



Pursuant to the provisions of Article 9 of the Law No. 03/L-222 on the Tax Administration and Procedures, the Director General of Tax Administration of Kosovo issues:

PUBLIC EXPLANATORY DECISION NO. 01/2015
ON
INDIRECT AUDIT METHODS

PURPOSE

The purpose of this Public Explanatory Decision is to clarify the right, manner and circumstances in which it is based the Tax Administration of Kosovo when applying Indirect Audit Methods in order to assess objectively tax liabilities of the taxpayer.

The mission of TAK is the development on the highest level of voluntary compliance in accordance with applicable laws and regulations and also providing professional, transparent and effective services for the taxpayers.

However the Tax Administration has an obligation and duty set by law to ensure the uniform implementation of legal provisions for all taxpayers, in the same manner for similar situations.

DEFINITION

Indirect Audit Methods (IAM) includes determination of tax liabilities through an analyze of financial issues of the taxpayer by using information issued from a range of sources, beyond tax declarations, formal books and data of the taxpayers.

Assessments often are based on the proofs depended from circumstances that shows a reasonable assessment of correct liabilities of the taxpayer. These information may be provided from the analyzes of changes in net assets of the taxpayer, documentation of taxpayer's expenses in cash or bank deposits, sources of taxpayer's funds and applications for funds etc.

Indirect methods provide to the Tax Administration a very useful tool to determine the correctness of taxpayers' declarations therefore as such encourage compliance of liabilities because they set taxpayers liabilities when reported data from the taxpayer do not reflect in adequate way the financial issues.

The use of indirect methods is served to certify/control the declared data (figures). For more, they serve to verify/control if there were declared lower revenues (under-declare of revenues) respectively higher expenses (overestimation of expenses).

LEGAL BASE

Law No. 03/L-222 on Tax Administration and Procedures in Article 17 (Tax declarations), paragraph 1, emphasize:

Each person subject to any type of tax under legislation applicable in Kosovo shall submit to TAK or its agent a completed tax declaration required by such legislation.

While in paragraph 2 is said:

Where circumstances indicate that a person should submit a tax declaration but has not done so, TAK shall have the authority to require that such person submit a tax declaration. Where such a requirement is not met, TAK may exercise the authority provided in Article 19 of this Law.

Article 19-Director General's Assessment of Tax, gives a right to TAK to assess taxpayer's tax liability. Quote of paragraph 1, 2 and 3:

1. *Where the Director General believes that the information provided by a person on a tax declaration does not correctly disclose their tax liabilities, or where a taxpayer has not submitted a declaration required by this law, the Director General may make an assessment of their tax liabilities, including, but not limited to, assessments resulting from use of false invoices or transactions. Except for cases involving criminal tax offences or where the amount of tax due can be determined with reasonable certainty, assessments under this paragraph shall be made following the initiation of audit procedures as described in Article 14 of this law, if such procedures are required. The limitation imposed by this paragraph shall not apply to the provisions of Article 21 of this Law (Jeopardy Assessment).*
2. *The Director General's assessment shall be made to his or her best judgment and shall be based on all the evidence available to him or her, including:*
 - *Books, records, receipts, invoices or other relevant information of the taxpayer;*
 - *Books, records, receipts, invoices or other relevant information of third persons;*
 - *Information from persons who can verify the accuracy of the taxpayer's declarations, books and records;*
 - *Other objective information about taxpayer's income or transactions relevant to its liability;*
 - *Information obtained during visits to taxpayers as provided in paragraph 1 of Article 14 of this law;*
 - *Application of this law and/or the applicable income tax or VAT laws of Kosovo.*
3. *If a taxpayer's books or records have been lost or destroyed or other circumstances exist that make a determination of a tax liability impossible, the Director General shall make an assessment based on an estimate. The estimate must be based on assets, turnover, production costs, comparative costs and other direct and indirect methods that are relevant for calculating the tax liabilities.*

Application of Indirect Audit Methods (IAM) is also regulated through Administrative Instructions No. 15/2010 respectively its article 30:

1. As provided in paragraph 3 of Article 19 of the Law, when circumstances exist that make determining, a tax liability difficult, due to lack of records, false records or similar reasons the TAK may use indirect methods that are relevant for calculating the tax liability of the taxpayer. These methods may be used in cases in which no declaration has been submitted as well as in cases in which there is doubt as to the correctness of the tax liability declared.

2. Prior to using an indirect method of determining a tax liability, TAK must attempt to determine the correct tax liability using regular direct methods of auditing books and records of the taxpayer.

3. Indirect methods of verification and re-calculation of profits are essential tools for bringing audits to an effective conclusion in the absence of proper books and records. There are a variety of indirect methods which can be used. Some common examples are:

- *Source and Application of Funds Method ,*
- *Bank Deposits and Cash Expenditure Method,*
- *Markup Method,*
- *Unit and Volume Method,*
- *Net worth method.*

In the practice of the tax administrations are used other indirect methods too, for example:

- *Re-calculation,*
- *Internal comparison of enterprises,*
- *External comparison of enterprises etc.*

Clarification for the term “absence” of books respectively proper records

In paragraph 3 of article 30 of Administrative Instruction mentioned above, the phrase “in the absence of proper books and records” it requires a special explanation in order to be treated and understood correctly.

It is unavoidable that this term should be understandable considering the text of the law. This means that indirect assessments methods may be used if books and records are not done in a proper/regular manner. This provision does not mean that indirect assessments methods may be used only if there are not books respectively records. In contrary, the IAM should be applied in cases when books and records are incomplete and are not reliable.

Legislative requests to use Indirect Methods

If the taxpayer fails to fulfill legal requests that are related with its tax liabilities, the Tax Administration of Kosovo should select the more suitable method to set more objectively the liability, either by examine provided registrations or in their absence when they are assessed uncompleted or unreliable, by using indirect assessment methods.

They are not limited only in the situations when data seems not reliable. IAM may be used to show incorrectness of declarations even in cases when data are presented “as correct statements”.

The use of IAM for aspects of tax assessment should not be understood as an opposite method in traditional sense for documenting of audits. This method simply uses proofs and other documents to verify the tax base (undeclared incomes).

Indirect method is same effective in detection of un-reported (under-declared) incomes or sells from legal and illegal activities. Through this method may be identified different types of incomes and expenditures that businesses do not report, either for tax purposes or other purposes. Often businesses reduce their expenses in order that percentages of their gross profit to correspond with those of the industry!.

When should be used an indirect method?

Different from supporting in exclusive manner in the data registered from the taxpayer, to verify tax liability through indirect methods it is required support in a series of other documents, most part of which is created for other purposes.

The correct analyze, presentation of these other documents and circumstantial evidence of incomes, may show the un-reported tax liability (under-declared) of the taxpayer. Each assessment from the tax officer should be based on facts.

Indirect assessment methods may be used if:

- *Books and records of the taxpayers are insufficient or does not reflect taxpayer's financial issues completely and in a correct (full) manner;*
- *Inspector has doubts in under-declaring of the incomes.*

Indicators of the need to use one or more indirect methods include:

- *Un-clarified assets or declared incomes that are not in accordance with a mode of life of a taxpayer or his life standard;*
- *Declared incomes are not in accordance with taxpayer's business activity;*
- *Failure to keep appropriate data or declaration file;*
- *Declarations from the taxpayer that do not reflect continuous loss declared for a long period;*
- *Businesses that mainly operate with cash (most of transactions/operations are done with cash);*
- *Maintaining of the data is poor, internal controls are weak and documents are not completed, etc.*

All of this information can be provided through a well prepared interview with the taxpayer, information from third parties as well as collecting information through first contact. All of the proofs should be documented. For example family holidays with a high cost should be provided

from the agency that has organized the holidays or for example purchase of the land should be proofed from directory for cadastre and geodesy, interview with a land seller or mediator.

Selecting indirect method that should be used when making attempts to set the correct incomes of the taxpayer will be depended from the nature of business, special factors and circumstances of the case. It is very important the availability of appropriate data.

Date: 15/05/2015

Director General, TAK

(Behxhet Halita)

