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Developing Tax Audit Skills

Tax Audit Training Manual for the General Commission for Taxes of Iraq

Strengthening Public Finances and Financial Markets (FFM) in Iraq

Co-funded by the European Union

التعاون الألماني
DEUTSCHE ZUSAMMENARBEIT

Implemented by
giz Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

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Published by
Deutsche Gesellschaft für
Internationale Zusammenarbeit (GIZ) GmbH

Registered offices
Bonn and Eschborn, Germany

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Project
Strengthening Public Finances and Financial
Markets (FFM) in Iraq

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November 2023, Baghdad

This publication was produced with the financial support of the European Union (EU) and the German Federal Ministry for Economic Cooperation and Development (BMZ). Its contents are the sole responsibility of GIZ and do not necessarily reflect the views of the EU or BMZ.

Acknowledgement

The Strengthening Public Finances and Financial Markets (FFM) project would like to thank the following people and institutions who made this publication possible:

- Ministry of Finance of Iraq
- General Commission for Taxes of Iraq

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List of abbreviations

BMZ	German Federal Ministry for Economic Cooperation and Development
CEDM	Compliance, enforcement and debt management
CFO	Central Filing Office
C-G	Commissioner General
CIT	Corporate income tax
EU	European Union
FBSA	Federal Board of Supreme Audit
FFM	Strengthening Public Finances and Financial Markets
GCT	General Commission of Taxes
GDP	Gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH
GoI	Government of Iraq
IFMIS	Integrated Financial Management Information System
ITA	Income Tax Act
ITAS	Integrated Tax Application System
LI	Legislative Instrument
LTO	Large Taxpayer Office
MTO	Medium Taxpayer Office
PAC	Public Accounts Committee
PAYE	Pay-as-you-earn
SOPs	Standard operating procedures
STO	Small Taxpayer Office
TADAT	Tax Administration Diagnostic Assessment Tool
TC	Technical Cooperation
TCC	Tax clearance certificate
TIN	Taxpayer identification number
TNID	Tax not in dispute
TPS	Taxpayer Services

FOREWORD

The purpose of this Tax Audit Training Manual is to support the staff of the General Commission of Taxes (GCT) of Iraq in addressing important needs. The main challenge is the lack of capacity to carry out tax audits in an efficient and professional manner to enhance tax revenue collection and accountability.

The GCT was established on 27 February 1982 under Ministry of Finance Act No. 92 of 1981. The Commission is a body of the Ministry of Finance that replaces two previous commissions, namely the General Income Directorate, responsible for administering the Income Tax Act, and the General Revenue Directorate, which administered the Real Estate Tax Act.

The GCT is mandated to collect non-oil tax revenue under the following legislation:

I. Income Tax Act No. 113 of 1982, as amended in 2003;

II. Real Estate Tax Act No. 162 of 1959, as amended;

III. Land Tax Act No. 36 of 1997 (hotels and restaurants);

IV. Inheritance Tax Act No. 64 of 1985

V. Resolution on Real Estate Transfer Tax (Resolution No. 120 of 2002);

VI. Direct Deduction of Tax Instruction No. 1 of 2007, as per Federal Budget Instruction of 2008.

The vision of the GCT is to build an efficient tax administration system that applies tax laws impartially and fairly and adopts international best practices and scientific approaches in its day-to-day administration of taxes. It also aims to foster greater awareness about its role in tax revenue collection and demonstrate the capability and flexibility required in the discharge of its responsibilities to promote economic transformation and adapt to change.

The Government of Iraq has expressed its interest in carrying out non-oil revenue reforms and therefore needs to build the capacity of the GCT Tax Audit Department. Effective tax auditing will help provide valuable information on domestic revenue generation and equip parliament with independent insight into the effectiveness of tax policy and the level of tax compliance among national and international businesses and individuals required to pay taxes to the government.

Through multilateral agreements and funding from the European Union and the Federal Republic of Germany, the government is embarking on a drive to modernise domestic non-oil revenue mobilisation, with a view to diversifying the country’s revenue base, in a move away from overdependence on oil revenue. The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, as an implementing partner, engaged the services of an international tax expert to support the GCT in this endeavour.

GIZ, like many other development partners in the field, is convinced that effective and efficient tax auditing is key to promoting sustainable domestic revenue generation, especially in post-conflict environments where tax institutions are weak due to prolonged instability. Strong tax audit capacity will not only enhance human resource and institutional capacities, but also contribute to preventing and reducing excessive tax avoidance and illicit transfers of profit across borders by multinationals and individual businesses.

This Tax Audit Training Manual is unique in that it is tailored to the needs of the staff of the Tax Audit Department and will give users the confidence to venture into professional tax auditing and examine taxpayers' tax planning activities. It is based on the legal and regulatory framework governing domestic revenue mobilisation in Iraq.

The author, Dr Olympio Attipoe, has over 30 years of accumulated experience in the field of domestic revenue administration and the investigation of tax fraud, illicit financial flows and tax avoidance. Before joining GIZ, he held the position of Commissioner of the South Sudan Revenue Authority and worked with the United Nations Development Programme (UNDP) South Sudan country office as a technical specialist on the project Support to Public Financial Management. He also worked with ActionAid International as country tax justice advisor based in Maputo (Mozambique). Before joining UNDP South Sudan, Dr Attipoe worked with the Ghana Revenue Authority for over 17 years as a senior revenue officer.

One of the purposes of the GIZ project's fiscal reform component is to support the GCT in developing its tax audit capacity and to produce a tax audit training manual and standards for GCT staff. The aim is to promote efficiency and effectiveness in the country's domestic revenue mobilisation system and to enhance transparency and accountability in its revenue generation system.

I am convinced that the person best qualified to develop this Tax Audit Training Manual is the GIZ Tax Advisor Dr Attipoe, taking into account his deep understanding of non-oil revenue administration and the importance of tax auditing in promoting sustainable domestic revenue generation and accountability.

The Manual is structured into eight chapters. Chapters 1 to 5 set out the theoretical and practical framework, which includes accountability and oversight, approaches to tax compliance, income taxation, withholding tax administration, tax audit practice, the doctrine of entirety, value added tax, tax avoidance and a tax audit checklist. Chapters 6 to 8 provide a comprehensive review of the literature on risk management in tax administration, the standard operating procedures of a good tax system and appropriate measures for recovering tax debt. These chapters will guide users in their work and help them gain a deeper understanding of the GCT's tax planning activities, including tax laws and regulatory frameworks and the forms used by the GCT for tax collection purposes.

I fully endorse the Tax Audit Training Manual for GCT staff and am certain that it will enhance their skills and capacities in this field, enabling them to carry out tax audits in a professional and transparent manner.

Heyam Mohammed Ali
Deputy Head of the General Commission for Taxes of Iraq

Baghdad, November 2023

PREFACE

One of the main challenges for effective non-oil revenue administration across the world is the ever growing informal sector – the shadow economy, combat economy and coping economy – existing alongside the formal national economy. Iraq has felt and is still feeling the far-reaching effects of such activities.

This Tax Audit Training Manual has been developed on the basis of wide consultation and consensus among stakeholders and the tax institution responsible for collecting non-oil revenue for the Government of Iraq. The Manual seeks to provide a fundamental understanding of how to conduct tax audits and investigations to protect government revenue from leakage through the illicit transfer of profits across borders, tax avoidance and excessive tax planning activities by taxpayers to conceal profits and tax information.

This Manual is intended to be used as a reference document and is written using very technical language. This will, from the outset, draw the reader's attention to the highly technical nature of taxation in general and tax auditing and tax investigation in particular. The document is called a manual to indicate that further work is needed to develop separate reference documents on specific topics.

It is important for the reader to understand that tax auditing is key to ensuring efficient tax administration capable of generating revenue in a transparent and accountable manner for sustainable development. The focus of the Manual is on addressing accountability and transparency in domestic revenue generation systems, the principles and ethics of good tax audit standards, risk management in revenue administration, compliance and the enforcement of tax laws. It is my view that enhancing tax audit capacity will curtail excessive leakage in the domestic revenue generation system due to tax avoidance, the illicit transfer of profits across borders and the generally low level of tax compliance in the country.

The Manual is arranged into eight chapters to provide a clear understanding and appreciation of the impact of tax auditing and tax investigation on government domestic revenue mobilisation reforms.

Olympio Attipoe PhD
Senior Tax Advisor, GIZ

Baghdad, November 2023

1 Chapter One

1.1 Introduction

1. Chapter 1 of this Tax Audit Training Manual provides a general overview and practical knowledge of the tax planning activities of Iraq's General Commission of Taxes (GCT) and serves as a guide for the GCT Tax Audit Department staff to enable them to carry out tax audits in a professional and efficient manner.

1.2 Purpose of the tax audit training manual

2. The purpose of this Manual is to guide GCT staff in conducting tax audit assignments. The primary focus is on the investigation of tax fraud, tax performance and compliance auditing and international best practice standards and procedures to ensure professionalism and integrity in GCT tax audit operations and revenue collection activities.

3. The Manual was developed in compliance with Chapter 9 of the government White Paper on diversifying non-oil revenue mobilisation in the country. It also provides a roadmap for the training of trainers. It was prepared on the basis of a document review and interviews with stakeholders.

4. The GCT is expanding the scope of performance auditing to include tax compliance activities. The Manual provides a basic understanding of the principles of tax auditing and sets out ethical standards for tax auditors. It also explains how GCT staff can conduct tax performance audits and broaden their understanding of GCT tax performance reporting and accountability.

1.3 Background

5. The tax audit function plays a critical role in the administration of tax laws in any country. The primary responsibility of tax auditors is to detect and deter non-compliance, illicit tax planning and tax evasion. They are therefore required to interpret complex tax laws and carry out intensive examinations of taxpayers' books and records.

6. A tax audit is an examination carried out to determine whether a taxpayer has correctly assessed and reported their tax liability and fulfilled other tax-related obligations. Tax audits are often more detailed and extensive than other types of examination, such as general desk checks, compliance visits/reviews or document matching programmes.

7. Holding the executive arm of government accountable generates tension, but it is important for the legislature to exercise their constitutional responsibility and explore the difference between traditional accountability and what it means to hold yourself and others accountable. In this regard, enhancing the capacity of GCT Tax Audit Department staff to effectively carry out tax audits will not only equip parliament to perform its oversight responsibilities in an efficient manner, but will also promote transparency in revenue mobilisation, reporting, accountability and allocation for effective service delivery.

8. This Tax Audit Training Manual critically examines various types of taxes collected by the GCT. The most important are corporate income tax (CIT), pay-as-you-earn (PAYE) and other withholding taxes, such as real estate tax, land tax, withholding tax on goods and services, dividend tax and capital gains tax. The Manual also takes a critical look at the application of the applicable tax law.

1.4 Exogenous economic factors

9. In order to determine the level of compliance with tax laws and regulations, the Tax Audit Training Manual also examines certain economic activities that undermine revenue mobilisation in any country. Notable among them are the shadow economy, the combat economy and the coping economy.

10. **Shadow economy**. The shadow economy, sometimes referred to as the underground or informal economy or illegal economic activity, is a system in which goods and services are traded in illegal or illicit business transactions that do not comply with the requirements established in tax laws and regulations. Shadow economy activities are more deeply rooted in environments where the tax infrastructure is very weak and the capacity of tax administration staff is notably low. Examples of shadow economy players are powerful politicians, high-profile citizens and their foreign counterparts, and individuals in positions of authority.

11. **Combat economy**. This type of economy is characterised by armed combatants involved in a conflict taking advantage of the deteriorating security situation and the breakdown of government systems and structures to exploit resources and sell them without the revenue receipts passing through the normal financial systems. Combat economies have different ways of perpetrating this exploitation of the country's resources without government intervention and knowledge. These approaches include:

a. taking control of territories, means of production and economic resources to finance and sustain the conflict;

b. displacing and disempowering certain groups in society as economic strategies of war aimed at controlling resources so that they can be exploited to finance the conflict.

12. **Coping economy**. Prolonged conflicts and economic marginalisation expose most countries' population to vulnerability as their asset bases are eroded and undermined. These groups in coping economies are not static but vary over time as a result of changes in the political regime and external shocks. Iraq is no stranger to the phenomenon of coping

economies. Vulnerable individuals affected by the prolonged conflict that led to the destruction of their livelihoods use any means they can to survive and cope with socio-economic marginalisation and deprivation.

2 Chapter Two

2.1 Accountability and oversight

2.1.1 Introduction

13. The capacity to deliver improved public services, including socio-economic infrastructure, such as roads, schools and health-care and sanitation facilities, depends on the transparent and efficient management of public finances. Most developing countries still face challenges in ensuring the effective management of their financial resources. Governments are unable to mobilise sufficient revenues, budget execution remains difficult and there are shortcomings in terms of transparency and achieving the expected results. In this regard, budget execution and expenditure management are bound by political imperatives as well as by economic logic.

14. The government must act in a responsible manner and be accountable to the people it serves; otherwise it risks losing the reins of political power. Accountability within government is a measure that is used to control the power vested in elected government officials. Without accountability, what is left is a political structure that has absolute power to act without conscience or atonement.

2.1.2 Definition of accountability

15. Accountability, like electricity, is difficult to define, but possesses qualities that make its presence in a system immediately detectable.

16. Accountability can be referred to as a ‘relational concept’ which operates along four axes:

a. Who is accountable?

b. What are they accountable for?

c. Who are they accountable to?

d. How can accountability be enforced?

17. Accountability is a situational concept in that it needs to be specified in context: *Who* is accountable *to whom* and *for what?*

18. Accountability teaches us a culture of responsibility and determines how individuals and institutions choose to hold themselves accountable for achieving desirable outcomes. To be accountable, you must first be responsible, shift the focus away from excuses, stop the blame game, learn from mistakes and start delivering results. Holding the executive arm of government accountable is a function of the legislature. It is important for the legislature to exercise their constitutional responsibility to promote ‘good governance’ by observing the following principles:

a. openness and transparency;

b. appropriate mechanisms for political, legal, public and auditing accountability;

c. appropriate provisions to maximise the effectiveness of the separation of powers and checks and balances;

d. encouragement of public participation.

19. The provision of information is central to ensuring accountability which, in the public sector, can be considered from the following viewpoints:

a. civil servants who represent the bureaucratic system and often work on the ‘front line’;

b. ministers who represent the political sphere or are involved in more behind-the-scenes operations.

2.1.3 Financial accountability

20. **Federal Board of Supreme Audit of Iraq**. The constitutional role of the Federal Board of Supreme Audit (FBSA) as an administratively and financially independent institution with legal personality is critical in promoting transparency and accountability. The FBSA, which was established in 1927, is the highest financial control body. It was restructured and is now attached to the Iraqi Council of Representatives pursuant to Article 103 of the Iraqi Constitution of 2005. The FBSA is represented by its president who is authorised to exercise control over public funds by auditing government bodies and institutions under its control in all of Iraq, pursuant to Act No. 31 of 2011 (amended). The FBSA is one of Iraq’s leading institutions, entrusted with the task of protecting public funds, detecting fraud and evasion, combating administrative and financial corruption and effectively contributing to the enhancement of the national economy, with a view to building a new Iraq with governance based on robust economic and financial foundations and sound and well-established legal and scientific standards.

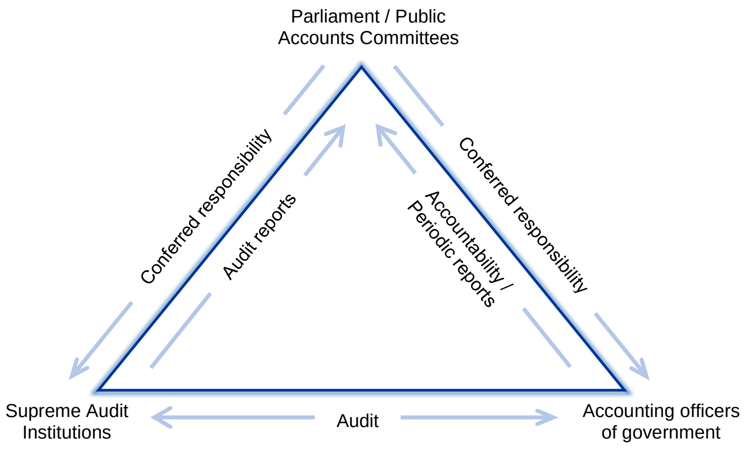
21. The FBSA is mandated to audit public entities, including ministries, government departments, agencies and commissions, local government authorities, public corporations and organisations established by an act of parliament. Over the years, the FBSA has demonstrated its commitment to protecting the public purse. Thanks to a focused vision and the ambitious aspirations of successive administrations, the FBSA has been able to enhance its strengths, keeping pace with the latest audit methodologies and international standards and improving the capacities, expertise and skills of its employees. This has given

it the ability to issue high-quality, professional reports and formulate strategic and annual plans which are followed closely and proficiently.

22. The role of the supreme audit institution in promoting accountability is crucial for resource mobilisation and utilisation and for reporting. The legitimacy of the government in the eyes of its citizens, especially in a post-conflict environment, depends on its ability to mobilise resources in a transparent and accountable manner and to allocate these resources in an equitable way for service delivery. Therefore, putting efficient accountability mechanisms in place to enhance '**command and control' in public financial management** is critical for socio-economic development. The accountability framework developed by Priest and Stanbury (1998a) contains the following six main elements:

1. the principal delegates authority to the agent to act on behalf of the principal;
2. the principal may well provide instructions to the agent as to how to carry out their duties;
3. the principal may specify criteria against which the performance of the agent will be assessed;
4. the principal obtains information about the agent's actions (performance) from the agent and/or from other sources;
5. the principal assesses the performance of the agent in light of the tasks delegated to them;
6. the principal rewards or sanctions the agent accordingly and thus closes the 'accountability loop'.

Figure 1: Westminster system of accountability and oversight



23. Parliament is one the key agents for holding the executive accountable. It has the power to review both proposed and actual expenditures (i.e. the Public Accounts Committee – PAC). Generally, the methodologies it uses are scrutiny, surveillance, public exposure and debate through the various specialised government institutions that are mandated by the constitution of a country to provide a wide range of accountability mechanisms.

24. Parliament needs useful information to perform its role. Information is generally provided to parliament by the government auditor/supreme audit institution. The role of the parliament's PAC is to examine the reports of the supreme audit institution and follow up on issues raised in them. Parliament need not follow the government's lead but can initiate inquiries into broader aspects of economic management which it may conduct itself or suggest to the supreme audit institution.

2.1.4 Value for money

25. The belief that any socio-economic project being implemented by government is for the benefit of the people in the target society or community is a mere 'fallacy of composition'. The fact that a project is carried out does not mean that the project will achieve the desired outcome. Measuring the value for money of any government's socio-economic projects should be based on the following:

a. identify the social impact of implementing the project and other benefits;

b. critically compare the cost of the project to the expected benefits to society;

c. determine if the project will achieve the desired outcome once completed;

d. determine how the current project could lead to future projects.

26. There are challenges in most initiatives implemented by government due to the failure to observe value-for-money principles. More specifically, government projects face difficulties in implementation for the following reasons:

a. the government's inability to clearly define value-for-money criteria at the project planning stage, as projects are implemented based on political considerations without a clear specific project objective;

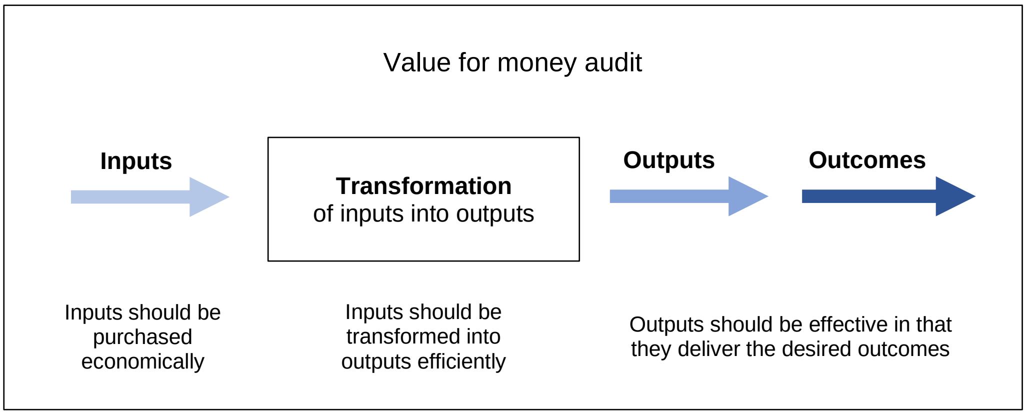
b. little or no incentive to achieve innovation and efficiency throughout projects;

c. poor monitoring of project implementation and poor sense of judgement;

d. the cost and benefits of projects are misunderstood.

27. Value for money is based not only on the minimum purchase price (economy), but also on the maximum efficiency and effectiveness of the purchase.

Figure 2: Input-output model in the PAC



2.2 Tax compliance

28. There are two broad approaches to the problem of tax compliance, namely the economic approach and the behavioural approach.

2.3 Economic approach

29. The economic approach identifies the following factors affecting tax compliance.

30. **Financial encumbrance.** There is an inverse relationship between the amount of tax owed and taxpayer compliance. For instance, if an individual or a business has a tax liability that can easily be paid, they may be willing to comply. However, if the tax liability is large, potentially threatening the viability of the business, the owner may avoid paying it all or try to conceal information on the returns reported to incur a smaller (but incorrect) tax liability (ATO, 2000/2001).

31. **The cost of compliance**. According to Adam Smith (1776), one of the canons for an efficient tax system is that it should be convenient for the taxpayer to pay the tax they owe. Taxpayers are faced with a number of common costs when attempting to honour their tax liabilities and obligations – the cost of compliance. They include time spent on completing tax returns, the cost of the services of accountants to prepare financial statements and tax returns and psychological costs such as stress caused by uncertainty as to whether all tax requirements have been met. This list is not exhaustive. The higher the compliance cost, the higher the chance of non-compliance (OECD, 2014).

32. **Incentives**. Giving the taxpayer incentives may have a positive effect on tax compliance (Kirchler, 2007). In tax jurisdictions where the government provides tax incentives, such as tax holidays, free zones and special lower tax rates, compliance levels are normally high.

2.4 Behavioural approach

33. Factors that affect compliance behaviour are described in this section.

34. **Individual differences.** Individuals are different from birth, and gender, age, education level, moral compass, industry, personality, circumstances and personal assessment of risks are some of the factors that influence tax compliance behaviour (ATO, 1997).

35. **Fairness and inequity.** According to Adam Smith (1776), a good tax system must be fair and equitable. Taxpayers who perceive a tax system to be unfair or who have personal experiences of unfair treatment are less likely to honour their tax obligations voluntarily (Reckers et al., 1994).

36. **Perception of minimal risks**. If a taxpayer has the opportunity to conceal their income and not comply and believes that there is only a minimal risk of being detected and punished, they will take that risk (Kirchler, 2007). Some people regard tax avoidance and tax evasion as a game to be played; they like testing their skill in avoiding being caught (OECD 2004a).

2.5 Challenges for tax compliance

37. There are external factors that affect taxpayer compliance behaviour, for example, the nature of the business or industry, the prevailing economic climate and market conditions, such as demand and supply. These are factors that influence competitive advantage, creating a perception that non-compliance is the solution.

38. It is important for a tax authority, as part of its strategy to enhance tax compliance, to seek to create an environment that will enable taxpayers to overcome the factors referred to above and encourage positive tax compliance behaviour and attitudes (Reckers et al., 1994).

2.6 Indicators for voluntary tax compliance

39. The level of tax compliance can be determined by looking at compliance indicators, such as the ratio of tax revenue to gross domestic product (GDP) (OECD, 2004a). A higher tax-to-GDP ratio signifies an increase in the level of tax compliance.

40. Other compliance indicators are the percentage of income reported for taxation purposes and programme impact indicators, which assess the effects of specific programmes or initiatives on the compliance behaviour of the target taxpayer population (ATO, 2001).

41. Other indicators for tracking the level of tax compliance examine registration, the filing of tax returns, correct reporting of income and expenses and payment of the correct amount of tax due. Trends should be examined or compared in terms of percentages rather than the additional revenue generated by applying the specific compliance strategy or in terms of the ratio of tax revenue collected through enforcement activities, such as audits, penalties and fines, to the total revenue collected, compared with the amount paid voluntarily (Netsanet-Shiferwa 2020).

42. The level of tax compliance can also be measured by looking at the tax gap. The tax gap is the difference between the actual revenue collected and the amount that would be collected if there were 100% compliance (James et al., 2001). For the purposes of this Manual, tax compliance refers to whether taxpayers file their tax returns, report the correct tax liability and pay the taxes due within the statutory period.

2.7 Taxpayer rights and obligations

2.7.1 Introduction

43. Revenue from taxes is necessary to finance public expenditures. The powers granted to tax authorities and individuals under the legislation of different countries (administrative rulings, statutes, constitution, etc.) vary widely. There is also a need to protect taxpayers, including protection of personal privacy and property, the right to confidentiality and penalties for misuse of confidential information.

2.7.2 Right to be informed, assisted and heard

44. Taxpayers are entitled to have up-to-date information on the operation of the tax system and the way in which their tax is assessed. They are also entitled to be informed of their rights, including their rights of appeal and the right to be heard. Taxpayers can expect that the information provided to them should reflect the complexity of the tax situation, thereby enabling them to better understand their tax affairs.

2.7.3 Right of appeal

45. The right of appeal against any decision of the tax authorities applies to all taxpayers and to almost all decisions made by the tax authorities, whether relating to the application of the law or administrative rulings, provided that the taxpayer is directly concerned.

46. Taxpayers should pay no more tax than is required by the tax legislation, considering their personal circumstances and income. Therefore, while it is acceptable for taxpayers to reduce their tax liability by legitimate tax planning, governments make a distinction between this and forms of tax minimisation that are clearly contrary to the intent of the legislature.

47. Taxpayers are also entitled to reasonable assistance from the tax authorities so that they receive all the reliefs and deductions to which they are entitled.

2.7.4 Right to certainty

48. Taxpayers have a right to a high degree of certainty as to the tax consequences of their actions. Clearly, certainty is not always possible. For example, taxpayers may not always know in advance the effect of rules that are dependent on the facts and circumstances in a particular case. In addition, tax authorities may not be obliged to provide the taxpayer with certainty in relation to the application of anti-avoidance provisions aimed at taxpayers seeking to circumvent the intent of the legislation. However, it is clearly a goal that taxpayers should be able to anticipate the consequences of their ordinary personal and business affairs. Achieving this goal is often difficult because modern tax systems are complex and constantly evolving.

2.7.5 Right to privacy

49. All taxpayers have the right to expect that the tax authorities will not intrude unnecessarily on their privacy. In practice, this is interpreted as avoiding unreasonable searches of their homes and requests for information that is not relevant for determining the

correct amount of tax due. Generally, strict rules apply to entry into a person's dwelling or business premises by a tax official in the course of a tax investigation and to obtaining information from third parties.

50. In some countries, visits to a taxpayer require their consent; in most countries, a signed warrant is generally required to enter the home of a taxpayer who objects to a visit by the tax authority. Similarly, strict rules apply to obtaining information from third parties on the affairs of a taxpayer.

2.7.6 Right to confidentiality and secrecy

51. The information available to the tax authorities on the affairs of a taxpayer is confidential and must only be used for the purposes specified in tax legislation. Tax law usually imposes very heavy penalties on tax officials who misuse confidential information, and the confidentiality rules that apply to tax authorities are far stricter than those applying to other government departments.

2.8 Sources of taxpayer information

52. The operational technicalities of any good tax system are essentially based on sound and accurate sources of information about taxpayers acquired in a timely manner. Taxpayers often do not provide accurate information about their income and business activities for tax purposes, and this behaviour is what may constitute tax avoidance or evasion.

53. Tax authorities can obtain information on taxpayers from the following sources:

a. the taxpayer;

b. business associates;

c. financial statements of other companies;

d. Registrar of Companies and Businesses;

e. ministries and other government departments;

f. community leaders and traditional authorities;

g. embassies and high commissions.

2.9 Taxpayer interview techniques

54. The taxpayer interview is the most important step in ascertaining a taxpayer's income and in the collection process. It is an opportunity to gather information that will lead to a fair determination of a taxpayer's income or closure of a case file and to educate the taxpayer about future compliance. The tax authorities must bear in mind the four principles or canons of taxation, as postulated by Adam Smith in 1776, namely equity, certainty, economy and convenience.

55. **Equity**. The process of determining taxable income is very difficult, partly due to the behaviour of taxpayers who often choose not to disclose accurate information about their businesses, employment and investments. However, the tax authorities have a responsibility to be fair to all taxpayers, according to their ability to pay tax. The tax burden must be equally distributed among taxpayers. It stands to reason that those with higher incomes must pay higher taxes. The tax laws must be seen to be structured in such a way as to treat all taxpayers fairly according to their level of income and ability to pay.

56. **Certainty**. The method and measures adopted to impose taxes must be transparent and simple for taxpayers to understand. According to this principle, taxpayers must know when and how to pay their taxes and how much they have to pay. The tax that each individual is required to pay should be clear and certain and not arbitrary. If taxpayers know how much tax they have to pay and when, they will be able to plan their budget for the tax period. The government too must know how much revenue will be generated over a given period for the purposes of fiscal planning.

57. **Economy**. Tax authorities must be efficient in their day-to-day administration of tax collection to generate revenue for the government. The crucial issue is for tax authorities to keep the administrative cost of collecting taxes as low as possible. Taxes that are too expensive or take too much time to collect should be avoided completely.

According to Adam Smith: '*Every tax ought to be so contrived, as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.*'

58. **Convenience**. This principle states that, in administering tax laws to collect revenue, tax authorities must ensure, both within and outside tax structures, an environment that is convenient for taxpayers in terms of the timeframe, the method of payment and the location of tax offices. The tax system should be structured so as to provide a clear pathway for taxpayers to file returns and pay the taxes due without difficulty. The administrative processes and standard operating procedures (SOPs) must be simple and clear to ensure greater convenience for taxpayers. It is also important for the government to have a trouble-free environment to implement tax policies.

As underlined by Adam Smith: '*Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it*.'

2.9.1 Planning interviews

59. There are two types of interviews tax officers conduct to gather information about a taxpayer:

a. interview to ascertain the income of a new taxpayer who has come to register with the tax authority for the first time;

b. interview with an existing taxpayer for enforcement purposes to collect tax due or follow up a delinquent account.

2.9.2 Conducting a successful interview

60. People differ in character and therefore react differently to a tax officer. Some may be uncomfortable and apprehensive, and others may be defensive and vague when answering questions. A professional tax officer is expected to explain the purpose of the interview to the taxpayer in a polite, non-threatening manner and to conduct the interview using a patient approach and treating the taxpayer as an equal.

61. Some interviewees may be tetchy, but do not be drawn into an argument with them. Stay calm and politely explain what has to be done. Ensure that you are in control of the interview but bear in mind that it is useful to allow the taxpayer to talk and express any concerns before further questioning.

2.9.3 Interview techniques

62. The following techniques are sometimes adopted in conducting an interview with a taxpayer:

a. Identify yourself. 'I am ………………………., an officer of the GCT'.

b. Review the registration form completed by the taxpayer and other supporting documents made available to the office (permanent files).

c. Ask the taxpayer about their employment history, especially current and recent jobs, and about any part-time employment records.

d. If the taxpayer provides their employment history, probe further to find out how much their monthly salary or annual income is.

e. Ascertain who else might be supporting the taxpayer by contributing to the children's upkeep, including their education and training.

f. Find out from the taxpayer the actual date of commencement of their business activities.

g. Find out the source and amount of initial capital invested into the business.

h. Ask the taxpayer whether their residence is rented or not; if it is rented, find out how much rent they pay each month or year.

i. Ask about the status of rental residential or commercial property and any rent paid.

63. It is crucial for tax officers to be competent in using these interview techniques. The interview is the fundamental basis for accurately determining the taxable income of a taxpayer. It is applicable for both the initial estimate and for presumptive and self-assessment regimes.

3 Chapter Three

3.1 Income taxation

64. The GCT is mandated to collect non-oil tax revenue under the following legislation:

- Income Tax Act No. 113 of 1982, as amended in 2003;
- Real Estate Tax Act No. 162 of 1959, as amended;
- Land Tax Act No. 36 of 1997 (hotels and restaurants);
- Inheritance Tax Act No. 64 of 1985
- Resolution on Real Estate Transfer Tax (Resolution No. 120 of 2002);
- Direct Deduction of Tax Instruction No. 1 of 2007, as per Federal Budget Instruction of 2008.

3.2 Types of taxes

65. There are two types of taxes that are administered by the Iraq Customs Authority and the GCT, namely direct and indirect taxes. The GCT is generally responsible for the administration and collection of direct taxes.

3.2.1 Direct taxes

66. Direct taxes collected by the GCT fall into three major categories. These are taxes on income from employment, businesses and investments.

3.2.2 Tax on employment income

67. According to Article 2(5) of Income Tax Act No. 113 of 1982, as amended in 2003 (Income Tax Act No. 113), taxable income from employment includes: salaries, pensions, bonuses, wages for specified work in a limited period of time, allowances for workers, including payments in cash and benefits in kind, such as housing, food and accommodation provided free of charge to workers, specifically:

a. salary, wages, leave pay, fees, commissions and gratuities;

b. personal allowances, including cost-of-living, subsistence, rent, entertainment and travel allowances;

c. discharge or reimbursement of an expense incurred by an individual or an associate of the individual.

3.2.3 Corporate income tax

68. According to Article 2(1) and (2) of Income Tax Act No. 113, taxable income from businesses includes:

a. profits from commercial activity or activity of a commercial nature, occupations and professions, including contracts, undertakings and compensation for non-performance when not paid to make good a loss sustained by the taxpayer;

b. interest, commissions, discounts and profit from trading in bonds and securities.

3.2.4 Investment income tax

69. According to Article 2(3), (4) and (6) of Income Tax Act No. 113, taxable income from investments includes:

a. rent from agricultural land;

b. profits from the transfer of ownership or usufruct of immovable property by any means, even if transferred only once, such as sale, exchange, compromise, renunciation, donation, partition, liquidation of *waqfs* (religious endowments) and long leases;

c. income from any other source not exempted by law and not liable to any other tax in Iraq; notwithstanding the provisions of this Article, dividends are not liable to income tax if a company has deducted or is entitled to deduct tax therefrom under Article 15 of the Act;

d. however, dividends distributed by limited liability companies that are not exempted under the Industrial Investment Promotion and Development Act must be taken into consideration when calculating the basis for determining the graduated tax rates applicable to other income.

3.2.5 Tax imposition and assessment

70. Article 3 of Income Tax Act No. 113 provides that taxes are imposed on income as follows:

a. Tax shall be imposed on the income referred to in paragraphs 1, 2, 3 and 6 of Article 2 and shall be computed on the amount arising in the year preceding the year of assessment.

b. Tax shall be imposed on the income referred to in paragraph 5 of Article 2 and computed on the amount arising in the year of assessment, if the amount is known. However, where it is not possible to determine the amount of income, **wholly** or **partly**, the financial authority – the GCT – may take the income of the preceding year as the basis for assessment.

c. If the source of income ceases to exist during the year of assessment, the financial authority shall assess, impose and collect the computed tax and record it as final income for that year, as an exception to the provisions of **paragraph 1** of Article 3.

d. The financial authority may provisionally assess the income referred to in paragraph 1 of Article 3 before the beginning of the year of assessment and collect the tax as a payment on account for the year of assessment in question.

e. Tax shall be imposed on the income of non-residents in the year of its receipt or registration in their account unless their income had already been assessed in the previous year in accordance with paragraph 1 of Article 3.

3.3 Withholding tax administration

3.3.1 Introduction

71. Withholding tax is any tax deducted at source from the income of a person by an authorised agent or financial authority, in the case of Iraq, and forwarded to the tax authority. It is a major source of revenue generation for most governments because it saves time and effort as the cost of collection is minimal (near zero). It provides revenue collectors with an insight into the operations of taxpayers, enabling them to ascertain actual income based on their turnover. It also brings more taxpayers into the tax net. This tax is generally withheld on account until taxpayers file their tax returns with the tax authority.

3.3.2 Withholding agent

72. A withholding agent is any person or financial authority prescribed as such under Article 17 of Income Tax Act No. 113. The withholding agent may be an employer paying wages, a legal entity paying dividends, persons paying interest (other than payment of interest on loans or other debts) and persons paying royalties to individuals or legal entities.

3.3.3 Withholding by employer

73. Employers are withholding agents, as specified under Article 17 of Income Tax Act No. 113, that withhold taxes, adjusted according to the amount of tax to be collected, from the payments made to their employees, including payments in cash and in kind, pensions and any other payments subject to tax made by an employer to an employee. The employer is under an obligation to pay any money deducted from the income of an employee to the financial authority at the appropriate time, as prescribed by the Income Tax Act.

74. **Article 18 of Income Tax Act No. 113** imposes an obligation on the employer to provide the following information to the relevant financial authority – the GCT – as specified in the demand notice from the authority:

a. names and addresses of all employees and details of the salaries, allowances and other amounts paid to them;

b. names and addresses of those receiving pensions, allowances and the like from or through the employer, with details of the amounts;

c. directors and other senior officers involved in the organisation's management shall be considered employers and must sign and provide all the relevant documents and information required.

75. The law also provides directions on how non-residents should be treated. The representative of a person residing in Iraq or outside the country is required to withhold taxes due and pay them to the relevant financial authority – the GCT. Specifically, Article 19 of Income Tax Act No. 113 provides that taxes on the following income for which residents and non-residents are liable must be withheld and paid to the GCT:

a. interest on debentures, mortgages, loans, deposits and advances;

b. annual allowances, pensions and other yearly payments.

3.3.4 Indirect taxes

76. Indirect taxes include value added tax (VAT), customs duties, excise duties, communication service tax, sales taxes and excise taxes, among others. Indirect taxes are basically taxes where the tax burden is transferred to another entity or individual. They are usually imposed on a manufacturer or supplier of goods or services who then transfers all or part of the tax burden to the consumer.

77. Taxpayers are not aware that they are paying such taxes and do not pay them directly. Instead, they are collected by an intermediary that passes them on to the government. They apply to people using certain services and purchasing or importing certain products.

3.3.5 Sales tax

78. Goods such as household items, clothing and other basic commodities bought in supermarkets are subject to sales tax. It is usually added to the final retail price charged at the point of purchase. The store therefore collects the tax and pays it to the government.

3.3.6 Excise tax

79. Excise tax is also collected in most countries. When a manufacturer, for example, Choco Milo, buys the raw materials it needs to make its products, it pays indirect taxes on them. In the normal course of business, the manufacturer can pass on the burden to consumers by selling the finished product at a higher price, including the tax paid on the raw materials.

3.3.7 Customs tax

80. These are taxes levied on imported products at the port of entry. For example, when a container filled with frozen chicken from another country enters Iraq, the importer pays a tax (customs tax), which is then passed on to consumers.

3.3.8 Advantages

81. Taxes may sound like an added burden for consumers, but indirect taxes are not always just a negative thing. Here are some of their advantages:

a. **The poor can do their share.** Unlike direct taxes that usually exempt the poor, indirect taxes allow them to make a contribution to the government's tax revenues.

b. **They are not obvious.** Indirect taxes are incorporated into the sale price of an item and are therefore not noticeable. People do not feel they are being taxed simply because the tax is charged in small amounts.

c. **Collection is easy.** Unlike direct taxes where documents need to be prepared and filing is required, indirect taxes are paid at the time the consumer buys a product. The tax is collected by the supplier and paid to the government.

d. **They discourage consumption of harmful products.** Alcohol and cigarettes are heavily taxed. The higher price discourages people from buying them, saving them from consuming harmful products.

4 Chapter Four

4.1 Tax audit practice

4.1.1 Introduction

82. A tax audit is an examination of a taxpayer's returns by the tax authorities to verify the accuracy of the information on income and deductions reported in their books of accounts and filings submitted to the tax office. Generally, a tax audit is carried out by tax officials in their tax jurisdiction. A specialised department is created within the tax authority to perform tax audit functions. Table 1 shows similarities and differences between tax audits and traditional audits.

Table 1: Similarities and differences between tax audits and other types of audit

Tax auditing	Traditional auditing (government, private auditors)
Internal desk auditing and external auditing	External auditing
Audit is done to determine the accuracy of income and deductions reported by the taxpayer and to ensure compliance with tax laws and regulations	Audit is done to ensure compliance with SOPs, regulatory frameworks and financial management regulations
Tax auditors express a definite opinion and the result is implemented	Auditors express an independent opinion and result may not be implemented or implemented only in part
Internal desk review is done annually	Auditing is done annually by visiting the organisation under investigation
Auditors are all tax authority staff	Auditors are staff of the national audit office/court of audit or private firms in the case of private businesses
External audit is done every two, three or five years	Annual, half yearly and special audits
Notice of audit is given including checklist, date and period to be covered	Notice of audit is given including checklist, date and period to be covered

Tax auditing	**Traditional auditing (government, private auditors)**
Legal authority to enter taxpayer's premises without prior notice	Must give prior notice to auditee
Auditees are individuals and private businesses	Auditees are government institutions, such as ministries, departments, commissions, agencies and metropolitan, municipal and district assemblies
Tax auditor audits the work of traditional auditors and certified accountants	External auditor audits the work of internal auditors and accountants
Auditor is appointed by tax authorities (Commissioner General)	Auditor is appointed by government (Auditor General), and by shareholders in the case of private businesses
Auditor must be a professional tax practitioner with years of experience in the industry	Auditor must be a professional accountant, with a degree and certified in accounting and other specialised areas, where necessary
Auditor investigates specific matters at any time	Audit is a scheduled annual procedure
Audit report is submitted to the head of the tax authority for implementation	Audit report is submitted to parliament and to shareholders in the case of private businesses

4.1.2 Responsibilities of a tax auditor

83. The responsibilities of a tax auditor include the following:

a. conduct internal and external tax audits to ensure compliance with tax laws and SOPs;

b. evaluate and analyse accounting systems and tax control units to reduce taxes;

c. provide training to staff on tax regulations and procedures;

d. maintain all required tax documents;

e. assist companies in tax filing and preparing for audits;

f. prepare tax audit reports;

g. offer recommendations on good tax filing and reporting.

84. A tax audit can take the form of either general tax auditing or specific tax auditing. Specific tax audits include:

a. payroll audit;

b. corporate tax audit;

c. withholding tax audit;

d. fixed assets audit;

e. compliance audit.

4.1.3 General tax audit

85. The general tax audit involves tax auditors going into the field without having been assigned specific types of tax to be audited. They look at general compliance issues in relation to a tax file in the period under consideration. This type of audit takes a considerable amount of time and is usually recommended when a particular tax file is being tax audited for a specific time.

4.1.4 Planning for a tax audit

86. The Tax Audit Training Manual should be used in conjunction with Iraq's Income Tax Act No. 113 and other relevant tax laws and regulations. Auditors are expected to be fully conversant with the relevant tax laws and regulations and with their internal SOPs. They are also expected to be familiar with all GCT's internal forms, definitions and procedures.

4.1.5 Audit elements

87. An auditor's primary function is to determine if a tax has been correctly reported and collected. Audits should be completed in a professional and efficient manner and should create the least possible inconvenience to taxpayers.

4.2 Essential elements of a tax audit

4.2.1 Taxpayer relationships

88. The benefit derived from developing a good relationship with a taxpayer is two-fold. The taxpayer tends to become more comfortable with the audit situation, which allows the audit process to flow more smoothly and the auditor to secure taxpayer cooperation, enabling timely completion of the audit.

4.2.2 Planning activities

89. Planning a tax audit begins when an audit assignment is communicated by management to GCT technical staff. It is important that all tax audit activities, including pre-audit preparation, be documented. There must be a proper structure to determine what type of tax audit (general or specific) is to be carried out on a case-by-case basis before the audits begin. The scope of the audit should be structured according to the risks detected during the process undertaken to identify and select the type of taxpayer to be audited. The tax audit process can be effective and run smoothly if the scope of the audit is defined beforehand, completing the following steps:

a. the head of the Tax Audit Department should develop an effective audit structure that clearly defines roles and responsibilities;

b. the audit team should be formed with a clearly defined leadership and reporting structure;

c. an audit team meeting should be held to determine the type of taxpayers to be audited and the areas of focus for the audit period.

90. **Tax audit notification letter.** The letter of notification (letter of engagement) announcing a tax audit is a fundamental requirement under GCT internal procedures. The letter is written by the head of the Tax Department and the team leader for the GCT Audit Department to GCT stating the decision of the Commission to audit the entity. The letter normally contains the following information:

a. the objective of the tax audit;

b. the taxpayer's duty to make their books and records available for the audit;

c. the period and date of the impending audit;

d. the scope and type of audit;

e. the team's composition;

f. the duration of the audit.

4.2.3 Examination of records

91. Gathering and evaluating sufficient records is key to providing an adequate basis for determining the accuracy of the tax returns filed. The auditor should always discuss and review with the taxpayer what records are available in manual and electronic format. The use of relevant auditing tools, such as computer-assisted audit techniques, is encouraged as a way of streamlining the audit process.

4.2.4 Application of law

92. A tax auditor must be knowledgeable in all laws and regulations governing tax administration within the tax jurisdiction. Copies of all tax laws, regulations, written rulings and guidelines, as amended and updated annually, should be available to all audit staff.

4.2.5 Documentation

93. Documentation is used to compile pertinent facts discovered during an audit. A well-documented audit will consist of a complete record of evidence examined by the auditor to support any findings in the audit working papers included in the electronic audit case folder.

94. The first face-to-face meeting between the tax auditor and the taxpayer occurs during the opening conference. The auditor keeps a record of the tax audit process and information regarding the taxpayer's business.

4.3 Conducting an audit

95. The auditor's first task before actually commencing the audit is to hold an opening conference with the management of the company to agree on the rules of engagement and request the assignment of a focal person to coordinate with the auditor, respond to any

queries that may arise and provide the files and other relevant documents required for the audit.

4.3.1 Steps for conducting an audit

96. The following steps should be followed to conduct an audit.

Table 2: Steps for conducting an audit

No.	Step	Description
1	Ensure the required document-tation is available	1. Ensure the following documents are on file: a. audited financial statements; b. management accounts, if any; c. actual annual returns; d. self-assessment returns. 2. Trace annual returns to financial statements. 3. Compare management accounts with audited financial statements. 4. Compare annual returns to self-assessment returns and note any discrepancies.
2	Carry out checks	5. Reconcile returns with the purchase accounts in the general ledger. 6. If purchases are large, determine whether or not stock should be maintained if none is shown on the returns. 7. Examine the general ledger accounts for any entries that seem unusual and authenticate the nature and source of unusual ledger entries. 8. If you detect that the cost of sales requires further investigation, look for any significant gross profit percentage changes by comparing the year under review with previous years. 9. Critically examine the meaning and relevance of any notes to accounts or any attached statements qualifying the financial reports prepared and presented by the taxpayer's auditors. 10. Scrutinise imported goods; if the taxpayer is a direct importer of goods and services, the total cost of goods imported should be available from the finance/procurement department. These amounts should be cross-checked and compared with the deductions stated in the audited financial statements. Any inconsistencies could be due to the following: a. purchases are overstated based on declared values; b. purchases are being withdrawn for personal use; c. stock is not being declared; d. there are hidden sales – only certain components of the goods sold were being declared or a percentage of sales is not being recorded in the books of accounts;

No.	Step	Description
		e. purchases that are not related to the business are being used.
3	Review the notes to the financial statements	1. **Borrowing.** Establish the sources of loans, their legitimacy and interest on them. 2. **Raw materials.** Access the stock card or sheet and understand the costing method and approach used in evaluations to check whether they are permissible or not. 3. **Direct costs.** Access the document containing the breakdown of direct costs and carefully analyse the details. 4. **Interest payments.** Identify the sources of loans and check the bank statement and loan agreement to determine that the appropriate interest rate is being charged on the accounts. 5. **Procurement of property, plant and equipment.** Request acquisition documents, invoices, receipts and change of ownership agreements. Determine whether withholding taxes were paid. 6. **Transport, marketing and distribution costs.** Verify in the relevant ledgers and obtain detailed documentary evidence supporting transactions. 7. **Depreciation.** Ensure that the assets were used to generate income, that they are in the name of the company and that there are no private elements. Note that only direct and administrative charges are added. 8. **Directors' remuneration**. Check whether the directors filed annual returns accurately, declaring all the assessable income, including taxable allowances and benefits in kind. 9. **Wages and salaries.** Obtain all relevant computerised documents on payments of salaries and wages and cross-check them with the returns filed in the year of assessment.
4	Produce auditor's working papers	During the performance of the tax audit, concise but detailed working papers must be produced to show the outcome of the documentation process. The working papers must include the records pertaining to the tax audit procedures adopted, the material evidence obtained, allocation of work among audit team members, the findings and final report, etc. The main objective of tax audit working papers is to provide tax officers with all the relevant information obtained during the tax audit. They are used to review and confirm the findings and conclusions of a tax audit assignment. They contain important documentary evidence of the tax audit process which is collected and retained for future use. The working papers must include details of the examination of data and the sources of all financial information, the results, the dates on which the examinations were carried out and the names of the tax auditors. They can be divided into two parts, namely the permanent audit file and the current audit file. **Permanent audit file.** The permanent audit file contains information which is of continuous interest and relevant to future tax audits. This includes information such as company registration certificates,

No.	Step	Description
		partnership deeds, ownership documents for fixed assets used to generate income, tenancy agreements, articles of association, lease agreements, loan agreements, leases, documents related to internal control of the entity, record of accounting policies followed by the company on a continuous basis, significant observations from previous audits and a copy of the current audit report.
5	Draft the final report	The tax audit report must contain the following information: a. Scope and objectives b. Findings c. Recommendations and action plans d. Conclusion The tax audit report must clearly state what type of tax areas the tax audit addresses and the documents reviewed. The report must also comprehensively detail findings on other issues arising from the audit. The conclusions section of the tax audit report will provide details of any breaches of tax law by the taxpayer and order the taxpayer to take appropriate action to correct irregularities and pay the penalties imposed. The tax audit report will also state the total tax liability resulting from the tax audit or any tax credit. It is important to clarify that tax auditors do not issue opinions but rather a final report based on law which the taxpayer is bound to comply with.
6	Hold the exit conference	Tax auditors are required to hold an exit conference with the taxpayer to discuss the findings and give them a chance to respond to any issues that have arisen before the final report is issued.

4.3.2 Forms of tax audit

97. Tax audits can be distinguished between external audits and internal desk reviews. An external tax audit takes place when GCT staff visit the premises or offices of the taxpayer to undertake a tax audit. This type of tax audit will involve checking the taxpayer’s records for the period under audit:

a. examine the relevant books of accounts and records the taxpayer is required by law to keep to determine the accuracy of the outcome and compliance with tax laws and SOPs;

b. examine the taxpayer’s records to determine the level of compliance and the accuracy of tax payments;

c. examine the taxpayer’s records to determine the level of compliance in terms of tax filings, as required by law;

d. examine the taxpayer’s records to determine the payment of tax due for the period under audit;

e. examine the taxpayer's records to determine whether other GCT departments have taken the necessary steps, in accordance with tax law, to prevent tax delinquency;

f. produce a true and fair report to help GCT management improve the performance of its oversight responsibilities to protect the public purse.

4.3.3 Triggers for external tax audits (at the taxpayer's premises)

98. Generally, according to international good practice, conducting a tax audit and examining a company's books, records and other relevant documents relating to its business is not an annual process. Normally, a tax audit takes place every two to four years. This type of audit can be conducted at any time the GCT deems necessary, depending on the circumstances. The audit may require GCT staff to visit private business premises. The following situations could trigger such a visit by GCT staff to a taxpayer's premises;

a. a taxpayer has not been audited at least once every five years;

b. a taxpayer is suspected of concealing income to avoid paying the correct amount of tax, regardless of whether the tax office staff have proof or not;

c. deductions and income are incorrectly reported in the audited income statement submitted to the tax office;

d. additional information is discovered from other taxpayers' records submitted to the tax office;

e. GCT staff suspect there have been unfair tax deductions during work in government ministries, regional government, local government and other government agencies;

f. information is shared by other institutions outside the jurisdiction of the GCT.

99. An **internal desk review** is the annual process of evaluating the returns filed by the taxpayer, as prescribed by the GCT and in accordance with applicable tax laws and regulations. It provides tax officers with first-hand information on the returns filed, tax not in dispute and other withholding taxes due for the year of assessment. The tax officers only consider the face value of the documents and returns filed by the taxpayer, without making any further queries or requests for additional documents or explanations. Such reviews are important because they enable all taxes not in dispute to be collected and penalties to be imposed and collected, where appropriate.

4.3.4 Ethical principles of tax auditing

100. A tax auditor whose duty it is to determine whether a taxpayer pays the appropriate tax to the treasury or whether other government institutions comply with applicable tax laws and SOPs should possess the qualities described below.

4.3.5 Integrity

101. Tax auditors must be straightforward, honest, sincere, fair and objective in their dealings with auditees as part of their professional duties. As stated by **Lord Justice**

Lindley in the famous London and General Bank case: *'an auditor must be honest, that is, he must not certify what he does not believe to be true. Further, he must exercise reasonable care and skill before he believes that what he certifies is true.'*

4.3.6 Objectivity

102. In the performance of their professional duties, tax auditors should be free of any prejudice or bias. As stated by **Justice Lopes in the Kingston Cotton Mills** case: *'an auditor is not bound to be a detective or to approach his work with suspicion or with the foregone conclusion that something is wrong.'* An auditor should adopt an attitude of 'professional scepticism' and should not assume that the auditee is dishonest or honest.

4.3.7 Confidentiality

103. Tax auditors must demonstrate utmost confidentiality in the performance of their professional duties. They must not divulge any information acquired in the course of the audit about the taxpayer to third parties without official authorisation or unless they are legally or professionally bound to do so.

4.3.8 Skills

104. Tax auditors should perform audits and prepare audit reports in a highly professional and diligent manner. It is important for anyone required to perform a tax audit to have the necessary training, experience and expertise. Such skills are acquired through a combination of the following:

a. general education;

b. technical knowledge on tax auditing;

c. practical experience with a well-established tax or audit institution;

d. keeping abreast of current developments in the tax field, such as court rulings and judicial precedent and relevant regulatory frameworks, laws and statutory obligations.

105. Ultimately, a tax auditor should have good knowledge of the business of the auditee and how it operates and functions as well as general knowledge about the economy and industry. It is also important for tax auditors to use tools such as the International Monetary Fund's Tax Administration Diagnostic Assessment Tool (TADAT) to evaluate the health of Iraq's tax system and formulate recommendations for tax reforms.

4.3.9 Independence

106. Auditors should be independent and their judgement should not be influenced by the auditee. They must not have any personal interest in the auditee's business dealings that could affect their integrity or objectivity in any way.

4.4 General issues to look out for in tax auditing

107. When examining the auditee's records, the tax auditor should check that:

a. all mandatory tax returns were filed by the taxpayer by the due date;

b. all the mandatory books of accounts are being kept in accordance with Iraq's accounting standards and international best practice;

c. all taxes not in dispute were paid in accordance with applicable regulations and procedures;

d. all ownership documents for immovable assets used in generating income have been made available;

e. all withholding tax returns for employees and other persons, as prescribed by law, have been made available;

f. audited financial statements have been signed by the directors and the external auditor;

g. the required tax and penalty notices have been issued and sent to the taxpayer;

h. the tax credit certificate has been issued to the withholding agent;

i. the correct capital allowance rate has been used to calculate the relief on depreciable assets;

j. allowable expenses are properly substantiated with valid receipts, invoices and other legally acceptable documents.

4.4.1 Deductible expenses

108. The general principle is that taxpayers are allowed to deduct all expenses incurred in generating income from revenues before profit is declared. Under Article 8 of Income Tax Act No. 113, expenses can be deducted from income before it is taxed. However, the expenses must be incurred in generating the income and must be recorded in the taxpayer's books of accounts for verification.

109. There are three main requirements for expenses incurred in generating income to be allowed as deductible:

a. they must be a revenue expenditure;

b. they must be wholly, exclusively and necessarily incurred in generating the income;

c. they must be of permanent advantage to the business.

110. The expenses allowable under Article 8 of Income Tax Act 113 are as follows:

1 a. interest paid on money borrowed and invested in generating income;
1 b. rental of the premises used to earn income;
1 c. depreciation of buildings owned by the taxpayer and used by them to earn income;

1 d. the annual superficiary cost which includes the lease on the land and the cost of the buildings constructed on them if the building used to earn income is built on leased land;

1 e. amounts expended for the maintenance of machinery and equipment or the replacement of tools and parts;

1 f. the proportion, as determined by the applicable regulations, of the cost of tangible fixed assets (excluding buildings and land), such as machinery and other equipment, that can be claimed for depreciation or consumption by reason of their use during the year in which the income arises;

1 g. debts related to the source of the income if the financial authority – the GCT – is satisfied that they cannot be recovered during the year in question, even if they were due before its commencement; bad debts recovered shall be taxed in the year of recovery;

2 a. taxes and fees actually paid except income tax and real estate tax;

3 a. pensions, salaries and contributions according to pension and social security laws;

4 a. donations paid in Iraq to the government and social sector departments and to scientific, cultural, educational, charitable and spiritual organisations that are legally recognised as such and included in the list issued by the Minister of Finance; contributions in the form of subscriptions allowed by the government;

5 a. alimony ordered by the court and paid in cash by the taxpayer; in this case, the taxpayer is not entitled to the allowance under Article 12 of the Act;

6 a. life insurance premiums paid in the year, provided that they do not exceed IQD 2,000 a year, and other insurance premiums (not related to the source of income), provided that they do not exceed IQD 500; the insurance policy must be with an Iraqi insurance company;

7 a. amounts of amortisation of intangible assets not exceeding the cost incurred by the taxpayer and in accordance with the limits specified in the regulations on depreciation.

4.4.2 Capital expenditure

111. Tax auditors should be conversant with the classification of expenditure as capital or revenue in the determination of taxable income. Viscount Cave provided this definition: ‘When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.’

112. Capital expenditure may take the form of a physical tangible asset, an intangible asset (goodwill) or expenses that bring about a benefit or favourable conditions of an enduring

nature. Repairs of a capital nature, for instance, alterations, extensions or improvements of the asset, are therefore not allowed as a deduction.

4.4.3 The doctrine of entirety

113. In the application of the doctrine of entirety, consideration is given to the magnitude or importance of the function of the part of the asset being replaced. In the case of a car, the engine constitutes the most important single component without which the vehicle cannot function. Therefore, when the engine is replaced or overhauled, the cost is treated as a capital expense.

Justice Rowlatt stated in Bullcroft Main Collieries Ltd v O'Grady: '*Of course, every repair is a replacement. You repair a roof by putting on new slates instead of the old ones, which you throw away … But the critical matter is … what is the entirety? … If you replace in entirety, it is having a new one and it is not repairing an old one … I think the chimney is the entirety*'.

4.4.4 Wholly

114. 'Wholly' refers to the quantum of the amount expended. The total amount should be for business purposes. It should be wholly related to the generation of the income.

115. In the case of **Bowden v Russel & Russel, Mr Taylor**, a solicitor with Russel & Russel, visited America and Canada with his wife to attend the annual meeting of the American Bar Association in Washington and the Empire Law Conference in Ottawa in an unofficial capacity. He intended to have a holiday at the same time. He attended five conference sessions, only one of which was on English law. He recorded the expenses for the visit (excluding those of his wife) in the accounts. The whole amount was disallowed because the trip had a dual purpose.

4.4.5 Exclusively

116. 'Exclusively' refers to the purpose for which the expense was incurred. The expense must be relevant to and have a bearing on the operation of the business. If the expense contains any private elements, it must be disallowed.

117. In the case of **Boardland v Krama Pulai Ltd**, the directors of three companies published and circulated a pamphlet criticising the political situation in Malaysia and claimed the cost in their accounts. The amounts were disallowed on the grounds that they had no bearing on earning profit for the business.

4.4.6 Necessarily

118. 'Necessarily' implies that the expense should be such that it cannot be avoided if the business is to earn income. There must therefore be some form of compulsion on the taxpayer, in other words, the business could not go on without incurring the expense. In the case of **Norman v Golder, Mr Norman**, a professional shorthand writer who was hired to record proceedings in the High Court, had to sit in an uncomfortable position to make his recordings due to the lack of space. As a result, he became ill. He contended that the

medical bills should be deducted as an expense. The medical expenses were disallowed on the grounds that they were not necessary to enable him to do his work.

4.5 Tax audit checklist

119. What issues should auditors bear in mind when auditing the accounts of any business entity? (1) They have the right to examine its founding documents. (2) They have the right to have access to the books of accounts and check them. (3) They have the right to obtain information and explanations from the business.

Table 3: Tax audit checklist

No.	Key thematic areas	Specific considerations and actions	General considerations and actions
1	Filing of returns	Verify submission of the following: • Annual returns • Quarterly returns • Monthly returns • Desk review • Periodic audit	
2	Withholding taxes	• Verify all applicable withholding taxes. • PAYE of employees of companies partnerships, sole traders, companies limited by guarantee, trusts and NGOs • Withholding tax on investment returns, dividends, lottery • Monthly VAT withholding	
3	Business ownership status	• Verify the ownership status of the business, company, partnership or sole trader. • Examine the permanent note to determine the original and current owners and if there were mergers, takeovers or changes in the shareholding structure. • Verify any capital gains arising from takeovers.	→ Check if there were takeovers and take appropriate action
4	Examination of accounts	• Verify the accounts of companies, partnerships, NGOs and sole traders, as follows:	• Deductible expenses • General principle – the central test of deductibility when considering general expenses (and flat-rate

No.	Key thematic areas	Specific considerations and actions	General considerations and actions
		• Analyse the profit and loss account to verify the following: purchases and returns, sales/revenue and returns, interest on loans, fuel and lubricants, PAYE figures, employer's pension contribution, directors' remuneration and other benefits in cash and kind. • Verify all other allowable expenses captured in the profit and loss account. • Evaluate the balance sheet, including depreciable assets, the depreciation rate, asset ownership status, capital and personal expenditure: a. repair and maintenance b. travelling expenses c. salaries and wages d. consumption of stores and spare parts e. depreciation f. legal, professional and consultancy charges g. filing fees h. capital written off i. miscellaneous expenditure written off. • Scrutinise liability and capital reserve accounts to ascertain amounts constituting income. • Scrutinise audit report and notes to accounts for comments, if any, on deferment/non-accounting of income. Scrutinise liability accounts to identify liability of a contingent nature debited to the profit and loss account. • Verify the cash book/ journal to determine if the accounts are maintained	expenses operated administratively by the tax authority) is whether the expense has been expended wholly, exclusively and necessarily in the performance of the duties of the employment. • Request bank statements and loan agreements. • Obtain list of books of accounts maintained by the taxpayer. If books of accounts maintained on computer, then obtain certificate from software developer/vendor for books of accounts generated by the computer. • Compare list of books maintained with previous year's schedule. • Obtain list of activities/principal lines of business from auditee and changes from previous year (if any) (i.e. both new and discontinued businesses). • Verify above with the financial statements of the current year, board and general meeting minutes and previous year's income tax return. • Identify and disclose new activities in pre-operative stage, even if they do not generate revenue. To this end, scrutinise accounts such as capital work in progress, pre-operative expenditure and interest costs. • Check if the taxpayer carried out more than one business or profession in the previous year, even if

No.	Key thematic areas	Specific considerations and actions	General considerations and actions
		according to the jurisdiction's accounting standards. • Verify the ledger, carbon copies of bills and original bills wherever issued to the person/entity and receipts in respect of expenditure incurred by the person/entity. • Verify the cash book and journal, if the accounts are maintained according to accrual basis accounting. • Verify notes to accounts for disclosure of significant accounting policies. • Compare with previous year's tax audit report for basis adopted. Scrutinise notes to accounts and auditors' report and verify any change in the method of accounting and quantification. Disclose details of deviation in the method of accounting employed (based generally on Iraq Accounting Standards). Disclosure of accounting policies Prior period items Extraordinary items Changes in accounting policy Ensure disclosure is consistent with significant accounting policies under notes to accounts.	discontinued within the year. • Verify notes to accounts for disclosure of significant accounting policies. • Compare with previous year's tax audit report for basis adopted.
5	Partnership business	• Verify the partnership deed for the names of the partners and the profit-sharing ratio. Disclose changes in the ratio. Ratio for sharing losses, if different from the profit-sharing ratio, should be disclosed. • Cross-check the names of the partners and the profit-sharing ratio with those recorded in the accounts of the current	• Scrutinise general ledger for items constituting allowable expenses, particularly capital expenditure, which are deductible under tax laws. • Check depreciation schedule for any capitalised assets claimed as an allowance under tax

No.	Key thematic areas	Specific considerations and actions	General considerations and actions
		year and the previous year to ascertain any changes. • Auditor should carefully read the partnership deed and note down all the important provisions regarding: a. Nature of the business b. Profit-sharing ratio c. Interest on capital and drawings d. Loans and drawings e. Borrowing power of partners f. Salary and remuneration g. Capital of partners h. Restriction on the rights of partners	laws and ensure separate disclosure. • Ensure appropriateness of deductions (particularly weighted deductions) claimed under the relevant sections. • Disclosure of accounting policies • Prior period items • Changes in accounting policy • Ensure disclosure is consistent with significant accounting policies under notes to accounts
6	Directors files	• Obtain a schedule of bonuses and commissions paid/payable to employees stating the name of the employee, designation, amount of bonus/commission paid/payable, etc. • Check payroll records for any deductions on account of a provident fund, superannuation fund or contributions towards any other employee welfare fund. • Obtain and verify chart for employees' contribution to the above funds with their respective due dates and actual dates of payment.	
7	Purchase of goods and materials	• Quantify and verify from excise records the amount of credit available for the year, amount utilised and the outstanding balance. • Provide a summary of the above account with a description and ensure disclosure.	Document the system of accounting used at the time of purchase of goods and materials.

No.	Key thematic areas	Specific considerations and actions	General considerations and actions
8	Sole trading business	Focus on the profit and loss account and the balance sheet.	• Critically evaluate annual drawings. • Investigate the social status of the owner. • Check the number of dependent children and expenditure on each of them annually and their personal expenses. • Investigate any introduction of additional/new capital. • Check expenditures to distinguish business expenses from personal expenses. • Compare the previous year's profit and loss account with the current year's. • Verify the source of the capital invested.
9	Rental income	Request and verify rental agreements	• Check the residential and commercial status of the rental agreement. • Check the names and positions of the employees occupying the property. • Check whether the appropriate rates are being used (residential or commercial rates). • Cross-check information provided by the taxpayer, if necessary. • Conduct an interview with the taxpayer to address all queries not answered by the GCT.
10	Tax audit working papers	Request working papers on tax audits already carried out by the GCT.	• Check the queries your team raise against what was captured in the audit working papers. • Review the working papers to determine any

No.	Key thematic areas	Specific considerations and actions	General considerations and actions
			discrepancies with the team's observations.
11	Tax payable/paid	Request access to the Integrated Financial Management Information System (IFMIS) to verify tax paid for the period under review.	• Examine the tax audit report to determine any tax payable. • Check the IFMIS to ascertain actual payments according to the tax audit report on file.

4.6 Tax avoidance

120. Tax avoidance is an artificial but permissible way of arranging personal or business transactions to limit or curtail one's tax liability. It is the legitimate use of loopholes in tax law to lessen one's tax burden. To use the words of Professor Quitcroft, it is 'the act of dodging tax without breaking the law'. However, the position of the learned Professor is only sustainable in situations where there is no anti-avoidance legislation.

4.7 Approaches to curb tax avoidance

4.7.1 Judicial approach

121. Following the advent of the Second World War, judicial sympathy shifted drastically away from the taxpayer towards support for the government's fiscal policy. For example, the then Master of the Rolls, Lord Greene, issued a sturdy warning to would-be tax avoiders in 1941 with the following words:

> *For years a battle of maneuver has been waged between the legislature and those who are minded to throw the burden of taxation off their own shoulders on to those of their fellow subjects. In that battle, the legislature has often been worsted by the skill, determination and resourcefulness of its opponents, of whom the present appellant has not been the least successful. It would not shock us in the least to find that the legislature is determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.*

4.7.2 Literalist approach

122. The common approach of the courts in the developed world's tax systems to interpreting statute law may be said to have created the conditions that promote tax avoidance and tax planning. This approach, best described as formalist and literalist, has inevitably influenced the framing of tax law. The language of a UK tax statute, for example,

is intentionally tight; the law-makers aim to leave no conceivable ambiguity or doubt that might mean that the tax is not imposed in circumstances where it was intended to be.

123. The literalist approach is neatly summed up in the famous statement made by Lord Cairns in 1869 in **Partington v Attorney-General**:

> *If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute*

124. In 1952, Viscount Simonds reiterated this approach in the context of tax avoidance legislation in **St Aubyn v Attorney-General**:

> *The question is not at what transaction the section is, according to some alleged general purpose, aimed but what transaction its language, according to its natural meaning, fairly and squarely hits.*

125. When the literalist approach to statutory construction operates by reference to a formalist view of documents and of the rights of the parties under them, the result is that a transaction that might in other countries be seen as artificial and tax-driven is accepted at its face value. This combination of literalism and formalism was regarded for many years as being sanctioned by the case of **Duke of Westminster v Inland Revenue Commissioners (IRC)**.

126. In this case, the House of Lords upheld an arrangement under which the Duke made covenanted payments to his staff in lieu of wages. The explanation for the arrangement was that, in the 1930s, the Duke could deduct covenanted payments from his income for tax purposes, but he could not deduct the wages paid to his domestic staff, which were personal expenses.

127. A majority of the House of Lords held that the Duke should be taxed according to the legal form of the transactions and not according to their economic substance. In the words of Lord Tomlin in **Duke of Westminster v IRC** (1936, AC 1, p. 19):

> *Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be … This so-called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.*

128. However, Lord Norman also gave a stern warning on tax avoidance in Lord Vestey's Executors v IRC (1949, 31 TC, p. 90) with the following words:

> *Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved.*

There has therefore been a lot of controversy over the limits to legitimacy of tax avoidance since it is an admitted evil.

129. Modern global business transactions have led to an increase in tax avoidance involving varying degrees of complexity. Lord Denning was an outspoken proponent of the anti-tax avoidance campaign. **In Griffiths v J.P. Harrison (Watford) Ltd** (1963, AC 1), Lord Denning delivered a portentous dissenting judgment describing tax avoiders as:

> *Prospectors digging for wealth in the subterranean passages of the revenue, searching for tax repayments.*

130. The controversy surrounding tax avoidance in the various views expressed by the courts is all about whose job it is to close the loopholes in tax law. While some are of the opinion that it is the responsibility of those who make the law, others hold the view that judges cannot just fold their arms and blame the law-makers. In **Magor and St Mellons Rural District Council v Newport** (1951), on appeal to the House of Lords, Lord Simmonds described the Denning approach as:

> *a naked usurpation of the legislative function … If a gap is disclosed the remedy lies in amending the law.*

4.8 Purposive approach

131. Over the years, the courts have moved away from the strict literalism of Lord Cairns and Lord Tomlin. The literal approach to statutory construction is still important, in the sense that where the words of the tax legislation and regulatory frameworks are clear, the courts will normally give effect to them, but it is important to acknowledge and understand that

language is rarely confined to one interpretation only. Emphasis is laid on the contextual or schematic method of construction. As Lord Wilberforce commented in 1981:

> *A subject is only to be taxed upon clear words, not upon 'intendment' or upon the 'equity' of an Act … What are 'clear words' is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded.*

132. Justice Cory in Alberta (Treasury Branches) v Minister of National Revenue (1996 1 SCR 963, p. 976) stated:

> *I recognize that agile legal minds could probably find an ambiguity in as simple a request as 'close the door please' and most certainly in even the shortest and clearest of the ten commandments.*

4.9 New realism approach

133. Tax avoidance took a different direction from the 1970s onwards. It became big business, and schemes were commercially marketed. These schemes were aimed at manufacturing a loss, which could be used to offset tax liability. In these circumstances, the loss being manufactured is not a real loss, otherwise the taxpayer would not benefit from it. New realism describes the approach adopted by the courts to curb these complex and artificial tax avoidance schemes.

134. The courts emphasised the legal substance and nature of the transaction over the form (or the economic substance of the transaction). The new realism first gained acceptance in **W.T. Ramsay Ltd v IRC**, when the Law Lords struck down a scheme as a fiscal nullity. The case established an example of a circular scheme in which transactions were entered into, money changed hands and documents were executed with legal effect. At the end of the day, however, everyone was back where they started apart from the payment of a fee to the promoter of the scheme. Lord Templeman vividly described the artificiality of it all:

> *The facts … demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax … the play is devised and scripted prior to performance. The object of the performance is to create the illusion that something did happen, that Hamlet has been killed and that Bottom did don an ass' head so that tax advantages can be claimed as if something had happened.*

135. The new realism also embraces a willingness to examine the actual legal effect of a transaction, or a series of transactions, very carefully to determine exactly what actual legal rights and obligations they give rise to. The courts are, however, not bound by the labels the parties themselves give to their transactions or by their form if the legal effect is something different.

136. A perfect example of this is the case of **Ensign Tankers (Leasing) Ltd v Stokes**. It involved an attempt to arbitrage capital allowance for firm production costs without incurring the full amount of the expenditure against which the deduction was being claimed. Essentially, the tax avoidance scheme documents sought to characterise the balance of the costs as a non-recourse loan. The House of Lords analysed the transaction and concluded that, on a true construction of the documents and their legal effect as a whole, the taxpayer never paid or was liable to pay the full amount claimed. Accordingly, they got their allowance on the costs they had actually borne, and nothing more.

137. The sentiment of the Ensign Tankers case finds more recent expression in the following definition of tax avoidance offered by the House of Lords in **IRC v Willoughby**:

> *The hallmark of tax avoidance is that the taxpayer reduces his tax liabilities without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.*

4.10 Anti-tax avoidance legislation

138. Lord Morton once described the struggle between parliament and the taxpayer's advisors as an undignified game of chess. Parliament imposes a charge; advisors find a way to avoid it. Parliament enacts anti-avoidance legislation; advisors devise a more elaborate avoidance scheme, as in **Chapman v Chapman** (1954 AC 429, p. 468).

139. The controversy over whether anti-avoidance legislation runs the risk of affecting the innocent as well as the intended targets is still ongoing all over the world. However, countries such as Canada, Australia and South Africa are notable in that they have comprehensive anti-tax avoidance legislation against mechanisms to avoid tax. It is important to note that transfer pricing anti-tax legislation alone, as may be stipulated in any taxation act, is not enough to address the currently complex nature of tax mechanisms being adopted by multinational enterprises and other taxpayers.

140. Specific anti-tax avoidance legislation is a familiar part of statutory tax provisions. While they contribute significantly to the complexity of anti-tax avoidance legislation, they also offer considerable advantages in that they are targeted at specific areas covered by tax law and the avoidance issues that arise in those areas.

141. A general anti-avoidance rule inevitably requires the tax authorities to form an opinion in the first instance about whether transactions that have the effect of reducing tax liabilities fall within the parliament's intent or not. The critical balance, therefore, between the public interest in seeing that taxes are not unduly avoided and the legitimate interest of taxpayers in their commercial and private affairs lies in ensuring that:

a. the rule is sensibly targeted;

b. there are sensible procedures for invoking the rule;

c. there is proper oversight of its use.

142. Anti-avoidance rules should effectively be a weapon of last resort. It is important, therefore, to ensure that they are applied sensibly and consistently, with a minimum risk of partial or uneven application. It is against this background that, in some tax jurisdictions, with a view to ensuring a consistent approach, all decisions to invoke the general rule are dealt with centrally. The purpose of this centralised decision-making on general rules of anti-tax avoidance legislation is to promote uniformity and the development of expertise in what is likely to be a sensitive and difficult area of tax administration.

4.11 Transfer pricing

143. In a transaction between persons who are related or associated, transfer pricing is normally used to shift tax liabilities among associates to derive the best overall tax outcome. The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the Organisation for Economic Co-operation and Development (OECD) provide guidance on the application of the arm's length principle, which is the international consensus on transfer pricing.

144. A transfer price is the price at which goods or services are sold between divisions of a company or between companies in the same group. Developing countries suffer most from the fallout of transfer pricing abuse because it is difficult to track and analyse. It is a deliberate act of moving income or profits from a high-tax jurisdiction to a low-tax jurisdiction.

145. The mining and extractive industries are particularly susceptible to the problem of transfer pricing. It has been observed that transfer pricing is a mechanism that is depleting the tax base in Africa, and everything possible should be done to make sure that loophole is closed.

4.12 Determination of transfer pricing

146. Transfer pricing abuse can either be across international borders or within one country across regions. The critical issue is the capacity of tax and audit office staff to track those who engage in transfer pricing and how to determine the tax liability resulting from this damaging practice.

147. The following example illustrates how to track transfer pricing between related or associated persons as a practical explanation of enforcement.

148. LAFARI Company Ltd is a holding company that produces plastic bottles for mineral water producers. Natural Fresh Company Ltd packages mineral water for export only. Western Company Ltd has 60% of the shares in Natural Fresh Company. The open market price of a plastic bottle is IQD 3 per unit. LAFARI Company Ltd sells all its products to Natural Fresh Ltd. Extracts of the income statements of the two related companies are shown below. We assume that these two companies are operating in Ghana.

Table 4: LAFARI Company Ltd – Tax statement

LAFARI Company Ltd	
Sales	**IQD**
900,000 plastic bottles at IQD 3 per unit	2,700,000
Less expenses for the tax period	1,200,000
Net profit	1,500,000
A. Tax at 25% (high tax rate in the city)	375,000

Table 5: Natural Fresh Company – Tax statement

Natural Fresh Company	
Sales	**IQD**
Domestic and export market (sales)	5,500,000
Purchases (900,000 at IQD 3 per unit)	2,700,000
Other expenses	450,000
Net profit	2,350,000
B. Tax at 18.5% (low-tax region)	434,750

149. The tables above show that the tax declared by the two related companies for the tax period under review is (A + B, 375,000 + 434,750) = IQD 809,750. The question now is how to determine whether these two related companies are engaged in transfer pricing from the respective income statements submitted to the tax authority. It is general practice in most tax jurisdictions that where an arrangement exists between parties in a controlled relationship, they should calculate their income and tax payable according to the arm's length standard.

150. The arm's length standard requires parties in a controlled relationship to quantify, characterise, apportion and allocate amounts to be included in or deducted from income to reflect an arrangement that would have been made between independent parties. The **arm's length principle** set out in **Article 9** of the **OECD** Model Tax Convention requires an associated enterprise to charge the same prices in their controlled transaction as would be charged by independent entities in an uncontrolled transaction in otherwise comparable circumstances.

151. The tax authority can recharacterize an arrangement made between parties in a controlled relationship, including the recharacterizing of debt financing as equity financing.

152. The arm's length price is determined under the comparable uncontrolled price method, and when this is not possible, the resale price method or the cost price method is used.

153. Let us now examine the statements for Western Company Ltd and Natural Fresh Company in accordance with Article 9 of the OECD Model Tax Convention to determine the total tax avoided by the companies (the comparable uncontrolled price is the open market price of IQD 5 per bottle).

Table 6: Western Company Ltd – Taxation acc. to Art. 9 of OECD Model Tax Convention

Western Company Ltd	
Sales	**IQD**
900,000 plastic bottles at IQD 5 per unit	4,500,000
Less expenses for the tax period	1,200,000
Net profit	3,300,000
C. Tax at 25% (high tax rate in the city)	825,000

Table 7: Natural Fresh Company – Taxation acc. to Art. 9 of OECD Model Tax Convention

Natural Fresh Company	
Sales	**IQD**
Domestic and export market	5,500,000
Purchases (900,000 bottles at IQD 5 per unit)	4,500,000
Other expenses	450,000
Net profit	550,000
D. at 18.5% (low-tax region)	101,750

154. Investigation and further examination of the records and accounts of the two companies revealed that the total tax the two related companies should have paid is C (825,000) + D (101,750) = IQD 926,750. Instead, they paid A (375,000) + B (434,750) = IQD 809,750. The amount of tax avoided is 926,750 – 809,750 = IQD 117,000.

155. Further reading is recommended on other anti-avoidance rules such as thin capitalisation and income splitting.

5 Chapter Five

5.1 Value added tax

5.1.1 Definition and concept

156. Value added tax (VAT) was introduced in some countries around 40 years ago – in the United Kingdom, for instance, in 1973. VAT is payable on supplies of goods and services and is calculated as a percentage of the basic price paid for them. Taxable entities, that is, entities carrying out business activities (e.g. sole traders, partnerships and companies) with turnover above a certain threshold, are required by law to charge VAT and pay it to the tax authorities.

157. Governments use VAT as a means of revenue mobilisation to prop up the economy. There are usually two VAT rates – the standard rate or flat rate and the zero rate. The standard rate is applied to the majority of goods and services, but in some countries a higher rate is applied to items such as jewellery, domestic electrical appliances, small boats and aircraft.

158. **Input tax.** A supplier of goods and services at each level of production or distribution charges VAT on the goods and services acquired by the buyer. These goods and services are the entity's 'inputs', and the tax on them is its 'input tax'.

159. **Output tax**. When a taxable entity supplies goods and services to other entities, the latter are charged VAT by the former on the goods and services. These goods and services are the entity's 'output', and the tax on them is its 'output tax'.

5.1.2 Completing VAT returns

160. VAT is usually computed at monthly or quarterly intervals (tax periods). The entity calculates the output tax collected and the input tax paid and subtracts the input tax from the output tax. If the net amount is positive, that is the amount the entity must pay to the tax authority. If it is negative, the amount is refunded to the entity.

Example 1: Calculation of VAT returns

161. In the tax period ended 31 October 2020, Latif Ahmend, a wholesaler who is a taxable person, bought standard-rated goods for resale. The total value of the goods bought was `IQD 12,000` (exclusive of VAT and indirect taxes). Latif Ahmend also sold standard-rated

goods for IQD 15,200 (exclusive of VAT and other indirect taxes) in the same tax period. The standard VAT rate is 12.5%,

Output VAT

Computation of VAT, NHIL and GETFL on goods sold

	IQD	IQD
Sales (exclusive of VAT, NHIL and GETFL)		15,200
NHIL (2.5% * 15,200)	380	
GETFL (2.5% * 15,200)	380	
NHIL + GETFL	760	
TOTAL Sales + NHIL + GETFL		15,960

Computation of output VAT: 12.5% * 15,960 = 1,995

Input VAT

Computation of VAT on goods purchased: 12.5% * Purchases = 12.5% IQD 12,000 = 1,500

Therefore, the amount payable to the GCT

	IQD
NHIL	380
GETFL	380
VAT payable/refundable (output tax charged – input tax paid) (1,995 – 1,500)	495
TOTAL	1,255

Example 2: Calculation of VAT returns

162. In the period ended 31 July 2020, Mustafa, a manufacturer who is a taxable person, bought the following goods:

Standard-rated goods: IQD 80,000 (VAT inclusive)

Higher-rated goods: IQD 70,000 (VAT inclusive)

163. During the same period, Mustafa sold the following goods:

Standard-rated goods: IQD 110,000 (VAT inclusive)

Higher-rated goods: IQD 120,000 (VAT inclusive)

The standard rate is 12.5%, the higher rate is 17.5%, NHIL is 2.5% and GETFL is 2.5%.

Input VAT

VAT component of VAT-inclusive price = (rate / 100 + rate) * VAT-inclusive price

At the standard rate: 12.5 / 112.5 * 80,000 = IQD 8,888.88

At the higher rate: 17.5 / 117.5 * 70,000 = IQD 10,425.53

Total input VAT payable is: (8,888.88 + 10,425.53) = IQD 19,314.41

Output VAT

Compute the VAT-exclusive price of goods sold

At the standard rate: 100 / 112.5 * 110,000 = IQD 97,995.54

At the higher rate: 100 / 117.5 * 120,000 = IQD 102,127.65

For standard-rated goods

Computation of VAT, NHIL and GETFL on goods sold

	IQD
Sales (exclusive of VAT, NHIL and GETFL)	97,995.54
NHIL (2.5% * 97,995.54)	2,449.88
GETFL (2.5% * 97,995.54)	2,449.88
NHIL + GETFL	4,899.76
TOTAL Sales + NHIL + GETFL	102,895.30

Computation of output VAT: (12.5% * 102,895.30) = 12,861.91

For higher-rated goods

Computation of VAT, NHIL and GETFL on goods sold

	IQD
Sales (exclusive of VAT, NHIL and GETFL)	102,127.65
NHIL (2.5% * 102,127.65)	2,553.19
GETFL (2.5% * 102,127.65)	2,553.19
NHIL + GETFL	5,106.38
TOTAL Sales + NHIL + GETFL	107,234.03

Computation of output VAT: (17.5% * 107,234.03) = 18,765.95

Total output VAT charged is: (12,861.91 + 18,765.95) = IQD 31,626.95

Therefore, the amount payable to GCT is

	IQD
NHIL (2,449.88 + 2,553.19)	5,003.07
GETFL (2,449.88 + 2,553.19)	5,003.07
VAT payable/refundable = output tax charged – input tax paid = 31,626.95 – 19,314.41 =	12,312.54
TOTAL Sales + NHIL + GETFL	22,318.68

5.1.3 Accounting for VAT

164. Every taxable person must keep a VAT account and enter all input and output taxes together with the amount payable to the tax authority or the amount to be refunded. The double-entry system is summarised below.

In respect of goods and service purchased:

a. debit the purchases account with the value of the goods purchased (excluding VAT);

b. debit the VAT account with the VAT paid on purchases (input tax);

c. credit the accounts of the relevant creditors in the purchases ledger with the purchase invoice total value (value of goods + VAT).

In respect of goods and services sold:

a. debit the accounts of the relevant debtors in the sales ledger with the sales invoice total value (value of goods + VAT);

b. credit the sales account with the value of the goods sold (excluding VAT);

c. credit the VAT account with the VAT charged on sales (output tax).

Example 3: Calculation of VAT returns

165. During the three-month period ended 31 October 2020, Fatma, a wholesaler, made the following purchases of goods:

Month	Purchase excl. VAT (IQD)
August	80,000
September	90,000
October	120,000

166. She sold goods in the same period as follows:

Month	Sales excl. VAT (IQD)
August	120,000
September	130,000
October	150,000

167. All the goods purchased and sold are subject to VAT at the standard rate of 12.5%. Fatma's VAT account for the period ended 31 October 2020 is shown below.

Table 8: Fatma's VAT account – Input tax

VAT ACCOUNT Fatma – INPUT TAX		
Month/year	**Paid to**	**IQD**
31 August 2020	Sundry creditors	10,000
31 September 2020	Sundry creditors	11,250
31 October 2020	Sundry creditors	15,000
Total input tax paid		36,250

Table 9: Fatma's VAT account – Output tax

VAT ACCOUNT Fatma – OUTPUT TAX		
Month/year	**Charged to**	**IQD**
31 August 2020	Sundry debtors	15,000
31 September 2020	Sundry debtors	16,250
31 October 2020	Sundry debtors	18,750
Total output tax charged		50,000

Tax payable/refundable = output tax charged – input tax paid = IQD 50,000 – c IQD 36,250 = IQD 13,750

As output VAT is greater than input VAT, tax is payable to the tax authority.

5.1.4 Zero-rated goods

168. Certain goods and services are considered to be 'zero-rated'. These goods are legally taxable, but the rate of tax is nil. This category includes goods and services such as medical appliances, books and educational materials, water and power, and export items. A VAT-registered person supplying zero-rated goods or services does not have to charge customers output tax but can recover the VAT paid to suppliers as input tax.

Example 4: Calculation of VAT returns

169. Hajia owns a business that exports all its goods. In the three-month period ended 31 July 2020, she made the following purchases:

Month	Purchase excl. VAT (IQD)
May	20,000
June	15,000
July	26,000

170. All the purchases are subject to VAT at the standard rate of 12.5%. Hajia sold all the goods to overseas buyers so the goods are zero-rated. In this period, Hajia sold goods as follows:

Month	Purchase excl. VAT (IQD)
May	25,000
June	30,000
July	35,000

Hajia's VAT account for the three months ended 31 July 2020 is shown below.

Table 10: Hajia's VAT account – Input tax

VAT ACCOUNT Hajia - INPUT TAX		
Month/year	**Paid to**	**IQD**
31 May 2020	Sundry creditors	2,500
31 June 2020	Sundry creditors	1,875
31 July 2020	Sundry creditors	3,250
Total input tax paid		7,625

Table 11: Hajia's VAT account – Output tax

VAT ACCOUNT Hajia - OUTPUT TAX		
Month/year	**Charged to**	**IQD**
31 May 2020	nil	0
31 June 2020	nil	0
31 July 2020	nil	0
Total output tax charged		0

Tax payable/refundable = output tax charged – input tax paid = IQD 0 - 7,625 = - IQD 7,625

Tax is refundable by the tax authority.

5.1.5 Exempt goods and services

171. A supplier of exempt goods and services does not have to charge output tax to customers and is not entitled to recover the tax paid on purchases relating to those categories of goods and services. The VAT on these exempt purchases must be treated as a cost to the business, and the purchase invoice totals (value of goods + VAT) should be debited to the purchases account. No VAT account is kept.

6 Chapter Six

6.1 Risk management

6.1.1 Introduction

172. Tax compliance risk management is a critical element of strategies adopted by modern tax authorities across the world. It can be defined as measures, techniques and tools implemented by the tax administration to improve the efficiency of the revenue generation system as efforts are made to manage compliance risks.

173. The primary purpose of any tax authority is to collect taxes in accordance with applicable tax laws and regulations in a transparent and accountable manner in order create confidence in the tax system and enhance the sustainability of revenue administration. Paying taxes is not something people enjoy doing, and some taxpayers, due to deliberate actions, ignorance about tax requirements or carelessness or because of weaknesses in the tax administration system, fail to meet their tax obligations. Therefore, tax authorities should develop measures and mechanisms to curtail the illicit transfer of profits across borders, tax fraud and non-compliance.

174. The growing complexity of tax administration as the world has gradually moved toward global standards and sophisticated business structures, coupled with complex financial reporting standards, has increased the risks tax authorities are facing in mobilising all forms of revenue. Tax authorities are under increasing pressure from the government to generate more revenue to meet budgets and development priorities. In order to address all these challenges, tax authorities have developed certain measures and SOPs to mitigate the risks associated with tax administration for more efficient and accountable revenue mobilisation.

6.1.2 Objective of risk management

175. No administration operates in a risk-free environment, and tax authorities must take deliberate action to manage risk and enhance business processes in tax administration, with a view to achieving the best outcomes and keeping non-compliance to a minimum. The objective of risk management is to provide and preserve value for the administration's stakeholders. Management decisions about the day-to-day operation of the tax administration are key to achieving this, which means that management must consider both the internal and external environments to determine the amount of financial and human resources that need to be deployed in order to achieve organisational goals. Therefore, risk

management enables the tax authorities to operate in a more efficient and effective manner in environments filled with risks.

6.2 External environment

176. There are a number of factors in the external environment that affect the operation of a country's tax administration. These external factors include legislation, public opinion and economic conditions.

177. **Legislation**. Laws provide the basis for taxation. To evaluate the efficiency and effectiveness of any tax administration system, it is important to first consider the degree of complexity of the tax structure it is expected to administer and the extent to which that structure remains stable over time. In a very complex global business environment, even the most sophisticated tax administration system can easily be overburdened with an unprecedented workload and increasing numbers of taxpayers. Tax authorities therefore need good tax law for good enforcement, and it is important to ensure that the law is enforceable in the environment in which the administration operates. The law also sets the framework for the formal powers of the tax authority.

178. **Public opinion**. The legitimacy of any government in the eyes of the general public, especially in post-conflict settings, depends on its ability to generate revenue in a transparent and accountable manner and allocate it equitably and transparently for service delivery. Perceived poor performance and lack of transparency and accountability in the use of public resources can lead to negative public opinion and taxpayer attitudes toward taxation and the government in general. In addition, if the tax system is perceived as being unfair and complex, tax evasion, tax avoidance and illegal tax planning activities are likely to increase and affect tax administration in general.

179. **Economic conditions**. Corporate organisations are the major contributors to a country's domestic revenue through the different types of taxes they pay. Therefore, the economic environment is crucial and has a great impact on the effectiveness of a tax administration. In projecting revenue for the fiscal year's budget, the size of the economy and economic activities are the critical factors for a government to consider. As a result of globalisation and trade competition, the tax policies of other countries in the region and trade partners have some influence on domestic tax administration.

180. In formulating efficient tax laws, the government must shift the focus from existing business processes and pay more attention to the commercial and industrial world. The domestic tax administration should not impose an unnecessarily heavy burden on businesses because it could trigger a huge risk for the tax administration. Modern tax administration strategies should consider the taxpayer's perspective because most businesses engaged in international trade no longer consider national borders an impediment to their activities.

6.3 Internal environment

181. There are several factors in the internal environmental that influence tax administration and can constitute a risk for it. They include organisation, resources and tools.

182. **Organisation**. One of the critical internal risks that impacts on tax administration is the lack of knowledge or failure to understand the organisational culture. The management and administrators must try to manage this risk carefully through effective induction training, awareness creation and clear procedures for delegating authority and assignments. Every member of staff must understand and accept what they are expected to do and why. There must be effective coordination among all the functional units within the organisation to enable each one to contribute, as part of a team, to the overall goal of the tax authority. All departmental structures and performance goals should be aligned with the organisation's overall mission statement and strategies to enable it to achieve its objectives.

183. **Resources**. Running an efficient and effective tax administration system requires deployment of human, financial and material resources to operationalise it. In terms of human resources, the qualifications and experience of the employees have a big impact on performance. Furthermore, the allocation of financial and material resources must be consistent with the system's targets and expected deliverables. The deployment of staff must be based on risk prioritisation and knowledge of the assignment. It is a high risk to base the location of staff and assignment of responsibilities on their current experience and knowledge. Rather, staff will need to adapt to current needs and risks associated with the environment over a period of time.

184. **Tools and access to data**. The availability of IT tools and access to data is of great importance. Intensive use of information technology creates opportunities to improve the performance of the tax administration, for example, enabling it to have reliable and updated taxpayer files and databases that allow cross-checking. Advanced tools are of no use if access to data is poor. Collecting data in digital form is therefore a crucial factor in tax administration.

6.4 Limitations of risk management

185. Risk management is said to be an instrument that can enhance tax administration and promote the efficient use of resources available to the tax authorities. However, there are some limitations to risk management as an instrument for reducing non-compliance and fighting tax fraud and illegal tax planning. Sometimes, it is important to consider changing tax laws and regulations over a period of time rather than trying to make administrative changes. This is important because the law itself can represent a risk to the tax administration. There are, however, many other factors that may directly influence risk management decision-making, including the following:

a. changes in the tax authority's budget, with the allocation of inadequate financial resources, which may substantially affect its capacity to deal with all the risks identified;

b. political influence on government decision-making to change specific tax legislation (e.g. powers for officials), which may represent an opportunity to deal with a risk;

c. weaknesses or shortages in staff skills, which may seriously affect a tax authority's ability to deal with major risks.

6.5 Risk categories

186. Risk management strategies have been put into practice in many OECD countries. Among the risk areas most frequently identified by tax authorities are (Tax Administration, 2015, p. 130):

a. transfer pricing;

b. VAT fraud;

c. hidden economy;

d. unpaid tax debts;

e. avoidance schemes.

187. There are many similarities in terms of identified risk areas in different countries, particularly in the case of VAT (Developments in VAT, 2009, p. 18). These risks fall into four groups:

a. failure to register;

b. failure to file returns on time;

c. failure to correctly report tax liability (including the following subareas: tax avoidance, tax evasion, practices to inflate tax returns, specific industry areas, cross-border transactions, reporting non-compliance);

d. failure to pay tax on time.

6.6 Risk management process

188. One of the most crucial strategies adopted by contemporary tax institutions in the improvement of tax administration is compliance risk management. This encompasses the measures, strategies and tools put in place by tax institutions to enhance efficiency in the revenue generation system and ensure tax compliance is increased. The main objectives of a compliance risk management strategy are to promote voluntary tax compliance, enhance staff performance, ensure efficient use of financial resources and stimulate effective tax auditing to achieve greater tax compliance.

189. In the late 1990s, the OECD and the European Union (EU) produced guidelines on compliance risk management for efficient tax administration by the managers of tax institutions. These guidelines were comprehensively explained and detailed in the series of reports published by the OECD (e.g. Compliance Risk Management: Managing and Improving Tax Compliance, 2004, 73 pp.; Compliance Risk Management: Use of Random Audit Programs, 2004, 51 pp.) and the EU (Risk Management Guide for Tax Administrations, 2006, 98 pp.; Compliance Risk Management Guide for Tax Administrations, 2010, 110 pp.). There are five major steps in the compliance risk management process, namely risk identification, risk analysis, risk prioritisation, risk treatment and evaluation.

6.6.1 Risk identification

190. The first stage in the risk management process is the identification of risks. In this stage, all the possible risks that may impact on the objectives of the organisation are documented. Risk identification is crucial because if risks are not identified at this stage, they are unlikely to be detected and proactive measures will not be put in place to mitigate them. Furthermore, the timing of risk identification is critical for decision-making because the sooner a risk is identified, the sooner the impact of the risk can be controlled. The point at which the risk is identified is very important for the formulation of mitigating measures. If risks are identified in a timely manner, urgent mitigation measures can be put in place to reduce or eliminate their impact on the organisation's objectives. Mitigation measures can curtail the collection risk of non-payment, limit its impact and reduce the gap between contravention of the law and punishment. The potential risks are listed below.

191. **Registration risk**. This risk has the potential to reduce or increase tax revenue as there are people who are not eligible for tax registration who register or remain registered, which means that incorrect information is kept in the registration system, and people who are required to register but fail or refuse to do so. Registration risk concerns four categories of taxpayers:

1. those that are on the register when they are not required to be in the first place and those who remain in the registration system when they should no longer be registered, for example, for fraudulent purposes;
2. those operating in the informal economy and those who use avoidance mechanisms to remain unregistered;
3. those recorded in the tax registration system due to incorrect information and data quality issues, which can potentially lead to loss of revenue;
4. those who are no longer in business, are bankrupt or deceased or have liquidated or sold their business.

192. **Filling risk**. This risk is widespread in tax administration, especially in emerging and developing economies. If taxpayers file their returns late or not at all, it will impact on revenue collection in the period of assessment and prevent the tax authority from achieving the expected targets. The proactive way to handle this risk is to focus on taxpayers who are most likely not to file their tax returns as prescribed by law.

193. **Payment risk**. This risk is critical because non-payment of tax due will affect achievement of revenue targets. Payment risk is related to filing risk but should be treated separately because certain payments are based on returns and there are always tax payments that should be made on a monthly and quarterly basis before the end of the assessment year.

194. **Declaration risk.** This risk can affect the total amount of tax collected at the end of the year due to deliberate attempts by the taxpayer to conceal income or to incorrect information inadvertently provided by the taxpayer about their income on tax returns. Over the years, most tax authorities have focused on this risk area to determine how taxpayers should be

selected for auditing. As a result of continued evaluation of tax performance, most tax administrations have developed different measures for examining declarations and returns submitted by taxpayers and take the necessary steps to classify taxpayers under the relevant risk level for action.

6.6.2 Levels of risk identification

195. The purpose of governments in establishing tax institutions is to generate revenue in a fair, transparent and accountable manner in order to deliver services. The risk identification stage can be a conduit through which tax authorities determine the level of compliance, forecasting what they expect to collect and establishing what is actually being collected. Tax gap analysis helps answer the question of what is missing, that is, the potential tax yield minus actual tax revenues. The tax gap reflects the estimated financial extent of the risk. Determining the tax gap is not easy; sometimes statistical support is possible, based on research, data and analysis.

196. Tax gap analysis can be conducted by assessing the compliance risk of different groups of taxpayers based on the following areas: aggressive tax avoidance, fraud, serious non-compliance, error and non-payment. The gap can also can be broken down into economic sectors. In some instances, the major problem may be that many potential taxpayers are simply not known to the tax administration. In others, it may be that many taxpayers who are in the system are substantially underreporting their tax liability. There may also be cases in which both are important.

197. **General level**. This involves a general risk overview of groups of taxpayers with different compliance levels.

198. **Medium level**. This focuses on risks associated with a group of taxpayers with a specific compliance level.

199. **Detailed level**. This involves looking at risks associated with a group of taxpayers identified as having a high risk of underreported income or a group of taxpayers identified as having a relatively low compliance level. It is, however, important to understand that there are differences between risky taxpayers and risky activities and that taxpayers have different compliance levels. Detailed risk identification can provide information on demographic and economic development issues and on regional and local government area segmentation.

6.6.3 Risk areas

200. A risk area is a combination of related risks which are interconnected, for instance, filing risk, payment risk and risks related to specific regulations. In most jurisdictions, the tax administration creates a national risk database to record all risks. However, it should not be forgotten that a particular risk area can have a direct or inverse relationship with another, so that a risk in one area can have an effect on one or more risks in other areas.

6.6.4 Classification of taxpayers

201. Taxpayers can be classified into different groups based on the sector of the economy and the trade or business they are engaged in, such as manufacturing, mining, general trading, import and export, construction services, communication industry, legal and accounting services, and transport services, including air, sea/river and land transport. These taxpayer categories have a significant bearing on the level of compliance risk. Different groups and sectors behave differently in terms of tax compliance. Below are some indicators that can be used to identify compliance levels:

a. the regularity of tax return submissions;

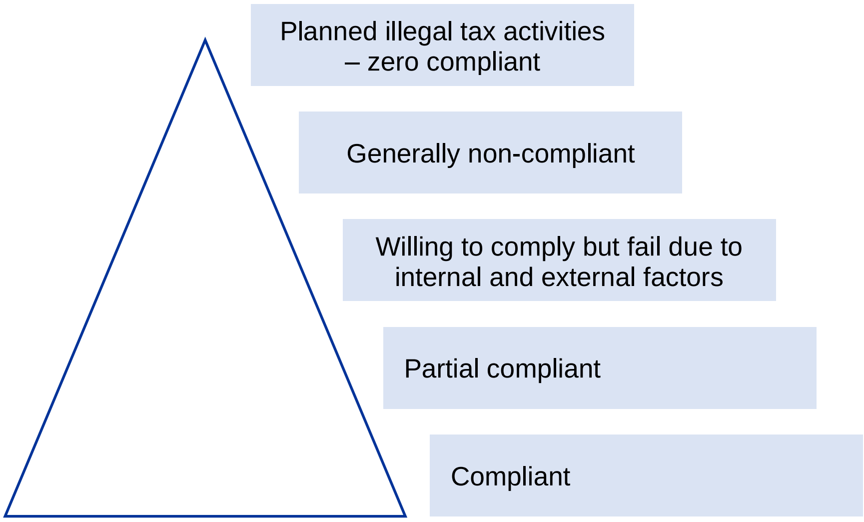
b. the regularity of tax payments;

c. the keeping of the required books of accounts;

d. the use of appropriate accounting and reporting standards;

e. the appearance of corrections on returns in the past.

Figure 3: Compliance level of taxpayers



6.6.5 Sources for risk identification

202. There are many sources that tax administrations can use to collect information and identify potential risks. None of them can give a perfect result, but tax authorities can use a combination of relevant sources.

203. **Environmental scanning**. The tax administration has a critical responsibility to evaluate and examine all external developments and the impact they could have on the resources used to operationalise the day-to-day administration of the institution. This is necessary because each input has its own risk and when it is put into use, new risks can emerge. Identifying new risks is a continuous process. It includes looking at information from the media, research (horizon scanning) and other sources. Effective networking and cooperation with other internal and external tax administrations, law enforcement agencies

and security organisations can result in the exchange of relevant information and awareness of new emerging risks. The idea is to gain insight into current situations and the complexity of present risks and develop mitigation measures for the future. For example, conducting a survey about smuggling goods over the border without paying import duties will involve cooperating with Customs and other security agencies to crack down on these activities, identify the taxpayer group perpetrating these illegal activities, determine the level of risk they pose for the economy and decide how to manage that risk.

204. **Community support**. Tax administrations should have good working relationships with communities and the environment in which they operate. In addition to security agencies, society can also be a source for risk identification, and trade organisations have the capacity to provide information on illegal business transactions. Communities and individual citizens can make a valuable contribution to information sharing on such activities, providing insights into the type of business activities going on and the risks such businesses pose for the tax administration. They know that there is mutual benefit in doing this because the tax revenue generated will be used to develop their community and society in general.

205. **New laws**. Formulating and reviewing tax legislation is crucial to tax administration. Tax administrations should therefore conduct surveys to determine the impact any new tax regulations and reviews will have on compliance. The challenge is that whenever new tax legislation is introduced or changes are made to existing tax laws, the taxpayer’s behaviour towards compliance may change as a result of the impact the new laws have on their business. It is important to examine the impact of the new laws to determine whether they could result in the emergence of new risks or the disappearance of all or some of the current risks.

206. **Data analysis**. The use of modern data analysis techniques can lead to the identification of new risks. The methodologies employed in data collection are crucial to identifying risk areas and hotspots.

207. **Random audits**. Tax audit is a critical tool for tax administration. It is the basis on which any final judgment or conclusion can be made on how much a taxpayer is expected to pay for a particular period. As it takes a number of years for a tax audit to be initiated on a taxpayer, random tax audits are the tool used by the tax administration to determine taxpayer compliance. Random tax audits can lead to the identification of new risks, and for the tax administration to get the best results from them, highly qualified and experienced senior tax officers should be assigned to conduct them.

6.6.6 Risk analysis

208. The stages of risk analysis involve the segmentation and categorisation of the most recalcitrant and risky taxpayers detected during the identification stage. The administration should take into account the chances of the risk occurring and the impact it may have on revenue collection. Risk analysis should go further than just finding out what is happening and the reasons for non-compliance. The ability of the tax authorities to pose questions as to why the taxpayer is failing to comply will create an opportunity for the tax administration to efficiently determine the types of mitigation measures to adopt in order to control, if not

completely eliminate, the risks. For instance, if non-compliant behaviour is the result of complexity and ambiguity in current tax laws and the excessive cost of travelling to pay the tax, the mitigation measures could be increasing tax awareness and setting up more local tax offices.

209. Risk analysis can be done manually by qualified human resources at the tax administration or through electronic means using computer systems. Depending on the risk areas and type of taxpayer, risk analysis can be carried out centrally or locally or a combination of both.

6.6.7 Sources for risk analysis

210. The world economy is moving towards complete globalisation, and tax administration is becoming more complex and diverse. Under these circumstances, the need for risk profiling for business processes is becoming more pronounced than ever. There are many sources from which data can be collected for risk analysis, and they can be grouped into the following categories:

a. macroeconomic data about the growth of the economy and tax data, for instance, the ratio of wages to tax revenue, debt to GDP, ratio of foreign direct investment to GDP and the growth rate of economic sectors;

b. taxpayers' data collected from their tax returns;

c. tax data acquired by administrations, for example, the date of last compliance activity and the number of returns filed late;

d. data supplied by a third party, for example, a bank;

e. information extracted from social media platforms and the internet.

211. **Limitations on sourcing data**. The data that can be used in analysis is limited by:

a. whether the tax administration has the capacity to capture the data collected;

b. the legal process required for data collection and storage;

c. the risk of misinformation – capturing incorrect data on top of existing data;

d. the capacity of the tax administration's IT system;

e. the costs of collecting the data;

f. uncooperative taxpayer behaviour;

g. the capacity of the staff engaged in data collection;

h. the availability of the logistics necessary for data collection.

a. Analysis

212. Once the risks have been identified, data needs to be collected and classified into risk areas and categories for examination. Risk analysis is used to disaggregate the data to

determine the characteristics and features of the risks identified. The data analysis stage involves a process where the data collected is examined using human knowledge and intelligence and computers and machines or a combination of both. Potential risks can be determined by adding data and using human intelligence and machines to make it meaningful. ‘Data’ can be defined as a collection of facts and figures that can be processed to produce actionable information.

213. Generally, items of data on their own have no value unless they are compared with others. Such a comparison is normally referred to as a variable, which must be weighed to determine a potential risk. The result is a risk indicator which can take the form of a selection rule used in combination with a number of parameters. For instance, when a tax return is being examined, the amounts stated are measured against certain standard parameters, and if they exceed these parameters, then immediate action is required to correct the information. In such cases, there may be a risk of under-declaration of turnover. This risk can be determined by comparing the turnover figure stated with the amount declared the previous year or by comparing it to the turnover of similar taxpayers. In this case, the risk indicator can be determined if the variable is weighted. In analysing data, complex indicators and variables may emerge, and it is therefore very important to use techniques such as data mining and data warehousing. This means that, in the analysis phase, tax officers to have specific knowledge and basic skills in electronic data processing.

b. Pre-registration

214. Tax registration is an obligation in any tax jurisdiction except for people exempted from paying tax who are not eligible to register. Tax administrations must take registration risks very seriously and seek to develop mechanisms to ensure that all those who earn or receive taxable income are identified and registered in accordance with existing tax laws. During the registration process, the tax administration should carry out checks on applicants for tax registration. This is crucial due to the increase in fraudulent business activities and identity fraud. Tax authorities can use the following techniques to carry out checks on applicants, comparing the information supplied on registration forms:

- ✓ compare the information provided with that of other applicants already captured in the same registration system and portal;
- ✓ examine the applicant’s postal addresses;
- ✓ cross-check telephone numbers;
- ✓ examine banking information;
- ✓ check references;
- ✓ check employment information;
- ✓ check if there is information in other government departments;
- ✓ check credit reference agencies;
- ✓ check passports and national identity cards provided.

215. Generally, fraudsters may try to register to obtain a taxpayer identification number (TIN) for their own illegal business activities. In order to eliminate this potential risk, tax authorities should roll out an effective public awareness programme to educate the general taxpaying community on the importance of providing true information for tax registration and the implications of falsifying information and misleading the tax authority.

c. Post-registration

216. Taxpayers are expected to file returns declaring their income and paying the tax due. The tax administration should adopt effective measures to increase taxpayer education in order to promote voluntary compliance. The tax payment and declaration risk can only be mitigated after it has occurred. There are several factors that contribute to this risk occurring.

d. Submission of returns

217. Taxpayers are obliged to submit monthly, quarterly and annual returns on prescribed forms in accordance with existing tax laws. In order for the tax authorities to mitigate risks, they should put measures in place to cross-check the information provided on the returns in line with SOPs. The information to be verified on returns includes the following.

- ✓ the amount of tax declared on the return should be compared with other related figures from the taxpayer’s books of accounts to determine the accuracy and reliability of the tax information provided;
- ✓ the return can be cross-checked against previous returns submitted by the same taxpayer;
- ✓ the return submitted can be compared with those of other taxpayers with a similar profile (examining profit margins, business type, mark up, etc.);
- ✓ the return can be compared against internal SOPs.

e. Periodic tax audits

218. Tax authorities should carry out periodic and random tax audits to determine the potential risks and take action to mitigate or eliminate them. This is crucial because, in some cases, where the risk is allowed to exist for a long period of time, the action taken to mitigate or eliminate it may not produce any tangible results if it has already had a serious impact on the tax administration.

f. Spontaneous action

219. There are some sources for risk analysis that are not regular and only occur incidentally. Tax authorities should take a proactive approach to analysing the data as soon as it is received;

a. the characteristics of the taxpayers involved;

b. the reasons for changes in taxpayer behaviour;

c. the likelihood and frequency of the risk;

d. the indicators/selection rules and parameters;

e. the risk dynamics;

f. the impact of risk analysis;

g. potential risk mitigation options;

h. the trend – whether the risk is becoming more or less severe;

i. possible treatment options;

j. cost of treatment;

k. the impact on the tax administration's objectives: low, medium, high, very high.

6.6.8 Risk prioritisation

220. This stage of the risk process is to determine which taxpayers have a high-risk profile and which a low-risk profile. The objective of this stage is to evaluate the extent of the risk, estimate the potential number of taxpayers falling into the high-risk category, select which are most likely to impact on the tax administration and prescribe the appropriate mitigation measures to control, if not completely eliminate, the risk. Tax authorities have a responsibility to allocate enough resources (both human and financial) to control and mitigate a risk once it has been prioritised.

221. The degree of compliance is influenced by the taxpayer's perception of the services delivered by the government to its citizens. If there are feelings that there is an inequitable distribution of national resources or a lack of transparency and accountability by government to the people, the credibility of the tax administration can be negatively affected.

222. There are certain factors that need to be considered in the risk ranking and prioritisation process:

- ✓ the amount of tax due within the period of assessment, determined in the risk analysis stage (result from tax gap analysis can be used);
- ✓ whether there are available resources to be used in the process to mitigate the risk (return on investment can be used);
- ✓ tax awareness is crucial in risk management because risk mitigation will deter taxpayers and can have positive or negative consequences for taxpayers and society as a whole; as the management of certain risks can affect taxpayers and society, the approach should be carefully selected to ensure social acceptance;
- ✓ changes in government and political expediency can also affect some specific risks; the direction taken by the government can mean that risks that are not important today are highly significant tomorrow, for instance, new laws may be passed which could affect taxpayer behaviour;
- ✓ the organisational culture of the tax authorities can play a significant role in the choice of specific risks (determining which risks are high and which are low);

- ✓ every taxpayer should be given a fair opportunity to be treated equally in risk management and control processes; random selection can be used, and the results can identify new risks for analysis.

6.6.9 Risk treatment

223. Risk management or treatment is the stage that comes after risk ranking and prioritisation, which provides a clear picture about the risks that can be controlled or managed. The choice of risks in the prioritisation stage will depend on the resources made available to the tax administration for this process. If there are enough resources available, more risks are likely to be controlled and mitigated. Risks should be selected concurrently, determining those that should be accepted and those that should not. Risk management can take different forms depending on the availability of resources. These include risk transfer, risk reduction, risk mitigation and risk covering.

224. **Risk mitigation**. Risk mitigation can be defined as the measures adopted to eliminate the negative impact of risk on tax administration. For the risk to be neutralised completely, the measures must be implemented in the most efficient and effective manner. The tax authorities should involve all the functional departments in the risk mitigation process either at a centralised or decentralised level.

225. **Risk transfer**. It may be that another government department or outside organisation is best placed to deal with the identified risk. An example is the payment risk. Depending on legislation, it may be possible to require a bank guarantee against future tax liabilities. The risk of not paying is therefore transferred from the tax administration to another organisation, in this case a bank. In this way, the passing of risks can be considered as the ultimate form of risk reduction. However, because the risk still exists, despite being on someone else's plate, it must be considered as a specific form of risk treatment.

226. **Risk reduction**. The tax administration's ability to reduce the risks the organisation is exposed to before they materialise will give it room to focus on high risks and risks that are most likely to materialise. Risk reduction can also free up financial and human resources to be channelled into controlling other risk areas.

6.6.10 Risk reduction

227. Risk reduction is possible in a number of ways, such as (1) limiting opportunities and (2) reducing intentional and unintentional errors. The approaches will be described in more detail:

Limiting opportunities

228. The tax administration can reduce the chances of people making deliberate or inadvertent errors. If it is able to put effective measures in place to reduce risks to zero, it means that mistakes cannot be made any more and the risk therefore no longer exists. There are certain measures tax authorities can adopt to reduce, if not completely eliminate, the chance of errors being made, including the following:

a. changing regulations and laws; if the risk identified is the result of existing legislation, amending the law will automatically lead to a reduction in that risk and better enforceability;

b. if a new law is developed to replace an existing law, it means that the risks are either eliminated completely or reduced to a minimum.

229. **Consistency**. The tax administration should ensure consistent terminology and interpretation of the provisions of different laws. If the same terminology is used in different laws, the possibility of mistakes being made is reduced or eliminated. The tax authorities should provide clear practice notes on how certain provisions of the law should be interpreted to help consultancy firms, organisations in key sectors of the economy and taxpayers have a clear understanding of tax law.

230. **Thresholds**. Tax authorities should establish specific thresholds in tax regulations which can cause some risks to disappear, although a new risk can appear around the threshold.

231. **Standard allowances**. Providing for standard allowances and harmonised rates in tax regulations can eliminate the complexity and ambiguity sometimes associated with the application and interpretation of the law.

232. **Introduction of an e-tax system**. The introduction of the computerised Integrated Tax Application System (ITAS) will eliminate the manual processing of data and allow returns to be filed online. This will reduce, if not eliminate, input errors both at tax administration and taxpayer level.

233. **Quality assurance**. An e-tax system usually has a built-in quality assurance mechanism which validates inputs before processing. This mechanism makes it difficult for certain errors to be made.

234. **System accessibility**. There is a need for the tax administration to assign authorisation levels in the e-tax system for staff and taxpayers. This is crucial to avoid unnecessary information being uploaded and to create opportunities for system control and audit.

Reducing errors

235. Clearly, not all mistakes made by taxpayers are intentional; some are committed inadvertently. Tax authorities should therefore develop very effective taxpayer awareness and education programmes to teach taxpayers about their rights and obligations and the penalties for failing to file returns in accordance with tax laws. The different elements of error reduction are explained below.

236. **Simple legal frameworks**. The simpler tax regulations are for taxpayers to understand, the fewer unintentional errors and mistakes they will make.

237. **Simple return forms.** Tax authorities should develop simple, uncomplicated return forms to ensure taxpayers can complete and submit them easily. The easier the forms are, the fewer errors taxpayers are likely to commit.

238. **Access to information**. Clear and unambiguous practice notes and leaflets containing explanations of basic SOPs on specific issues related to taxpayer returns and the filing process will reduce unintentional mistakes by taxpayers. The tax authorities should also use other means of communicating information to taxpayers, such as radio, TV, print media, websites and signposting, depending on the nature of the information.

239. **Contacts**. The authorities should ensure there are easy ways for taxpayers to contact the tax administration. They include internet services, telephone and secure social media networks. This ensures quick access to information and enables taxpayers to provide accurate information to the tax office.

240. **Client services**. It is sometimes very important for the tax administration to set up client desks at their offices. The logic is that some taxpayers will visit a tax office for information and education on certain issues requiring face-to-face interaction.

241. **Tax education**. Tax authorities should develop education programmes in different forms to suit all manner of taxpayers. A public forum and town hall meeting could be organised to educate taxpayers and provide them with information. In developing tax education programmes, care should be taken to cover all the different groups of taxpayers in the economy.

242. **Physical help.** Tax authorities should be flexible in performing their duties in order to gain the trust and confidence of taxpayers. Under certain circumstances, some taxpayers may need to come to the tax office, mostly for help with completing tax returns or drafting certain types of letters to the tax office. These types of taxpayer require physical help, despite the services provided by the e-tax system; some people will find it difficult to file their returns electronically. Helping them physically will reduce potential errors. Such help can also be provided by private institutions, such as consultancy firms, social organisations or unions, and by friends and family members.

243. **Third party services**. Tax authorities should be able to have some partnership arrangements with third parties to manage taxpayer information. Such arrangements usually help taxpayers who have challenges and are unable to go to the tax office for physical help. The third party can be a registered organisation that provides certain customer services related to tax administration or an individual or union. The third party is independent and not influenced by the taxpayer.

244. **Field visits**. Periodic and random on-site visits are made to the taxpayer's business premises during working hours to collect information for the tax authorities to use to manage risks in the future. The purpose of such visits is to:

a. collect information on employees working for the organisation at the time;

b. identify the types of taxpayers and categories of employees (local or expatriates);

c. check whether the books of accounts are being kept in accordance with tax law;

d. collect information about how the organisation is being managed, checking good governance of corporate structures, the presence of the board of directors, etc.

e. determine the scope of the business activities;

f. examine the pricing structure of goods and services;

g. check that products are consistent with standards.

245. The tax administration can also use the test purchasing technique to determine the status of the business and the actual price the product is being sold at on the open market. Test purchasing is an undercover operation by the tax administration to determine the true value of the product and to find out if a particular business is still in operation. Posing as customers, tax officers order and pay for a product. When carrying out this kind of undercover or unannounced visit to a taxpayer's business premises, the tax administration should be sure it has the legal authority to carry out the operation and carefully consider the risks involved and the safety of its officers.

246. **Opportunities for voluntary disclosure**. Tax authorities should provide taxpayers who have made a mistake in their tax return with a window of opportunity to make voluntary corrections to the information even though the risk has already materialised. The penalty can be waived if the taxpayer complies with the requirements of the invitation to correct errors in their return. This invitation can be made as a result of the random selection of taxpayers for a desk review of their annual returns. This method is more of a risk management measure than risk reduction because it is not possible to eliminate or reduce risks that have already materialised.

247. **Risks appraisal**. Tax authorities should have a risk evaluation mechanism in place to measure the effectiveness of actions taken at every stage of the risk management process. There is a saying that 'you can't manage what you can't measure'. There are some basic questions the tax administration should ask in the risk appraisal process:

a. where were the risks identified?

b. when were the risks identified?

c. were the risks properly analysed?

d. were the right kind of mitigation measures adopted?

e. what were the risk triggers?

f. were there internal or external drivers?

248. The risk appraisal process can involve evaluating all risks to determine how effective the actions were in achieving the tax administration's goals and expected results. Organisational effectiveness and efficiency can be determined when a risk appraisal is carried out in an efficient manner. This will provide a clear picture of the ability of the tax administration to manage the risks identified or where there is a need for external support in terms of financial or human resources or both.

249. Risk appraisal can be carried out by using a variety of methods, including the following:

a. conducting a random tax audit of selected taxpayers to test taxpayer surveys used to measure the taxpayer's faith in the tax system (taxpayer behaviour and societal culture);

b. examining the accounting principles and methods used by the taxpayer;

c. analysing the rate of filings by the taxpayer;

d. carrying out a tax gap analysis to determine the culture of compliance based on actual tax paid;

e. carrying out a field visit to taxpayer's business premises;

f. carrying out specific tax audits, for example, on withholding taxes, VAT, corporate tax and fixed assets, and compliance tax audits to address particular problems arising from these tax areas;

g. measurement can also focus solely on the number of errors (without taking into account the amount involved); this requires a smaller sample.

7 Chapter Seven

7.1 Standard operating procedures

250. Tax authorities all over the world have internal mechanisms for the day-to-day operation of the tax administration. SOPs may vary from country to country, but they are generally formulated and structured for effective and efficient tax administration through the functional core departments and units described below. The purpose of SOPs is to set out clear operational guidelines for each unit engaged in direct tax collection and taxpayer management. They establish the operational arrangements under which the main units of the Compliance, Enforcement and Debt Management (CEDM) Department operate within the tax administration.

7.2 Responsibilities of the CEDM Department

251. The head of department oversees the overall tax planning activities of the tax administration and reports to the office manager. The CEDM Department is usually divided into three main units, namely the Compliance Unit, the Debt Management Unit and the Enforcement Unit. Each unit is managed by a head or supervisor with a number of officers working under them.

252. **Supervisors**. Supervisors are the heads of the CEDM units and report directly to the head of the CEDM Department who oversees their daily activities in managing the units. They allocate and assign tasks, review workplans and carry out appraisals of the officers who work under them.

253. **Officers**. Officers are the employees who work in the various units within the CEDM structure. They report directly to the head of the unit they are assigned to. They perform the duties assigned to the CEDM Department, carry out field work and submit reports to the heads of unit which are further reviewed by the head of the CEDM Department. The functions of the CEDM Department are:

a. compliance;

b. enforcement;

c. debt management.

254. Income Tax Act No. 113 and Real Estate Tax Act No. 162 (1959), as amended, mandate the GCT to administer and give effect to the tax laws of the country through the

Commissioner General. These laws also allow the Commissioner General to issue written directives, as deemed necessary, for their effective implementation.

255. The operationalisation of Act No. 113 and Act No. 162 requires the development of internal SOPs to guide the day-to-day tax planning activities of the tax authority. Compliance, enforcement and debt management are the main functions of any tax authority, including the identification of taxpayers and tax assessment, collection and recovery.

256. The CEDM Department can be structured into three units, namely the Compliance Unit, the Enforcement Unit and the Debt Management Unit.

7.3 Compliance unit

257. It is the responsibility of the Compliance Unit to identify both new and existing taxpayers who fail to fulfil their tax obligations in accordance with tax laws and regulations. The Unit's main duty is to inform taxpayers of their legal obligations, as defined by tax law, for example, registering their business, keeping the required books of accounts, keeping accurate records of business transactions, filing the required tax returns on time and paying the taxes due.

258. **Functions of the Compliance Unit**. The functions of the Compliance Unit are to:

a. establish compliance protocols to monitor taxpayer compliance issues, such as tax registration, failure to file returns, failure to pay tax due on time, failure to issue the prescribed receipts and invoices and preventing tax officers from entering business premises;

b. ensure the tax administration issues demand notices for tax payment and the filing of returns;

c. identify and monitor non-filers, late-filers and stop-filers;

d. identify and monitor non-remitters and late remitters;

e. ensure the list of delinquent returns is prepared at the appropriate time;

f. ensure desk checks of tax returns are carried out within the legal framework;

g. ensure audit accounts are signed before submission to the office;

h. ensure appropriate penalties are imposed for tax offences in accordance with tax laws and regulations;

i. refer cases to the Enforcement Unit for appropriate action;

j. generate operational reports.

7.3.1 Compliance activities

259. The compliance programme involves investigation and the application of tools to resolve non-compliance issues.

260. **Compliance investigation**. This is a process that involves identifying taxpayers who have not honoured their tax obligations. Taxpayers have a legal obligation to file returns and make payments by the established due dates, provide full and accurate information and maintain proper records. Where the taxpayer fails to meet any of these obligations, compliance issues such as the following arise:

a. non-filers are taxpayers who have not filed their returns by the due date;

b. nil-filers are taxpayers who have filed their returns indicating no business activity or no tax liability for the period;

c. stop-filers are taxpayers who have defaulted in filing over a period of time;

d. late-filers are taxpayers who have filed after the due date;

e. credit-filers are taxpayers whose returns show credit over a period of time;

f. short-payers are taxpayers who pay less than the full liability;

g. non-payers are taxpayers who file a return with tax payable but fail to pay;

h. non-registered taxpayers are registrable persons who are not registered with the GCT.

261. **Non-filers and stop-filers**. These categories of taxpayers are those who have never filed tax returns with the tax authorities in the course of their business history or used to file returns but have stopped doing so. The Compliance Unit reviews all taxpayers' records and databases (e.g. ITAS) periodically to identify those who have stopped filing and determine if they are still in business, cross-checking with other types of tax. The compliance officer prepares a list of taxpayers who have stopped filing or have never filed a tax return. The head of the Compliance Unit should prepare an investigation report on stop-filers and submit it to the head of Audit for further action.

Table 12: Non-filer and stop-filer compliance procedures

Step	Task	Person responsible	Action	Remarks
1	List of non-filers	Head of Compliance Unit	Run non-filers report on ITAS Open case file and assign case to supervisor	
2	Reception and assignment of cases	Compliance supervisor	Create and assign case files to officers in batches	
3	Reception and update of cases	Compliance officers	• Select case files • Follow up on taxpayers who have defaulted in filing returns	

			• Update case files with returns/information obtained • Impose penalties as applicable • Report to head of Compliance Unit through supervisor	
4	Closure of case	Head of Compliance Unit	Where returns have been filed, case is closed	
5	Where returns are not filed	Head of Compliance Unit	Recommend the case be escalated for enforcement action through head of Unit	
6	Escalation of cases outside the office	Head of Compliance Unit	Recommend the case be escalated for enforcement to head of Unit	
7	Escalation (continued)	Head of Compliance Unit	Escalate the case to Head Office through appropriate management channels	
8	Closure of Case	Head of Compliance Unit	Close when escalated case is finally resolved	

262. **Nil-filers**. This term refers to taxpayers who file nil returns indicating no business activity for the period. The Compliance Unit reviews all taxpayer records and databases (e.g. ITAS) periodically to identify those who filed nil tax returns and determine if they are still in business, cross-checking with other types of tax. The compliance officer prepares a list of taxpayers who show a pattern of consistently filing nil returns and submits it to the supervisor. The head of the Compliance Unit produces a compliance investigation report and submits it to the head of Audit for further action.

Table 13: Nil-filer compliance procedures

Step	Task	Person responsible	Action	Remarks
1	Generation of list of nil-filers and assignment	Head of Compliance Unit	• Run nil-filers report on ITAS at end of each tax period • Assign batches for monitoring	
2	Creation of case files	Head of Compliance Unit	Create case file for each taxpayer and assign in batches to officers	
3	Verification of business operation	Compliance officers	• Check for pattern of nil filing	

			• Establish if taxpayer files payment returns for other types of tax • Verify at taxpayer's premises • Report to supervisor	
4	Closure of case	Head of Compliance Unit	Close case where there are no adverse findings (as basis for nil filing)	
5	Recommen-dation	Compliance officers	Report adverse findings of persistent nil filing to office manager and recommend for audit	
6	Escalation of case	Head of Compliance Unit	• Refer list to head of Audit • Based on the audit outcome, the office manager directs head of CEDM Department on necessary action	

263. **Late-filers**. Late-filers are taxpayers who usually file their returns after the due date prescribed in the relevant tax laws. The Compliance Unit reviews all taxpayer records and databases (e.g. ITAS) periodically to identify those who filed returns after the due date. The compliance officer prepares a list of taxpayers who show a pattern of consistently filing returns late and submits it to the supervisor. The head of the Compliance Unit produces a compliance investigation report and refers the case to the head of Audit for further action.

Table 14: Late-filer compliance procedures

Step	Task	Person responsible	Action	Remarks
1	Generation of list of late-filers	Compliance officers	• Run report on ITAS • Refer report to head of Compliance Unit	
2	Creation of case files	Compliance officers	Create case files and assign in batches to compliance officers	
3	Computation of penalties	Compliance officer	• Compute and impose penalties manually (where system does not generate penalties for late filing) • Report to head of Compliance Unit	
4	Imposition of penalties	Compliance officers	Recommend penalty computed for approval through head of Compliance Unit to head of CEDM Department	

5	Approval of penalties imposed	Officer manager	• Approve penalty • Notify taxpayer of penalty imposed through Taxpayer Services (TPS)	
6	Closure/referral of case	Compliance supervisor	• Update taxpayer's records and close case, according to SOPs, when penalty is paid • Refer case to Debt Management Unit through head of Compliance Unit when penalty remains unpaid	

264. **Credit filers**. This category of taxpayers are those who file returns with overpayments or tax credit for the period. The Compliance Unit reviews all taxpayer files and databases (e.g. ITAS) after the submission of returns to identify those who filed such returns. The compliance officer prepares a list of taxpayers on file who have overpaid and prepares an investigation report for submission to the Audit Department for action.

Table 15: Credit-filer compliance procedures

Step	Task	Person responsible	Action	Remarks
1	Generation of list of credit-filers and assignment	Head of CEDM Department	• Run credit-filers report on ITAS at end of each tax period • Assign batches for monitoring	
2	Creation of case files	Compliance supervisor	Create case file for each taxpayer and assign in batches to officers	
3	Verification of business operation	Compliance officer	• Check for pattern of consistent credit filing • Establish if taxpayer files payment returns for other types of tax (e.g. CIT returns) • Verify at taxpayer's premises • Report to supervisor	
4	Recommen dation	Compliance supervisor	Make recommendation to head of Compliance Unit for appropriate action	
5	Closure of case	Head of CEDM Department	Close case where there are no adverse findings (basis of credit filing confirmed)	

6	Recommen dation	Report adverse findings of persistent credit filing to office manager for referral	
7	Escalation of case	• Refer list to head of Audit or to head of CEDM Department for further action • Based on the audit outcome, the office manager directs head of CEDM Department on necessary action or acts on recommendations of CEDM (HQ)	
8	Closure of case	Close case after necessary action on audit outcome	

Compliance status checklist

- ✓ Filing of returns
- ✓ Personal income tax/CIT payment
- ✓ Payment of PAYE and other withholding taxes
- ✓ VAT payment
- ✓ Excise tax payment
- ✓ Rental income tax payment
- ✓ Payment of penalties
- ✓ Arrangement to pay tax arrears

265. The Compliance Unit has a responsibility to make recommendations to the Enforcement and Debt Management Units for further action.

7.3.2 Sources of information for compliance activities

266. There are several sources from which information can be gathered and used for compliance activities. These include leads, reverse leads and third party information or informant reporting.

267. **Leads**. These are sources of information outside the GCT, for example, the Registrar of Companies, government ministries, departments and agencies, metropolitan, municipal and local government offices, district assemblies, the Iraq Chamber of Commerce, business magazines and adverts, government records, published contracts and the telephone directory, which can be consulted for the names, trade names and addresses of potential taxpayers.

268. **Reverse leads**. Reverse leads are obtained through a programme under which the GCT compares its list of registered taxpayers against businesses in specific areas of the city (for example Rubai Street in Baghdad). Those not found on the list are contacted and registered.

269. **Third party information**. Relevant information obtained from independent persons who are not necessarily connected to the GCT (for example informants). Such information can trigger compliance actions.

7.3.3 Compliance strategy

270. The GCT has a variety of tools for identifying people who have not fulfilled their obligations under tax law, including reviewing records/data to confirm registration, filings, payments and other requirements. In addition to checking leads, records can be reviewed and visits made to business premises to identify potential unregistered taxpayers. Compliance tools include:

- ✓ operation dragnet;
- ✓ tax education;
- ✓ VAT invoice monitoring;
- ✓ manual backdated penalties;
- ✓ test purchasing (undercover customer);
- ✓ events and entertainment monitoring;
- ✓ tax clearance certificate.

Operation dragnet (tax compliance campaign)

271. Operation dragnet involves sending compliance officers unannounced to a selected geographical area to conduct tax compliance checks on every business. This method is usually very productive in identifying potential taxpayers who have not registered or filed the required returns. The compliance team, led by a supervisor, go from door to door visiting each business in the target area. If the taxpayer is not present or the person is not registered, the team issues an invitation and provides registration forms to be completed and submitted within five working days. A copy of the invitation letter should be kept on file temporarily for follow-up action. If the person fails to respond within five working days from the date of the invitation letter, the compliance officers initiate appropriate action against them.

Table 16: Procedures for operation dragnet

Step	Task	Person responsible	Action	Remarks
1	Creation of case	Head of CEDM Department	Create and assign cases for operation dragnet	
2	Preparation to carry out operation dragnet	Head of CEDM Department	• Receive cases • Select teams and supervisors for field operation • Liaise with head of TPS through head of Accounts for receipt books	
3	Coordination of operation	Head of Compliance Unit	• Form teams for field operation based on plan drawn up in advance by CEDM Department for the period • Secure logistics for operation • Brief officers for field operation	
4	Field operation	Compliance officers	Teams go door-to-door to identify new taxpayers and non-compliant persons	
5	Collection of revenue in the field and accounting for revenue received	Compliance officers	• Carry out tax education where necessary • Issue receipts for payments received during the operation • Account for revenue collected to TPS	
6	Non-compliant taxpayers	Compliance officers	Issue invitation (signed by head of CEDM Department) to non-compliant taxpayers to report to the office within the period prescribed by law	Head of CEDM Department
7	Unregistered persons	Compliance officers	• Issue TIN registration form to unregistered persons for completion and submission within the period prescribed by law • Team leaders report outcome of the operation to head of Compliance Unit	
8	Review of field reports	Head of Compliance Unit	Review reports of team leaders and recommend appropriate action to head of Unit	
9	Response to invitation	Head of CEDM Department	• Refer potential taxpayers who report to TPS office for registration • Handle cases of non-compliant taxpayers at the	TPS

			Unit, depending on the type of violation	
10	Documen-tation and reporting	Compliance supervisor	• Document case history using form/file • Update case on ITAS or in manual environment • Report to office manager through head of CEDM Department	Head of CEDM Department

Compliance educational field visits

272. Compliance educational visits are an efficient and effective tool for follow-up visits to evaluate the level of compliance and ascertain and address compliance difficulties encountered by registered taxpayers. Such visits are mostly made to small and medium-sized businesses that have been registered for some time and to newly registered taxpayers that are not showing growth in revenue performance but may not immediately require a comprehensive audit, taking into account audit resource constraints. Under such circumstances, a compliance evaluation visit may be a more cost-effective tool that can be employed as a preliminary probe to determine whether or not an audit is required.

273. The head of the CEDM Department should authorise the head of the Compliance Unit to develop a field visit plan of action for the year, broken down into quarters. The Compliance Unit should always form various teams, depending on the scope of the visits to target taxpayers and the area of operation. Compliance educational field visits should be a routine activity, and the main objective should be to inspect business records. The officers may also offer advice to taxpayers and explain compliance issues, such as a taxpayer's obligations under tax law and the consequences of failing to comply with them. The officers are required to prepare a report after completing their field visit and submit it to their head of Unit for further action, such as designating the taxpayer for investigation and issuing the appropriate demand notices and warning letters.

Table 17: Procedures for compliance educational field visits

Step	Task	Person responsible	Action	Remarks
1	Generation of compliance field report	Head of Compliance Unit	• Run compliance report on ITAS • Assign groups of taxpayers for compliance officers to visit	
2	Distribution of taxpayer groups	Head of Compliance Unit	Distribute taxpayer groups to the teams of compliance officers	
3	Creation of case files	Compliance officers	• Submit report on case files to head of Compliance Unit for action	
4	Verification of	Compliance officers	• Conduct routine visits and inspect business records	

	compliance levels		• Complete compliance educational field visit forms, as prescribed by law • Offer advice to the taxpayer, explaining compliance issues, such as a taxpayer's obligations under tax law and the consequences of flouting the law • Update cases with information from visits • Prepare field report	
5	Submission of reports	Compliance officers	Submit report to head of Compliance Unit using case history form	
6	Review of reports	Head of Compliance Unit	• Review report and decide on appropriate action to be taken (e.g. warning notice, invoice monitoring, etc.) • Make recommendation to head of Compliance Unit to close case or otherwise	
7	Closure of case	Head of CEDM Department	• Review case • Close case or refer to office manager for further action	

Test purchasing

274. Test purchasing is normally conducted at the taxpayer's premises where intelligence gathered over a period of time has confirmed that the taxpayer is doing business but has failed to register with the tax authority. The taxpayer may be engaged in selling or producing goods at prices different from the open market price and concealing the income from the tax authorities. The different sources of intelligence the tax authorities usually rely on include security agencies, local authorities (metropolitan and municipal governments), consumer complaints, community reports and business organisations. They normally carry out test purchasing by forming a team of men and women to covertly visit the taxpayer's business premises and points of sale, posing as customers. Each team member buys products or items from the taxpayer and submits a report to the head of the Compliance Unit. The tax authorities have a responsibility to provide adequate security for their staff in case something goes wrong.

Table 18: Procedures for test purchasing

Step	Task	Person responsible	Action	Remarks
1	Approval to conduct test purchase	Head of CEDM Department with approval	• Approve programme to conduct test purchasing • Provide funding to head of CEDM Department	

		from office manager	• Arrange for police assistance	
2	Creation of case files	Head of CEDM Department	• Create case files based on risk factors (e.g. volume, value, rate and period of transaction, etc.) • Assign case file to head of Compliance Unit for action	
3	Selection of team for test purchase	Head of Compliance Unit	• Receive case • Assign compliance officers (teams) • Brief compliance officers and police on operation	
4	Conduct of test purchase and reports		• Undertake purchase • Where VAT invoice is issued, officer should report the fact to the office manager through GCT chain of command to close case • Where VAT invoice is not issued, compliance officers should request police to effect arrest • Where taxpayer asks for an out-of-court settlement, compliance officers should recommend the taxpayer for audit through management channels • If the taxpayer does not ask for an out-of-court settlement, compliance officers should make recommendation to office manager for prosecution through management channels	
5	Prosecution and closure of case	Office manager	Close case or escalate it to CEDM/Legal through management channels	

Investigation of receipts and invoices

275. Tax authorities have many ways to check taxpayer compliance with tax laws. Carrying out real-time investigation of receipts and invoices issued by taxpayers on their business premises is crucial to determining their authenticity and veracity. This process of obtaining purchase and sales information from a source independent of the taxpayer's declarations through direct observation and recording of transactions as they occur in real time usually provides accurate information to the tax authorities as to whether the taxpayer is complying with applicable tax regulations and laws. The investigation should involve the deployment of a minimum of two officers to the taxpayer's premises to carry out physical checks and monitor the issuance of receipts and invoices for a period of at least one month.

276. At the end of the agreed period, the officers deployed must prepare a comprehensive report on any cases of non-compliance and submit it to the head of the Compliance Unit, who passes it on to the office manager.

277. Some of the possible adverse findings resulting from test purchasing are:

a. failure to issue VAT receipts and other invoices, as prescribed by the tax authority in accordance with tax laws;

b. concealing the business's real sales figures;

c. keeping different books of accounts for the business and for tax purposes;

d. engaging in business other than that disclosed to the tax authorities.

Circumstances leading to invoice investigation

278. There are many different factors that will trigger invoice investigation, depending on the nature and scope of the business the taxpayer is engaged in. However, some of these factors are specified in tax laws as part of standard anti-avoidance tax planning activities:

a. when a taxpayer is found or suspected to have under-declared, with the suppression of cash sales and purchases;

b. where a taxpayer keeps no business records;

c. where the registration threshold of a taxpayer is in dispute;

d. when there is information that a taxpayer is not issuing proper invoices, as prescribed by tax law;

e. when there is information that a taxpayer is not registered with the tax authorities.

279. The field report on the invoice investigation should be submitted to the head of the Compliance Unit who will ascertain what action is to be taken, depending on the findings and the gravity of the offence. Below are some actions the head of the Compliance Unit can take against taxpayers:

a. issue a warning letter to the taxpayer;

b. instruct the taxpayer to effect a payment to correct an under-declaration;

c. post adjusted assessment to taxpayer's ledger by completing the appropriate forms;

d. issue a copy of the assessment notice and forward it to the Debt Management Unit for it to pursue debt collection;

e. recommend an audit into the taxpayer's business activities;

f. impose the appropriate penalties, as prescribed by tax law;

g. the office manager should report any recalcitrant taxpayers to the Legal Department for further action.

Table 19: Procedures for invoice investigation

Step	Task	Person responsible	Action	Remarks
1	Approval of programme	Office manager	• Approve programme to conduct invoice monitoring • Provide logistics	
2	Determination of non-performing sectors for monitoring	Head of CEDM Department	• Create cases • Select cases according to sectors or information available (in selection, pay attention to time of year)	
3	Selection of team for monitoring	Compliance supervisor	• Assign team members • Update with relevant information (e.g. venue) • Notify taxpayer of selection for investigation, indicating date of commencement, duration and names of officers conducting the investigation	
4	Receipt of case/ conduct of investigation and reporting	Compliance team	• Receive case • Update case with information from the field • Monitor • Collect data on sales and invoices issued • Record outcome on CEDM • Prepare daily, weekly and monthly reports	
5	Analysis of evidence/ records	Compliance supervisor	• Compare sales data with three-month average of previous returns filed • Make recommendation to head of Compliance Unit for further action (e.g. warning notice) where an offence has been detected by officers	
6	Escalation of case	Head of CEDM Department	Where the difference is more than 15%, the case is recommended for audit through the office manager	
7	Closure of case	Office manager	Close case or escalate recalcitrant cases to Legal	

Backdated penalties

280. This is a punitive measure prescribed by tax law that can be imposed on any taxpayer who is in business but fails to register with the tax authorities, for example, if a taxpayer did

not register for tax on the required date or declares a false date of commencement of business. The head of the Compliance Unit should lead the investigation and give appropriate instructions to compliance officers to impose the necessary penalties in accordance with tax law. The penalty notice should be issued and delivered to the taxpayer by post or by hand.

7.4 Debt management unit

7.4.1 Introduction

281. Debt management refers to a set of programmes and activities aimed at recovering debt when normal compliance procedures have failed. The term 'debt management' may also apply to any actions taken to have taxpayers settle their tax debt either voluntarily or by compulsion within a reasonable time, as prescribed by tax law.

282. The Debt Management Unit's main responsibility is the collection of delinquent taxpayer accounts (tax debts) in accordance with tax laws. It can do this through measures and techniques aimed at recovering tax debt when compliance procedures have failed. Debt management procedures are designed to manage tax defaults and include strategies to help reduce the level of debt and move towards eliminating it completely. Debt management also applies to any action seeking to ensure tax debt is settled in the shortest possible time.

Functions of the Debt Management Unit

283. The functions of the Debt Management Unit include the following:

a. monitor, establish and manage taxpayer debt stock;

b. monitor delinquent taxpayer accounts and carry out trend analysis (movement of debt stock);

c. carry out tax gap analysis to determine what has been paid and what should have been paid;

d. update/amend debt stock and add penalties and interest as specified in tax law;

e. collect debts;

f. generate operational reports;

g. refer cases of recalcitrant tax defaulters to the Enforcement Unit for appropriate action.

Tax debt

284. Tax debt is any tax liabilities, penalties and interest which remain unpaid after the due date, as prescribed by tax law.

Sources of tax debt

285. The tax authorities are mandated to collect taxes on behalf of the government. This includes tax liabilities, penalties and interest. There are several sources of tax debt, as set out in the relevant tax laws and regulations:

a. positive returns filed without payment;

b. short payment (on account/part payment);

c. dishonoured cheques;

d. provisional and/or audit assessments;

e. annual estimates and projections (self-assessment);

f. penalties/interest;

g. tax not in dispute;

h. under-provision or under-estimation in tax assessment.

Responsibilities of debt management officers

286. The Debt Management Unit has the following responsibilities in ensuring that tax liabilities are paid and all penalties provided for in tax laws and regulations are collected:

a. creating and maintaining case files;

b. reviewing files to ensure tax arrears are paid;

c. ensuring that the proper tax and penalty notices are sent to taxpayers;

d. locating taxpayers by telephone, email, fax, text message or post or by visiting them personally at their residence or business; this may require the assistance of the TPS Unit;

e. interviewing taxpayers to determine the fastest way to collect tax debt;

f. referring recalcitrant debtor cases to the Enforcement Unit after all other efforts to collect have proved futile.

Figure 4: Debt Management Module

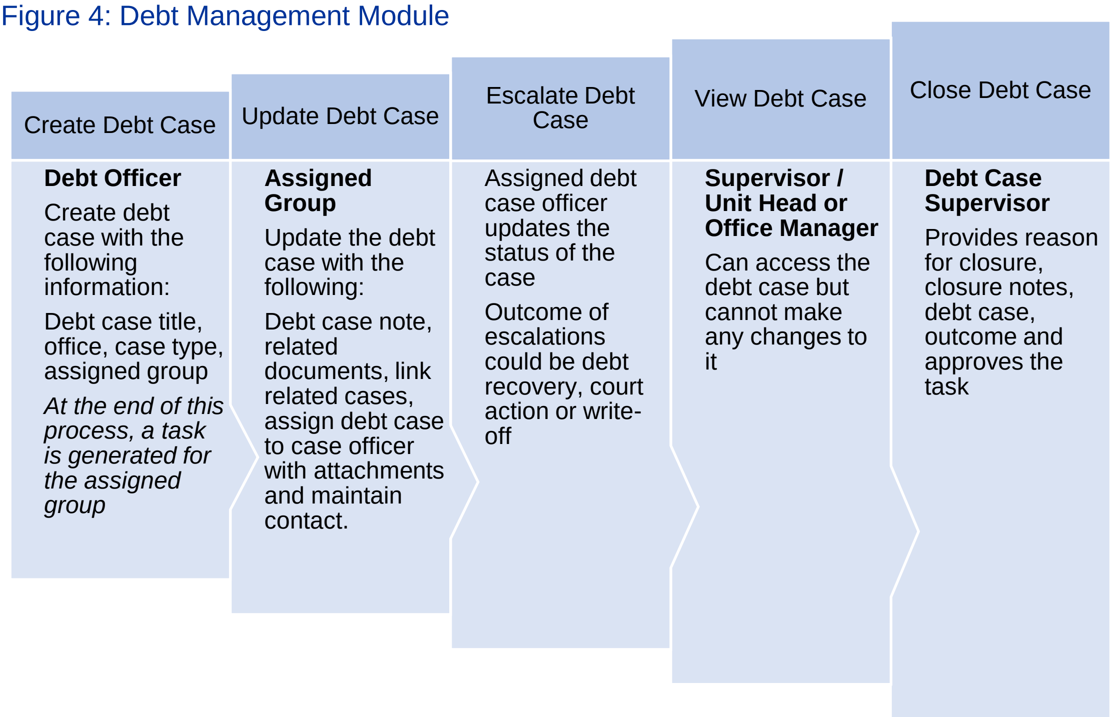


Table 20: Debt management case file process

Step	Task	Person responsible	Action	Remarks
1	Creation of case file	Head of Debt Management Unit	• Run arrears list on ITAS or manual • Create case files	
2	Assignment of case files	Head of Debt Management Unit	Assign case files for group and team members to manage	
3	Receipt of debt management case files	Debt management officer	• Receive case files to pursue and update • Cross-check accounts enquiry for confirmation of debt by ITAS or TPS • Calculate penalties manually where the system does not and inform taxpayer through TPS	
4	Contact with taxpayers	Debt management officers	• Update case files with any additional information after visit to taxpayer • Update case files with penalties/interest and final demand notices issued by attaching copies • Update case files with all correspondence	

			• Update case files with manual payments that have not been captured on the system through accounts adjustment • Update case files with tax credit certificates from other offices through account adjustment	
5	Full payment at initial contact	Debt management officer	• Update records with payment receipts • Make recommendation to head of Debt Management Unit for closure of case files when full payment is made	Office manager through head of CEDM Department
6	Closure of case	Head of CEDM Department	Close case files	
7	Where part/short payment is made	Head of Debt Management Unit	Where short or part payment is made, refer to workflow process on short payments	
8	Application by taxpayer for extension of time/part payment	Head of Debt Management Unit	Where application is made for an extension of time for payment, refer to workflow process on instalment agreements	Office manager through head of CEDM Department

7.4.2 Payment of taxes in instalments

287. The principles of taxation as postulated by Adam Smith are still relevant in tax administration today. The tax authority should make tax payment convenient and economical for both the tax administration and the taxpayer. Measures should be instituted to provide an opportunity for taxpayers to make payments in instalments within the period of tax assessment. It is also important for tax authorities to be efficient in tax collection in order to minimise the cost. At the taxpayer's request, an instalment payment arrangement can be made to enable the taxpayer to settle the tax due. These arrangements are normally an efficient way of collecting taxes economically.

288. The reasons for establishing an instalment agreement include:

a. cash flow problem;

b. financial incapacity;

c. natural disaster;

d. sickness.

Decision to accept an instalment agreement

289. The tax administration decision's to accept an application to pay taxes in instalments should be based on the taxpayer's inability to pay their taxes in full on the due date and their previous payment history. The tax administration should investigate the returns filed by the taxpayer to determine whether the taxpayer has reported a profit or loss. This is the best way for the Commissioner General to make a decision on whether or not to accept the application for payment in instalments.

Possible terms and conditions for an extension of time to pay taxes

290. The granting of an extension is subject to the following requirements:

a. the applicant must apply to the Commissioner General by completing the relevant application form for an extension, in accordance with tax laws and regulations;

b. the applicant must have a TIN;

c. the applicant must provide evidence of lack of liquidity (e.g. bank statement, cash flow statement, debtors);

d. the applicant must be up to date in filing tax returns;

e. the extension of time for payment of taxes cannot be applied to currently maturing debt;

f. application for a further extension of time to pay a rescheduled debt must be made before the end of the extended period;

g. the extension of time granted to a taxpayer to pay a debt should be a reasonable period, as prescribed by tax law;

h. the applicant must agree to make timely payments;

i. the applicant must provide accurate information on business income;

j. interest on tax arrears is calculated according to the applicable provisions of tax laws and regulations;

k. the instalment agreement may be terminated and enforced collection action may be taken if the taxpayer:

    a. fails to make timely payments

    b. accumulates additional tax arrears

    c. provides inaccurate or incomplete information.

Approving authority

291. In most tax jurisdictions, decision-making on applications to pay taxes in instalments is structured in tax law in such a way as to prevent the concentration of power in the hands of one person, with a view to enhancing the transparency of the process. Rules relating to

the level of authority, as prescribed by tax law, in granting applications for payment by instalment must be strictly adhered to. The tax authority has the responsibility to review the processes and procedures for granting applications for payment by instalment regularly through administrative directives. The level of authority required to grant an application depends on the amount involved.

292. The table below provides an example of how the levels of authority for granting applications for payment by instalment should be structured, with the thresholds established in tax regulations.

Table 21: Thresholds for an extension of time to pay taxes

Approving authority	Amount (IQD)	Duration
Officer Manager	Up to 1,500,000	No more than 12 months
Deputy Commissioner	Up to 3,000,000	No more than 12 months
Commissioner	Up to 6,000,000	No more than 12 months
Commissioner General	Above 6,000,000	No more than 12 months

293. The administrative procedures for granting instalment applications are normally incorporated into the internal SOPs. The first step is for the taxpayer to apply to the tax authority for payment by instalment stating the specific reasons for the request. The application is first submitted to the office manager, who will forward the application to the head of the CEDM Department for processing. It will then be sent to the head of the Debt Management Unit for further processing.

294. The head of the Debt Management Unit will process the application and prepare a payment by instalment agreement setting out the principal tax amount due plus penalties and interest. The final instalment payment agreement is then signed by the tax officer responsible and the original copy sent to the taxpayer using the contact details provided. Following approval, a schedule notice is issued to the taxpayer.

Cancellation of the instalment agreement

295. An agreement can be cancelled when a taxpayer fails to abide by the conditions under which the application for payment by instalment was granted. This includes failing to make timely payments, providing inaccurate information and accumulating further tax arrears. When any of the above occurs, the head of the Debt Management Unit should seek approval from the office manager, through the head of the CEDM Department, to cancel the instalment agreement in respect of the outstanding amount.

Remission of tax debt

296. When a taxpayer who has an instalment agreement or tax arrears fails to make any payments over several years, after further investigation of the taxpayer's business activities, the tax authority can opt to 'downgrade' the case file before the debt is finally declared uncollectable.

Reasons for writing off tax debt

297. Tax debt may be written off in the following circumstances:

a. the business has ceased operation or has been liquidated;

b. the taxpayer is deceased and no distrainable assets have been identified;

c. the taxpayer becomes unemployed and has no means of paying the tax;

d. the taxpayer is bankrupt.

298. Debt management officers should use the above sources to confirm information provided by the taxpayer and to identify collection possibilities. Where collection is possible, payment should be demanded immediately.

Inability to locate taxpayer

299. If the debt management officer cannot locate the taxpayer, the office should:

a. check routine internal sources, such as registrations and tax returns;

b. ask the Post Office for a current address;

c. use all known third party debtors;

d. visit the taxpayer's last known address and interview neighbours and customers;

e. consider requesting a police inquiry.

Table 22: Procedures for granting applications for payment by instalment

Step	Task	Person responsible	Action	Remarks
1	Receipt of application for instalment agreement	Taxpayer	Submit application for instalment agreement stating reasons to office manager	
2	Creation of instalment plan	Office manager	• Receive instalment application • According to 'authority level' criteria, office manager decides whether to deal with the case or escalate it to a higher authority • If within authority level, office manager assigns application to head of CEDM Department to agree terms with taxpayer and draw up an instalment payment plan	

3	Instalment agreement	Head of CEDM Department	Assign instalment application to debt management supervisor for a payment plan to be drawn up	
4	Payment plan	Debt Management Unit	• Assign application for payment by instalment to Debt Management supervisor for a payment plan to be drawn up	
5	Creation of instalment case file	Debt management officer	• Create instalment agreement case • Ensure debt is on the taxpayer's ledger • Add and update all mandatory fields, including prevailing interest rate • Calculate and record total interest payable	
6	Approval/ rejection of instalment application	Head of CEDM Department	• Approve or reject instalment agreement • Indicate reasons for rejecting instalment agreement • Instalment plan arrangements are recorded in taxpayer's ledger	
7	Approval of application	Head of Debt Management Unit	Notify taxpayer of approved payment plan through TPS	
8	Breach of instalment agreement	Head of Debt Management Unit	• Monitor instalment plan • Record cancellation details • Demand immediate payment • Report cancellation of agreement to head of CEDM Department	
9	Cancellation of instalment agreement	Head of CEDM Department	Notify taxpayer through management channels	
10	Recovery of full payment	Office manager	Trigger action to recover full payment	

7.5 Enforcement unit

300. The Enforcement Unit's main responsibility is to enforce the tax laws in respect of non-compliance and debt payments. It does this through various internal mechanisms and procedures aimed at compelling taxpayers to comply with applicable tax laws. Enforcement actions are usually a last resort used against taxpayers when all other efforts to secure voluntary compliance have failed.

Functions of the Enforcement Unit

301. The functions of the Enforcement Unit include the following:

a. establish, monitor and manage enforcement actions against taxpayers;

b. enforce tax debt collection;

c. take action to enforce the filing of returns and other taxpayer obligations;

d. liaise with relevant departments/units for the seizure and restraint of assets, restraint of persons, restraint orders, third party recovery, civil recovery, prosecution, etc.;

e. generate operational reports.

302. In discharging its functions, the Enforcement Unit relies on case files.

7.5.1 Procedures prior to the enforcement action

Locating taxpayers and their assets

303. If there is no response from taxpayers to letters and telephone calls or if mail is returned undelivered, the next step is to visit the taxpayer to obtain information regarding payment or assets. If it is not possible to locate the taxpayer, it may be possible to locate their assets, such as a bank account, through third party debtors.

Sources of information

304. The following sources of information can be used:

a. **Case file –** The first step is to review the case history record and the latest registration form to obtain information on the location of the taxpayer or the taxpayer's assets. The enforcement officer will check all addresses and telephone numbers listed and review tax returns and financial statements (including notes to statements prepared by accountants) for sources of income, assets, business relationships and addresses.

b. **Post Office and business directories –** If the enforcement officer is not sure of the exact location of the address provided, they must ask the Post Office for directions to the location or contact business directories for information on the taxpayer (digital address system, Google search, etc.).

c. **Motor vehicle registrations** – Vehicle registration records show the year, make and model of the taxpayer's vehicles. The police or the Vehicle Registration Department can help track taxpayers through information on registered vehicles.

d. **Public records** – The Registrar of Companies or the Registrar General has registration records for all businesses. These records may identify assets belonging to the taxpayer.

e. **Other government agencies** – the Passport Office, Immigration Service, Social Security Administration and metropolitan, municipal and local government offices may have useful information.

f. **Utility service providers** – Telephone and internet service providers and water and electricity companies can provide the most current information on taxpayers' addresses.

g. **Professional and trade associations** – They can provide the names of individuals and businesses, addresses, telephone numbers, emails, etc. (e.g. Chamber of Commerce).

h. **Other businesses** – Suppliers of materials and goods for the type of business in question may be helpful. If the business uses specialised equipment (e. g. construction equipment), check with the distributors of such equipment.

i. **Neighbours** – Ask neighbours at the taxpayer's residence or business premises the following questions:

    a. Was the taxpayer's residence or business premises rented? If so, ask who the landlord was and how to locate him. Ask the landlord for the rental application or agreement; it may provide information on the taxpayer's employer, bank, etc. to enable further action. Did the taxpayer formerly own the premises? Try to contact the new owner for information about the taxpayer's bank, present address, etc.

    b. Did the taxpayer have children in school? School records may show the name of the taxpayer's employer, other addresses, telephone numbers, email addresses and the name of the school to which records were transferred.

    c. Ask for the names of friends or relatives who may have information about the taxpayer.

    d. Where does the taxpayer work now?

    e. Is the taxpayer a member of a union or trade organisation?

j. **Websites** – Check the location of taxpayers using the internet, where available.

k. **Police and other security agencies** – If you are still unable to locate the taxpayer after these investigations, you can send an inquiry and a request to find the taxpayer to the police or other security agencies.

7.5.2 Notice to obtain information

305. Occasionally, taxpayers or other people (e.g. third parties) may refuse to provide the information needed to resolve a non-compliance investigation. In these cases, the relevant provisions of tax laws and regulations can be applied to:

a. access premises, sites, property, books, records and computers;

b. require someone to provide electronic or hard copies of books, records and information, including information needed to create a document;

c. require someone to be examined under oath.

Purpose of the notice to obtain information

306. A notice to obtain information can be used for a number of purposes, including:

a. requiring someone to produce the information needed to prepare tax returns or financial statements;

b. verifying information;

c. determining tax liability;

d. identifying assets that could be used for tax collection.

307. Any person served with such a notice may bring another person, such as an attorney, to the interview.

Preparing the notice to obtain information

308. When gathering evidence or asking for records from more than one person, separate notices should be served, even if those concerned are husband and wife. In addition, if one person is served with notices involving more than one taxpayer, the notices should be served separately and include descriptions of the requested items. If the notice is not addressed to the taxpayer, change the description to ask only for information that the addressee can be expected to have.

309. If the person is only being examined on oath, rather than being asked to produce documents and records, the notice should indicate the books, records, papers and other data that information is required on. It should also state where and when the person is required to appear and give them reasonable notice, in accordance with tax laws and regulations.

Table 23: Procedures for enforcement activities

Step	Task	Person responsible	Action	Remarks
1	Locating taxpayer's assets	Enforcement supervisor	Allocate case files to enforcement officers for them to pursue	
2	Locating tax debtors	Enforcement officer	• Make telephone contact and/or serve a notice • Pay a visit to taxpayer's premises • Check internal sources for alternative contact methods (registration, returns, financial statements, etc.) for information on sources of	

			income, assets, business relations, etc. • Check Post Office and business directories • Check motor vehicle records • Check public records (Registrar of Companies, immigration and other government agencies) • Check utility service providers (electricity, water and telecommunication companies) • Check professional trade associations and Chamber of Commence • Check other businesses (suppliers, distributors, etc.) • Ask neighbours at residence/business premises relevant questions • Check the web for information	
3	Escalation of case	Head of CEDM Department	• Make recommendation to police and other security agencies to help locate taxpayer through office manager • Depending on the outcome of the case, it is either closed or recommended for escalation to management for enforcement action	

7.6 Case management

310. Case management is used to provide information on all issues that require a memorandum for approval by the head of the CEDM Department or the office manager. Cases can also be exceptions to normal business flows or processes. In other words, a case is an electronic memorandum which records all the steps followed from the beginning of either a taxpayer request or an internal issue through to its conclusion.

311. The Case Management Module can therefore be used by all the functional units to record exceptions to normal business flows or processes. It has all the detailed information from the beginning to the end of an issue stored centrally. It is able to link related previous and current cases with the associated documents (e.g. returns filed over a tax period). In addition to this, office managers and supervisors can use case management to allocate assignments to subordinate staff and monitor progress to ensure accountability.

312. The benefits of using case management to facilitate tax administration functions include:

a. centralisation and storage of information;

b. improved workflow and allocation of tasks;

c. improved integration as a number of functions (such as amendments) can be initiated from the case screens;

d. greater compliance and more efficient procedures:

   a. taxpayer enquiries

   b. compliance monitoring

   c. audit and assessment

   d. objections and appeals

   e. revenue deferment (instalment agreement)

   f. debt management

   g. offences.

Table 24: Procedures for case management

Step	Task	Person responsible	Action	Remarks
1	Creation of case file	Case officer	Create case file – the following information is required: • Case title • Office • Case type A task is generated Note: Task is only for monitoring purposes. Case officer can start working on the file once it is created	
2	Assignment of case file	Case officer		
3	Update of case file	Team member assigned to case file	• Case notes • Related documents • Link to related cases • Assign case files to case officer	
4	Update of case – in progress	Team member assigned	• In progress • On hold	
5	Closure of case – submission of case for closure	Case Officer	• Provide reason for closure • Close notes • Case outcome • Approve task	

8 Chapter Eight

8.1 Punitive measures to recover tax debt

8.1.1 Confiscation of records and books of accounts

313. These measures are also part of enforcement techniques and are carried out in the form of a surprise visit to the taxpayer's premises to retrieve records, including IT equipment, without prior notification, in cases where the taxpayer is unwilling to cooperate and intentionally conceals and refuses to submit records to the tax office. This action can be initiated based on the following offences:

a. using own invoices/receipts/proforma invoices not permitted under applicable tax laws and regulations;

b. using false/fake GCT invoices;

c. hiding true records on a computer, flash drive or server;

d. using inappropriate books of accounts to record business transactions;

e. employing under-carding (i.e. carbon shifting to falsify invoices).

314. If the tax authority detects any such offence committed by taxpayers, the head of the CEDM Department must initiate an investigation to establish the extent of non-compliance. In serious cases of non-compliance, the office manager should request authorisation (indicating the name of the taxpayer and the nature of the non-compliance) from the Commissioner General to search, seize and arrest. The Legal Department will advise the Commissioner General on the appropriate actions to take in accordance with tax law.

315. The Legal Department will authorise a search warrant, and the assistance of the police will be required to carry out the search. The enforcement officers will submit reports, including the seized records, to the office manager for further investigation and action.

8.1.2 Recovery of debt through third party debtors

316. Measures are taken to recover tax debt from third parties holding, about to hold or having authority to hold money (banks) on behalf of a tax debtor. The action requires legal backing and must comply with the relevant provisions of tax law. Under **Article 19 of Income Tax Act No. 113**, a third party has an obligation to pay any tax due on behalf of a taxpayer whether the person is residing in Iraq or elsewhere at the end of the year of

assessment. The relevant financial authority – the GCT – requires the taxes due from the following types of income to be paid by the third party on behalf of the taxpayer:

a. interest on debentures, mortgages, loans, deposits and advances;

b. annual allowances or pension salaries or other yearly payments.

8.1.3 Sources for third party debtors

317. The following are some of the sources for third parties the tax authority can use to recover tax debts:

a. banks/non-bank financial institutions (deposits);

b. employers (wages and salaries);

c. creditors (business receivables, etc.);

d. investments and shares.

8.2 Procedures for recovering tax debt from third party debtors

318. The office manager creates a case file for a third party debt order which is forwarded to the head of the CEDM Department for further action. The head of the CEDM Department takes over the case file and reassigns it to an enforcement officer, through the head of the Enforcement Unit, with instructions to look for third party debtors. The enforcement officer identifies all third parties holding, about to hold or having authority to hold money on behalf of the tax debtor. The enforcement officer then prepares the third party debt order in triplicate for the supervisor using the appropriate forms, as prescribed by tax law.

319. The head of the Enforcement Unit reviews the case file and makes a recommendation for action to the office manager through the head of the CEDM Department. The office manager forwards the case file for approval, preparing a request for the Commissioner General to issue a third party debt order for the taxpayer's account to be garnished. All previous correspondence relating to the debt should be attached to the case file. When the Commissioner General issues the garnishee order – notice of a third party debt order on the taxpayer's account – it is returned to the originating office for execution. The garnishee order obtained from the Commissioner General for execution must be served on someone in authority, such as:

a. company officer;

b. bank manager;

c. partner of a partnership;

d. employee who is required to pay the taxpayer (tax debtor), such as an accountant.

8.2.1 Serving the third party debt order

320. The third party debt order is served as follows:

a. serve the original on the party holding the taxpayer's money (third party debtor);

b. serve the duplicate on the taxpayer;

c. place the triplicate in the taxpayer's file.

321. The person holding the taxpayer's money should be informed that once the required amount has been paid to the tax authority, it will no longer be owed to the taxpayer. It should also be explained that failing to pay the amount to the tax authority can attract penalties and the third party will be held liable in accordance with the relevant provisions of tax laws and regulations.

322. The person who receives the order must pay the amount of the accrued tax debt to the tax authority within the period stated in the order. If no money is owed to the taxpayer, the third party should be instructed to indicate this on the order and sign and date it.

323. If the third party receives the order but does not reply by the date specified, the enforcement supervisor must contact the third party to seek a reply. If there is still no reply, the third party should be informed that they could face criminal prosecution under tax law.

8.2.2 Serving the release of the third party debt order

324. Once the third party debt order has been served, the funds payable to the taxpayer, up to the amount stated in it, will remain frozen until they are released or the amount of the garnishment is paid.

8.2.3 Release of the third party debtor

325. Once the tax amount owed to the tax authority has been fully paid, the Commissioner General releases the third party debtor or the charged asset. Examples of other conditions that may result in the release of a third party debtor or charged asset include:

a. the third party applied for an instalment agreement and it was accepted;

b. the cost of disposing of the charged asset is likely to be more than the tax due;

c. the action of disposing of the charged asset is likely to affect the taxpayer's livelihood and prevent them from supporting themselves and their family.

326. The enforcement officer should complete the appropriate forms, as prescribed by tax law, to process the release of the third party. The officers of the Enforcement Unit must keep the original copy of the release form in the case file and send the duplicate copy to the taxpayer.

Table 25: Procedures to enforce tax collection through third party debtors

Step	Task	Person responsible	Action	Remarks
1	Reporting of tax debt	Office manager	• Receive report on outstanding debt from head of CEDM Department with	

			recommendation for third party debtor action • Create case for head of CEDM Department to pursue	
2	Recovery from third party debtors	Head of CEDM Department	• Receive case from office manager • Assign case to enforcement supervisor for further action	
3	Preparation of third party debt order	Enforcement officer	• Receive case • Identify third party debtors • Prepare order in triplicate, following the notes on the form • Review order • Make recommendation to office manager via head of unit	
4	Receipt of third party debt order	Head of CEDM Department	• Receive approved order from office manager • Assign order to enforcement supervisor for service	
5	Execution of third party debt order	Head of Enforcement Unit	• Serve order on third party debtor for endorsement and execution • Give original copy of order to third party debtor • Send duplicate copy to taxpayer	
6	Documen-tation for office records	Head of Enforcement Unit	• Report outcome to office manager through head of CEDM Department • Keep triplicate copy in taxpayer’s file or scan and attach triplicate copy in the ITAS environment • Update case history file	
7	Release order	Head of Enforcement Unit	• Prepare release order (in triplicate) when full payment has been made • Secure office manager’s approval through head of CEDM Department	
8	Service of release order	Head of Enforcement Unit	• Serve third party debtor with original copy of release order • Put a copy in tax debtor’s file	
9	Closure of case	Office manager	Close case and update taxpayer’s case file	
10	Escalation	Office manager	• Where third party funds are insufficient to settle debt, employ other enforcement tools to recover outstanding amount	

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Land Tax Act No. 36 of 1997 (hotels and restaurants);

Inheritance Tax Act No. 64 of 1985

Resolution on Real Estate Transfer Tax (Resolution No. 120 of 2002)

Direct Deduction of Tax Instruction No. 1 of 2007, as per Federal Budget Instruction of 2008

Appendix

Training course module overview

Module 1: Tax audit practice

1) **Exogenous economic factors that undermined revenue mobilisation**
    a. Shadow economy
    b. Combat economy
    c. Coping economy
    d. Case study

2) **Accountability and oversight**
    a. Definition of accountability
    b. Financial accountability
    c. Value for money
    d. Case study

3) **Introduction to tax auditing**
    a. Definition of tax audit
    b. Objectives of a tax audit
    c. Similarities and differences between a tax audit and a financial audit
        - ✓ Tax auditor
        - ✓ Government auditors – supreme audit institution
        - ✓ Financial auditors – private firms
        - ✓ Case study

4) **Essential elements of tax auditing**
    a. Taxpayer relationships
    b. Planning activities
    c. Examination of records
    d. Application and interpretation of tax laws
    e. Documentation
    f. Case study

5) **Ethical principles of tax auditing**
    a. Integrity
    b. Objectivity
    c. Confidentiality
    d. Skill
    e. Independence
    f. Case study

6) Types of tax audit

a. External tax audit
   - ✓ Triggers for external tax audit

b. Internal annual desk reviews

c. Specific areas of tax auditing
   - ✓ Payroll audit
   - ✓ Corporate tax audit
   - ✓ Withholding tax audit
   - ✓ Fixed assets audit
   - ✓ Compliance audit
   - ✓ Case study

7) Planning for a tax audit

a. Rules of engagement
b. Audit team
c. Letter of notification/engagement
d. Case study

8) Performing a tax audit

a. Pre-audit conference/meeting
b. Reconciliation of returns
c. Revision of notes to financial statements
d. Auditor’s working papers
e. Draft findings
f. Exit conference/meeting
g. Auditor’s report
h. Tax audit techniques
i. Document verification
j. Case study

9) Tax audit risk management

a. Introduction
b. Objectives of risk management
c. Factors affecting risk management
d. Limitations of risk management
e. Categories of risk management
f. Levels of risk management
g. Risk management process
h. Case study

10) Audit checklist

a. Key thematic areas

b. Specific considerations and actions
c. General considerations and actions
d. Case study

Module 2: Legal environment of tax auditing – Application of tax law

11) Allowable deductions

a. Doctrine of entirety
b. Wholly
c. Exclusively
d. Necessarily
e. Case study

12) Tax compliance

a. Economic approach
b. Behavioural approach
c. Filing of returns
d. Levels of tax compliance
e. Case study

13) Income tax

a. Trade and business income
b. Employment
c. Investment
d. Imposition of penalties
e. Filing of returns
f. Case study

14) Tax avoidance

a. Judicial approach
b. Literalist approach
c. Purposive approach
d. New realism approach
e. Anti-avoidance legislation
f. Case study

15) Taxpayer rights and obligations

a. Right of appeal
b. Right to pay no more than the correct amount of tax
c. Right to reasonable assistance
d. Right to certainty
e. Right to privacy
f. Right to confidentiality and secrecy

g. Case study

Module 3: Accounting for tax purposes

16) Books of original entry: books of prime entry or day books

a. General journal
b. Special journals
c. Sales journal
d. Purchases journal
e. Returns inwards journal
f. Returns outwards journal
g. Cash book

17) Ledgers

a. Principles of accounting
b. Trading profit and loss account
c. Trial balance
d. Balance sheet
e. Bank reconciliation
f. Account for non-profit organisations – income and expenditure
g. Company account
h. Partnership account
i. Sole Trading Business
j. Manufacturing account
k. Cash flow
l. VAT accounting
m. Case study

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