Date: 30 June 2007

To: Nato Beruashvili, Fiscal Reform Team Leader

From: Neli Baeva, IT and Tax Specialist

CC: Olin McGill, COP

Re: Algorithm and formulas for provisional assessment of VAT

ALGORITHM & FORMULAS FOR PROVISIONAL ASSESSMENT OF VAT

INTRODUCTION

Based on Article 51(1e) & 68(3) from the Tax Code, the tax authority has the right to assess a taxpayer's liability for the tax period and type of tax the taxpayer failed to declare after a notification letter has been sent to it.

Article 68. Assessment of Tax.

1. According to this Code, a tax assessment shall be treated as entering into the records of a tax agency the amount of a taxpayer's/tax agent's/other responsible person's tax liability for a specific tax period. Assessment includes the adjusted assessment and the expected assessment. However, in the case of an amended assessment, the expected assessment should be eliminated.
2. The tax agency is authorized to make an assessment of tax liability of every taxpayer/tax agent/other responsible person under this Code and other normative acts of the tax legislation, on the basis of one or more of the following sources of information:
    a) information contained in a taxpayer's/tax agent's tax returns;
    b) information concerning payment of a sum described in Article 218.4 of this Code;
    c) audit materials and other relevant information known to the tax agency.
3. ***If a taxpayer/tax agent/other responsible person does not submit the information needed to assess the tax, the tax agency shall be entitled to make a tax assessment on the basis of any information available to it.***
4. In cases where the tax legislation does not require payment together with the submitted return, and in cases when the tax agency considers a previous assessment to be incorrect, the tax agency shall make an assessment and send an assessment notice to the taxpayer/tax agent/other responsible person.
5. When payment of taxes is connected with submitting of returns, submission of a tax return showing a tax liability shall be deemed to be:
    a) an assessment of such tax;
    b) tax notice and tax liability that shall be paid within the deadlines established under the legislation.

Article 51. Rights of Tax Agencies.

1. Due to the provisions of this Code, tax agencies, according to the procedure established by legislation. shall have the right:

a) to inspect ……
b) to receive ….
c) to investigate …..
d) to summon a ….
e) independently define the amount of a taxpayer's tax liability on the basis of the information (including the information on the taxpayer's expenditures) existing in the tax agency, or through a comparative method (similar to other such taxpayers) if the taxpayer does not present all documents needed for tax control, or carries out financial accounting in violation to established rules, as well as in other cases considered under this Code.
f) to apply sanctions against …..
g) to withdraw …..
h) to develop ….
i) to test …..
j) to invite specialists or experts for purposes of tax administration;
k) for official purposes, to obtain data free of charge ….
l) to require and obtain copies of accounting documentation (in special cases copies approved by taxpayer)
m) to install meters or take indexes, as well as seal documents or other materials.

2. The tax agencies shall also have other rights defined under this Code and other normative acts of the tax legislation.

* * * * * * * * * * * *

PURPOSE

Making a provisional assessment is a step within the non-filers business process and aims to:

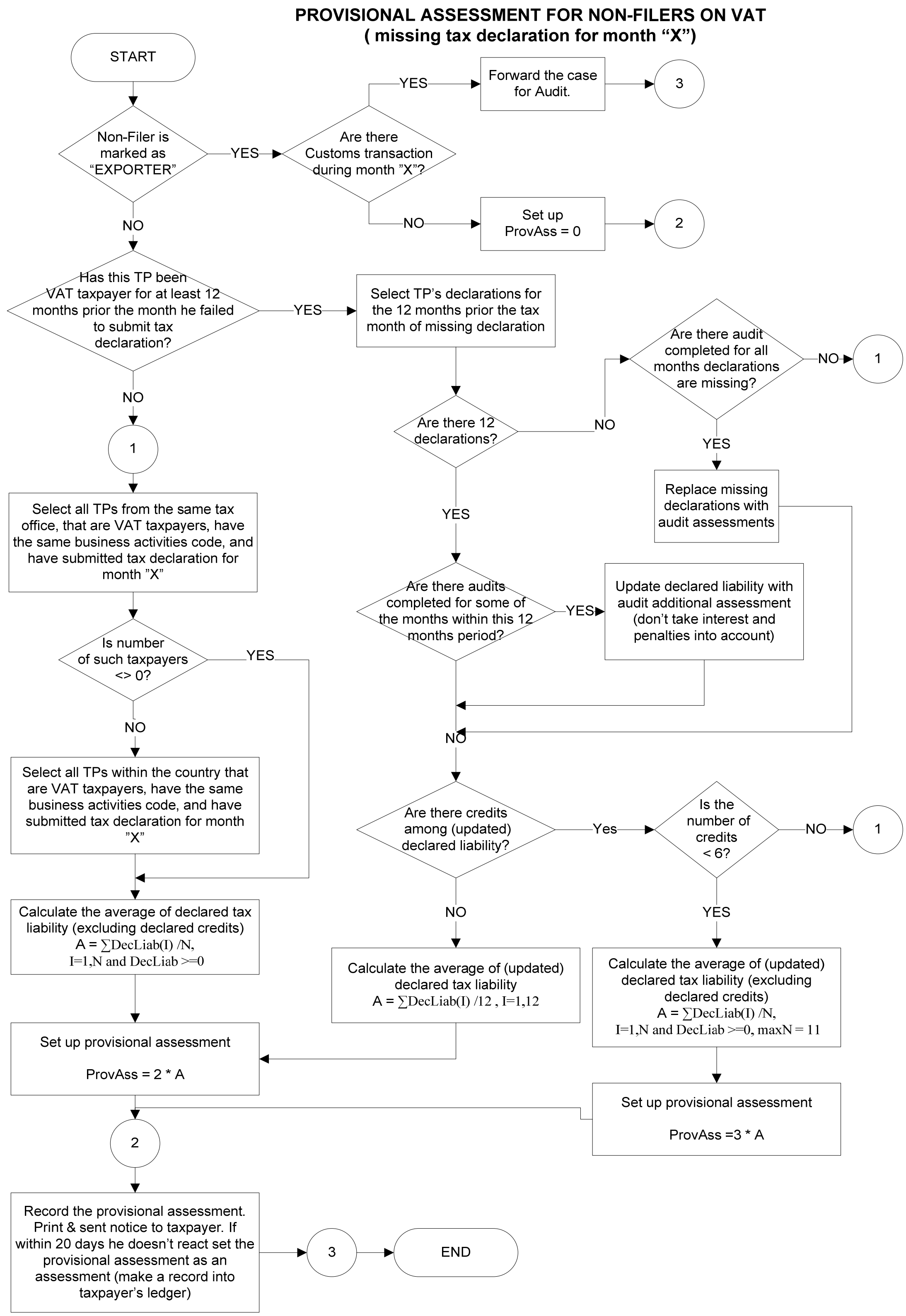
- Provoking the taxpayer's reaction, and
- sssessing taxpayer's liability as accurate as possible using the available information about declared liabilities from previous tax periods and the results of an audit or information about the business sector.

Algorithms to make a provisional assessment in cases of filing non compliance for different types of taxes differ and should reflect the specifics of the tax type in question.

This paper offers algorithms and formulas for making a provisional assessment on VAT. The diagram is followed by a description of the criteria and logical chains to be followed, as well as different formulas to be used.

ALGORITHM & FORMULAS

Graphical Presentation



Description

Scenario 1:

Taxpayer which failed to submit a tax declaration for month “X” is marked in the system as “EXPORTER”.

A) During month “X” this taxpayer doesn’t have any Customs transactions, so the conclusion is that he/she doesn’t have any business activity to report and its tax liability for month “X’ is zero. The system automatically sets the provisional assessment to zero and, following the procedure, prints a notification letter to send to the taxpayer. If the taxpayer doesn’t react within 20 days this provisional assessment becomes an assessment and it is recorded into the taxpayer’s ledger. There is information from tax declarations submitted by the taxpayer for a period of 12 months prior to the month the taxpayer failed to submit a tax declaration.
B) During month “X” this taxpayer has Customs (at least one) transactions, so he had business activities to report. Obviously there is something wrong. Case is forwarded for immediate audit.

Scenario 2:

A taxpayer who failed to submit a tax declaration is not marked as “EXPORTER” and has been a VAT taxpayer for less than 12 months before the month (month “X”) he/she failed to submit a tax declaration.

Select all VAT taxpayers from the same tax office, with the same business activity (use business activity code) which have submitted tax declarations for month “X” on VAT.

If the number of such taxpayers is zero do the selection within the country.

For the selected group of taxpayers, calculate the average declared liabilities on VAT for month “X” excluding declared credits.

Formula (1): $A = (\sum \text{DecLiab}(I), I=1,N) / N$

only for $\text{DecLiab}(i) >= 0$; N – number of taxpayers have declared Debt for month “X” on VAT.

Set up provisional assessment for non-filer to:

Formula (2): $\text{ProvAss} = 2 * A$

Record the provisional assessment. Print & send notice to taxpayer. If within 20 days he fails to respond in any way set the provisional assessment to assessment, recording it into taxpayer ledger.

Scenario 3:

Taxpayer is not an exporter and has been registered as VAT taxpayer for at least 12 months prior the month for which he failed to submit a tax declaration.

Select the taxpayer's tax declarations for the12 months prior the month "X".

1) If there are missing declarations and no audits have been completed for all missing declarations, exercise Scenario 2:
2) If there are missing declarations, but for all missing declaration there is a completed audit then use audit assessments for the missing declarations (without interest and penalty). Now you have assessments for 12 months.

2.1) If no credits among those 12 assessment set up provisional assessment as doubling the average of the 12^{th} assessments.

Formula (3): Prov Ass = 2 * (∑ DecLiab(i), i=1,12) / 12

2.2) If there are credits among 12 assessment, but number of credits is less than 6, set the provisional assessment to triple the average of the debts.

Formula (4): ProvAss = 3 * (∑ DecLiab(i),i=1,N) / N where only DecLiab(i) >=0 attend and N is <=11

3) No missing declarations for 12 months period.

3.1) No audits have been executed for any of the months within the 12 months period.

3.1.1) No credits have been declared. Set up a provisional assessment using *Formula(3).*

3.1.2) Credits have been declared. If the number of credits is less than 6, use F*ormula (4)* to calculate the provisional assessment. Otherwise exercise Scenario 2.

3.2) Audits have been completed for some months within the 12 months period. Update the declared liabilities with any relevant additionally assessed liability from an audit (without interest and penalty); the resulting figures will be updated declared liabilities.

3.2.1) No credits among 12 updated figures. Use *Formula (3)* to calculate and set up the provisional assessment.

3.2.2) There are "credits" within 12 figures. If the number of credits is less than 6 use *Formula (4)* to calculate and set up the provisional assessment; otherwise execute Scenario 2.