The data provided by the company clearly shows the amounts excluded from gross premiums did not meet this criteria. Therefore, the Department should have disallowed the exclusion of these amounts from taxable premiums and assessed the company an additional \$6.8 million in taxes. Because these errors were not corrected, the Department is unable to collect over \$4 million in taxes due to the statute of limitations.

Additionally, some annuity schedules contained errors that were not corrected during the Department's desk audit process. One company deducted over half a million dollars on two separate lines, thus doubling the deduction and not paying \$18,000 in taxes. The company also did not report nearly \$1 million in annuity premiums on the schedule detailing the taxability of annuity premiums. Even though the company paid tax on these amounts because they were included on a separate schedule, the Department should be identifying and correcting errors to ensure returns are accurate.

These errors indicate breakdowns in the Department's review of tax returns and supporting schedules. Because current schedules interrelate and can be confusing, errors can happen easily and go undetected. The Department needs to create a reference for annuity reporting elections, modify forms and instructions, and develop detailed policies and procedures over the insurance premium tax to help alleviate these problems in the future.

Other Errors Found on Tax Returns

Insurance premium tax returns examined also contained errors unrelated to annuity reporting. For example, total gross premiums did not always contain all taxable amounts; penalties and interest were not always assessed; and interest was not calculated correctly. Further, schedules and calculations for retaliatory taxes were incorrect. Because of these errors, about \$5 million went uncollected for years 2000 to 2004. Increased controls and better review will help the Department ensure insurance premium taxes are properly reported.

Amounts reported on supporting schedules were not always reported on tax returns. For example, an insurance company did not include "other consideration" products in their gross premiums. In its response to our inquiry the Department stated the following:

"Other considerations" are included in the taxable measure determined for the Insurance Premium Tax. In its desk audit, the Department reconciles that "other considerations" located on Schedule T with Schedule 1 of the insurer's Annual Report . . . Upon researching the return filed for . . . the 2004 tax year it is apparent that Department staff did not correctly reconcile the return with Schedule T of the Annual Report.

Because the Department did not correct this error, the company has incorrectly reported gross premiums since the 2000 reporting year. As a result, approximately

\$154 million in premiums were not included in gross premiums for reporting years 2000 to 2004, resulting in \$5.4 million in taxes due. Of this, the Department can collect a little over \$2 million for reporting years 2003 and 2004, due to the statute of limitations.

Further, while statutes allow the Department to assess penalty and interest on late or deficient payments, this was not always done. Of 14 returns subject to penalty and interest, the Department incorrectly calculated interest on 9 returns and failed to assess penalty and interest on the remaining 5. For the nine returns the Department assessed interest, it did so for the entire month instead of a fraction of the month as required by statute. NRS 680B.039 states that any insurer who fails to pay the proper amount is subject to a penalty of not more than 10% and interest at a rate of 1.5% per month or fraction of a month from the date the tax was owed until the date of payment. While the monetary impact of the additional penalties and interest assessment is not significant, the Department needs to calculate and apply penalty and interest in accordance with statutes to be fair to taxpayers.

Lastly, retaliatory tax schedules on many returns were incomplete or incorrect. Retaliatory taxes are assessed on companies who are not physically located in the State of Nevada. Additional taxes are applied when taxes in the state in which the company is located would exceed those applied in Nevada. Our review found 22 of 57 schedules were incorrect. In most cases, additional taxes are not due; however, the Department's review is insufficient in ensuring retaliatory schedules are correct. Since the Department is requiring companies complete this information, it should be reviewing the information for accuracy and completeness.

If the Department had sufficient procedures detailing how desk audits should be performed, these errors may not have occurred. However, the Department currently has few policies and procedures that assist staff in the administration of the insurance premium tax.

Inadequate Industrial Insurance Oversight

Administration over the industrial insurance returns is not sufficient to ensure returns are accurate and taxes paid appropriate. In addition, taxpayers are remitting funds to the Department when there are no taxes due. This has occurred because of a lack of policies and procedures; forms and instructions on completing tax returns are

inadequate; and the Department has not informed taxpayers of available credits or refunds due. Oversight needs to be strengthened to ensure taxes collected are appropriate and accurate.

The Department has not reviewed certain quarterly and none of the annual industrial insurance returns for reporting years 2003 and 2004. Industrial insurance taxpayers are allowed credits against their taxes for amounts assessed by the Division of Industrial Relations for their oversight of industrial insurers. While some industrial insurers do not owe taxes because these credits offset taxes due, our review indicated one insurer was deficient in its tax payment by \$9,300. By not reviewing some quarterly and annual returns, the Department is unable to confirm the accuracy of reported premiums, claimed deductions, and payments made.

The Department also applied credits to quarterly returns incorrectly for 9 of the 10 industrial insurance returns we reviewed. The Division of Industrial Relations assesses insurers for the estimated cost of its program for each fiscal year. Payments are due in four installments that are not necessarily due with each quarter end. As a result, payments tend to occur in the latter half of the year. The Department applied this credit to quarterly returns and not the returns in which the insurer paid the related assessment. This allowed some credits to be applied against taxes before payments were actually made. Credits should be applied to quarterly returns based on when payment is made to ensure deductions to taxes are valid.

In its review of quarterly returns for 2003, the Department recalculated and applied the Division of Industrial Relations "true-up" credit to tax returns incorrectly. The Division of Industrial Relations adjusts its original assessment each year once actual expenditures are known. This "true-up" creates a credit for some companies and an additional liability for others. These amounts must be accounted for and adjusted as necessary on industrial insurance tax returns. In fiscal year 2003, information received from the Division of Industrial Relations regarding "true-up" calculations was confusing. Rather than clarifying the information with the Division of Industrial Relations, the Department recalculated the credits incorrectly. As a result, the balances from 2003 being carried forward to subsequent tax years are wrong. Incorrect carry forward amounts will affect future periods and may affect taxes owed.

Finally, some industrial insurers did not take Division of Industrial Relations credits due them. As a result, insurers remitted funds to the state even though taxes were not due once credits were applied. Four insurers we reviewed submitted payments equaling \$650,000 for the 2003 and 2004 reporting years that were unnecessary. Because Division of Industrial Relations credits typically offset taxes due, these insurers continue to accumulate large credit balances. Current forms and instructions do not adequately discuss these credits and how they should be accounted for on annual returns. Therefore, many industrial insurers are not taking advantage of the credits available to them. Statutes require the Department to notify taxpayers when they have been taxed or assessed more than the law allows; yet, we found no evidence the Department has notified industrial insurance companies of this issue.

Forms and Instructions Need Enhancement

Current tax forms and instructions provided by the Department are insufficient to ensure amounts reported are accurate and do not provide taxpayers with appropriate assistance or gather necessary information. The Department can model forms and instructions from those of other states to ensure proper information is requested and instructions are precise and complete.

Reporting forms for life and health insurers do not request sufficient information from those companies who choose to report annuities on a “back-end” basis. Our review of insurance premium tax returns showed companies electing to be taxed on the “back-end” for annuities reported little, if any, taxable amounts. Current tax reporting forms do not request companies submit this information. In addition, instructions fail to address how companies should report annuity premiums. Forms should request each company report annuitizations if they choose to be taxed on the “back-end” to ensure all companies are paying the appropriate taxes on annuity premiums.

In addition, annual reporting forms do not request certain information be segregated. Specifically, statutes provide an exemption for premiums paid with funds from pension, annuity, or profit-sharing plans that are qualified or exempt pursuant to the Internal Revenue Service Code. Qualified premiums are shown on the annuity schedule, as well as another schedule which calculates taxable premiums. In some instances, the amounts on the two schedules did not agree. For example, one

company reported \$430,000 in qualified annuity premiums on the annuity schedule. On the second schedule the company excluded \$1.7 million as premiums received from qualified funds. Because forms do not request detailed information, we could not be certain the variance and additional deduction was appropriate.

The Department can model its forms after those used in other states with similar needs. The California Life, Accident, and Health Insurance Tax Return requests companies provide more detailed information than the current forms provided by the Department. Separate schedules are required for annuity reporting based on the company's election and qualified and nonqualified premiums are segregated on the schedules. Further, instructions are provided for each line item of each schedule to assist companies in completing forms accurately. The Department can use these forms as a guide to ensuring its informational needs are met, which should allow for more efficient review of returns and better administration of the insurance premium tax.

Controls Over Other Areas Can Be Strengthened

Inadequate controls over other areas of the insurance premium tax administration allowed \$1.1 million to be inappropriately refunded or forfeited by the Department. For instance, refunds were issued without investigation into the circumstances creating the overpayment, memorandums for deficient payment and interest and penalty assessments were not issued in a timely manner, and incorrect credits were allowed to be taken on property and casualty returns. Errors occurred because the Department assumes information provided to it is correct, and it does not use all available information to determine accuracy. Further, the Department has not developed policies and procedures over any facet of insurance premium tax administration. Policies and procedures will assist the Department in determining the appropriateness of returns ensuring transactions are proper, complying with laws and regulations, and collecting all taxes due. Further, detailed policies and procedures can help ensure consistency in reviewing returns and aid in training and assisting staff if personnel change.

Refunds Not Always Appropriate

The Department issues refunds for overpayment of insurance premium taxes when companies request amounts overpaid be returned. Yet, the Department does not

always review the circumstances in which the overpayment was created to ensure refunds made are appropriate. Of the five refunds we examined we could only verify one was correct. Insufficient examination regarding refund requests resulted in about \$465,000 being inappropriately refunded and another \$272,000 issued where it is questionable whether the refund should have been processed at all. If the Department had appropriate procedures regarding how refunds should be calculated, reviewed, and issued, these problems may not have occurred.

The Department issued a refund of nearly \$800,000 without thoroughly reviewing the annual return which created the overpayment. The refund related to tax year 2001 which showed the company originally calculated \$697,000 in insurance premium taxes. However, the company amended this tax return excluding \$19 million in annuity premiums originally reported as taxable. This exclusion reduced the tax liability for the company to \$34,000. Had the Department compared the 2001 return to the prior year it would have found the company changed its method for reporting annuity premiums. The Division of Insurance indicated this company did not receive approval to change the method for reporting annuity premiums; therefore, the company inappropriately excluded the \$19 million in annuity premiums. This resulted in a refund of \$465,000 more to the company than it was due.

Other refunds were also processed by the Department without investigating the circumstances creating the significant overpayment. The Department refunded \$272,000 paid by two home warranty protection companies. The companies requested the refunds under the premise the products sold qualified as service contracts (nontaxable) instead of insurance products (taxable). However, both companies made quarterly payments during 2004 as if the amounts were taxable insurance products and had paid taxes on these products in the past. Even though gross premiums declined by over 90% on each company's 2004 annual return, the Department processed the refunds without investigating whether the claims made by the company were accurate.

In response to our inquiries regarding the steps taken to ensure refunds are accurate, the Department stated it assumes the information provided by an insurer is accurate unless proven otherwise. In addition, the Department confirmed it does not currently have policies and procedures relating to refunds. When issuing significant

refunds the Department should take the appropriate steps to ensure amounts are actually due to be returned. This can be accomplished by developing detailed procedures which include, but are not limited to, the review of documentation to validate the accuracy of the refund request.

Amounts Lost Due to Delays

The Department failed to issue memorandums related to deficient payments and penalty and interest assessments in a timely manner. As a result, the Department lost the ability to collect about \$566,000 in amounts owed the State. If the Department had adequate policies requiring these memorandums be issued in a timely manner, this may not have occurred.

The Department computes deficient payments and related penalty and interest assessments on companies who do not pay all the taxes due on annual and quarterly returns. Companies are notified through a memorandum calculated by the Department which itemizes additional taxes due, penalties assessed, and any associated imputed interest. Statutes allow the Department 3 years to notify the taxpayer of amounts due from the month following that which the assessment is related to, or from when the return is filed, whichever period expires later. Yet, our review of Department records showed 375 memorandums totaling over \$1.2 million, some relating to reporting year 2001, were waiting for management approval. Because some of these memorandums were for periods beyond the 3-year limitation, the Department has lost the ability to collect these amounts. Based on our analysis of Department calculations, amounts forfeited exceed \$566,000 and could be more depending on when the memorandums are finally mailed.

Incorrect Credits Affect Refunds Issued

Not all credits applied against taxes due were correct. Inaccurate credits resulted in \$137,000 more being refunded to insurers than should have been. This occurred because the Department did not review statements to ensure they were calculated in accordance with law.

Property and casualty insurers are allowed a credit against taxes due for amounts paid to the Nevada Insurance Guaranty Association (Association). Within certain parameters, the Association is obligated to pay the claims of insolvent member

insurers. The Association assesses every member insurer for the cost of the program each year. In return, each insurer is allowed a credit against taxes equal to 20% of the yearly assessment for 5 successive years beginning with the calendar year following the year in which the assessment was paid. However, credit statements prepared by the Association allowed 20% of the assessment to be taken in the year paid, one year earlier than allowed by law. Our review of refunds showed the incorrect credits resulted in the Department refunding \$137,000 more than it should have had the credits been accurate. In addition, some companies would not have been due a credit and would have owed the Department additional taxes had credits been calculated appropriately.

Delinquent Annual Returns Unknown

Finally, the Department failed to determine those companies who did not properly file tax returns. This procedure had not been performed for several years. We determined those companies who should have filed a 2004 annual return and found 31 deficient filers. After our inquiry, the Department performed a review of non-filers back to reporting year 1998 and found several companies who had not filed returns for previous years. While the monetary impact was not significant for 2004, insurers who fail to submit returns should be reported to the Division of Insurance per NRS 680B.060. Further, determining deficient filers is important as one tax return can account for thousands of tax dollars. The Department should continue to review for companies who have not filed, at least on an annual basis, to ensure all taxes due are collected.

Clarification Needed on Certain Issues

During our review of the insurance premium tax, we were unable to resolve several issues affecting how the tax is administered. Issues included the taxability of certain insurance license holders, whether certain products issued by life and health insurers should be taxed, and the appropriate method of accounting for dividends paid by insurance companies.

The Division of Insurance licenses 19 types of licensees to provide various services to Nevada citizens. We requested the Department tell us which types of insurers were subject to taxation under insurance premium tax statutes. The Department indicated that 5 of the 19 insurance types were taxable under NRS 680B.027. Of the 14 remaining license types, we were able to determine 10 of them

were not taxable or taxes were collected by somebody else. Due to a lack of definitive guidance regarding the remaining 4 license types, we were unable to determine the taxability of the license types. Compounding this issue further, the Department collected taxes from some of the license holders it considers to be nontaxable. Our calculations indicate about \$1.8 million in taxes were collected from license types the Department stated were not taxable entities. The Department needs to have a better understanding of the types of insurers subject to taxes and have documentation supporting the taxable or nontaxable status of each license type.

As previously discussed in this report, the Department did not obtain the guidance necessary to ensure refunds issued to two home protection license holders in fiscal year 2005 were appropriate. Explanations for the refunds indicate the company considered a majority of its products to qualify as service contracts in 2004, which are not taxable. In prior years, the companies considered these products as taxable. However, we could not determine whether this reclassification was accurate or appropriate based upon available information. The Department needs to investigate the proper classification and taxability of these products.

While reviewing insurance premium tax returns, two issues arose where the Department could not provide sufficient clarification regarding the accounting for each issue. First, the Department was uncertain of the taxability of deposit-type contracts issued by life and health insurance companies; and second, the deductibility of certain dividends is questionable. The determination regarding these issues may affect taxes due for several companies. Therefore, resolution of these issues is essential to ensuring appropriate taxes are paid.

Deposit-type contracts are defined as those that do not incorporate insurance risk from the death or disability of policyholders. Current statutes apply insurance premium taxes upon the net direct premiums and considerations of a company. NRS 679A.115 defines a "premium" as consideration for insurance, by whatever name called. The term includes any "assessment," or any "membership," "policy," "survey," "inspection," "service," or similar fee or other charge assessed or collected by the insurer or his agent in consideration for an insurance contract or its procurement. Based on the definition above, it is questionable whether deposit-type contracts should

be considered insurance products. Our review of annual tax returns showed companies are not consistent in their inclusion or exclusion of these items. Of four companies providing these types of products in our sample, two of them excluded deposit-type contracts from taxable premiums and two reported these products as taxable. While the Department desk audited each of these returns, it did not modify the reporting of these products on any of the returns.

Confusion also exists regarding the deductibility of certain types of dividends. Dividends can be made to policyholders in several forms. Annual statements submitted to the National Association of Insurance Commissioners require insurance companies to categorize dividends into the following:

- Paid in cash or left on deposit.
- Applied to pay renewal premiums.
- Applied to provide paid-up additions or shorten the endowment or premium-paying period.
- Other.

Paid-up addition dividends are used to purchase additional insurance thereby increasing the amount of insurance the policyholder has in force. Two Attorney General Opinions have stated that dividends are taxable, when applied by the insurer as premium for paid-up additional insurance. Therefore, companies must add paid-up addition dividends issued during the reporting year to their gross annual premiums.

Nevada statutes also allow insurers to deduct dividends, savings, and unabsorbed premium deposits that are returned to policyholders in cash or credited to their accounts. Uncertainty exists as to whether paid-up addition dividends should be allowed as a deduction. The Department indicated a deduction should not be allowed for these dividend types. However, several companies claimed a deduction for paid-up addition dividends on annual returns, which the Department allowed. Paid-up addition dividends allowed to be deducted exceeded \$10 million on seven returns we reviewed for reporting year 2004. Therefore, it is significant that the Department determine the proper manner of accounting for these items.

When instances arise which create uncertainty, the Department should obtain further information to ascertain the validity of the transaction. Further, the Department

should be skeptical when transactions or requests are contradictory to what has been done in the past. If the Department continues to process insurance premium tax returns without the appropriate information, it cannot be certain it is collecting all taxes due the State of Nevada.

Recommendations

1. Develop detailed policies and procedures for all facets of the application, administration, and collection of the insurance premium tax.
2. Develop and maintain a reference of the annuity reporting election of each company and approved changes.
3. Modify forms and instructions to request pertinent information, provide detailed information for completion of forms, and allow for more efficient administration and review of the insurance premium tax.
4. Assess penalty and interest in accordance with law.
5. Properly train Department personnel to oversee industrial insurance premium tax administration.
6. Notify taxpayers of overpayments with instructions for requesting refunds as required by law.
7. Issue insurance premium tax debit and credit memorandums in a timely manner.
8. Coordinate with the Nevada Insurance Guaranty Association to correct property and casualty credit statements and only offset taxes by amounts allowed in law.
9. Communicate with the Division of Insurance regarding insurance premium tax issues, including deficient filers or other matters that may arise where it may assist the Department in administering the tax.
10. Obtain clarification regarding those issues pertinent to ensuring the insurance premium tax is properly administered.

Real Property Transfer Tax Oversight Should Be Strengthened

The Department can improve its oversight of the real property transfer tax. Specifically, the Department should develop administrative guidelines for counties and develop formal audit processes and procedures to ensure the tax is administered consistently and equitably among all counties. Additionally, the Department did not reconcile county RPTT reports and remittances to ensure all money is collected and reported information is accurate. Finally, one county needs to properly approve a local ordinance to continue assessing and collecting additional taxes on property transfers. The State receives the largest portion of the RPTT making proper administration of the tax crucial to ensuring fairness to taxpayers.


Consistency Among Counties Needed

Nevada counties, responsible for the collection of real property transfer tax, are not consistent in administering certain facets of the tax. For instance, exemptions requiring supporting documentation vary between counties. Further, some counties retain certain documentation for exemptions while others do not. In addition, two counties have reached contradictory conclusions regarding one exemption which means some taxpayers are paying taxes and others are not.

The Department has not developed comprehensive guidelines for counties to follow for granting exemptions and retaining supporting documentation when collecting the RPTT. Statutes allow for exemptions from RPTT if certain specific conditions are met. However, not all counties require documentation for the same exemptions to ensure the conditions specified in law are met. Exhibit 7 shows each county and its documentation requirements regarding each exemption. Exemptions effective during our audit period are detailed in Appendix D.

**Supporting Documentation Requirements
by County and Exemption**

County	Exemption number (NRS 375.090)												
	1	2	3	4	5	6	7	8	9	10	11	12	13
Carson City	X					X		X		X	X		
Churchill						X							
Clark	X				X	X		X					
Douglas	X					X		X					
Elko													
Esmeralda													
Eureka						X							
Humboldt													
Lander													
Lincoln	X					X							
Lyon	X					X		X					
Mineral						X							
Nye	X					X		X					
Pershing													
Storey													
Washoe	X			X		X		X					
White Pine													

 County indicated that support was required but did not specify which exemptions support was required for.

 County did not respond to the request for information.

Source: Survey of County Recorders.

Note: Exemption numbers and related statutes are those in effect for fiscal year 2005. Nevada Revised Statutes related to NRS 375.090 changed effective July 1, 2005.

Supporting documentation is not required by statute in order to claim an exemption from RPTT. Yet, in order to substantiate the applicability of certain exemptions, supporting documentation is necessary. For example, one exemption to real property transfer taxes detailed in NRS 375.090(1) shown in Appendix D states the following:

A mere change in identity, form or place of organization, such as a transfer between a corporation and its parent corporation, a subsidiary or an affiliated corporation if the affiliated corporation has identical common ownership.

Evidence the two companies meet this criteria cannot be obtained from real property transfer tax forms submitted at recording. Yet, three counties who provided detailed responses indicated they do not request support for this exemption. Support should be requested for those exemptions that cannot be validated through information provided

when transferring property. The Department should determine those exemptions needing support and request counties review appropriate documentation. This would help the Department ensure all taxes are assessed and collected properly.

Some counties include a notation on the Declaration of Value form indicating supporting documentation was reviewed and deemed sufficient. However, other counties failed to notate their review of supporting documentation even though the Department requested them to do so. For those documents we reviewed where the county did not notate a review, we were unable to determine whether the exemption claimed was valid. Because not all counties retain supporting information, notation by recorder's office staff is essential for confirming the appropriateness of exemptions.

Resolution of contradictory legal opinions related to the administration of RPTT was not pursued by the Department prior to our audit. Two county district attorneys issued conflicting opinions regarding an exemption to RPTT, which allows transfers of property between individuals within the first degree of consanguinity to be exempt from taxation. The opinions, dated in 1985, differed on whether kindred of the half blood, stepparents and stepchildren were included under the exemption. Although the Department's responsibility for RPTT did not begin until 2003, the Department should have requested clarification of the issue at that time. As a result, counties continue to interpret this issue differently with some citizens paying taxes on transfers of property while others do not.

Currently, the state retains the largest portion of RPTT at \$1.30 for every \$500 of declared property value. Therefore, it is important that all 17 counties are consistent in their application of the tax and the related exemptions. Because the Department is the responsible oversight authority, it is essential it develops guidelines and resolves differences so counties can administer the tax as fairly and equitably as possible.

Audit Process Not Formalized

The Department has the authority to audit each Nevada county and its administration and collection of the RPTT. However, formal processes and procedures have not been developed by the Department. The development of policies and procedures over the RPTT audit process will help ensure consistency, efficiency, and the proper management of the Department's resources.

Since the Department was given oversight responsibility in 2003, the Department has completed audits of RPTT records in Elko, Humboldt, Lander, Pershing, and Storey counties. However, audits in the remaining 12 counties, which constitute 99% of the RPTT remittances in fiscal year 2005, have not been performed. Before the Department initiates the remaining audits, it should develop the procedures and methods by which they will be conducted. Specifically, the Department should determine the timing and frequency that each county will be audited. The Department should also develop auditing criteria and procedures and sampling methodologies. These will assist the Department in performing audits that are informative, helpful, and consistent among counties.

Reconciliation of County Remittances Should Be Performed

The Department requires monthly reports from each county detailing the RPTT activity for the period. During fiscal year 2005 and prior, the Department did not compare these reports to amounts transferred to the State Controller. Had the Department compared the two, it would have discovered several variances including errors made on monthly reports and remittances. Our review of the monthly reports and remittances for fiscal year 2005 found that in five counties the differences between the monthly reports and remittances indicated about \$490,000 more was remitted than should have been. Errors included the inappropriate transfer of collection allowances, counties cutting off month end collections incorrectly, and counties not incorporating refunds in reported amounts.

The Department stated in a reporting guide it published in March 2004 that remittances should balance to the sum of the monthly recorder's reports. The Department began reconciling reported amounts to remittances received from the counties in mid-2005. To help ensure the State is collecting all appropriate funds and data collected and distributed is accurate, the Department should continue to reconcile monthly activity reports and amounts remitted to the State.

Tax Unauthorized at Local Level

The Department has been receiving and distributing funds for RPTT from Churchill County that are unauthorized. The local ordinance enacting additional RPTTs

expired nearly a decade ago. As a result, the County collected and the Department distributed about \$45,000 in fiscal year 2005 more than was properly authorized.

Churchill County originally enacted a local ordinance to impose an additional \$0.10 assessment on property transfers in August of 1991. This additional assessment was allowed by Chapter 491, Statutes of Nevada, 1991, and also included a provision to disallow the imposition of this tax after June 30, 1996. Subsequently, Chapter 475, Statutes of Nevada, 1993, removed the sunset provision for Churchill County. However, the ordinance passed by Churchill County in 1991, was never updated to remove the provision limiting the time period in which it could assess the tax.

Recommendations

11. Develop policies and procedures regarding the administration of the real property transfer tax and related audit function.
12. Issue guidelines to counties for applying exemptions, including requirements for supporting documentation and verification it was received.
13. Develop a process for the reconciliation of monthly reports and related remittances.
14. Ensure counties assessing additional tax amounts comply with statutory and local requirements regarding establishment of the rate and collection.

Appendices

Appendix A Audit Methodology

To gain an understanding of the Department of Taxation, we interviewed management and staff, reviewed applicable laws, regulations, and policies and procedures significant to the financial and administrative practices of the Department. We also reviewed legislative and executive budgets, legislative committee minutes, Interim Finance Committee minutes, and Department annual reports. In addition, we identified significant control structures relevant to the Department and reviewed controls over these areas. Our review included the general control environment, financial environment, and programmatic areas.

To determine whether the Department was properly administering the insurance premium tax, we determined the completeness and accuracy of the Department's database by comparing pertinent information to the Division of Insurance's listing of insurers. We held discussions with Division of Insurance management to verify taxable insurers and discuss other issues. We judgmentally selected 15 annual returns submitted during fiscal year 2005 ensuring at least 5 were industrial insurance returns. Additionally, we randomly selected another 35 companies from the Division of Insurance's listing of insurers. Because some companies submitted both property and casualty and industrial insurance returns, our total sample equaled 57. Using a similar process to the Department, we reviewed each return for mathematical accuracy, evidence of management review, consistency with premiums reported to the National Association of Insurance Commissioners, adequacy of support for credits and offsets taken, and accuracy of reported annuity premiums. For some life and health insurers, we reviewed annual returns from calendar years 2000 to 2004 and evaluated the accuracy and consistency in reporting. Next, we traced tax payments to the state accounting system and pertinent tax return information to the Department's database. Further, we reviewed the refunds issued by the Department during fiscal year 2005. We selected the five largest refunds and determined if they were reasonable and

mathematically accurate. To determine those amounts the Department failed to collect because memorandums were not issued, we reviewed Department spreadsheets and identified those amounts past the limitations imposed by statutes. Finally, we determined those companies who had not filed annual returns that should have by reviewing the Department's database.

To determine if the Department was administering the real property transfer tax (RPTT) accurately and equitably, we surveyed all 17 county recorders' offices regarding their administration of the RPTT. In addition, we compared each county's monthly tax collections report with amounts remitted either monthly or quarterly. We questioned the Department regarding differences found. Finally, we evaluated the status of the Department's process of auditing county RPTT records.

To determine if counties were consistently and accurately levying RPTT, we selected Clark, Washoe, and Douglas counties and obtained transaction detail for 2 months during fiscal year 2005. We held discussions with each county recorder regarding their administration of RPTT. We verified the reliability of data received by tracing information to paper documentation at each location. Next, we selected a random sample of 400 RPTT transactions from Clark County, 60 from Washoe County, and 40 from Douglas County based on the number of transactions at each county. For each sample selection, we reviewed the associated deed and declaration of value form for appropriateness and consistency. For exemptions, we determined if supporting documentation was reviewed by the county as necessary. For taxed transactions, we recalculated taxes paid and, in certain instances, compared information from county assessors to the declared property value.

To determine if the implementation of the new Unified Tax System at the Department impacted any findings or recommendations regarding the insurance premium tax or real property transfer tax, we discussed with management the current status and projected role of the project relevant to these taxes.

Our audit work was conducted from July 2005 through March 2006 in accordance with generally accepted government auditing standards.

In accordance with NRS 218.821, we furnished a copy of our preliminary report to the Executive Director of the Department of Taxation. On August 24, 2006, we met

with agency officials to discuss the results of the audit and requested a written response to the preliminary report. That response is contained in Appendix E, which begins on page 38.

Contributors to this report included:

Shannon Ryan, CPA
Deputy Legislative Auditor

Daniel L. Crossman, CPA
Deputy Legislative Auditor

Dianna Giovannoni, CPA
Deputy Legislative Auditor

Timothy K. Brown, CPA
Audit Supervisor

Stephen M. Wood, CPA
Chief Deputy Legislative Auditor

Appendix B

Prior Audit Recommendations

As part of our audit, we requested the Department of Taxation determine the status of the seven recommendations made in our prior audit of the Department in 1999. The Department indicated that all seven recommendations had been fully implemented. The scope of our current audit did not include the prior recommendations. Therefore, we did not verify the Department's response to the prior recommendations.

Appendix C
Tax and Fee Collections
Fiscal Years 2003 to 2005

Tax/Fee Type	2003	2004	2005	Percentage Change FY 03-05
Sales and Use Tax	\$2,424,657,995	\$2,821,593,025	\$3,279,620,496	35.3%
Intoxicating Beverage Tax	19,793,754	36,670,163	39,134,707	97.7%
Cigarette Tax and Fees	62,027,334	122,747,208	129,683,040	109.1%
Other Tobacco Products	5,916,301	6,927,276	7,557,607	27.7%
Estate Tax	39,203,340	26,018,237	21,774,432	-44.5%
Lodging Tax	11,875,153	13,305,505	15,134,104	27.4%
Net Proceeds of Minerals	25,162,206	37,162,642	39,690,846	57.7%
Centrally Assessed Property Tax	64,794,636	69,035,179	62,903,566	-2.9%
Business Tax and Fees ⁽²⁾	79,765,693	22,216,500	1,297,383	-98.4%
Insurance Premium Tax	173,990,728	194,218,036	215,356,492	23.8%
Tire Tax	1,483,883	1,632,492	1,678,740	13.1%
Government Service Fee	22,208,165	25,925,323	28,091,131	26.5%
Bank Excise Tax	--	1,508,192	3,084,456	N/A
Business License Fee ⁽²⁾	--	11,851,752	14,486,315	N/A
Live Entertainment Tax	--	4,345,868	8,516,031	N/A
Modified Business Tax ⁽²⁾	--	161,649,489	226,923,505	N/A
Real Property Transfer Tax ⁽¹⁾	--	88,024,737	148,730,974	N/A
Total Taxes/Fees Collected	\$2,930,879,188	\$3,644,831,624	\$4,243,663,825	44.8%

Source: Department of Taxation's Annual Report, fiscal years 2003-2004 and 2004-2005.

⁽¹⁾ Real property transfer tax as shown reflects only the portion deposited to the General Fund. This amount equals \$1.30 for each \$500 of valuation. Another \$0.10 is deposited directly to low income housing and \$0.55 is returned to the respective county. Churchill, Clark, and Washoe counties have additional assessments on transfers of real property.

⁽²⁾ The business tax and fees was repealed effective 9/30/2003 and replaced by the modified business tax and business license fee. Collections of the business tax and fees in fiscal years 2004 and 2005 relate to liabilities generated in fiscal years 2003 and prior.

Appendix D

Real Property Transfer Tax – Statutory Exemptions

NRS 375.090 Exemptions. The taxes imposed by NRS 375.020, 375.023 and 375.026 do not apply to:

1. A mere change in identity, form or place of organization, such as a transfer between a corporation and its parent corporation, a subsidiary or an affiliated corporation if the affiliated corporation has identical common ownership.
2. A transfer of title to the United States, any territory or state or any agency, department, instrumentality or political subdivision thereof.
3. A transfer of title recognizing the true status of ownership of the real property.
4. A transfer of title without consideration from one joint tenant or tenant in common to one or more remaining joint tenants or tenants in common.
5. A transfer of title between spouses, including gifts, or to effect a property settlement agreement or between former spouses in compliance with a decree of divorce.
6. A transfer of title to or from a trust without consideration if a certificate of trust is presented at the time of transfer.
7. Transfers, assignments or conveyances of unpatented mines or mining claims.
8. A transfer, assignment or other conveyance of real property to a corporation or other business organization if the person conveying the property owns 100 percent of the corporation or organization to which the conveyance is made.
9. A transfer, assignment or other conveyance of real property if the owner of the property is related to the person to whom it is conveyed within the first degree of consanguinity.
10. The making, delivery or filing of conveyances of real property to make effective any plan of reorganization or adjustment:
 - (a) Confirmed under the Bankruptcy Act, as amended, 11 U.S.C. §§ 101 et seq.;
 - (b) Approved in an equity receivership proceeding involving a railroad, as defined in the Bankruptcy Act; or
 - (c) Approved in an equity receivership proceeding involving a corporation, as defined in the Bankruptcy Act, if the making, delivery or filing of instruments of transfer or conveyance occurs within 5 years after the date of the confirmation, approval or change.
11. The making or delivery of conveyances of real property to make effective any order of the Securities and Exchange Commission if:
 - (a) The order of the Securities and Exchange Commission in obedience to which the transfer or conveyance is made recites that the transfer or conveyance is necessary or appropriate to effectuate the provisions of section 11 of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79k;
 - (b) The order specifies and itemizes the property which is ordered to be transferred or conveyed; and
 - (c) The transfer or conveyance is made in obedience to the order.
12. A transfer to an educational foundation. As used in this subsection, “educational foundation” has the meaning ascribed to it in subsection 3 of NRS 388.750.
13. A transfer to a university foundation. As used in this subsection, “university foundation” has the meaning ascribed to it in subsection 3 of NRS 396.405.

Note: The above exemptions were effective during the scope of this audit (fiscal year 2005). Significant revisions to NRS 375.090 during the 2005 legislative session effective July 1, 2005, included adding exemptions for transfers within the first degree of lineal affinity (between in-laws) and conveyances by deed which becomes effective upon death of the grantor pursuant to NRS 111.109.

Appendix E
Response From the Department of Taxation



KENNY C. GUINN
Governor

THOMAS R. SHEETS
Chair, Nevada Tax Commission

DINO DICIANNO
Executive Director

STATE OF NEVADA
DEPARTMENT OF TAXATION

Web Site: <http://tax.state.nv.us>

1550 College Parkway, Suite 115
Carson City, Nevada 89706-7937
Phone: (775) 684-2000 Fax: (775) 684-2020

LAS VEGAS OFFICE
Grant Sawyer Office Building, Suite 1300
555 E. Washington Avenue
Las Vegas, Nevada, 89101
Phone: (702) 486-2300 Fax: (702) 486-2373

RENO OFFICE
4600 Kietzke Lane
Building L, Suite 235
Reno, Nevada 89502
Phone: (775) 688-1295
Fax: (775) 688-1303

HENDERSON OFFICE
2550 Paseo Verde Parkway Suite 180
Henderson, Nevada 89074
Phone: (702) 486-2300
Fax: (702) 486-3377

September 5, 2006

Paul Townsend, CPA, CIA
Legislative Counsel Bureau
401 So. Carson St.
Carson City, NV. 89701

Re: Legislative Counsel Bureau Audit Findings August 2006

Dear Mr. Townsend,

The Department has reviewed the audit recommendations from the audit of the Department which were provided to us on August 16, 2006. The Department is in agreement with all recommendations and has included implementation plans in the response. I am confident the recommendations when implemented will add efficiency and effectiveness to the administration of the Insurance Premium Tax and Real Property Transfer Tax and provide equitable reporting for all taxpayers and companies.

Recommendation 1. Develop detailed policies and procedures for all facets of the application, administration, and collection of the insurance premium tax.

Response: Detailed policies and procedures for the application, administration and collection of the Insurance Premium Tax will be rolled out in the Unified Tax System's (UTS) Phase III portion of the project scheduled for June 2007. Policies and procedures will be available to staff online and will be able to be printed when needed.

Recommendation 2. Develop and maintain a reference of the annuity reporting election of each company and approved changes.

Response: The Department will develop and maintain annuity reporting elections by contacting the insurers to verify the current election status and then maintaining the election information going forward. Phase III of UTS should enable staff to track election changes and compare fluctuations in reporting from year to year in order to flag transactions for further review. The Department will keep track of all approved election changes through desk audits of the Insured's returns when it appears the election has changed. The Department will then verify with the Division of Insurance that the election has been approved for the change.

Recommendation 3. Modify forms and instruction to request pertinent information, provide detailed information for completion of forms, and allow for more efficient administration and review of the insurance premium tax.

Response: The Department will review other State's forms and instructions including California, and compare the forms and information in order to modify and update the Department's forms and provide complete instructions.

Recommendation 4. Assess penalty and interest in accordance with law.

Response: This will be addressed with the rollout in the Unified Tax System Phase III portion of the projected scheduled for June 2007.

Recommendation 5. Properly train Department personnel to oversee industrial insurance premium tax administration.

Response: The UTS system will provide policies and procedures online for the training of staff on the Insurance Premium Tax. It will be a more formalized system of training than the Department conducted in the past as all processes were manual at that time.

Recommendation 6. Notify taxpayers of overpayments with instructions for requesting refunds as required by law.

Response: When Phase III of the UTS system is completed in June 2007 it will include online credit notices which will automatically be generated and sent to the taxpayers to advise them when an overpayment or refund is due. The credit notice will include instructions for claiming the refund or credit.

Recommendation 7. Issue insurance premium tax debit and credit memorandums in a timely manner.

Response: When Phase III of UTS functionality is implemented the Department will automatically issue debit and credit memorandums on an ongoing basis. They will be issued within 30 days of establishing the debt.

Recommendation 8. Coordinate with the Nevada Insurance Guaranty Association to correct property and casualty credit statements and only offset taxes by amounts allowed in law.

Response: The Department will contact the Nevada Guaranty Association and discuss the issues raised in the audit. However please be aware that the Department of Taxation has no authority over the operations of the Nevada Guaranty Association.

Recommendation 9. Communicate with the Division of Insurance regarding insurance premium tax issues, including deficient filers or other matters that may arise where it may assist the Department in administering the tax.

Response: The Department will coordinate with the Division of Insurance to set up a process of exchanging information and/or reports; and sending them copies of notices, A/R reports, debit notices, delinquency notices, etc.

Recommendation 10. Obtain clarification regarding those issues pertinent to ensuring the insurance premium tax is properly administered.

Response: The Department will coordinate a meeting between the Division of Insurance Deputy Attorney General and the Department's Deputy Attorney General to clarify what are taxable and what are non-taxable items. The meeting will be given a priority status in order to resolve the outstanding issues.

Recommendation 11. Develop policies and procedures regarding the administration of the real property transfer tax and related audit function.

Response: The Department is currently developing written audit procedures that include determining sample sizes; selection methodology; timing and the frequency that each county will be audited to maximize the resources of the Department.
A manual of standards was developed in 2004 which is being reviewed and updated, and will then be distributed to staff to better administer the tax.

Recommendation 12. Issue guidelines for counties to ensure consistency in applying exemptions, including requirements for supporting documentation and verification it was received.

Response: Since October 2003 the Department has created and disseminated the following guidelines to the County Recorders: Real Property Tax Reporting Guide (published twice since inception); Guidance Letter 05-001 (and revised); Guidance Letter 05-002; Dissemination of various AGO, DA and LCB opinions; Regulations – LCB File No. 224-03; List of government agencies eligible for exemption; Documents Taxable and Non-Taxable List; Brochure on RPTT; Mock company organization papers, i.e. incorporation, LLC papers; and Dissemination of “Nevada Business Entities” by Nevada State Bar (with permission).
Guidance Letter 05-001, advised the type of documentation county recorders should request for Exemption 1, and included the taxable and non-taxable documents list.

The Department is creating additional guidelines for the counties to include all aspects of the Real Property Transfer Tax (RPTT) and will distribute them as soon as completed and approved.

Recommendation 13. Develop a process for the reconciliation of monthly reports and related remittances.

Response: The process for reconciliation of recorders’ reports to treasurers’ reports was begun by the Department in July 2005 and is now fully implemented.
The variance generally does not relate to over-assessment, missing, misclassification or unaccounted for funds, but is instead related to the varying reporting requirements between recorders and treasurers or failure by the county to take the collection allowance.

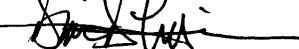
Recommendation 14. Ensure counties assessing additional tax amounts comply with statutory and local requirements regarding establishment of the rate and collection.

Response: The Department polled each county when initially given the oversight of RPTT to determine the regulations and particular taxes that were being collected for each county as it related to NRS 375. From this process the Department incorporated into its audits a check for the authority and collection of all components of the RPTT.
The only instance the Department is aware of where authority to collect was in doubt was Churchill County. Churchill County has corrected the lack of a current ordinance, and the Department is in receipt of a current ordinance passed by the County Commissioners granting authority to collect the LGTA component of the RPTT tax.

I would like to thank the Legislative Council Bureau audit staff for their professionalism and dedication in providing a valuable service to the Department.

If you have additional questions please contact me at 775-684-2060.

Sincerely,



Dino DiCianno
Executive Director
Nevada Department of Taxation

**Department of Taxation
Response to Audit Recommendations**

<u>Recommendation Number</u>		<u>Accepted</u>	<u>Rejected</u>
1	Develop detailed policies and procedures for all facets of the application, administration, and collection of the insurance premium tax.....	<u> X </u>	<u> </u>
2	Develop and maintain a reference of the annuity reporting election of each company and approved changes.....	<u> X </u>	<u> </u>
3	Modify forms and instructions to request pertinent information, provide detailed information for completion of forms, and allow for more efficient administration and review of the insurance premium tax.....	<u> X </u>	<u> </u>
4	Assess penalty and interest in accordance with law.....	<u> X </u>	<u> </u>
5	Properly train Department personnel to oversee industrial insurance premium tax administration.....	<u> X </u>	<u> </u>
6	Notify taxpayers of overpayments with instructions for requesting refunds as required by law	<u> X </u>	<u> </u>
7	Issue insurance premium tax debit and credit memorandums in a timely manner.....	<u> X </u>	<u> </u>
8	Coordinate with the Nevada Insurance Guaranty Association to correct property and casualty credit statements and only offset taxes by amounts allowed in law	<u> X </u>	<u> </u>
9	Communicate with the Division of Insurance regarding insurance premium tax issues, including deficient filers or other matters that may arise where it may assist the Department in administering the tax	<u> X </u>	<u> </u>
10	Obtain clarification regarding those issues pertinent to ensuring the insurance premium tax is properly administered.....	<u> X </u>	<u> </u>
11	Develop policies and procedures regarding the administration of the real property transfer tax and related audit function.....	<u> X </u>	<u> </u>
12	Issue guidelines to counties for applying exemptions, including requirements for supporting documentation and verification it was received	<u> X </u>	<u> </u>

**Department of Taxation
Response to Audit Recommendations
(continued)**

<u>Recommendation Number</u>		<u>Accepted</u>	<u>Rejected</u>
13	Develop a process for the reconciliation of monthly reports and related remittances	<u> X </u>	<u> </u>
14	Ensure counties assessing additional tax amounts comply with statutory and local requirements regarding establishment of the rate and collection	<u> X </u>	<u> </u>
	TOTALS	<u> 14 </u>	<u> 0 </u>