



Proposing a Rigorous Tax Audit Procedures in IRAQ

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Abstract

The concept of tax audit procedures is related to the provisions and use of tax audit by the government tax agencies Internal Revenue Service (IRS) that are collecting tax from companies and individuals who are by law bound to pay tax. The major purpose of this study is to investigate proposing a rigorous tax audit procedures in Iraq. The study generated data from individuals, companies, tax experts and IRS staff through a cross-sectional questionnaire survey approach using drop and pick means of data distribution. The finding from study tested show that factors such as : individuals, companies, tax experts and IRS staff are key factors impacting tax procedures. However, the finding also show that individuals and companies point of view the audit procedure in Iraq lack the Accuracy and Flexibility and take long time to be accomplish. The results are slightly worse from Companies' point of view comparison to Individuals' point of view. The result are slightly worse from companies point of view comparison to individuals. The same finding from tax point of view the audit tax procedure in Iraq lack the accuracy but it's slightly quick and flexible. As expected, from the IRS staff's point of view the audit tax procedure in Iraq is accurate, quick and flexible which indicated a big problem because of the gap between the IRS staff clients point views.

Keywords : Tax audit procedures , IRS processes , taxpayers

1.0 Introduction

Generally, the tax audit procedure seems to be the same and similar across many countries of the world. For instance, critical observations across European, Asian and Middle East Countries revealed similar tax audit procedures applying. Thus, no major clear differences among the various taxes audit procedures in these countries can be found. For better understanding, first, it is important to define tax audit. Many views of tax audit have emerged over the time. For instance, it is refers to as enquiry into the background of tax returns which is often submitted by the tax



agency or individual. Thus, it is a proper investigation of the tax return to ascertain the fact about the tax returns which the taxpayers paid.

According to Inland Revenue Board of Malaysia (2003) "A tax audit is an examination of a taxpayer's business records and financial affairs to ascertain that the amount of tax due should be reported and paid are in accordance with tax laws and regulations". Similarly, Tally Solutions (2009) argued that generally, the word audit is always attributed to financial statement. In that, it means the financial statement auditing of the companies. They further argued that in a situation like that, it is expected that the auditor would provide professional and experts view with regard to the quality of the financial statement by proving and confirming the authenticity of the statement. In fact, they put it in this manner "Audit implies to non-financial matters as well, like audit of operations, efficiency etc. In simple terms, Audit means critical and intelligent examination of facts – financial or otherwise, to give in the form of certificate or report an attestation, an expert opinion or advice".

Audit could also be referred to as the independent assessment of financial information that involve any company which could be either profit oriented or not, regardless of the size and legal form of such company, especially when the assessment is being carried out and then provide proof for opinion.

Tax audit often creates feelings of anxiety to the taxpayers even when it is perceived that the tax documents are in good shape. Although, tax audit emanated as a result of irregularity in the tax being collected, or could also be as a result of conducting a sample random sampling which then dictate a irregularities.

The important of tax audit cannot be undermined in any economy. For instance, tax audit help the government to ascertain the actual amount being collected as a tax from the taxpayers. Accordingly, it helps the taxpayers to know whether they have paid the actual amount due to them as tax or they have over paid the amount they supposed to pay. Similarly, the tax audit assists the government in making accurate decisions and policies which have to deal with money such as the budget because most of the money announced in the budget is the money collected from the tax. Thus, knowing the actual amount collected would help the government to be precise in the budget decisions. According to the Inland Revenue Board Malaysia (2013), tax audit would definitely assist audit officers to carry out their tasks efficiently and effectively, and assist taxpayers in fulfilling their obligations.

From the ongoing, we could understand that tax audit involves series of processes that are conducted by either the tax agencies or the Internal



Revenue Service (IRS) and by State departments of taxation. These are the organizations that are charged with responsibilities of overseeing the tax process of collecting tax from companies and individuals who are by law are bound to pay tax.

Tax audit have being considered very rigorous and cumbersome by many people. However, in the recent times, the tax agencies have tried as much as possible to make the process more comfortable. For instance, Inland Revenue Board Malaysia (2013) noted that a tax audit is usually seen as a routine, which in the past has gained a reputation of being an extremely nerve wracking process for the taxpayer. Despite this, it is believed that in the recent time, many government tax agencies attempt to make the process of the tax audit as comfortable as possible for all parties concerned.

As (Andreoni and al. 1998) declare The problem of tax compliance is as old as taxes themselves, Characterizing and explaining the observed patterns of tax noncompliance, and ultimately finding ways to reduce it, are of obvious importance of nations around the world. The economics of tax compliance can be approached from many perspectives: it can be viewed as a problem of public finance, law enforcement, organizational design, labor supply, or ethics, or a combination of all of these. And as (Hsu, L. (2013) suggest that individual taxpayers' willingness to detect evasion can be very strong and should not be ignored when designing a compliance improvement audit scheme. To implement the endogenous audit mechanism in the real-world tax environment, an economical and simplified procedure can be annexed to the tax-return filing process.

2.0 Overview of tax system in Iraq

Iraq is one of the Arab countries in the Middle East with its capital city as Baghdad. It is one of the countries that make up the gulf Countries. Iraq is comprised of eighteen administrative divisions, known as governorates, three of which comprise the Kurdistan Regional Government (KRG). It is a country governed by a documented constitution, thus, this made Iraq a federated state just like any other country such as U.S.A with a federal states.

Since after the war (2003) in Iraq the government has embarked on several reformed programs to enhance the lives of the citizens. For instance, David Biggs (2010) in one of the documents released of recent noted over the past six years, the Iraqi government has engaged with the international communities and partners for the purpose of reforming the country. Such areas of reforms include Iraqi social, economic, political life and tax system. Quoting from his words, he said "prominent in the Compact is the need to improve governance, including Public Financial



Management (PFM). The latter is particularly important in the context of Iraq given its huge oil reserves and revenues that place a premium on the efficient and effective management of public resources”. With reference to tax system reform, the government aimed at the followings:

1. The need to ensure that appropriate tax provisions governing petroleum operations by private and state owned companies are in place as soon as possible, preferably in a separate petroleum tax law.
2. A review of the legislation on income tax on individuals and companies with a particular focus on the exemptions, with a view to reducing the current wide range.
3. The development of a plan for the design and implementation of the Value Added Tax (VAT).
4. For tax administration, the establishment of a large taxpayer’s office, and the development of a tax administration modernization strategy. Collections, arrears and transfers need urgent attention.

All these efforts are trying to deal with the disadvantages of current tax legislation which (Raem, T.) observed as the following:

1. Complexity.
2. Schedule nature.
3. Unclear Tax Base.
4. Lack of Impartiality.
5. Multiple Legislative Texts.
6. Lack of laws and regulations to ensure strict implementation.
7. Lack of logical organizational structure.

Furthermore, it has been noted that the revenue generation in Iraq are mostly generated from government oil exports while revenue from taxation provides relatively little public finance about 5% in 2007 which is expected to rise in the subsequent years. In view of the government effort in reforming the economy, David Biggs (2010) as reported that the government has recorded some tremendous improvement most especially in the area of tax administration. In terms of transparency of taxpayer obligations and liabilities, Iraq’s taxation system allows a relatively informed taxpayer to understand his level of tax liability, with some confidence that a fair system is in place. Controls in taxpayer registration exist and the system of penalties for noncompliance sufficient.

It has also been observed that the serious problem facing the Iraq government is that of tax audit and fraud investigation arrangements. These problems have proven very serious and seem to defy solutions. Even though, collection of tax arrears does not seem to create urgent and immediate problem, still a better tax and tax audit systems are indispensable for future preparation of a stronger taxation system.



Secondly, David Biggs (2010) reported that although there seem to be in place enough provisions for the adequate collected tax revenue transfer from the authorities to the government, yet tax reconciliation systems that would assist the government and tax authorities to verify tax returns and assessment are still missing. In the light of this, Shafaq, a member of the Board of Directors of Baghdad Chamber of Commerce stressed that the chamber has faulted the current tax system. For example, he said “We are against the tax system, and we believe it is better to stop work in pursuance of it at present, until establishing of security and completing the different aspects of services in the country, so that the state can exercise its right to impose taxes on citizens, but now the citizen pays without an income”.

In the overall, there is seems to be no proper and specific tax system in Iraq. For instance, experts have called for a specific tax policies, together with macroeconomic stability would also provide incentives for individuals to move from informal into more formal activities. This is because, in Iraq, it is observed that more of the Iraqi people engaged in informal business activities, thereby making it more difficult for tax to be collected from them. For instance, about 80% of the labor force in Iraq engaged in informal activities while many could be said to be unemployed. Therefore, David Biggs (2010) noted that in this kind of situation, one should expect a very extremely low tax structure as it is in the present. He argued that about 30% in Hilla and 32% in Irbil that government are able to collect tax from.

2.1 Relevant Issues

The economic reform has been the top agenda of many Arab countries in the recent past years. For instance, Chemingui and Lofgren (2004) have noted that economic reform which also consists of tax reforms have been in the top agenda of the Gulf Corporation Council (GCC) countries including Iraq in the greater part of 1980s and early 1990s. This was attributed to the unimaginable rise in the global price of crude oil. However, the essence of these reforms is to actually find a better economic system that would assist them to a better economic growth and development.

Furthermore, it is crystal clear that in many Arab economies like Iraq there are highly depend on oil. This therefore means that the only source of government revenue is that of sales and taxes from crude oil. Thus, there were no alternative sources of financing avenues with regard to government projects. However, the situation became worse during the Asian financial crisis and sharp decrease in oil price, the government was left with no option than to find a better way of solving these problems.



Within this context, two major issues arose. First, is the need to find an alternative revenue generation and financing avenues or opportunities by introducing a domestic tax system (Chemingui et al., 2004). The government aimed at dealing the fluctuating nature of government revenues, expenditures and deficits.

The second issue here is for a better public resource management such as a better tax audit procedures that help government to ascertain the actual amount being collected as a tax and for a proper accountability and utilization of these taxes being collected.

These therefore create the need for this study to take off. Bridging this gap becomes very imperative for this study. Thus, proposing a more rigorous tax procedure in Iraq is timely at this crucial period in order to achieve a full and meaningful economic reform. But don't forget that In general, most taxpayers prefer to have an honest tax practitioner to help them to comply with the income tax laws. In fact, most of the taxpayers rated the honesty of the tax practitioner as the most important attribute. Therefore, honesty of the tax practitioner is the priority, followed by minimizing with conflict avoidance and creative accounting and aggressive tax planning (Choong and al. 2008).

3.0 Scope and objective of Audit

For an effective and proper tax audit, two major factors must be considered. First, is the scope of the tax audit. This means that there is a need to specify the boundary and limit of the tax audit in order to assist the auditors to know where the auditing activities are limited to. According to the Institute of Chartered Accountants of India, "the scope of audit refers to the identification or delineation of audit related aspects with regard to the objective of audit, procedures, areas to be covered etc. thus; it equally refers to the auditor's interest concern in the basic accounting records and source documents.

However, the scope of audit could be governed by the following:

1. The engagement terms.
2. Relevant statutory provisions.
3. Relevant Institute pronouncement.

Second, is the objective of the tax audit. What the tax audit is aiming to achieve should also be stated and make clear. For instance, the Institute of Chartered Accountants of India noted that the main objective of an audit is to express an opinion about the truth and equity of the financial statements. The expression emanates after performance of audit procedures i.e., to give the opinion about the financial statements, the auditor examines the financial statements to satisfy himself about the



truth and equity of the financial position and operating results of the enterprise. Other objectives include:

1. Detecting and preventing of errors.
2. Detecting and preventing of cheats.

3.1 Audit Time Frame

Because of the nature of tax audit process, it has become very imperative to set up a time frame to be able to save time and avoid delay in resolving tax audit problems. In dealing with audit time frame, two major issues are very essential. First, the actual time needed to complete an on-site examination of records. In this case, Inland Revenue Board Malaysia (2013) has asserted that the reasonable time frame required for tax audit could be between two to three days. Although, they argued that despite this, it is possible that audit time frame could be altered, based on the required extension. However, this would depend on some necessary factors such as the followings:

1. The size of the business and the complexity of business transactions.
2. The form in which records are kept.
3. The extent of co-operation from the taxpayer.

The second case to note is that of the applicability of the audit time frame. This is very crucial because audit time frame may only be applicable to field audits. Therefore, other types of audits such as correspondence and desk or office tax audits are not included in this case. This means that audit time frame can only be apply to field type of tax audit procedure.

3.2 Types of Audits

Once the tax audit agency discovered or ascertained that there is a discrepancy between the actual amount a taxpayer supposed to pay and the amount he/she paid or on the other hand, the amount he/she paid is higher than what he/she supposed to paid, the agency would first communicate to the taxpayer by writing informing him/her that return has been selected for an audit. The three different common types of tax audits used by IRS are indicated and briefly explained below.

3.2.1 Correspondence Audit

As the custom suggests, it is kind of tax audit conduct through the mail. It seems to be the most famous and common kind of audit. The taxpayer is expected to come with any documents required by the IRS. The essence of these documents is to support and prove to the IRS about his/her tax return paid.



3.2.2 Desk Audit

This type of tax audit is conducted mainly at the internal revenue branch office. It is called also office audit. Where the IRS determines both the time and the kinds of documents the taxpayer should come with. It usually handles direct and straightforward tax matters or tax adjustments that could be easily settled through correspondence. For instance, where a taxpayer is invited to an interview at IRB's office in order to obtain additional information when it is necessary. In this case, all necessary information concerning or relating to income and expenditure including different kinds of claims argued by the taxpayer with regard to his/her income tax return. Accordingly, certain desk audit matters maybe refer to the field audit action if deemed necessary. Therefore, in such case condition, the taxpayer has the right to be inform via a letter of field audit notification, this formed part of the usual procedure before field audit could be properly take off.

3.2.3 Field Audit

This kind of tax audit seems to be exact opposite of desk audit. However, in field audit, it actually takes place within the taxpayers' environment, which could be his/her house or premises. The taxpayer would give a prior notice before the tax audit is being carried out. Within this context, all business records of the taxpayer are being investigated in detail. However, whether the taxpayer is a sole proprietor or partnership form of business and his/her business record seem to be incomplete, then other documents such as non-business records or documents maybe looked into. Non-Business records like his/her personal bank statement of account is critical where this condition mentioned above exist. In some countries, this kind of audit is common most especially when the business income is above \$100,000.00 U.S.A dollars.

4.0 Current Practice

However, first, it would be imperative for us to briefly recap and re-examined the meaning of tax and different types of tax system. Tax could be defined as any compulsory levied imposed by the government on individuals and companies for the purpose of development (Sujjapongse, 2005). Simply, there are forms of revenue generated by the government by taxing various individuals and companies residing in that country.

Basically, there are two major types of taxes which are:

1. Direct tax.
2. Indirect tax.

The direct tax is taxes which are deducted from the sources. They include the following; personal income tax, corporate income tax etc. for



example, personal income tax deals with deductions from individual personal income irrespective of whether the individual is local or foreigner, as long as the individual is residing in that country and engage in one form of business activities or the other, While the corporate income tax is tax deducted from the income of corporate which doing business in the country. For instance, Sujjapongse (2005) noted that the corporate income tax is no doubt a form of a direct tax which the government levied on the net profit of any legitimate whether juristic company or partnership venture at the end of every of their transaction period.

The indirect tax is tax which is indirectly deducted from the taxpayer without him/her knowing. This type of tax includes; excise duties, custom duties etc. for example, excise duties tax. Sujjapongse (2005) argued that excise tax is those taxes imposed on selected goods which are deemed prohibited or being restricted. The main objective of this type of tax is to actually control and restrict the consumption of some goods that maybe considered dangerous to human health. This equally according to Sujjapongse (2005) tends to “promote social and economic equity, encourage saving, and to reflect energy conservation and environmental issues”. Here, it is important to note that all goods which are subject to excise tax equally remain subject Value Added tax while Customs duties are also indirect taxes imposed on imported goods from other countries. Any goods which deemed to unfit to be imported are therefore considered prohibited.

Furthermore, having highlighted the background of this study, it is important to look at the current practice of tax audit procedures most especially within the Arab countries context.

5.0 Suggestions

Based on the various review on tax audit procedures and bearing in mind the current tax audit practice in Arab countries, we suggest the following rigorous tax audit procedures for Iraq.

1. Audit Type/Venue Selection: first, the tax authority has to decide where to hold the tax audit and this could either be any of the followings;
 - a) Correspondence Audit.
 - b) Desk Audit.
 - c) Field Audit.
2. Audit Commencement: this is concern with the notification of the taxpayer who tax return has been selected for audit through the use of computer as earlier indicated in the previous section above. Both letter and telephone call correspondence are usually adopted in this case for



effective and proper notification. Here both the audit period and time frame of the audit visit and notification period are so indicated.

3. Auditor's Visitation: visitation of the tax authority to the taxpayer is also very necessary in this regard. However, we should bear in mind that audit visitation is only applicable to field audit. The actual aim of this visit is to get the needed and required information of the taxpayer's business activity as well as discuss the coming audit. At this stage, the tax auditor also interviews both the taxpayer and the person in charge of the taxpayer business records about their business process and activities.

4. Records Examination: the audit officer examines the business records presented by the taxpayer and goes further to inspect or investigate the available stock and equipment in order to verify his claims with regard to tax returns. All books and electronic copies that is necessary for the audit which the audit officer wants to take back to office for proper investigation must be given or surrender to him. Others personal books or records might also be examined where necessary most especially in this case of sole proprietor.

5. Audit Time Frame: for effective and proper tax audit a time limit is deemed very necessary, and this time frame should be within two to three days interval. However, this is also only applicable to field tax audit. Additionally, in setting a time frame for tax audit, the following conditions are very imperative:

- a) The size of the business and the complexity of business transactions.
- b) The form in which records are kept.
- c) The extent of co-operation from the taxpayer.

6. Audit Settlement: this takes place immediately after the tax audit is being completed. The tax auditor will prepare a report of the outcome of the audit findings for audit manager's approval. It is very important that the tax auditor will inform the taxpayer the outcome of the tax findings being carried out. Some information to be included in this case may include the followings:

- a) Audit issues that raised.
- b) Why and rationale such audit issues, and finally,
- c) The amount of proposed tax adjustments (if any) and the years of assessment involved.

6.0 Operational and Design of the Study

6.1 Study Design:

This study would adopt cross-sectional method in achieving its objectives. The cross-sectional design which also is referred to as social design probably it is more often used by the social scientists or social science field in carrying their research work. It mainly concentrates on collecting data on a single point not only that but also in a particular time



unlike the longitudinal design which has to collect data in various period of time and in different point (Zikmund, 2003). The data collected during three work days, in the Offices of the Tax Authority (from individuals taxpayers) and (IRS staff), in companies from Accounts staff and from Private tax accounting offices (tax experts).

6.2 Unit of Analysis:

This will actually focus on the various individuals and companies who are taxpayers. This means that all the people who are paying their taxes accordingly would be utilized in this study. This would also include all those have had encounter with tax agency and authority with respect to tax audit. Like the Private tax accounting offices beside the IRS staff for internal point of view.

6.3 Sampling Method:

Several sampling techniques exist when one talk about sampling in a research. However, a sample random sampling technique will be adopted within the context of this study. Neils (2008) asserted that sample random sampling method is probably the better sampling technique as it is very easy and equally gives all elements an equal opportunity to be selected or chosen to participate in the study. In this case, the propose study tends to ensure that every element is given equal chance of be selected in this study. The following is the sample distribution on the study units.

Table (1) sample distribution

Units	Individuals	Companies	Tax experts	IRS staff
Sample	200	40	20	20

6.4 Variables of the Study

The following three variables will be examined and measured according to the rigorous tax audit procedure diagram (Appendix-1):

1. Accuracy of the Tax audit. (Audit Settlement)

This element is determined in view of the following:

- The amount that paid as taxes is fair.
 - Tax audit for one case finish from the first time.
 - The amount of Tax that paid is correct.
- ### 2. Quick completion of the tax audit. (Audit Time Frame)

This element is determined in view of the following:

- The tax audit takes less than 3 work days.
- The necessary papers to finish the tax audit take no time to accomplish.
- Responses for enquires is quick.



3. Flexibility of the tax audit. (Audit Type/Venue Selection)

This element is determined in view of the following:

- a. The tax audit could be finished via correspondence only.
- b. Ability of choose between office and field audit.

6.5. Measurement of Variables

The study theorized tax audit procedure as any process or procedure that are employ in the investigation of tax returns as paid by the taxpayers. A questionnaire (Appendix 2) is directed to the respondents to assess the effectiveness of tax audit procedure and a five-point likert-scale of 1-strongly disagree to 5-strongly agree will be applicable in this respect for all eight elements that are discussed above.

6.6. Results of the study

To check the stability of the questionnaire we calculate Chronbach's Alpha factor and find it equal (0.74) which means that the questionnaire is stable and applicable.

Using SPSS to analyse the responses of the questionnaire by calculating the arithmetic mean and standard deviation for the elements with the following measure guide (Table 2)

Table (2) arithmetic mean guide for responses

Response	arithmetic mean
Strongly disagree	0 – 0.99
Disagree	1 – 2.33
Agree	2.34 – 3.67
Strongly agree	3.68 - 5

We find the following results (Table 3)

Table (3) results of analyzing the questionnaire responses

Unit of Analysis	Accuracy		Quick completion		Flexibility	
	arithmetic mean	standard deviation	arithmetic mean	standard deviation	arithmetic mean	standard deviation
Individuals	1.23	0.34	1.66	0.25	1.66	0.36
Companies	1.12	0.33	1.28	0.36	1.54	0.28
Tax experts	2.20	0.21	2.45	0.18	2.66	0.19
IRS staff	3.50	0.18	3.66	0.22	3.91	0.20

From the above table we can establish the following results:

1. From the Individuals and Companies' point of view the audit tax Procedure in Iraq lack the Accuracy and Flexibility and take long time to be accomplish. The results are slightly worse from Companies' point of view comparison to Individuals' point of view.



2. From the Tax experts' point of view the audit tax Procedure in Iraq lack the Accuracy but it's slightly quick and Flexible.
3. As expected, from the IRS staff's point of view the audit tax Procedure in Iraq is accurate, quick and flexible which indicate a big problem because of the gap between the IRS staff and clients' point of views.

7.0 Conclusion

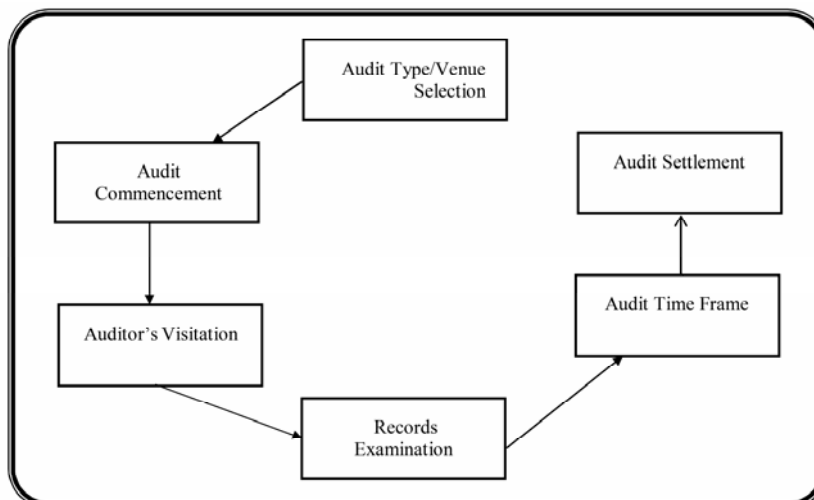
Based on the available evidences demonstrated above, we concluded that there is need for urgent rescue of the tax audit procedures system in Iraq. It would assist the government in making accurate decisions and policies which have to deal with taxpayer's money such as the national budget. Accordingly, it would also strengthen the tax administrative system in Iraq, assist audit officers to carry out their tasks efficiently and effectively, and assist taxpayers in fulfilling their obligations. The Rigorous tax audit Procedures must be more Accurate, fast and flexible.

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Appendix 1: A rigorous tax audit procedure diagram



Appendix 2: The Questionnaire (Translated From Arabic)

You are one of the respondents, being selected randomly to give your opinion on this issue. The questionnaire will only take you a couple of minutes. We are looking forward to your full cooperation in assisting us to complete this research.

We appreciate your willingness to participate in this survey. You can be assured that all the information furnished by you will be kept strictly private and confidential.

Part 1: DEMOGRAPHIC DATA:

Tick ✓ where is applicable

Name (optional) :

1. You can describe yourself as:

- Individual taxpayer.
- Accountant.
- Tax expert.
- IRS staff.

If you are an Individual taxpayer or a company representative answer the following:

2. The average amount of taxes you pay every year is:

- 0 – 1.000.000 IQD.
- 1.000.000 – 10.000.000 IQD.
- 10.000.000 – 100.000.000 IQD.
- More than 100.000.000 IQD.

3. How many times your taxes did have Audit?

- Never.
- Once a year.
- Twice a year.
- More than three times a year.

4. Do you consulted any tax expert about your tax audit:

- Yes.
- No.

5. Did you pay any fines related to your tax audit before:

- Yes.
- No.



Part 2: According to your experience dealing with Tax Audit Procedures in Iraq, please complete the following table describing your opinion (Tick \checkmark where is applicable).

Section A: These statements relate to Accuracy of the Tax audit.

Elements	Strongly disagree	disagree	Not sure	agree	Strongly agree
The amount that paid as taxes is fair					
Tax audit for one case finish from the first time					
The amount of Tax that paid is correct					

Section B: These statements relate to the Quick completion of the tax audit.

Elements	Strongly disagree	disagree	Not sure	agree	Strongly agree
The tax audit takes less than three work days					
The necessary papers to finish the tax audit take no time to accomplish					
Responses for enquires is quick					

Section C: These statements relate to the Flexibility of the tax audit.

Elements	Strongly disagree	disagree	Not sure	agree	Strongly agree
The tax audit could be finished vie correspondence only					
Ability to choose between office and field audit					