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# METHODOLOGY OF THE TAX CONTROL IN ALBANIA

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**ABSTRACT**

The mission of the tax administration in Albania is to encourage and achieve the highest level of implementation and voluntary compliance of tax obligations. Also, the mission is to ensure the highest degree of public trust to the integrity and efficiency of the tax administration. Actually, the law "On Tax Procedures in RA" regulates the procedures for administering taxes and principles of organization and functioning of the tax administration in the Republic of Albania. The provisions of this law apply to all types of taxes, except when special laws provide otherwise. Balancing the tax administration resources through education and service to the taxpayer on the one hand, an efficient control and coercive measures on the other hand, is a key factor for increasing the level of voluntary fulfillment of tax obligations and effective enforcement of tax legislation. This study is based on tax legislation of the RA and tends to show the methodology of tax control in Albania. At the end of this paper, I will give my conclusions of the issue .

## 1. INTRODUCTION

It is the duty of the tax administration to ensure the correct enforcement of the tax laws established by legislative bodies, to determine and provide the understanding and application of provisions of these laws, treating equally and impartially taxpayers. Every taxpayer has the right of fair and professional treatment for issues related to tax liabilities. Qualities that should have the tax auditor are: honesty, ethical behavior, fairness in the application of law, competence and professional skills during the execution of tasks etc.Employees of Tax Audit Sector, should avoid any conflict of interest during the execution of tasks.

The tax auditor should respect the rights of taxpayers they control. Every taxpayer has the right of reasonable controls; the right of confidentiality for its financial records; the right of information; the right to be heard and the right to appeal, etc., and these rights are defined in Articles 30 and 38 of Law No. 9920 dated 19.05.2008 "On Tax Procedures in RA". This paper aims to demonstrate methods of tax control in Albania. This paper is based on my experience as an inspector of the tax audit in the Directorate of Taxation of Elbasan. This study is based on tax legislation in Albania as:

- Law no. 9920 Federal. 19.05.2008 "On Tax Procedures in the RA"
- Instruction of the Ministry of Finance No.24 dated 02.09.2008 "On Tax Procedures in the RA."

- Law no. 7928 dated 27.4.1995 "On Value Added Tax in the RA."
- Instruction of the Ministry of Finance No.17 dated 13.05.2008 "On Value Added Tax in the RA '.
- Law no. 8438 "On Income Tax" dated 28.12.1998.
- Instruction of the Ministry of Finance no. 5 dated 30.01.2006 On Income Tax ".
- Law no. 9228 dated 29.04.2004 "On Accounting and Financial Statements"

The next section explains checks of the taxpayer records, the methodology of tax audit and key poınts for tax audit.

## 2. CHECKS OF TAXPAYER RECORDS

### 2.1. Sales

For declaration of sales for tax purposes, the bill should be used with serial number. Inspectors should verify and control the serial numbers, that are missing. Where inspectors find absence of the serial numbers, any number series may be the result of random damage and should be included in the taxpayer's file, but in general they are indicators of sales that are unregistered.

- The taxpayer has used more than one invoice number series at the same time - if this happen, what is the control?
- The taxpayer has issued invoices with more than one copy - if so, what is the purpose and destination of the second copy and the other copies? The taxpayer has clearly specified?
- The taxpayer has sold merchandise discount, or between associated entities? If so, the taxpayer stated the exact value for tax purposes?

### 2.2. Customer Cash Collections

Usually, small businesses reflect the customer collections in the book notes. The auditor should examine these books to confirm whether the taxpayer is regular in reporting gross receipts. Ie., he has recorded item by item, every day, etc.? Is it acceptable for the auditor's knowledge of way of the recording circulation? What methods of accounting is used for cash payments? The auditor should test the methods of the treatment of money (cash in hand) to see if all collections are included in revenue. The controller must make the analysis for a reconciliation of taxes and the books of entries related to them.

Manipulating the value of situation of goods to a certain date. When a taxpayer has many goods, it is possible to manipulate sales prices. The following checks should be performed:

- The auditor should compare the opening balance in the tax statement with closing balance of the previous year.
- The auditor should verify the inventory of being together with accounts / income, if have the impairment of goods with below cost (which can be justified only if the market value is below cost)

## 2.3. Purchases

- The controller must choose some elements from the diary of acquisitions, focusing on elements with large quantities or unusual, or purchase from unusual supplier and should make the check by calculating the tax / VAT.
- The auditor must verify invoices selected for alternation, for duplicate, and for purchases that are not for the purpose of economic activity, for goods or services that were never received (this may be a good mechanism for attracting funds and reduction of tax illegally).
- The auditor should conclude whether owners consume or withdraw goods for personal consumption, such as food, clothing items, equipment, materials, vehicles, etc.. If so, should ascertain, whether are made deductions for purchases, or additions in the case of sales.

## 2.4. Expenses for the Economic Activity

Costs of taxpayers can be verified through the canceled checks and / or documents from original sources as for example, invoices and contracts to determine the validity of deductions.

## 2.5. Goods and Services for Personal Use or for Non-economic Activity

- The auditor should determine the method and accuracy of the accounting for goods that are withdrawn for personal use. The accounting for these goods must be made immediately to carry out the transaction (exit or entry) on the basis of evaluation at the end of the year. Normally, purchases must be discounted by the cost of goods, although their amount is credited to sales.
- The controller must make unbundling of payments for insurance. He must verify that the life insurance and medical insurance of owners / directors are not involved at the deductible expenses. The auditor must verify payments for premiums that cover the coming years of the year that you are considering.
- Expenses for rents can usually be verified through rent-giving amounts and contracts as well as receipts or canceled checks. The auditor should ensure that expenditure constitutes a deductible expense to the taxpayer and if so, to what extent. Payments covering a period, that does not belong to the current fiscal year are non-deductible.

## 2.6. Observations for Discoveries (Concealment of Income)

Purchases may be removed in order to camouflage the hidden turnover, to make tax evasion in connection of estimated VAT, income tax or excise tax. The clash between suppliers / importers and registered subject is also possible, and it is difficult to declare a few imported goods, which reduces customs duties. Use of goods for personal purposes constitutes a contraband, which leads to concealment of purchases.

The auditor should compare other data for purchases and purchase invoices to check the accuracy of the account.

Controlled data vary depending on the subject, but should include purchase orders, leaf-entries for goods, confirmation from the main gate when entering or leaving goods, data (proof) for the weight of a certain goods, proof for the benefit of goods, data on stock status, and goods that are still kept as stock. Total purchases for a certain period should be compared with the supplier payments as provided in the ledger and the bank confirmations.

## 3. METHODOLOGY OF TAX AUDIT

The inspector should provide basic information by checking accounting systems, interviewing the employer, accountant, and if necessary other employees, and then carry out the necessary checks on the relevant registers of the subject.

Areas that will be covered in the interview when the controller interviews the employer and his employers, the inspector should cover in detail the following areas:

- What type of payroll system are used?
- How does the payroll system?
- What payment are made?
- Who authorized the payments?
- Types of payments for the costs incurred.
- To whom expenses are paid, and in what circumstances?
- What procedures are used for requirements of expenditures ?etc..

***Records that should be examined***

The inspector should examine the relevant business records. These include:

- payroll records
- personnel records, contracts and other documents relating to the conditions of the employment (expenditure policies etc.)
- monthly statements and supporting lists
- accounting records (eg, Cash register)
- bank statements
- annual accounts etc..

***Controls on the correct completion of records and statements***

The inspector will check that the name and address of each employee to be properly registered. He will check that payroll records be updated and include all required information. The inspector will confirm that all taxable income and benefits to be included in the statement. This will be done through:

- interviewing the employer and employee
- control of individual contracts and other documents
- inspection requirements for expenses
- (if needed) check bank statements from the employer, or cash registry to verify that the amounts paid correspond to the amounts recorded.

***The accounting records - Book of cash payments***

Despite the designation, the book implies cash payments, registration of payments that increase or reduce the situation's bank account. Entries (collections) are debited and credited here properly in a large book. It should be made possible the pursuit of receipts (coupons) from bank accounts via their casting in book cash payments for collections with cash or checks, the expenditure side, complemented by the book for checks. Withdrawals in cash debited in the cash book.

***Cash Book***

Cash payments are usually held in the book of cash payments which record the amount of checks that are drawn on money. In the cash book recorded in detail withdrawals of money and payments for small purchases. Expenses in cash according to various posts are debited in the accounts at the big book properly. Cash payments can be financed in rare cases, even in cash receipts from sales, which are not recorded in the book of payments in cash.

***Bank reconciliations***

Once entries in the book of cash payments corresponding to bank accounts, should prepare "a reconciliation with the bank" to prove the accuracy of the balance to the book of bank accounts. Its aim is to ensure that all entries in the book of cash payments and bank accounts are accounted for.

***Diaries***

In the diary are recorded sales invoices or purchase invoices, usually in chronological order. The items of income can be marked in the book, are accounted for separately in the end, or recorded in a special book. Entries usually crossed with the relevant invoices, of the customer account book. The double accounting is created recording sales by items in the account book for sales, and the total monthly sales in the big book (at par value). Even the diary of purchases follows the same pattern, except entrances are on the opposite side.

***The personal book***

This term is becoming increasingly less useful, because these books are being used less recently. The personal book contains accounts that are normally at the big book, but the owner wants to have as confidential account. Loan account of a director, certainly is included in this book for private use. The salary of an employee is credited as private account book (personal) and debited to wages in a large book. Withdrawals and payments made on behalf of his (her) debited and credited in book of the cash payments. Similarly, the value of an asset that is transferred, must debited to the personal book and is credited in assets with the appropriate value.

***Reconciliation with the bank***

This is a method by which the situation of the bank account (cash or checks deposited) reconciled with the total declared income. Of course not all collections are included in the bank, or bank account may have not been detected. In larger entities, thought that this possibility, reduced by the fact that, entities managed by individuals and not owners.

Assuming that all checks etc., have passed through the bank, regularly throughout the financial year, it is clear that what it passed through the bank (deposit) must be equal to the sales of the year. It is not important, that the calculations be made for the entire financial year, for any occasion, but it engages performing other calculations, if this is not always necessary to determine the condition made at the beginning and the end of the period which we have selected.

What was unpaid in the previous year will be included in the bank account for the following financial year, and what it is not paid at the end of the current financial year, will be repaid at the following year. Fortunately, these figures are identified as debit account and there isn't a need to make calculations.

Another issue to be taken into account when make comparison, is to be sure that the figures at our disposal mist to be used on the same basis, ie. tax is included or not. Only judging on this topic emerges out what tax is included and what not. Revenues deposited in the bank will be included in taxable income, as long as the customer pays for goods and services. Even, the bank deposits have taxable elements. Even, debtors are taxable unless the client has the obligation to pay for a certain amount. Revenue, which is declared to the tax office can be calculated by including or excluding from taxation. When there are different tax liabilities, ie., excluded liabilities, with zero fees and taxable, perhaps it is better to be calculated on the basis of involvement in taxation in the first instance.

***Reconciliation with business coffers***

Hiding the daily turnover of work is one of the possible manifestations of the evasion that the controller facing. If a taxpayer has proved that a book his lap, where he throws his income, and he declares to the tax authorities less than gross flows resulting from the book that he holds, then there is a possible situation must exist tax evasion. Many subjects, in particular retailers, do not issue invoices, or do not keep records for each sale. If it turns out that is not a book for non-official use by the taxpayer, the auditor should make a detailed analysis of the balance of cash in order of discovery of unrecorded sales. A method to test if there is evasion, is the analysis of the balance of cash, using the technique of reconciliation with business coffers.

Daily circulation plus any other form of income entering in the the subject, should be equal to the situation bank account plus all costs (including salaries and the amount withdrawn), but not withdrawn from the bank for these purposes. Put it differently, any taxpayer can not spend more than it collects.

Daily turnover is calculated by determining the state of the bank account, adding costs such as the amount withdrawn for personal purposes, salaries, purchase of goods, costs for equipment, etc.. The biggest accuracy of this test depends on the degree of exhaustion of the question put to the taxpayer and the honesty of the answers he gives, so questions should be well thought out.

Occasionally happens that, calculated circulation is larger than the figure that has evidenced the subject. The difference represents a minimum figure, and that where possible, efforts must be made to prove that the turnover is greater.

Reconciliation with business coffers constitutes a very useful method for examining the reliability of data by the taxpayer, in the absence of the annual balance sheet. However, understanding of the principles can be useful when taking into consideration the annual accounts - for example, all capital is involved, or simply a balanced figure for concealment of unregistered sales? Before you make a reconciliation with business coffers., it is very important to interview the taxpayer how coffers operated. Once, the controller provides data regarding all the expenses made by the entity from his bank account and the expenses of coffers, he should make a comparison of the total, with the figure of recorded turnover . Then prepare the cash balance.

***Cash flow test***

The test for cash flow, represents a variant for testing the cash reconciliation. Through cash flow, we can test the movement of money in a short period, as it constitutes a useful tool for identifying errors in extracting daily turnover. This type of testing is a very useful way to test the accuracy of dumping of the daily turnover. It works by following the movement of money, inflows and outflows of the subject and identified situations where the coffers appear negative - something absolutely impossible in the reality. If coffers is identified with the negative situation (less), then the data are wrong (the presentation of balance of cash, receipts from sales or payments for purchase). The test for the movement in the cash is fast and simple, and proves that something is wrong with the data of the cash transactions. However, through the cash flow is not determined where the error is. The controller can assume that receipts from sales are not reported fully, but are other possible explanations (eg, the opening balance sheet non accurate). So this is not an evidence to prove evasion (although in most of the cases suggests that with persistence). The implementation of this test in the small entities is excluded.

***Coefficient of the increased prices (gross profit margin)***

The technique of raising the price is a valuable tool that can be used in any commercial company that buys and sells goods. Raising prices and margins are terms used by the controllers and merchants respectively. Often a trader will be able to explain the profit margin but will not know what the increase of price on average is.

Calculation of increased prices is the gross profit by dividing cost of goods, expressed in percentage. Margin that interests the trader, is the element of profit included in the sale price and is calculated by dividing gross profit with the sales price, expressed in percentage. Usually it is necessary to apply the increased prices for a period generally, and then foreseen the figures. A trader must certainly be given the opportunity to discuss the data found, so it is very important to ensure that the questions asked in the beginning, to cover all the explanations, eg lost goods, stolen goods, sales at cheap price, price discounts special goods etc.. When the increase of price determined for a "representative period", it can be applied to the cost of goods sold, derived by the annual accounts. Sales that result can be compared with the declared sales. It is very important to pay attention to special price reductions and similar forms, because this will affect the overall increased price and subsequent reconciliation.

# 4. KEY POINTS FOR TAX AUDIT

In conclusion during the tax audit process in Albania, inspector of tax control must make the following checks:

- ✓ Inventory of tax bills under serial no. How is cutting the bill and who is the person who deals with it. Verifying the purchase and use of fiscal casing.
- ✓ The inventory of materials at the time of the audit and tax assessment for differences when comparing with the materials inventory accounting.
- ✓ Verification of books of buying and selling and verification of non-disclosure, or inconsistencies in the statements of the entity.
- ✓ Identification of the wholesale price retail price.
- ✓ Control and analysis of all purchases according to their nature and origin: imports, VAT purchases or purchases excluded.
- ✓ Control of imports and exports and compare them to the tax system.
- ✓ Verification the accuracy of the VAT declaration, the declaration deadline and the periodicity of turnovers declared for each period.
- ✓ Analysis of the rate of VAT by making payment as compared with the subjects of the same the same sphere.
- ✓ Analysis of credit surplus for reimbursement.
- ✓ Cost analysis for each material or item that sells taxpayer.
- ✓ Inventory of the number of employees at the time of inspection.
- ✓ Verification of records for the movement of the staff and submission of the form to the tax office.
- ✓ Analysis of the jobs according to characteristics of activity and working hours.
- ✓ Controling salaries according to the task of each employee, according to the level of specialization and labor contract.
- ✓ Physical inventory of liquidity on hand, cash flow analysis, analysis of the changing situation of capital and asset inventory at the moment of control.
- ✓ Analysis of of balance sheet. Reconciliation of income and expenses recorded in accounting books and declared on the tax declarations, the calculating of depreciation of assets according to the norms prescribed under the law and no deductible expenses.
- ✓ Control of accuracy of payment of personal income, tax on dividends etc..
- ✓ Implementation of the law for the distribution of profit.
- ✓ Control for the law enforcement "Tax procedures”, for transactions in cash above the level specified in the law.
- ✓ The taxpayer's tax liabilities

Other checks that should be considered:

- ✓ The presented balances should reconcile with the figure of debtors and creditors under the previous year's balance sheet.
- ✓ Provisions for bad debts do not have any effect to the checking accounts.
- ✓ Prepayments balance can be included in the figures of debtors - this may be the cause of any difference if the figures do not reconcile. Any other reason could be that the accountant may have made adjustments later.
- ✓ There may be provisions to be revised.

- ✓ The collections should reconcile the situation at cash and bank account amounts.
- ✓ The collections can exceed the bills. It is necessary to examine how this thing happened and to explore the possibility that taxpayer might has been other sales invoices receipts of which are not registered.
- ✓ The accrued liabilities not included - if there is any difference, it should be considered that possibility.
- ✓ Payments to suppliers should reconcile to the amounts of cash and bank account status.
- ✓ Differences in costs. These expenses may be for personal purposes which are not registered. Another possibility is that creditors are stated with values higher (probably due to the inclusion of the reserve).

## 5. CONCLUSIONS

The main objective of tax administration is to increase the level of voluntary tax compliance through education, awareness and efficient service to taxpayers. The main reason of the tax audit is not the discovery and realization of income, the discovery of flaws, fix them up for the future, education of taxpayers, and especially prevention of tax evasion. The primary objective of tax control is to consolidate the current level of income derived from tax authorities, making identification of errors in the assessment and collection of tax revenues resulting from the declaration of less value, stimulate voluntary compliance of tax obligations, to prevent the tax avoidance and ensure discouragement of tax evasion. Before conducting the audit, inspectors should look carefully the last tax statement of the taxpayer, by searching any unclear issues, or any controversial issue. They should take into consideration the results of previous inspections, and if there are weak points at the previous control, they should be reviewed.

Employees of Tax Audit Sector, should avoid any conflict of interest during the execution of tasks. They do not have to manage, influence or guide the taxpayer in its activity and must declare in advance cases, when they are related directly or indirectly to the taxpayer. Also they can not control or estimate their taxes, or to persons connected with them.
The tax auditor should respect the rights of taxpayers they control. Every taxpayer has the right of reasonable controls; the right of confidentiality for its financial records; the right of information; the right to be heard and the right to appeal, etc., and these rights are defined in Articles 30 and 38 of Law No. 9920 dated 19.05.2008 "On Tax Procedures in RA".

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