

The performance of tax audit in erca, Ito branch



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Revenue is probably the most important part of the government and most of its plans and policies also depend on the amount of revenue collected.

Government has also given priority in reducing the budget deficit through the mobilization of internal resources. Good tax system, apart from generating revenue, minimizes distortion of resource allocation and simplifies its administration (World Trade Organization, 2003). Tax administration is a complex and dynamic responsibility. On a regular basis, leaders are faced with new issues, conflicting priorities, taxpayer compliance and emerging commitments (Thomson 2008).

As Berhan and Jenkins (2005) noted, governments of developing countries are eager to create modern tax systems although saddled with weak tax administrations, and sometimes have experimented with tax administration mechanisms that inflict higher compliance costs on the private sector. In order to make the multipart tax system relatively successful, it should be approached strategically and realistically in order to maximize taxpayer participation, create an efficient filing and audit administration, and encourage private sector growth. Tax involves every aspects of income generating activities and consumption items, and requires not only administrative capacity of revenue authority but also the involvement of private sectors through proper accounting and reporting (Tadros, 2009). Any tax in a tax system is vulnerable for evasion and fraud, which has become the concern of many countries.

For instance, Carousel Fraud and credit and/or refund abuse in European Union (EU) member countries (Keen and Smith 2007) and abuse of tax credit in Bulgaria (Pashev 2006) and the offence of non-issuance of value added

tax (VAT) invoices in Ethiopia (Alemu and Deresse, 2009) can be mentioned. Tax fraud is an intentional reduction of the tax liability stemming from real transactions. As Baurer (2005) noted, it is a deliberate misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. It typically includes underreporting profits and turnover, overstating deductions, underreporting employee wages, failure to register or file tax declarations, hiding of taxable receipts coming from the production and distribution of real products and services, overvaluing of VAT spent on inputs and abuse of tax return through fictitious transactions and trades.

Tax audit is an extension of the “ attest function” of the historical financial audit. It is the audit of an assessee’s accounting and other documentary evidences for the preparation of current tax returns, as well as the supporting working statements, followed by an audit report giving the auditor’s opinion about the degree of correspondence between the information contained in the tax return and the regulatory provisions of tax laws. In many countries (especially developing and transitional countries), audit performance is reported as a weak aspect of tax administration, irrespective of whether other aspects are working well (Ebrill et al. 2001). Several developing countries do not yet have effective audit programs due to; insufficient numbers of the required highly skilled and appropriately paid audit practitioners, absence of a sound institutional audit practice, illegal cooperation between taxpayers and auditors, lack of clear political support for the tax administration, and the deficiency of an appropriate legal and judicial environment.

On the other hand, audit is not a very welcome procedure for both the taxpayers and the economy. Conducting audits involves costs to the tax department as well as to the taxpayer. Tax administration agencies should, therefore, use their scant resources very judiciously to achieve maximal taxpayer compliance, and minimal intrusion and costs. Among others, having effective tax audit program is a key success factor for cost minimization and detection of tax evasion and fraud as well as proactively preventing tax frauds (Gupta and Nagadevara undated). Therefore, this study is conducted to review and examine the tax audit performance of Ethiopian revenues and customs authority the case of large taxpayers' office.

Statement of the problem

While the principal source of a government's revenue should be taxation, in many Sub-Saharan African countries this is often not the case. Many of the Sub-Saharan African countries rely on foreign sources of finance namely foreign loan and aid due to their poor tax administration capacity and collection ability. The tax base of developing countries adversely affected by administration problems including poorly conceived tax policies and lack of certainty regarding future policy changes. In addition, tax administrations can also create problems for the tax payers as they impose onerous reporting and record keeping requirements, perform excessive inspections and audits, fail to deal with their corrupt employees, and failure to provide transparency in the operations of tax administration (Baurer, 2005). In Ethiopia, taxation has been used for the purpose of raising as much revenue as possible to meet the ever-expanding public expenditure needs of the government.

It is also a mechanism for reduction of inequalities in income distribution, promotion of capital investment and trade, encouraging and/or discouraging certain industries depending on how suitable for country's economic development program. However, it is not often the case to collect the potential tax revenue in the country due to lack of awareness of taxpayers as well as paucity of tax agencies' cooperation with the business community. Tax systems are usually elaborated without proper discussion with the business community. In addition, the business owners do not have easy access to and clarification on information of the tax laws. The tax agencies do not also provide advising services. As a result, taxpayers misinterpret tax rules and regulations. Moreover, they lack awareness regarding the tax type to be imposed on their doings, purpose and operation of desk audit, goods and services exempted from tax, negative upshot of contraband trade, and reporting and filing requirements of the tax law. Tax evasion and fraud are still unsolved problems in the Ethiopian tax system.

Which includes; underreporting profits and turnover, underreporting employee wages, failure to register or file tax declarations, dearth of willingness to operate in accordance with tax laws, non-issuance of VAT invoices for buyers, and barter arrangements hidden from tax authorities. To mitigate such and so fraud problems, therefore, a successful audit program should be implemented which is capable to investigate, detect and prevent loss of tax revenue. To the greatest possible extent, tax systems should be supported by clear and straightforward laws and procedures that facilitate revenue collection, develop taxpayers' awareness, and minimize taxpayers' effort and compliance costs. The administration should be provided with

appropriate enforcement tools, including conduct of effective audit. Hence, to create an effective and fair tax system, it is vital to address the administration problems that affect it. However, this study is limited to the issues regarding the performance of income tax audit.

Objective of the Study

The main objective of this term paper is to analyze the performance of income tax audit conducted in large taxpayer's office of Ethiopian Revenues and Customs Authority. 1. 3. 2 Specific Objectives This study is undertaken specifically to: To analyze the income tax audit performance of the branch office Identify problems of income tax audit Analyze the role and significance of tax audit in increasing revenue Trace out the basic concepts of tax audit along with the different methods of its implementations. Provide concrete suggestions to the issues relating to income tax audit problems In addition to the above specific objectives this term paper tries to answer the following research questions: What are the income tax audit examination techniques?

Scope and Limitation of the Study

The study focuses only on analyzing the performance of income tax audit in LTO branch office as well as different problems that are occurred during income tax auditing. This project is not without limitation, there is a shortage of time to collect necessarily data and there is also shortage of written materials, availability of sufficient current literatures and lack of familiarity with the topic to analyze it further. Budget is also another limitation we may face for this project. Finally it would not easy to get all relevant information from respective offices.

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Significance of the Study

The researchers believe that the result of this term paper would have the following significances. It helps in identifying and addressing some of the problems related to income tax audit performance in LTO branch of the authority. The study may contribute to create awareness to the authority's officials and other stakeholders. This term paper could be used as an initiation and indication for those who are interested to conduct further study on the related issue.

Research Design

Methodology

The study will adopt mixed research approach in order to achieve the stated research objective and to answer research questions. Specifically, the study will use quantitative survey and qualitative in-depth interview and documentary analysis. The survey will be conducted with audit experts and audit team leaders. In addition, documentary analysis will be made using annual reports and other documents which will be a relevant to conduct the study.

Data and source

Both primary and secondary sources of data are used for the study. Primary sources are collected through interview and secondary sources are collected from different literatures such as books and other written materials.

Data collection methods

Primary data will be collected through interview and secondary data will be collected from various printed materials and other documents such as books, reports of the branch office, and different circulars of the authority. The tax audit employees for interview are selected randomly from the tax audit department of the branch.

Data analysis techniques

To analyze and interpret the raw data, content analysis method is applied. Primary and secondary data gathered through the above methods will be organized and interpreted by descriptive analysis.

Literature Review The literature review chapter is presented in two parts. The first part of the literature review chapter selectively reviewed the theoretical frame work of income tax audit in particular and tax audit in general. The second part of the review literature is focused on the empirical evidences about performance of income tax audit and its procedures as well as techniques.

Theoretical and Conceptual Frame Work of Tax Audit

An audit is the independent examination of financial statements of related financial information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon. 1 To the tax administration, tax audit refers to the examination of tax returns by concerned tax officials primarily with respect to checking as to timely arrival, inclusion of all required forms and attachments, and arithmetical accuracy. This may be

called internal tax audit. A tax audit is one of the most sensitive contacts between the taxpayer and a revenue body. The presence of an auditor in a taxpayer's private dwelling or premises, coupled with the exploration of private and business issues and the gathering of information from taxpayers' books and records, or just the disruption of day-to-day workflow, represents a burden on the taxpayer and may be seen by some as an unwarranted intrusion into their affairs.

Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying provided information. An income tax audit is an inspection conducted by a government representative to confirm that someone's taxes were prepared correctly. Tax audits are very intimidating for most taxpayers, and the important thing to remember about audit notices is that they are not accusations, and that taxpayers are not being required to prove that they are not guilty of something when they are audited. The tax audit function plays a critical role in the administration of tax laws in all countries. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex laws, carry out examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the " public face" of a revenue body.

These factors, as well as the absolute size of the audit function in most revenues bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function. A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than <https://assignbuster.com/the-performance-of-tax-audit-in-erca-lto-branch/>

other types of examination such as general desk checks, compliance visits or document matching programs (OECD 2006a). As Biber (2010) noted, the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation.

Most taxpayers' report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected (Biber 2010). Thus, tax audit results in increased tax revenue in two ways: (1) directly through assessment of additional taxes; and (2) indirectly by discouraging underreporting of liabilities by all taxpayers. Further, Barreca and Ramachandran (2004) noted that the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations. The subsequent subsections discuss thoroughly about tax audit in a tax administration system that includes characteristics of effective audit program, types of tax audit to be performed, audit case selection methods, examination techniques to be applied for tax audit, and characteristics and required capabilities of effective tax auditors.