

Department of Taxation

Audit Highlights



Highlights of Legislative Auditor report on the Department of Taxation, issued on September 21, 2006. Report # LA06-22.

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. In fiscal year 2004, new taxes enacted included the bank excise tax, business license fee, live entertainment tax, modified business tax, and real property transfer tax. The Department collected more than \$4 billion in taxes and fees in fiscal year 2005. The Department's expenditures equaled \$31.5 million in fiscal year 2005.

Purpose of Audit

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 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.

Audit 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.

The Department in its response to our report, accepted all 14 recommendations.

Status of Recommendations

The Department's 60-day plan for corrective action is due on December 20, 2006. In addition, the six-month report on the status of audit recommendations is due on June 20, 2007.

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.

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.

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.

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.

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.

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.

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.