MODULE 13

TAX AUDIT AND INVESTIGATIONS

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Introduction

- The Companies and Allied Matters Act (CAMA) requires every company to keep accounting records and to prepare financial statements yearly. The Act also requires that these financial statements should be audited by the company's external auditor who will also make a report to the shareholders on the financial statements examined by him. This type of audit required by law is referred to as statutory.

Tax audit

- Tax audit is a routine examination of the tax returns, accounts, books, records, documents etc of a taxpayer by the tax authority in order to ascertain the level of compliance with relevant tax laws. It aims at determining the completeness and accuracy of taxes payable to the authority. The auditors will also be able to ascertain whether the taxpayer maintains adequate accounting records and books for determining the taxable profits and the tax payable.

  Tax audit is similar to special audit. They are additional to statutory audits are carried out by tax officials from relevant tax authorities.

Objectives of tax audit

The following are some of the objectives of tax audit:

- To enable the tax authorities to determine whether or not the taxpayers have complied with the relevant tax laws, rules and regulations and, if not, to take appropriate actions in accordance with the tax legislations.
- The fear of tax audit can deter a taxpayer from engaging tax evasion. In other words, tax audit encourage voluntary compliance with the tax laws and regulations. It ensures that a higher tax compliance rate is achieved.
- To ensure that declaration made by the taxpayers are accurate and reliable. Under the self-assessment system, a company files its tax returns reporting its income and tax liability. The objective of the tax audit is to ensure that the correct amount of income has been declared and the tax has been correctly compute and paid in accordance with the tax laws and regulations. Thus, incorrect accounting and/or arithmetical errors in the tax returns may be detected during the tax audit.

- To ensure that the taxpayer has maintained all the relevant documents, records and accounts to facilitate tax assessment. During field audit, the tax auditors are able to examine the taxpayer's business records in the taxpayers' premises. If such records and accounts are not adequate or are not properly maintained for the tax purposes, the tax authority has power to direct the taxpayer to maintained proper records and accounts.
- To collect taxes that could have been lost to the government. In Nigeria, tax audit and tax investigation often results in imposition of additional taxes, interests and penalty on the taxpayers properly due to the taxpayer's under-statement or omission of income, inclusion of non-deductible expenses in the profit and loss account, incorrect computation of tax liability, failure to render tax returns, late submission of tax returns, etc.
- It affords the tax authority and the taxpayers an opportunity to interact (especially during field audit) such that the taxpayer may ask question or seek clarification on some aspects of the tax laws and practice as may be necessary. It provides an avenue to educate taxpayers on new developments in the tax system and legislations.
- To enable the tax authority to gather as much information as possible about taxpayers (especially information that are of permanent nature) for storage and future use. Thus, the database of an existing taxpayer can be updated and more eligible taxpayers can be brought into the tax net.

- Tax audit can lead to the discovery of the existence of tax fraud or evasion. The tax auditors can then recommend such cases for further investigation.
- In the course of interactions with the taxpayers and examination of their records during the field audit, the tax auditors may discover that some provisions of the tax legislations are outdated or ambiguous or capable of various interpretations or have created loopholes for tax avoidance. These should be brought to the attention of the FIRS management with recommendation for charges in the tax laws.

Types of tax audit

1. **Desk Audit**

   Desk audit or examination usually takes place in the tax office. The tax official sits in the tax office and examines the tax returns and accounts submitted by the taxpayer. If necessary the tax official issues queries on the tax returns filed by the taxpayer and may request the taxpayers to forward further information, documents, etc to the tax office or appear personally in the tax office to clear some issues in the returns.

2. **Field Audit**

   Field audit or examination is usually conducted in the taxpayer premises. Field audit involve physical verification of documentary evidence and materials in the premises of the taxpayers so as to confirm the facts and the figures of the tax returns filed by corporate taxpayers. Thus, it gives the tax auditors an opportunity to examine the relevant documents, accounts, schedules, etc in the taxpayer's business premises and to obtain further information or explanations directly from the staff of the business. Before a field audit is conducted, the tax authority may notify the taxpayer of the expected date of commencement and duration of the audit, scope of the audit and the records and documents that may be required from the taxpayer.

Stages Involved in a Field Audit.

- Selection of companies for field audit
- Preliminary activities
- Pre-audit meeting.
- The audit proper
- Post-audit meeting.
- Audit report

Tax audit programme

This is a schedule of audit work expected to be performed on each item of such accounts income/turnover, expenditures, assets and liabilities.

The thrust of a tax audit will be that of verification of the figures and others information submitted by the taxpayers for tax purposes.

The primary purposes of tax audit have been expanded to monitor and maintain the confidence in the integrity in the newly introduced self-assessment system. It helps to improve voluntary compliance by detecting and bringing into account those who do not pay the correct amount of tax.

Tax audit is a routine exercise and the outcome usually lead to reassessment or referral for special investigation if tax evasion is suspected.

Benefits of Audit programme

The audit programme will be useful in the following areas:

- It will be provide details of works which the team leader requires individual members of the team to perform.
- It will provide information as to how much of the audit work has been completed as at a particular date, and how much is outstanding.
- It provides record of audit responsibility by providing a record of the audit staff members for each part of the completed work.
- Facilitates audit supervision and control, given senior members of the audit team information and knowledge regarding progress of the work done to date.
- Ensures continuity of the audit work, should there be a change in the personnel constituting the audit team, with new members being able to see at a glance the outstanding work to date. Thus, providing a basis for planning, and staffing the audit team.
- Provide an avenue for the team leader to allocate his available staff in the most productive and efficient manner possible.
- It is a time management tool.
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Tax investigation

Where the tax authority has evidence or strong suspicion of the existence of tax fraud or tax evasion, it may carry out a tax investigation. This is an enquiry to ascertain the level of fraud or willful default or neglect perpetrated by the taxpayer and to obtain evidence for possible prosecution of the culprit. Tax investigators have greater power and authority than tax auditors. Therefore, they may visit the taxpayer's premises without any prior notice and take possession of the relevant books and documents.

A tax investigation can extend to any number of years, unlike the tax audit which has a limited time frame. Where a case of tax fraud or evasion is established, the tax authority can raise an additional assessment on the taxpayer even beyond the six years allowed for making additional assessment under normal circumstances.

Circumstances that can lead to the Termination of Tax Investigation

An investigation of tax fraud or evasion can be terminated at any stage based on the following conditions:

- Where there is insufficient evidence to proceed further with the case.
- Where it is discovered that criminality is not involved. Probably a case of tax avoidance was mistaken for tax evasion.
- Where the suspect dies or becomes insane.
- Termination by law, for example, where a case becomes statute barred

Functions of Tax Intelligence Unit

The main function of this unit will be to gather and analyzed information and thus, maintained a database of information for civil/criminal investigation and Federal Inland Revenue Service in general. Specifically the unit will:

1. Liaise with tax office to obtain information on return filed, stop taxpayers, late taxpayers, etc for database;
2. Liaise on a regular basis, with banks and the corporate affairs commission to information on new accounts, new companies, that is, non-filers;
3. Liaise with Ministries/Government parastatals on contracts for current and prior years, for cross-checking the returns filed by the companies;
4. Gather and review information on newspapers, magazines and journals, radio and television for signs of potential civil and criminals violations;
5. Use intelligence techniques (for example, surveillance techniques and computer database searches) to gather information on a company's business, financial activities etc;
6. Carry out special enforcement program on suspected targets;
7. General intelligence collection;
8. Obtain information from third parties;
9. Refers cases to the civil or criminal investigation unit after carrying out relevant analysis;
10. Obtain and review published financial statements of offshore companies.

Responsibilities of the Criminal Investigations Unit

The criminal investigation unit is responsible to:

1. Investigate, penalize and recommend prosecution of cases of tax evasion. With tax evasion, you have fraud with "mens rea" the amount are clearly taxable (suppression of income, fictitious expenses) and does require an amendment to the tax laws. Evasion transactions are done knowing that it was unlawful to do. Normally charges are laid which could result to fines and/or jail term in addition to the tax and penalties. Examples are:
   - Arrangement premeditated to reduce tax payable;
   - Understatement or non disclosure of income;
   - Overstatement of expenses;
   - Creation of fictitious assets and expenses;
   - Disproportionate share of expenses and income between offshore and onshore entities;
   - The use of artificial transactions;
   - Complex management structure and associated entities that would result in tax evasion;
   - Non filing of tax returns and filing of incorrect returns ; and
   - Denial of Federal Inland Revenue Service access to records.

2. Investigate and liaise with relevant agencies for prosecution in cases of:
   - Fraudulent diversion of Federal Inland Revenue Service taxes such as Withholding Tax, Value Added Tax etc;
   - Fraudulent payment of income tax and other taxes through the falsified withholding tax receipts;
   - Abuses by companies and government agencies in Value Added Tax/Withholding tax deductions and remittance; and
   - Fraudulent procurement of tax clearance certificate, revenue receipt, withholding tax credit notes.
3. Carry out search and seizure where such will result in obtaining relevant document for an investigation.
4. Analyzed and evaluate evidences obtained to establish criminal violation, follow up with assessment, penalties and prepare case for prosecution.
5. Identify the areas for amendment to tax laws in order to plug all tax leakages;
6. Assist in preparing evidence for prosecution of violators;
7. Liaise with the National Drug Law Enforcement Agency (NDLEA), Economic and Financial Crimes Commission (EFCC), Nigeria Deposit Insurance Corporation (NDIC) and the Central Bank of Nigeria (CBN) to investigate violation of tax laws in cases of white-collar crimes such money laundering.

Review Questions

1. Under what circumstances would tax audit and tax investigation be carried out?
2. Explain briefly tax audit and tax investigation and point out the difference between the two terms. What are the circumstances that can lead to the termination of tax investigation?
3. What are the objectives of tax audit and investigation?
4. Discuss the stages involved in a tax investigation.

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