

Standard Summary Project Fiche

1. Basic Information:

- 1.1 CRIS Number: **2003/004-979-08-02**
- 1.2 *Twinning Number: LV/2003/IB/FI-02*
- 1.3 Title: **State Revenue Service Tax Control Improvement**
- 1.4 Sector: Taxation / Public Finance
- 1.5 Location: **Latvia, State Revenue Service**

2. Objectives

2.1 Overall Objective:

To protect budget revenues and increase voluntary tax compliance of taxpayers

2.2 Project purpose:

To establish effective control system for fight against cross-border tax evasion
To increase tax control effectiveness by the support of IT

2.3 Accession Partnership and NPAA priority

The activities of the project will help to implement the following intermediate objective of Accession Partnership:

To develop effective system for fight with tax evasion as well as strengthen the administrative capacity and control procedures in order to be able to implement the *acquis*.

The project will contribute to the achievement of the task in the NPAA:

LS-002 (Modernisation of State Revenue Service) 2.1.6. To continue the improvement of tax control

3. Description

3.1 Background and justification:

State Revenue Service is a state governmental institution functioning under supervision of the Minister of Finance and it ensures recording of taxpayers, collection of state taxes, fees and other state mandatory payments within the territory of the Republic of Latvia and on the customs border, as well as implements state customs policy and carries out customs matters.

One of the SRS main objectives is to form an effective tax control system that in co-operation with other state revenue administrations of the European Union would be a forceful mean of fighting against tax evasion.

Since the time of its creation the Latvian State Revenue Service - SRS has established a comprehensive tax control system that is based on the below-mentioned pillars.

MAIN PILLARS OF THE TAX CONTROL SYSTEM

The SRS tax control starts with receiving tax declarations and reports, when data **credibility checks** are performed. The data of submitted declarations are compared to the data included in other declarations and reports of a taxpayer, which are at a disposal of the SRS. The results of credibility checks can be a basis for performing more extensive checks (thematic checks or tax audit).

One of the most efficient but also labour intensive means of tax control applied by the SRS is **tax audit**. In the tax audit the correctness of tax calculation and paying is controlled, information submitted in declarations and reports is compared with accountancy data and justification documents, as well as correctness and completeness of accounting performed by the taxpayer is checked.

Taking into account complexity and costs involved, tax audit can be carried out only in the most risky companies. Therefore SRS is intensively using also selective control method - so called **thematic checks** to verify that accounting is kept correct, normative acts in entrepreneurship and tax calculating are observed. It is targeted at checking selected accounting documents, at checking compliance with selected normative acts. There is principal difference between tax audit and thematic check: tax audits are aimed at checking correction of tax calculations for previous periods, whereas thematic checks are targeted at selective control of the present situation.

If tax audits can lead to the calculation of additional tax amounts, thematic checks can lead to application of administrative fines. As an example one can mention control purchases at shops by tax inspectors. While making such a control purchase the inspector checks if it is registered in a cashiers' apparatus. Then he notifies that control purchase has been done after which the money and goods are being returned. Normally this is followed by checking the amount of banknotes and coins in the cashiers' apparatus and its comparison with the electronically registered data. Simultaneously, checking of invoices for selected goods can be carried out to verify that no goods of unknown origin/smuggled goods are traded. Other types of verifications carried out are listed in Annex 4. Very often the data gathered during thematic checks are used for carrying later on tax audits.

TASKS OF THE DIFFERENT ELEMENTS OF THE TAX CONTROL SYSTEM				
Credibility checks of declarations (done: in the premises of tax administration)	→	Thematic checks (done at tax payer's premises):	→	Tax audits (done: on the spot and in the premises of tax administration)
1. to identify risks that would identify incomplete tax payment;		1. to check if the tax liabilities are respected;		1. to check the correctness of tax calculation and payment;
2. to discover discrepancies and mistakes in tax declarations and reports in due time ;		2. to control how normative acts are observed;		2. to educate the taxpayer and to promote the voluntary tax compliance
3. to evaluate whether the information included in declarations and reports is in line with the data on type and size of the undertaking;		3. to promote voluntary tax compliance;		3. to discover cases of tax evasion
4. to verify validity of fluctuations of tax amounts paid into the budget		4. to check the reliability of information submitted in complaints and applications;		4. to check the pricing applied in transactions with related enterprises
		5. to verify technical means that are at the disposal of a taxpayer;		
		6. to collect additional information about the tax payer in order to perform a complete analysis and selection for tax audits;		
		7. to collect additional evidences for tax audit.		

Short description of the relevant national and internationally supported activities recently completed or ongoing to reinforce tax control is included in linked activities section.

ISSUES TO BE ADDRESSED

Notwithstanding the progress achieved in the area of tax control, the SRS lacks experience and tools to cope with the increasing problem of carousel fraud and fraud in international transactions. Also efficiency of the thematic checks has to be sufficiently increased to ensure adequate protection of the national budget revenues and own resources. This is very often during thematic checks that suspicions about involvement of carousel fraud are proved (e.g. as the result verification of accounting of the deals, identified as suspicious during data credibility checks; verification of justification and payment documents). Sometimes these are followed by other types of tax control to get missing proves.

Carousel schemes are being set-up and fictitious enterprises that circumvent liabilities towards the state budget are being established. The most typical example is that a chain of companies, many of which are intermediaries divert the attention of the tax administration from a fictitious enterprise that doesn't pay taxes and is not "findable" as well as from the company requesting VAT refund from the budget. The SRS increasingly faces organised tax evasion that is performed using modern technologies. Tax evasion spreads across the borders of the state. Enterprises from various states make use of imperfections in the tax control system and effect considerable losses to the state budget that will equally influence also Communities' own resources.

Very often carousel functioning is based on selling goods and providing services with increased costs. Cost non-compliance to the market prices is very often seen in transactions between related enterprises, which thus choose the most favourable tax regime. These enterprises decrease the amount of tax, violating the arm's length principle in transactions.

In order to cope with the situation following activities have already been realized:

- Methodical instruction has been elaborated and improved in relation to controls of VAT overpayment, audits of enterprises involved in transaction chains, procedure for initiation of criminal cases and information exchange with law enforcement institutions with a purpose to disclose and prevent cases of fraud.

- In 2002 (fully assembled in 2003) International Transactions Division has been established the functions of which methodical management and co-ordination of the SRS control work with international transactions. Main tasks of the new structural unit are to co-ordinate and manage work of the SRS with high level international transactions including organisation and co-ordination of simultaneous international audits to participate in development of policy related to international taxation issues as well as to manage and co-ordinate verifications of transfer prices. Currently the new structural unit analyses the situation in the area of international transactions and studies necessity for amendments in normative acts in order to prevent opportunities for tax evasion.

However, in order to reduce **carousel-fraud** related and cross-border tax evasion the SRS needs to be provided with modern methods and tools for identification, proving and combating these kind of violations as well as mechanisms of specific problem solution. Using experience of a member state more effective information flow between the institutions and the way of collecting information should be established, legislative requirements should be fine-tuned. Finally, a detailed description (specification) of the information system to alleviate the work of tax controller involved in identification of carousel fraud and fraud related to international transactions has to be provided. That is why in the framework of this project it is intended to elaborate a data base of International transactions and carousel fraud by using the experience of member-states. Basic pillars of the IS would be systematised data on fraud schemes, persons involved, performed activities of tax control, precedents, solution mechanisms. Besides, it will contain information about enterprises performing international transactions, the costs of transactions, etc. (to be used in transfer price audits). Also data given by customs offices on suspicious transactions, and prices of export and import goods will be codified. Consequently, by using options offered in the program, it will be possible not only to gather information with options for a help to make a further analyses, but also to use a data base of knowledge that would help with useful advice and possible solutions for the identification of fraud, inviting other structural units (Finance police, experts), gaining the evidence and proving the fraud cases.

Besides, as fight with consequences requires considerable resources and not always turns out to be successful, reduction of tax evasion is possible when constantly following the commercial activities of the taxpayer and performing thematic checks and observations. In this respect, the highest value added will be from **modernising and standardising implementation of thematic checks**, thus making them much more efficient and effective.

Each kind of control has its peculiarity that is connected with tasks, place of performing and the guaranteed results of each kind of control. In order to perform the control activities, the existing information about a taxpayer, licenses, declarations and reports that is available in the Data warehouses and Tax information system is used as much as possible. Unfortunately, no additional programs and functions have been developed for each kind of control according to their specifics. That is the reason why in the framework of this project it is intended to establish a separate program for the support of thematic checks that could help to offer suitable functions and possibilities of action for the specifics of thematic checks. In this way the effectiveness of thematic checks will be increased.

IT programs adapted for the specifics of control that are used in the SRS:

Credibility checks	Thematic checks	Tax audit
No specific software	No specific software	<ul style="list-style-type: none"> • Computerised audit selection programm • Computerised audit software (under preparation) • Audit support IT system (under preparation)

It is important to upgrade planning and controlling implementation of thematic checks, to improve the quality of checks performed; to establish new effective control forms.

This work has to be computerised and for this purpose it is necessary to design a detailed description (specification) of the IS to be implemented. Developing of the IS would allow getting information about the taxpayer from the SRS databases, as well as to prepare for checks, to fix, process and analyse the information, received during checks. The thematic check support system will include: the necessary information about the taxpayer to perform the check; document templates; tools of analyses; advice; precedents; normative acts.

When performing thematic checks, the inspector is working outside the office premises, that is – he/she is on the spot. Consequently, in this stage he would need information prepared by IS, as well as different kinds of advice, instructions and normative acts. When stating the law violations, an inspector has the right both to describe the goods and to seal the premises used for business activities. That is the reason why the action of inspector should be legally motivated and correctly formed. For this reason different forms and blanks would be needed, as well as a library of advice.

When Latvia joins the EU, the tax administration will need to perform information exchange with tax administrations of other EU member-states about transactions of community. Also in this stage the possibilities of IS would be needed for support of thematic checks in relation to a simplified communication between the inspector and the Latvian CLO (Central Liaison Office), as well as a correct formatting of the received information. As during the thematic check all the necessary information is gathered in order to perform analyses, as well as evidences for audits, IS of thematic check support should offer also tools for performing the analytic functions, including for simplified calculations and comparisons. After completion of thematic check a question about its formatting, export of information to the SRS data bases and its further usage for analyses and tax audits is important. Besides, the IS of thematic check support would offer the inspector a chance to plan his work, by marking the planned and performed activities in his agenda, as well as it would give a chance to the management to supervise the process of thematic checks.

According to the information available to the SRS thematic checks as they are done in Latvia are not carried out in the EU. Nevertheless tax administrations of the EU member states carry out similar checks that are taking place on taxpayers premises. Some EU member states use databases for registration of international transaction and carousel fraud. However the work related to codifying, systematisation and use of information in control work is still in the initial stage. Hence by using ideas and practice of member states it would be possible to create a unique programme where knowledge of member states in fight with fraud and control of international transactions could be combined with specific forms of control in Latvia. Considering above mentioned it could be problematic to purchase already developed software, because they have to be very specific, particularly adjusted to the work of tax administration.

In this way specific software could be developed based on results of analysis carried out by Twinning experts, which will carry out assessment if similar systems operational in the EU member states could be adapted to the situation in Latvia for control of international transactions and fight with fraud. If the IT system of a member state will satisfy needs of Latvian tax administration for 70 – 80 % then full development and adaptation of the system will be carried out within framework of Service contract. Nevertheless, if IT solutions existent in member states tax administrations will not satisfy needs of Latvian tax administration, completely new IT system will be developed.

The results of an analysis of computer equipment carried out by the SRS show that technical provision with computers is insufficient. Up to the moment, thematic checks at the SRS regional offices and the SRS Large Taxpayers Department are performed by 300 tax inspectors. Only 110 computers can be used on daily basis for work with current SRS IT systems, i.e., only every third tax inspector can prepare qualitatively for check and carry it out. Other computers should be eliminated hence they are technically outdated and cannot be used. Employees of the SRS responsible for thematic checks have only 2 portable PCs, which is too less considering that thematic checks are carried out on taxpayers premises where tax inspector has neither technical support nor support of other colleagues. According to the assessment of computer resources it would be necessary in near future to acquaint at least 40 portable PCs in order to provide corresponding quality of thematic checks and realize its objectives. Since in the near future due to the limited resources there are not resources envisaged in the budget for purchase of computers, it is planned to purchase them within framework this project. These computers will be provided for employees in regional offices, which regarding needs assessment have lowest technical resources. The division will be proportional to the number of tax inspectors involved in thematic checks.

There are no NGOs acting in the sector and there are no NGO's that could have a role in the project's activities.

3.2 Linked activities:

The overall coherence between the proposed project and other linked projects in tax control area is explained reflected in detail in Annex 5.

1. The SRS Modernisation project for 1998-2002 (developed in 1998 in co-operation with experts of the International reconstruction and development bank) - 5,00 MUSD loan.

One of the elements of the project was evaluation of the existing tax control system in the country, evaluation of the amount of work of the SRS, identification of problems and development priorities of tax control. The activities which are still being carried out in the frame of the WB project and relevant to the project proposal for Phare 2003 financing, but will not overlap with it.

2. The SRS investment project "The IT System for implementation of the state revenue and customs policy" 1997-2005 years.

Within the framework of the project the basic functionality of the Tax information system (taxpayers register, tax register and annual reports of enterprises) was developed and is operational in all the SRS territorial offices. The electronic filing system has been put into the operation, and taxpayers have possibility to submit tax returns electronically using the Internet. Activities for the development of the remaining functions are implemented in accordance with plans. The Tax information system includes electronic exchange of information in on-line regime with registers of state importance (Enterprise register, Citizenship and Migration Department, State Social Insurance Agency, State Treasury and others).

The development project of the Management information system and statistic information database - data warehouse is implemented. Within framework of the project of data warehouse development system following universes have been set operational: State budget revenue, Information of Taxpayers registration, profiling, Taxpayers returns, Customs data, Audit results etc.

The current project will not overlap with this one, since within this project it is proposed to create basic functional system for the SRS performance support, and with the current one International Transactions and Carousel Fraud Information Data base and Thematic checks support IT system will be established.

3. PHARE'98 project No:LE-9806.01 "Promotion of internal market capacity and enforcement" – 0,8 MEUR. 4th component "Tax audit"

Within this project user needs and user requirements have been elaborated for the supply of Computerised audit selection system within PHARE'99 project (see below).

The current project will not overlap with this one since within this project user needs and user requirements have been elaborated for the supply of Computerised audit selection system within PHARE'99 project No:LE9903.01, and with the current one International Transactions and Carousel Fraud Information Data base and Thematic checks support IT system will be established.

4. PHARE'99 project No:LE9903.01 "Supply of Audit System Software and Training of Personnel in SRS".

Within the framework of this project Computerised audit selection system "Escort Latvia" has been developed. The system has been introduced in order to implement unified selection quality standards in all SRS regional offices and in Large Taxpayers Department. It is based on standard programme ESKORT that is adapted to possibilities and needs of tax administration in Latvia. The system will select candidates for tax audit based on information about taxpayer available in the SRS Data warehouse (data of Taxpayers register, tax declarations submitted by taxpayer, statements, information on tax payment, results of thematic checks and other audits, customs info etc.). Application is based on risk analysis that is built on the knowledge base of the personnel of SRS Central Administration. In the future by using Escort it is anticipated to carry out selection of taxpayers for thematic checks too.

Here it is important to mention that the project proposed for Phare 2003 financing has a different orientation, although it wouldn't harm if later on Computerised audit object selection system would be complemented with some specific risk factors for identifying fraud.'

The risks SRS is most of all concerned about in the context of combating carousel fraud are not so much linked to the data of tax declarations and financial reports: these are risks linked to unusual deals of a tax payer, suspicious justification documents, etc. E.g. tax payer states that he sells goods, while he hasn't his own transport and hasn't documents on using of transportation services of other companies or documents on lease. The activities under proposed 2003 Project will be concentrating on elaboration of recommendations for ensuring quick identification of fraud cases, coping with consequences and preventing future fraud.

The current project will not overlap with this one, since within this project Computerised audit selection system has been developed, and with the current one International Transactions and Carousel Fraud Information Data base and Thematic checks support IT system will be established

5. PHARE 2001 project No:LE01.02.01 "Institutional strengthening of tax and customs administration".

One of the elements of the project is targeted at fine-tuning credibility checks system (1st pillar of the tax control system).

The current project will not overlap with this one since within this project it is proposed to provide consultations for effective establishment and development of credibility checks system, and with the current one International Transactions and Carousel Fraud Information Data base and Thematic checks support IT system will be established.

6. Under preparation project “Audit support IS” under the SRS Modernisation project 1998 -2002

Tender documentation has been elaborated for supply of Audit support information system within the aforementioned project.

The programme has to become an assisting tool for auditor, and its objectives are time economy; improvement of controls quality, unified practice; planning and control opportunities; differentiation of evaluation and analysis methods.

Task of Audit support IS is to facilitate work of auditors providing them with templates of forms and statements, necessary normative acts and recommendations. The programme will help to evaluate and analyse on the central level tax audit results, mistakes made by taxpayers and performance of the computerised audit selection program. That will allow to develop necessary measures for the improvement of tax control organisation.

Here it is important to mention that although some of its elements could be and will be used also for elaboration of thematic checks support IS (e.g. advice library), the audit support IS is mostly concentrated on specific needs of auditors. The audit support IS will consist of the mutually related components: audit programme, audit working papers, help desk, audit templates, diary, special powers of the head of the audit unit; virtual audit case.

Tender documentation has been elaborated for supply of Audit support information system.

The program has to become an assisting tool for auditor, and its objectives are:

- time economy;
- improvement of controls quality;
- implementation of unified practice;
- improvement of planning and control opportunities;
- differentiation of evaluation and analysis methods.

The Phare 2003 project will not overlap with this one, since within this project it is proposed to develop Audit support IT system, but within the Phare 2003 project International Transactions and Carousel Fraud Information Data base and Thematic checks support IT system will be established.

7. Under preparation – supply of Computerised Accounting Audit IT System under the SRS Modernisation project 1998-2002.

Within this project it is proposed to develop Computerised Accounting Audit IT System to ensure performing computerised audits.

The Directive Nr.2001/115/EC will soon come into force and will simplify and harmonise regulations for preparing VAT invoices. It provides that taxpayers will have to ensure electronic storage of invoices received and prepared electronically, which means that also follow-up of accounting has to be carried out electronically. This implies that the SRS has to be ready to carry out computerised tax audit.

Currently user requirements are being elaborated for purchase of the mentioned IT programme.

The Phare 2003 project will not overlap with this one, since within this project it is proposed to develop Computerized Accounting Audit IT System to ensure performing computerized audits. Within the Phare 2003 project International Transactions and Carousel Fraud Information Data base and Thematic checks support IT system will be established.

3.3. Results:

Guaranteed Twinning Results:

Establishment of system for fighting against International Transactions and Carousel Fraud.

- Rights of the tax administration and obligations of tax-payers revised with a view to alleviate and make more efficient fight with tax fraud (especially carousel fraud);
- The system of tax-control related exchange of information and cooperation fine-tuned between involved structures - National Tax Board, SRS regional offices and National Customs Board;
- New risk criteria for detection of illegal transactions developed;
- Comprehensive user requirement and justification for the International Transactions and Carousel Fraud Data Base developed;
- Solutions proposed for proving fraud cases;

- Sufficient number of tax inspectors (approximately 30) trained in detecting and combating most serious types of tax evasion;
- Necessary advice provided for developing of International Transactions and Carousel Fraud Data Base for needs of tax control;
- All technical documentation for developing International Transactions and Carousel Fraud Data Base: prepared: user requirements; user requirements, technical specification

Establishment of Thematic checks support IT system

- Rights of the tax administration and obligations of tax-payers revised with a view to alleviate and make more efficient fight with tax evasion;
- Up-to-date methods for detecting and preventing offences in accounting and tax calculations in place;
- New operative control methods elaborated with an objective to timely detect and prevent cases of non-payment of taxes and tax evasion;
- Employees of the SRS regional offices trained (training of trainers approximately 30) to ensure application of new methods of work in conducting thematic checks;
- Necessary pre-conditions established for creation of IT support system for Thematic checks.
- All technical documentation for developing Thematic checks support IT system: prepared: user requirements; user requirements, technical specification.

Overall Results of Service contract:

- International Transactions and Carousel Fraud Data Base and Thematic checks support IT system developed;
- Software adopted and tested to the current information system of the State Revenue Service;
- Software implemented in all State Revenue Service regional offices.

Results of Supply contract:

- Employees of the SRS regional offices carrying out thematic checks are supplied with computers.

3.4. Activities:

Contract 1 - Twinning covenant:

- Preparing necessary amendments for changes in laws as to the rights of the SRS and obligations of taxpayers in order to facilitate combating tax evasion;
- In-depth evaluation of the current situation and drafting recommendations for the improvement of the information flow between the institutions and the way of collection of information, including the legislative requirements;
- Analysing the current situation for institutional co-operation between National Tax Board, State Revenue Service regional offices, National Customs Board and Financial Police, and elaboration of specific internal agreements, procedures and instructions;
- Developing new risk criteria and analysis techniques for detection of illegal transactions;
- Proposing solutions and precedents for proving fraud cases;
- Elaboration of methodical guidances about control of international transactions;
- Study visit for acquiring experience in organisation of international transactions control (5 officials of SRS);
- Training of employees involved in tax control on the use of databases for needs of tax control; use of transfer prices in tax audit; international planning of taxes applied by enterprises (incl. involvement of off-shore companies in transaction chains) and related possibilities of control; detection and proving of fraud cases.
- Revision and extension of present methodology for carrying out on most important type of on the spot checks – thematic checks;
- Analysing the current situation and elaboration of propositions for developing of Thematic checks support IT system;
- Preparation of necessary amendments for changes in legal acts as well as SRS standards and instructions;
- Training of 20 employees involved in tax control (training of trainers): on timely detection of tax evasion; in on-field controls at taxpayers premises and application of new methods of work.
- Elaboration of the concept for establishment of International Transactions and Carousel Fraud Data Base and Thematic checks support IT system;

- Development of a comprehensive user requirement and justification for the International Transactions and Carousel Fraud Data Base;
- Assessment of corresponding IT systems operational in the EU member states and analysis of their possible adaptation in order to meet the user requirements of the Latvian administration. In case it will not be possible to adapt a system from a Member State (the functionality provided by the ready-made solution only meets less than 70% of the functional requirements) user needs and requirements for the implementation of the new system will have to be prepared;
- Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base according the results of the assessment and Thematic checks support IT system;
- Elaboration of tender documentation for developing of International Transactions and Carousel Fraud Data Base and Thematic checks support IT system

Contract 2 - Service contract:

- Programming of software (International Transactions and Carousel Fraud data base and Thematic checks support IT system);
- Documentation of software;
- Testing of software;
- Implementation of software in all SRS regional offices.
- Training of employees for work with software.

Contract 3 - Supply contract:

- Supply of 40 PC notebooks for inspectors who carry out thematic checks in SRS RO and Large Taxpayers Department (Technical specification will be elaborated by SRS).

Inputs:

Pre-accession adviser –12 man-months:

- Tasks of Pre-accession advisor:
 - to provide overall management of implementation of Twinning Covenant;
 - to be responsible for planning, organising and co-ordination of short term experts' (audit and IT experts) pool, training seminars and study visits within the Twinning Covenant;
 - to submit reports on regular basis about implementations of the Twinning Covenant;
 - to cover the activities of the covenant related to the evaluation of the present legislation/arrangements, etc.; determining necessary changes and working on the key aspects of the new work methods to be applied in tax control ("framework" activities).

Profile of the PAA:

strong experience in tax control area and strategic planning within the given field (preference would be given to a person that has a good insight not only in the particular fields addressed by the project but also strong general knowledge about the tax control system as a whole);
 not less than 10 years experience in a tax administration of EU member state;
 proved leadership skills (setting up new systems, implementing complex projects); preferably - experience in implementation of similar IT projects and appropriate knowledge;
 fluent English.

Twinning short-term expertise – 20 m/months

- Tasks of twinning experts:

To cover all specific measures mentioned under activities chapter.

Tasks of twinning experts:

- Elaboration of specific internal agreements, procedures and instructions in order to improve co-operation between National Tax Board, State Revenue Service regional offices, National Customs Board and Financial Police;
- Developing new risk criteria and analysis techniques for detection of illegal transactions;
- Proposing solutions and precedents for proving fraud cases;
- Elaboration of methodical guidances about control of international transactions;
- Training of employees involved in tax control use of transfer prices in tax audit, international planning of taxes applied by enterprises (incl. involvement of off-shore companies in transaction chains) and related possibilities of control, detection and proving of fraud cases.
- Training of 20 employees involved in tax control (training of trainers): on timely detection of tax evasion; in on-field controls at taxpayers premises and application of new methods of work;
- Elaboration of the concept for establishment of International Transactions and Carousel Fraud Data Base and Thematic checks support IT system;
- Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base **according the results of the assessment** and Thematic checks support IT system;

Tasks of IT twinning experts:

- **Development of a comprehensive user requirement and justification for the International Transactions and Carousel Fraud Data Base;**
- **Assessment of corresponding IT systems operational in the EU member states and analysis of their possible adaptation in order to meet the user requirements of the Latvian administration. In case it will not be possible to adapt a system from a Member State (the functionality provided by the ready-made solution only meets less than 70% of the functional requirements) user needs and requirements for the implementation of the new system will have to be prepared;**
- **Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base **according the results of the assessment** and Thematic checks support IT system;**
- Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base and Thematic checks support IT system;
- Elaboration of tender documentation for developing of International Transactions and Carousel Fraud Data Base and Thematic checks support IT system.

Training seminars on (6 seminars, 2 - 3 days each for approximately 30 officials from SRS regional offices, Large Taxpayer Department Audit Divisions, Thematic checks Divisions and National Tax Board):

- use of database for needs of tax control;
- detecting carousel fraud;
- adoption of transfer prices in tax audit;
- implications for a tax administration of international planning taxes by companies (incl. Involvement of offshore companies);
- possibilities to get information by carrying out on-field controls at taxpayers premises, and its further use for needs of tax control;
- timely detection of tax evasion by use of different types of tax control.

Study visit on use of international transactions and carousel fraud database and adoption of transfer prices in tax control for 5 officials from National Tax Board International Transactions Division and Audit division.

Profile of the short-term experts:

- 1) short-term tax control experts: not less than 10 years experience in a tax administration of an EU member state and not less than 5 years experience in a tax control area (good experience in developing tax control work); extensive experience in identifying problems, proposing solutions and implementing recommendations; fluent English.
- 2) short-term IT experts: not less than 10 years experience in IT system analysis and development of system architecture; not less than 5 years experience in a tax administration of a EU member state or the same duration of contractual relations with the tax administration; experience in similar projects; extensive experience in identifying problems, proposing solutions and implementing recommendations; fluent English.

3.5. Lessons learned:

From the implementation of the previous projects it was learned that ToRs for developing of the IS and technical specifications for the planned equipment have to provide for a certain flexibility to accommodate the problems stemming from the quick development of information technologies.

4. Institution Framework

The leading institution for implementation of the project will be the State Revenue Service (Structure of State Revenue Service see in Annex.7).

Following SRS regional offices and structural units of the SRS Central Administration will be involved in the development and implementation of the project:

- National Tax Board → Audit Division, International Transactions Division, Thematic Checks Division, Control work modernization and analysis Division, Tax administration organisation division;
- SRS Riga office, Large Tax-payers department;
- IT Department;
- Other structures, upon necessity

End users of results of the project and delivered software developed within the project will be the SRS regional offices and structural units of the SRS Central Administration the competence of which is supervision and modernisation of tax control work. Results of the project Users of the International Transactions and Carousel Fraud Data Base developed within framework of the project in the future could be also other state institutions, such as officials of law enforcement institutions and Prosecutors Office that investigate cases of VAT fraud, Central Statistical Bureau, Enterprise Register.

For the implementation of this project the Steering Committee will be established that will include the representatives from State Revenue Service. The Project Steering Committee will comprise: Director of SRS National Tax Board; Deputy Director of SRS National Tax Board; Head of Control Work Modernisation and Analysis Division; Director of IT Department; Director of SRS National Customs Board; Leaders of particular working groups (upon necessity).

5. Detailed Budget

	Phare Support			National Cofinancing		IFI	TOTAL eligible costs
	Investment Support	Institution Building	Total Phare (=I+IB)	Eligible costs	Non-eligible costs		
Contract I Twinning		400 000	400 000	44 000*			444 000
Contract II Service	750 000		750 000	250 000**	45 000		1 000 000
Contract III Supply	80 000		80 000	27 000**	4860		107 000
Total	830 000	400 000	1 230 000	321 000	49 860		1 551 000

* Parallel co-financing. Parallel co-financing will be applied for covering of office costs for experts, infrastructure facilities and travel costs for national counterparts

**Joint co-financing, excluding all taxes and duties

6. Implementation Arrangements

6.1. Implementing Agency

The Contractual and Financial Implementation:

PAO Ms.Valentina Andrejeva, State Secretary of Ministry of Finance:

Smilsu 1, Riga, Latvia, LV-1978;

phone +371 7226672, fax +371 7095503.

Implementing agency - CFCU

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Address – 1, Smilšu street, Riga, Latvia LV 1919
Tel.: +371 7094342, fax +371 7094348

The Technical Implementation of the project will be the responsibility of the SPO Mrs. Nelija Jezdakova, First Deputy Director General, Director of National Tax Board, State Revenue Service: Smilsu 1, Riga, Latvia, LV-1978; phone +371 7028810, fax +371 7028814.

6.2. Twinning

The contact person for the PAA within the project will be Mrs. Nelija Jezdakova, First Deputy Director General, Director of National Tax Board, State Revenue Service. Smilsu 1, Riga, Latvia, LV-1978; phone +371 7028810, fax +371 7028814.

The office of PAA will be located in premises of State Revenue Service.

The contact person for the Twinning short-term experts within the project will be Mrs. Inara Petersone, Deputy Director of National Tax Board, State Revenue Service, Smilsu 1, Riga, Latvia, LV-1978; phone +371 7028840, fax +371 7028841 and Mr. Uldis Cirulis, Deputy Director of IT Department, State Revenue Service, Smilsu 1/4, Riga, Latvia, LV-1978; phone +371 7028672, fax +371 7028622.

6.3. Non-standard aspects

There will be no non-standard aspects regarding implementation of the project. Standard procedures of the Commission in accordance with Practical Guide to PHARE, ISPA and SAPARD contract procedures will be followed under Extended Decentralised Implementation System. Prior to EDIS accreditation, DIS will be followed. EDIS will apply from the date of accession at latest. For twinning, twinning covenant will be followed.

Ratio: if during project implementation the project cost for some reasons will decrease, the Phare financing will also decrease proportionally.

6.4. Contracts

Twinning covenant – 400 000 €(parallel co-financing)

Service contract – 1 000 000 €(joint co-financing, excluding all taxes and duties)

Supply contract – 107 000 €(joint co-financing, excluding all taxes and duties)

7. Implementation Schedule

	Twinning Covenant	Service Contract	Supply Contract
Start of tendering	III quarter 2003	III quarter 2004	I quarter 2005
Start of project activity	I quarter 2004	I quarter 2005	III quarter 2005
Project Completion	IV quarter 2004	IV quarter 2005	IV quarter 2005

8. Equal Opportunity

When recruiting, promoting and rotating their employees, Latvian public institutions (including *inter alia* SRS) take into account professional qualification, level of competence, compliance with the Law on State Civil Service (when applicable), correspondence to the job description, performance and like factors, not their age, sex or nationality. There will be equal opportunity for both men and women.

9. Conditionality and sequencing:

- Recently established International Transactions Division is established and functioning before start of project activities;
- Adequate staffing in all involved institutions in place, able to perform the tasks of the project.

ANNEXES:

1. Logframe planning matrix
2. Detailed implementation chart
3. Cumulative contracting and disbursement schedule
4. The themes checked in the thematic checks
5. Detailed chart on linked activities
6. Structure of State Revenue Service
7. List of relevant Laws and Regulations
8. Reference to relevant Government and SRS Strategic plans and studies

ANNEX I LOGFRAME PLANNING MATRIX FOR			Program name and number	State Revenue Service	
Project: Tax Control Improvement			Phare		
				Contracting period expires:	Disbursement period expires:
				Total budget:	Phare budget:
				1.551 MEUR	1.230 MEUR
Overall objective	Indicators of Achievement	Sources of Information			
<ul style="list-style-type: none"> To protect national budget revenues and Community Own Resources from fraud and offences 	Major gaps of the tax control system bridged	<ul style="list-style-type: none"> Reports of DG-TAXUD, Reports of OLAF 			
Project purpose	Indicators of Achievement	Sources of Information	Assumptions		
<ul style="list-style-type: none"> To establish effective control system for fight against carousel fraud and cross-border tax evasion; To increase tax control effectiveness 	<ul style="list-style-type: none"> Legal framework and everyday operating methods and tools fine-tuned to create a comprehensive system of detecting and combating carousel and cross-border tax fraud. Efficiency and effectiveness of tax control measures (mostly – thematic checks) raised. 	<ul style="list-style-type: none"> Reports of DG-TAXUD, Reports OLAF 	<ul style="list-style-type: none"> Adequate co-financing and SRS staff resources provided 		
Results	Indicators of Achievement	Sources of Info	Assumptions		
Twinning covenant Establishment of system for fighting against International Transactions and Carousel Fraud. <ul style="list-style-type: none"> Rights of the tax administration and obligations of tax-payers revised with a view to alleviate and make more efficient fight with tax fraud (especially carousel fraud); Up-to-date methods for detecting and preventing offences in accounting and tax calculations in place; The system of tax-control related exchange of information and cooperation fine-tuned between involved structures - National Tax Board, SRS regional offices and National Customs Board; Comprehensive user requirement and justification for the International Transactions and Carousel Fraud Data Base developed; New risk criteria for detection of illegal transactions developed; Solutions proposed for proving fraud cases; Sufficient number of tax inspectors (~30) trained in detecting and combating most serious types of tax evasion; Necessary advice provided for developing of International Transactions and Carousel Fraud Data Base for needs of tax control; All technical documentation for developing International Transactions and Carousel Fraud Data Base: prepared: user requirements; user requirements, technical specification Establishment of Thematic checks support IT system <ul style="list-style-type: none"> Rights of the tax administration and obligations of tax-payers revised with a view to alleviate and make more efficient fight with tax evasion; Up-to-date methods for detecting and preventing offences in accounting and tax calculations in place; 	<ul style="list-style-type: none"> Recommendations for the improvement of the information flow between the institutions and the way of collection of information, including the legislative requirements drafted; Specific internal agreements, procedures and instructions for institutional co-operation between National Tax Board, SRS regional offices and National Customs Board elaborated, necessary amendments to the Law on the SRS drafted to adapt the scope of rights of tax administration and obligations of tax-payers to the issue of growing carousel fraud; Analysis techniques prepared for work with unusual deals of taxpayers, with suspicious justification documents, etc. Different solutions (depending on major types of tax-evasion schemes) provided for proving fraud and eliminating its consequences. User requirements and tender documentation prepared for International Transactions and Carousel Fraud Information Data Base. Principal blocks of the system: enterprises involved in carousel schemes; international transactions; corresponding prices; observance of non-connected enterprises principle in transactions. Approximately 30 employees of the SRS trained to work with new methods of fight with carousel fraud and (other) cross-border tax offences. At least five employees given possibility to take over experience from an EU country's officials real work. Comprehensive training guide established for the future needs of the SRS. Present methodology for carrying out thematic checks revised and complemented. Approximately 30 employees of the SRS (mostly-regional offices) trained to implement new methods of work. 	<ul style="list-style-type: none"> Project implementation monitoring reports, Reports of DG-TAXUD, Reports of OLAF Reports of SRS 	<ul style="list-style-type: none"> Adequate co-financing and SRS staff resources provided; Suitable Twinning partner selected 		
			<ul style="list-style-type: none"> Project implementation monitoring reports, Reports of DG-TAXUD, Reports of OLAF Reports of SRS 	The required IT systems development level is achieved	

		▪ Reports of SRS	
Activities	Means		Assumptions
<p><u>Twinning covenant</u></p> <ul style="list-style-type: none"> ▪ Preparing necessary amendments for changes in laws as to the rights of the SRS and obligations of taxpayers in order to facilitate combating tax evasion; ▪ In-depth evaluation of the current situation and drafting recommendations for the improvement of the information flow between the institutions and the way of collection of information, including the legislative requirements; ▪ Analysing the current situation for institutional co-operation between National Tax Board, State Revenue Service regional offices, National Customs Board and Financial Police, and elaboration of specific internal agreements, procedures and instructions; ▪ Developing new risk criteria and analysis techniques for detection of illegal transactions; ▪ Proposing solutions and precedents for proving fraud cases; ▪ Elaboration of methodical guidances about control of international transactions; ▪ Study visit for acquiring experience in organisation of international transactions control (5 officials of SRS); ▪ Training of employees involved in tax control on the use of databases for needs of tax control; use of transfer prices in tax audit; international planning of taxes applied by enterprises (incl. involvement of off-shore companies in transaction chains) and related possibilities of control; detection and proving of fraud cases. ▪ Revision and extension of present methodology for carrying out on most important type of on the spot checks – thematic checks; ▪ Analysing the current situation and elaboration of propositions for developing of Thematic checks support IT system; ▪ Preparation of necessary amendments for changes in legal acts as well as SRS standards and instructions; ▪ Training of 20 employees involved in tax control (training of trainers): on timely detection of tax evasion; in on-field controls at taxpayers premises and application of new methods of work. ▪ Elaboration of the concept for establishment of International Transactions and Carousel Fraud Data Base and Thematic checks support IT system; ▪ Development of a comprehensive user requirement and justification for the International Transactions and Carousel Fraud Data Base; ▪ Assessment of corresponding IT systems operational in the EU member states and analysis of their possible adaptation in order to meet the user requirements of the Latvian administration. In case it will not be possible to adapt a system from a Member State (the functionality provided by the ready-made solution only meets less than 70% of the functional requirements) user needs and requirements for the implementation of the new system will have to be prepared; ▪ Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base according the results of the assessment and Thematic checks support IT system; ▪ Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base and Thematic checks support IT system; ▪ Elaboration of tender documentation for developing of International Transactions and Carousel Fraud Data Base and Thematic checks support IT system <p>Service contract</p> <ul style="list-style-type: none"> ▪ Programming of software (International Transactions and Carousel Fraud data base and Thematic checks support IT system); ▪ Documentation of software; 	<ul style="list-style-type: none"> ▪ Pre-accession adviser - 12 man-months ▪ Short-term experts (twinning) - 20 man-month ▪ Training – 9 seminars ▪ Study visit (1 visit for 5 officials) ▪ Service of IT experts (12 man/months) ▪ Training 6 seminars ▪ Supply of 40 laptops 	<p>Reports of Project Steering Committee Monitoring reports SRS reports</p>	<ul style="list-style-type: none"> ▪ Strong project management team established in the SRS; ▪ Selected MS is able to provide necessary expertise

Preconditions			
<ul style="list-style-type: none">Recently established International Transactions Division is operational before the start of project activitiesAdequate staffing in all involved institutions in places, able to perform the tasks of the project			

ANNEX 2

Detailed implementation chart

	2004												2005											
	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D
Twinning covenant																								
Overall management of the project																								
Analysing the current situation and proposing recommendations for the improvement of the information flow between the institutions and the way of collection of information, including the legislative requirements and restrictions in this field																								
Analysing the current situation for institutional co-operation between National Tax Board, State Revenue Service regional offices and National Customs Board and elaboration of specific internal agreements, procedures and instructions																								
Proposing solutions for proving fraud cases																								
Developing new risk criteria for detection of illegal transactions																								
Analysing the current situation and elaboration of proposals for establishment of International Transactions and Carousel Fraud Data Base																								
Elaboration of tender documentation for supply of International Transactions and Carousel Fraud																								
Preparation of necessary amendments for changes in legal acts																								
Study visit for acquiring experience in organisation of international transactions control																								
Training of employees involved in tax control about tax assessment in international transactions, tax planning by companies and transfer prices, detecting carousel fraud.																								
Revising methods of Thematic checks																								
Analysing the current situation and elaboration of proposals for establishment of Thematic checks support IT system																								
Preparation of necessary amendments for changes in legal acts as well as SRS standards and instructions																								
Development of a comprehensive user requirement and justification for the International Transactions and Carousel Fraud Data Base																								
Assessment of corresponding IT systems operational in the EU member states and analysis of their possible adaptation in order to meet the user requirements of the Latvian administration.																								
Identification of user needs and formulation user requirements for International Transactions and Carousel Fraud Data Base according the results of the assessment and Thematic checks support IT system																								
Elaboration of tender documentation for supply of IT system.																								
Training of employees involved in tax control about timely detection of tax evasion , on-field controls at taxpayers premises.																								
Service contact																								
Programming of software (International Transactions and Carousel Fraud data base and Thematic checks support IT system)																								
Documentation of software																								
Testing of software																								
Implementation of software in all SRS regional offices.																								
Training of employees for work with software.																								
Supply contract																								
Supply of 40 PC notebooks for inspectors who carry out thematic checks in SRS RO and Large Taxpayers Department.																								

ANNEX 3

*CUMULATIVE CONTRACTING AND DISBURSEMENT SCHEDULE BY QUARTER***CUMULATIVE CONTRACTING AND DISBURSEMENT SCHEDULE**

FUND (EUR thous.)

	2004				2005			
	I	II	III	IV	I	II	III	IV
Contract 1 – Twinning contract*								
Contracted total:	400							
Phare:	400							
National:	44							
Disbursed total:	320	360		400				
Phare:	320	360		400				
National:	11	22	33	44				
Contract 2 – Service contract**								
Contracted total:					1000			
Phare:					750			
National:					250			
Disbursed total:					600		749	1000
Phare:					450		562	750
National:					150		187	250
Contract 2 – Supply Contract**								
Contracted total:							107	
Phare:							80	
National:							27	
Disbursed total:							64	107
Phare:							48	80
National:							16	27

* parallel co-financing

** joint co-financing (excluding all taxes and duties)

ANNEX 4

The themes checked in the thematic checks:

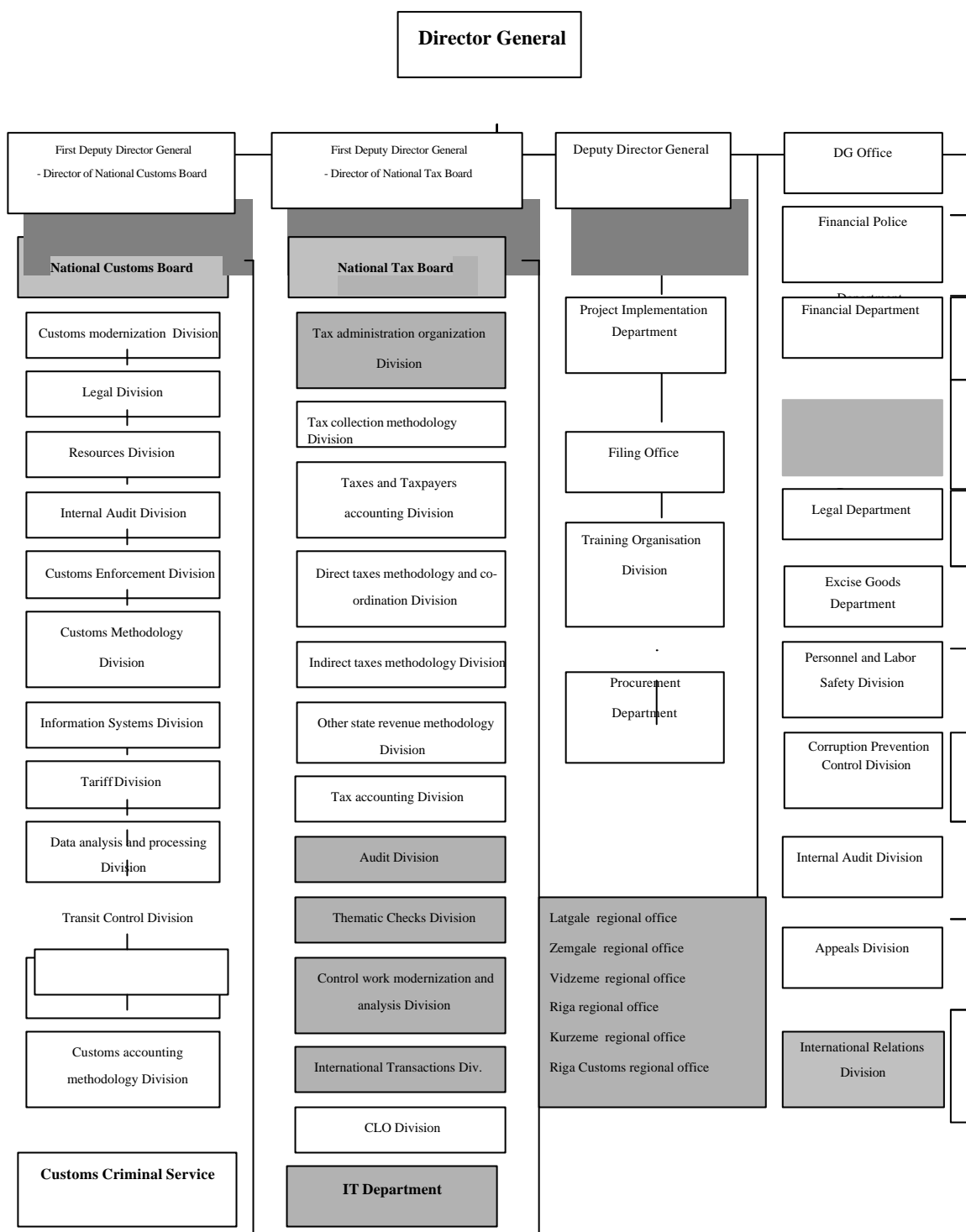
- employers (signing the employment contracts to perform the personal income tax and mandatory social insurance contributions);
- retail business (complete registration of incomes, following the expiry date of goods and observing the accounting of goods and a circulation order of delivery notes);
- service rendering (registration of incomes, observing the accounting of goods and a circulation order of delivery notes);
- wholesale trade (observing the accounting of goods and a circulation order of delivery notes, observing the rules of wholesale trade organising, observing the order of clearings);
- transactions with excise goods (observing the rules of alcohol movement, as well as the movement of tobacco and tobacco products and fuel etc.);
- warehouses for excise goods (observing the accounting of goods, permissions and licenses);
- gambling (permissions and licenses, the registration of incomes);
- transactions of net cash (observing the order of net cash accounting system, declaring the transactions performed in net cash);
- transactions with timber products (observing the order of using and formatting the consignment notes for timber products);
- accounting;
- capital expenditure of non-governmental organisations;
- calculating of property tax in municipalities;
- bill – account;
- scrap metal (observing the order of licensing, formatting and accounting of scrap metal delivery and realisation documents, observing the order of clearings, registration of incomes);
- checks of overpaid VAT refunds;
- imported permanent assets.

ANNEX 5

The following table characterises progress and planned activities in development of tax control:

Project objective	Year				
	2000	2001	2002	2003	2004
1. Tax audit system					
• Audit objects selection system	PHARE'98 Twinning LV98/IB/Fi01 Internal Market "Capacity Building and Enforcement" Results; User requirements and Technical specifications of Tax audit system for Risk analysis and object selection"		PHARE'99 Project LE 9903.01 "Supply of Audit System Software and training of Personnel in the SRS" Computerised audit objects selection system established	Complete implementation of audit objects selection system	
• Audit support information system				Supply of Audit support IS under the WB SRS Modernisation project 1998-2002	Implementation of audit support IS
• Computerised accounting audit IT system				Supply of computerised Audit IT system under the WB SRS Modernisation project 1998-2002	
2. Thematic checks system					
• Thematic checks support system					<u>PHARE 2003 project proposal</u>
3. Credibility checks of tax returns				PHARE 2001 LE 01.02.01 Institutional strengthening of tax and customs administration Twinning component	
4. International transactions control and Carousel Fraud			KPMG experts proposal under the WB SRS Modernisation project 1998-2002 – International Transactions Division was established		<u>PHARE 2003 project proposal</u>

STRUCTURE OF STATE REVENUE SERVICE



Structural units of the SRS involved in development of the project

ANNEX 7

List of relevant Laws and Regulations

1. Law “On Taxes and Fees”
2. Law “On the State Revenue Service”
3. Law “On Accounting”
4. Law “On the Annual Accounts of Undertakings”
5. Administrative Code of the Republic of Latvia
6. Law “On Value Added Tax”
7. Law “On Enterprise Income Tax”
8. Regulations of Latvian Cabinet of Ministers “Procedures for Application of the Norms of the Law On Value Added Tax”
9. Regulations of Latvian Cabinet of Ministers “Procedures for Application of the Norms of the Law On Enterprise Income Tax”
10. Regulations of Cabinet of Ministers “Procedure on how State Revenue Service assesses amount of tax payment based on calculations”

ANNEX 8

Reference to relevant Government and SRS Strategic plans and studies

1. National programme for Integration into European Union.
2. State revenue Service Strategic Plan 1999 – 2003.
3. State Revenue Service IT Strategic Plan.
4. State Revenue Service Tax administration strategy 2002 - 2004.
5. State Revenue Service Tax control strategy 2002 - 2004.