

GENERAL DEPARTMENT OF NATIONAL TAXATION

TAX EXAMINATION MANUAL # 1

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PREFACE

In the context of further progressing the uniform application of principles, procedures and guidelines to be observed in the conduct of tax examinations throughout the country, the GDNT has recently published and presented this manual as a methodological assistance and desk reference which will prove valuable to the tax inspectors and the other tax officials.

We acknowledge our sincere gratitude to the team members of the "Tax Collection Enhancement" project implemented by the JICA for their kind cooperation in developing, editing and publishing this edition.

GENERAL DEPARTMENT OF NATIONAL TAXATION

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**ORDINANCE OF THE DIRECTOR GENERAL, GENERAL DEPARTMENT OF
NATIONAL TAXATION OF MONGOLIA**

September 19, 2002

Number 175

Ulaanbaatar

Re: Approval of the Code of Conduct

In justification of Article 21.6.4 of the General Taxation Law of Mongolia and the Government Ordinance # 57 of 1999, this resolution adopts as follow:

1. to approve the "Code of Conduct of the Mongolian tax officials" as presented by the attachment.
2. to order to the senior tax officials and tax officers to comply with the Code of Conduct of the Mongolian tax officials and to the head of the Ethical Committee of the GDNT and its observance of this code
3. to make the resolution # 87 of the Director General, GDNT void in connection with enactment of this resolution

DIRECTOR GENERAL

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CODE OF CONDUCT FOR TAX OFFICIALS OF MONGOLIA

ONE. PREAMBLE

- 1.1 The purpose of this Code of Conduct is to establish ethical standards and rules to be bound by senior tax officials and tax officials (hereinafter referred as "tax officials") in the exercise of their duties applying to them in fulfilling objectives of the National tax administration, ensuring overall tax compliance and delivering services to the taxpayers, and to regulate relations pertaining to invoking disciplinary actions for the infringement of this code.
- 1.2 This code is intended to create necessary condition so that the tax administration exercises its power in a manner that is compatible with laws and the tax officials strictly observe their obligations set out in Public Service and General taxation laws, and to refrain them from any prohibited actions or any violations and eventually to protect value of the tax administration.
- 1.3 The ethical standards and rules set out in this Code shall not fully deny the personal interest of the tax officials, and however, shall be applied if their personal interest comes into conflict with the interest of the State or the tax administration.
- 1.4 The provisions of this code shall have no retroactive effect.

TWO. ETHICAL CANON AND RULES OF THE TAX OFFICIALS

As public servants, the tax officials shall conduct themselves in a manner that is faithful to their oath of office, compliant with or adherent to any rules and regulations set forth by the GDNT, and avoid any influence and respect legitimate interest of the taxpayers. By virtue of general obligations applying to them in the exercise of their duties, the tax officials are bound by the following ethical canon and rules:

2.1. Canon: The tax officials shall stay faithful to their oath of public servant and abide by rules and regulations adopted by the GDNT, and perform their duties at high level of qualification.

Ethical Rules:

- 2.1.1 The tax officials shall strictly observe the "Code of Ethics for public servants" adopted by Article 13 of Public Administration Law, the Taxation laws and the Government Decree No 58 of 1999.

- 2.1.2 In the exercise of their duties, the tax officials shall abide by the Procedural rules (professional standards), regulations and guidelines approved by the GDNT.
- 2.1.3 The tax officials shall always well aware of obligations and reputations of public servant and exercise their responsibilities in a higher professional manner.
- 2.1.4 The tax officials shall comply with the Internal labor procedures and it is
- 2.1.5 Unethical to have alcoholic beverages in the course of performing their professional duties or during the working hours.
- 2.1.6 A prior authorization should be obtained from the superior to take any additional or advanced course, seminar or studies.
- 2.1.7 Any serious disciplinary misconduct or criminal act should be informed to the head of the tax administration and, if necessary the written notification should be sent to the chair of the Ethics Committee. The receiver of such notification is obliged to keep the informer's name secret.

2.2. Canon: The tax officials should avoid any outside influences and refrain at any times from practicing any form of discrimination. It is unethical for them to exercise bureaucracy, act with unnecessary delay and exert oppression on others when carrying out their duties.

Ethical rules:

- 2.2.1 When on duty, the tax officials should not discriminate against, and exercise bureaucracy/red tape or exert pressures on taxpayers.
- 2.2.2 In the course of performing tax examinations on individuals and entities, the tax officials should avoid any relations, which is contingent upon or influenced by, and condition that could impair their objectivity.
- 2.2.3 When on duty, the tax officials should not fall under the influence of family members, relatives and others, favorably treat acquaintances, and misbehave as being in conflict to the jurisdiction in favor of personal interest or bias of any individual and entities. It is unethical to make a request to or pressure on other officials regarding the concerned matter.

2.3. Canon: The tax officials should respect taxpayers' legitimate interests and keep any secrecy of individuals and entities.

Ethical Rules:

- 2.3.1 It is unethical for the tax officials to make use of, in favor of his/her or other's personal interest, any information that has been obtained during the conduct of their official duty, or entrusted as secret by the Government agencies, individuals and entities, or has been kept in his or someone's custody.
- 2.3.2 Permission has to be obtained from the proper authority or his/her substitute before disclosing any kind of information about taxpayers taking account into an official request made by individuals or entities.
- 2.3.3 The confidentiality as regards taxpayers who are subject to an examination, scheduled timing for examination, name of inspectors or informer, content of the information, information obtained during the course of examination, result or findings of the examination, reference of members assigned to perform sudden examination, organized actions and the timing, methods and guidelines thereof should be strictly protected.

2.4. Canon: *The tax officials should honour their reputation of public servants and not allowed to act in a manner that represents possibility of abused power for someone's personal benefit.*

- 2.1.1 It is unethical for tax officials to maintain accounts and records and prepare financial statements of the taxpayers or to conduct independent examination thereon.
- 2.1.2 Inasmuch as the conflict of interest could entail adverse consequences to the public' trust in tax administration, the tax officials are not qualified to behave as below:
- Unless provided by law, to allow family members and relatives of direct superior or subordinates to work in the same unit, promote or place them in international seminars/courses and to join the competition/bidding selection board, or offer them get employed by the entities in which they are charge of;
 - To allocate tax proceedings among, undertake examinations on individuals and entities for which the family members, relatives or friends are working or supervising them over, treat them favorably, and to join the bidding selection board where the above persons compete for bidding, improperly influence on its decision, and negotiate or conclude procurement contracts for the behalf of the tax administration.
 - to benefit from the services provided by the taxpayers to themselves or family members, relatives and friends at no or reduced costs;
 - for their or someone's personal benefit, to do investment whatsoever in physical or intellectual kind to the taxpayers whom they are charge of;
 - to hold simultaneous jobs that are invariably unauthorized by law in a public and private capacity;

2.1.3 It is unauthorized for the tax officials to conceal illegal actions of the taxpayers and to abuse their power in following ways and manner:

- to use advantages which stem from their official status for themselves or others' personal gain and to provide professional and methodological advice on tax avoidance and evasion, or methods to hide their income;
- to exert oppression or harassment on other officials or their direct subordinates;
- to grant tax preferences and exemptions without any legal justification, to receive financial assistance from the taxpayers whom in charge, to purchase properties like real estate and other items at price less than fair market value;
- to undertake tax examination on their own initiative in order to further someone's personal interest with no official authorization, approved guidelines and assignment;
- to conduct incomplete examination without reasonable justification, fail to detect any infringements of the law, negotiate with taxpayers on personal basis, relieve them of tax infringement or payments, conceal this fact, disclose to unconfident body about examination findings and results, and to issue act, comment or report when the examination has not finalized;
- not to sign or stamp on the tax inspector's act, comment and report though they performed tax examination, or in contrast, to sign or stamp thereon and give any guarantees and references without conducting the examination;

2.4.4 It is unauthorized for the tax officials to take, or seek to take, improper advantage of their position in order to obtain personal benefit, undertake unlawful responsibilities before someone else or accept gift, favor or any kind of benevolence in consideration for performing their official duty.

2.4.5 The permission should be obtained from the direct supervisor of own institution to attend in banquet and food or drink furnished by the taxpayers. During such attendance it is unethical to over-drink, treat others with discourtesy, and violate the internal procedures of the inviting body.

An invitation should be refused in the following circumstances:

- before, during or after any actions of the tax administration such as assessing tax liabilities, collecting taxes or tax arrears, registering taxpayers, making additional changes to the State Registration Certificate, performing tax examinations and the like;
- meal or banquet offered by the negotiators, tender organizers and suppliers of the goods and services.

2.4.6 In cases other than stipulated by the treaties of Mongolia and official assignment mutually agreed upon Public administrations of Mongolia and foreign countries, or

permitted by the Institution by which they are employed, for the performance of official duties, it is unauthorized to travel domestically or internationally at the costs of those particularly of foreign citizens and legal entities.

- 2.4.7 It is strictly forbidden to take bribe or intermediate to bribe other officials. If the taxpayer offered any bribe, the tax officials should inform their superior at work or other jurisdictional authorities.
- 2.4.8 It is unauthorized for tax officials to use advantages stemming from their official position as a mean of taking personal vengeance.
- 2.4.9 The tax officials should use securities or official forms such as excise tax stamp, presumptive tax certificate and penalty assessment sheet on their own, and not allowed to get them used by others.
- 2.4.10 Cash receipts of tax payments should be transferred to the budget within 12 hours, and the period later than specified time could be construed as using budget revenue for their personal need and be subject to jurisdictional responsibilities.
- 2.4.11 It is unauthorized for managers, accountants and tax officials to fail to transfer the tax payments on time to the budget and retain them for their personal or institutional use.

2.5. Canon: It is unethical for tax officials knowingly to make false statements and misleading information regarding the Government policy and legal acts, and to provide impartial or illegal advice and services.

Ethical rules:

- 2.5.1 The permission has to be obtained from the proper authority before taking part in interviews or appearing on broadcasts on television, radio or other media on any matters dealing with policy pursued by the Government, its implementation, actions taken or implemented by the tax administration, and information about taxpayers. However, it is forbidden to disclose, without taxpayer's consent, the information that could adversely affect taxpayers' reputation and their business confidentiality, and to use such information for one's personal need.
- 2.5.2 It is unethical for tax officials to impartially interpret policy, decision and actions taken by the Government and the tax administration judged on their political point of view. Any critical points bearing in their mind on above-mentioned issues should be officially forwarded to the appropriate authorities.
- 2.5.3 The tax officials should abstain from any action that disclose guidelines or orders from the superiors and confidential information not already made public, and interpret the tax policy or laws and guidelines and instructions that support the

implementation thereof in a distorting manner.

2.6 Canon: *For the performance of their official duty, the tax officials shall conduct themselves in a manner that with respect for laws, compatible with the public interest, politically neutral and committed to the principle of hierarchy.*

Ethical rules:

- 2.6.1 In exercising their official power, the tax officials should not prejudice any political force by apparently standing for or criticizing one of the parties. They shall work in a politically neutral/disinterested manner.
- 2.6.2 The tax officials may be chosen as candidates for elective non-government office unless their assignment or election disturbs the performance of the official duty of a public servant.
- 2.6.3 The nominees for Presidential or Parliamentary candidacy must apply for leave from official position, but in case of candidacy to the full time assignment of the non-government office they should in advance inform the proper authority of the present institution.
- 2.6.4 In exercising their freedom of speech, press and religion, the tax officials are bound by an obligation as regards respect for their position and refrain from any action that likely give rise to negative affect on relations between public offices and the community in any way whatsoever.
- 2.6.5 By virtue of the general obligations applying to them in the exercise of their duties, the tax officials should maintain a high reputation for their impartiality, highest extent of kindness and best services, and treat all people with courtesy and sensitivity to their customs and aspirations. In resolving any matters, it is unethical for them to coerce others unlawfully, insult their dignity, use aggressive, slanderous or offensive language, and harass them in any ways.

2.7 Canon: *The tax officials should avoid waste and extravagance in the use of the official property and should not use property of any kind for other than officially approved activities or lease to others, nor shall they direct employees to use such property.*

Ethical rules:

- 2.7.1 The official properties such as technical appliances, assets or documents and information database should not be used for other than officially approved activities, direct them to others, nor spend them for different or personal use.
- 2.7.2 The tax officials should be fully responsible for keeping their own items such as

certificate of tax inspector, stamp and securities and should not give possibility to themselves or others to use or produce them illegally.

- 2.7.3 The stamp of a tax inspector should not be pressed on documents other than approved by the GDNT and other superior offices, nor used by others.

2.8 Canon: *The tax officials should honestly declare their property or income status.*

- 2.1.1 Whereas new recruits to the tax administration should fairly and impartially declare their personal property or income status and changes thereto as soon as they have been employed, the present staff should declare them once within the first quarter of the following year.

THREE. MANAGEMENT AND ENFORCEMENT OF ETHICAL RULES

- 3.1 The head of the tax administration and the Ethics Committee appointed by him/her shall supervise over the ethical status and professional standards of the tax official.
- 3.2 The head of the tax administration, based on any (outside) source (whatsoever) information or his/her own observation, shall verify whether the tax officials have been corrupted or accepted gifts or disclosed any confidential information, and prevent them doing so and eventually fail disciplinary charges or pass to the review of the Ethics Committee if such infringements detected.
- 3.3 The direct supervisor/ superior of any tax offices shall observe any substantive changes in living standard or personal behavior of the tax officials and ensure how the changes correlate with income and property status thereof.
- 3.4 The tax administration shall develop the information system that controls over implementation of the ethical requirements incumbent on tax officials.
- 3.5 The temporary Ethics Committee and its affiliate committees that are responsible for supervising and giving justifications on any ethics of the tax officials and implementing decisions made by the head in relation to ethical matters shall operate in the GDNT and the field offices. The chairman of the Ethics committee shall be the head of GDNT division in charge of human resource and personnel matters, but in the field offices the senior tax official shall carry such function.
- 3.6 The Ethics committee shall consist of more than 3 members. The head of the office concerned appoints the members.
- 3.7 The Ethics committee shall have the following rights and obligations:
- 3.7.1 to work out strategy for preventing the tax officials from ethical infringements and corruption and accordingly draw up a plan for future actions and determine

prerequisites for its implementation;

- 3.7.2 to inspect and justify actions of the tax officials who violated their ethical standards;
- 3.7.3 to appoint a professional working group, if necessary;
- 3.7.4 to collect evidence and additional information necessary for further examination of ethical manners from the proper authorities, conduct an inquiry and to transfer the case to the Ethics committee of the subordinating office for its further review;
- 3.7.5 to conduct an examination on operation of the Ethics committees other than one in the GDNT, and to dismiss their decisions which are unjustified and frivolous;
- 3.7.6 The Ethics committee shall review and evaluate the observations of the Code of Ethics in a following manner
- 3.7.7 on its own initiative;
- 3.7.8 based on the outside information or complains of individuals and entities;
- 3.7.9 as instructed from the authorities or higher Ethics committee;
- 3.8 Should the tax officials consider the decision of the Ethics committee groundless, they may file their complaints to the higher Ethics committee within 10 working days of receiving such decision.
- 3.9 The Ethics committee shall be empowered to conduct probable cause examination to detect the infringements, give comments in case of violations and to recommend invoking any kind of disciplinary actions. In doing so the committee shall:
 - 3.9.1 verify whether the tax officials breached the code;
 - 3.9.2 depending on the degree and extent of the violation, recommend on disciplinary actions such as to deprive or detain their official rights;
 - 3.9.3 suggest on what kind of disciplinary penalties should be applied;
 - 3.9.4 notify the head of the tax office if violation is not found and, if necessary, may disclose it to the remaining staff.

FOUR. RESPONSIBILITIES FOR BREACH OF CODE

- 4.1 Any faults or defaults of a tax official who violated the ethical rules established by this

code, other legislation or oath of office should be a sufficient ground to invoke disciplinary penalties.

- 4.2 The disciplinary penalties shall be imposed by decision of a head of the tax administration in accordance with the Public administration law.
- 4.3 Ordinances on disciplinary actions shall be attached the File of a tax official and, if necessary, disclose it to the remaining staff.
- 4.4 No disciplinary penalties are applied if one month elapsed since detection of violation or more than six months since violation occurred.
- 4.5 Depending on the repercussion or size of loss/damage to the state, the disciplinary action may be filed against the direct superior of the concerned tax official.
- 4.6 The disciplinary penalty such as demotion shall be applied to the senior tax official. Deprivation of right of a tax official or demotion may be imposed on the tax officials.
- 4.7 The disciplinary penalties should not be simultaneously imposed on one kind of violation.
- 4.8 After one year of imposing disciplinary penalties, it should be considered as having no such penalty.
- 4.9 The tax officials may forward their complaints against disciplinary action to the court.

FIVE. OTHERS

- 5.1 The tax officials who are dismissed or subjected to the disciplinary action shall return their official stamp, badge, certificate or certificate cover and settle any accounts connected with office property within 5 working days.
- 5.2 Dismissal from the tax administration shall be a ground to discharge from the public service or deny taking back to the tax administration, but could not be a ground to free from Criminal or other responsibilities.

TAX EXAMINATION REGULATION

ONE. PREAMBLE

- 1.1 The purpose of this regulation is to handle with relations pertaining to the supervision over tax compliance and conduct of tax examination by the National Tax Administration (hereinafter abbreviated as "NTA") and the state tax inspector (hereinafter referred as "tax inspectors").
- 1.2 The tax examination should be conducted in compatible with the tax laws and other jurisdictional acts of Mongolia.
- 1.3 The objective of the tax examination is to detect and discontinue any actions that violate the tax laws, and invoke responsibilities for and prevent from the infringements committed by the individuals and economic entities and organizations (hereinafter referred as "Taxpayers").
- 1.4 In fulfilling the set objectives, the division, unit and tax inspector shall be guided by the following principles:
 - 1.4.1 to perform tax examination in an impartial and high qualification manner, to accurately assess tax arrears, and improve efficiency of the tax examination;
 - 1.4.2 to treat taxpayers with courtesy, impartiality and equality;
 - 1.4.3 to encourage taxpayers who comply with tax laws;
- 1.5 The tax examination shall cover the period from the time the prior examination completed if the taxpayer previously been examined, and if not, from the establishment of that entity. However, the period for one examination shall be within the statute of limitations.
- 1.6 The capital city tax department shall conduct a tax examination on either its own or other taxpayers jurisdictional to district tax offices, but the aimag, district tax offices and the Centralized Budget and Revenue Monitoring Department (hereinafter abbreviated as "CBRMD") shall only perform examinations on their own jurisdictional taxpayers.

The partial examination on some central budget taxes may be generated,

irrespective of jurisdictional location, by examination select at the CBRMD as agreed with the tax examination division of the GDNT.

- 1.7 The tax examination division of the GDNT performs both regular examination and the re-examination within the NTA
- 1.8 The tax offices and the inspectors shall maintain a good primary source documentation and records in accordance with the approved forms and sheets, and use them for any statements and researches that are pertinent to the tax examination requirements.

TWO. PLANNING TAX EXAMINATION

- 2.1 It shall be adopted an overall policy for examining taxpayers once every two years and depending on the number of tax inspectors the annual plan for tax examination shall be drawn up as follow:
 - 2.1.1 The total sale of a taxpayer shall be taken as a base for selecting time interval between the examinations:
 - 2.1.1.1 The taxpayers with total sales exceeding 100 million tugrugs shall be examined once every two years;
 - 2.1.1.2 The taxpayers with total sales between 50-100 million tugrugs shall be examined once every three years;
 - 2.1.1.3 No less than 30 percent of taxpayers with total sales up to 50 million tugrugs shall be examined every year.
 - 2.1.2 It is assumed that one inspector shall spend 220-230 days per year to the tax examination
 - 2.1.3 Timing required for comprehensive examination on annual business operation of the taxpayers shall be fixed in accordance with the professional standard of the GDNT taking the amount of sales into consideration.
 - 2.1.4 Timing required for completion of selected, partial and specialized examinations shall be fixed, depending on nature of examination and extent of the works, by the guidelines issued by the head of the department or division.
 - 2.1.5 The number of taxpayers to be examined per year shall be determined in compatibility with provision 2.1.1 of this procedure, selecting from the total number of taxpayers registered at the beginning of the year.
 - 2.1.6 As adopted assumption, no less than 30 percent of the taxpayers at the beginning of the year shall be examined per year.

- 2.1.7 The number of tax inspectors required per year shall be determined by dividing total man/day by maximum man/day as set out in 2.1.2 of this provision, however, the approved vacancy shall be considered.
- 2.2 The Capital city, aimag, district tax department/ offices and the CBRMD shall submit their draft of annual examination plan/Examination statement # 01/ to the examination division of the GDNT within the January 10 of each year.
- 2.3 The tax offices may plan to generate examinations of around 10 to 20 percent of taxpayers as leads from third- party tips and decision or request of other agencies.
- 2.4 Along with drawing up its own examination plan within the aforementioned period, the tax examination division of the GDNT shall review and approve the draft plans submitted by the field offices and eventually develop the consolidated examination plan /Examination statements #02, #03/.
- 2.5 Upon receiving the approved plan, the tax offices together with members of tax examination, tax collection and information processing division/units shall make a selection of examination target /Examination statement # 03/.
- 2.6 The Capital city, aimag, district tax department/ offices and the CBRMD shall deliver the list of selection to the examination division of the GDNT within February 20th in order to avoid the duplication of examinations.
- 2.7 The selection for examination target shall be done jointly by the head of the tax examination division, GDNT, senior tax officials, and the tax officials in charge of third party information and tax-related researches.
- 2.8 The selection of taxpayers to be examined shall be implemented as below taking the following circumstances or characteristics into consideration:
- 2.8.1 it has elapsed the certain time since the prior examination;
- 2.8.2 the taxpayers who don not pay taxes or have a sufficient degree of probability to avoid/evade from taxes;
- 2.8.3 the taxpayers who submit "x" return, which declares no business operation conducted
- 2.8.4 some special characteristics or circumstances such as an examination intended to cover the producers of alcoholic beverages, beer, spirits and tobacco in accordance with general outline and directives of the GDNT.;

- 2.8.5 leads from information such as requests, complaints from the individuals and business entities or third party tips or confidential information etc;
- 2.8.6 leads from a request to deregister from the State registration or liquidation action;
- 2.8.7 Examination of some items discovered while receiving tax returns:
 - 2.8.7.1 misleading or inaccurate returns which contain suspicious items such as low income, increased expenses, or arithmetic errors were discovered during the receipt of tax returns;
 - 2.8.7.2 evidence of illegal practices in the income filings, for instance, income is relative low compared with income level of prior years or with those who have the same capacity, or there is a suspicion towards the incomplete declaration of sales income etc;
 - 2.8.7.3 gross marginal rate is far from or relatively lower than of those who are engaged in same businesses or local market value.
- 2.9 Once selected the target, the selection should be linked to the approved plan. The selection of examination targets takes place in sequence until the selected targets equal the planned number by adding or reducing if the selection is unrealistic.
- 2.10 The division or units responsible for the examination shall develop the examination routine/schedule /Examination statement # 04/ which to be observed during the examination.
- 2.11 In case where there arise some needs to change the approved plan, the tax offices may file a written request to the tax examination division of the GDNT.
- 2.12 The tax examination division of the GDNT shall supervise overall compliance of the examination plan.
- 2.13 Upon receiving the Examination performance statement/Examination statement #05/ from the tax offices within February 10th of the next year, the tax examination division of the GDNT shall prepare the consolidated statement of examination performance/Examination form# 06/.
- 2.14 The tax offices should keep Records of taxpayers examined/Examination statement #07/.

THREE. EXAMINATION ASSIGNMENT

- 3.1 Once selected the examination target, the head or senior official shall assign the

tax inspectors. In examination assignment, the following principles are expected from them to abide:

- 3.1.1 The examination should be done in the shortest possible time and with sufficient of work;
- 3.1.2 The experience, skill and expertise of the tax inspectors should be considered;
- 3.1.3 The examination should intend to train the tax inspectors towards the new skill and approaches, and improve their knowledge and expertise;
- 3.1.4 The tax examination should be conducted across specialization of taxpayers.

The tax inspectors should be specialized along tax categories and become well experienced in inspecting taxpayers in the particular business by assigning them to the particular taxpayers who attract utmost attention or run particular type of business and thus the inspectors become trained in conducting the examination in the shortest possible time and with great efficiency;

- 3.1.5 One inspector should not examination the same taxpayer twice;
- 3.1.6 The examination should be implemented by a group consisting more than two inspectors;
- 3.1.7 The tax inspectors should not be assigned to the taxpayers who are their parents, spouses, children, relatives, friends or those who have the personal parties towards the tax inspector. In case where such an assignment is unknowingly given, the tax examination should reject the assignment.

FOUR. PERFORMING THE EXAMINATION

- 4.1 The tax examination shall be conducted in compatibility with the applicable laws of Mongolia.
- 4.2 All tax offices throughout the NTA, the uniform provisions of tax laws should be applied for the same kind of violation and accurately assess the amended taxes, interest and penalties.
- 4.3 In the course of the tax examination, the head of the examination division/unit shall provide the inspectors with daily management, administration and professional guidelines and supervise over their performance.
- 4.4 The head of the tax examination division or unit shall appoint the inspector and grant the Examination Assignment form/Examination form #01/. The assignment

forms shall contain the name of the taxpayer to be examined, period covered by the examination, time commencing or completing the examination and type of examination (comprehensive or partial), and be signed and stamped by the authority who issued the assignment.

4.5 Upon receiving the Examination assignment, the tax inspectors shall perform the following tasks in the shortest possible time:

4.5.1 to fill in the Tax Examination Performance card/ Examination form #02/ and input into the database;

4.5.2 to learn about the taxpayer's business operation and collect necessary information from various sources:

4.5.2.1 to accept instruction and counseling on key issues and supposed approaches from the head of the examination division or unit;

4.5.2.2 to examine the contents of the examination file which includes taxpayer's file, the account background and history of reporting, and the prior examination file;

4.5.2.3 to verify if the tax inspector in charge of that taxpayer, other officials and economists have some information or third party tips about the target;

4.5.3 Before the taxpayer is contacted, the inspector should prepare items, necessary in the phase of the examination such as copies of applicable tax laws, manuals, assignment, certificate and stamp of the tax official, forms of examination finding act or conclusion, stationeries, calculator and wax stamp etc.

4.5.4 The examination should be conducted in accordance with "General guidelines for tax examination" and if necessary, the special guidelines shall be observed.

4.6 The taxpayers are noticed about the examination in following ways:

4.6.1 The notice of examination, which contains the duration of the examination or the period to be covered, should be made over the phone or in writing well before 30 calendar days. The taxpayers should be asked to prepare the documents, accounts, records their business operation and the taxpayers or their authorized representatives and accountants should be ready before the examination commences;

4.6.2 The examination generated as leads from the third party information or the random examination may be conducted without prior notice.

4.7 To initiate the examination, the inspectors should accomplish the following tasks:

- 4.7.1 The examination should be commenced within the period that set out in the examination assignment or the period agreed with the taxpayer. Should it becomes impossible to begin on the prescribed period, the taxpayers should be notices beforehand.
- 4.7.2 At the initial phase of the examination, the tax inspectors should present themselves saying their names, explaining the intention of the examination and disclosing them the tax inspector's certificate and examination assignment and the pertinent guidelines.
- 4.7.3 The parties should reach to an agreement that the examination should be done efficiently in the shortest possible time. Thus, the parties should tend to become more comfortable with the examination situation, which allows the examination process to flow more smoothly.
- 4.7.4 During the first face-to-face meeting with the taxpayer, the inspector should carefully listen to taxpayer's explanation or request, and make written notes on important matters.
- 4.7.5 Should it be considered necessary, the visit to the business premises, sites, storages and the branches should be paid and the meeting with relevant bodies should be organized.
- 4.7.6 The inspectors should have their superior decide, based their suggestion, where the examination will be conducted: whether the taxpayer's location or at their own office. If the taxpayer's location was selected, the temporary office should be prepared for the inspectors.
- 4.7.7 When an account is set up for examination, a list of following documents necessary for inspector's review should be assigned to the inspector: the state registration certificate or any other certificates, special licenses, accounts, documents and records of the business operation, financial statements and the tax returns etc
- 4.8 The inspectors should promptly perform the examination without any unnecessary delay or possible inconvenience for the normal business operation of the taxpayer. In doing so, the tax inspectors should:
- 4.8.1 make up a list of supposed tasks and establish their sequences in order to complete within the period set out in the assignment ;
- 4.8.2 if necessary, make an enquiry from some business tenants, match with their accounts and documents, and obtain additional documents, researches and

accounts from the taxpayers or other taxpayers who could furnish any helpful information;

- 4.8.3 record all mistakes or illegal practices discovered during the examination;
 - 4.8.4 examine the tax payments or offset settlements based on the original copies of the documents, and estimates the excess or due payments;
 - 4.8.5 verify the accuracy or correctness of the researches and calculations that affect on examination findings and support them with the pertinent forms and statements which would further be attached to the inspector's documentations such as acts, comments and reports etc;
 - 4.8.6 give a briefing to the superior on complicated or unusual items that are revealed in the course of the examination and receive their instruction and counseling;
 - 4.8.7 if necessary, the interviews could be hold several times with the taxpayer or other bodies, however, the written notes supported by their signature should be done each time.
- 4.9 Upon completion of the examination, the inspector shall accomplish the following tasks:
- 4.9.1 issue an inspector's act, comment or report in accordance with the "Procedure for issuing an inspector's act, comment or report " adopted by the resolution of the Director General, GDNT; sign and stamp thereon and its attachments for reference of the taxpayers.
 - 4.9.2 notice of timing to present the examination results and administrative remedies to the taxpayer and present them on the described time;
 - 4.9.3 get the inspector's act signed and stamped by the taxpayer, If he/she agrees with it;
 - 4.9.4 if the violation discovered during the examination is considered as constituting criminal offence, the inspector shall issue a comment and transmit it together with necessary materials to the jurisdictional authorities. When they present the comment, the taxpayers are requested to sign and stamp on the comment;
 - 4.9.5 if the taxpayer disagrees with the inspector's act and comment, the written explanation should be obtained from the taxpayer. In case where the taxpayer declines to give a written explanation, the notes should be made about it and, if possible, get the witnesses signed on the note.

- 4.9.6 If no violation or infringements revealed during the examination, the Report should be issued, presented to and signed or stamped by the taxpayer.
- 4.9.7 The inspector shall make notes on presentation of examination findings, the inspectors' act and comments. This note, which contains the progression of the examination, results, contents of taxpayer's oral statement, should be signed and stamped by both taxpayer and the inspector;
- 4.9.8 In case where the taxpayer has not received in person the inspectors' act or comments and its presentation notes, they should be mailed to the office address by the guaranteed post.
- 4.9.9 Once completed the examination, the documents should be returned to the taxpayer and the signature should be given by them on the complete receipt of those documents;
- 4.9.10 Within 3 working days from the date on which the examination findings are presented, the inspector should present them to the head of the division or unit and get him/her signed thereon.
- 4.9.11 The inspectors should fully fill in the Examination card and get it inputted into the database;
- 4.9.12 The inspectors should constantly update the Records of unusual or previously unrevealed violations/Examination form#08/ and the approaches applied to detect thereof.
- 4.9.13 Any illegal practices or third party tips obtained during the exercise of the tax examination should be noticed or delivered to the pertinent tax offices or other agencies.

FIVE. FOLLOW-UP ACTIONS AND EXAMINATION REVIEW

- 4.10 Follow-up actions and fulfillment of the tax inspector's act shall be handled by the tax collection officer who is in charge of that taxpayer and who belongs to the Capital city, aimag, district tax department or offices.
- 4.11 Any taxpayer disagreements or the comments passed to the jurisdictional authorities should be handled by that examination to receive a final resolution.
- 4.12 The head of the division or the superior of the examination section, or the senior officials shall supervise over the implementation of tax inspector's act and comments.

- 4.13 The tax examination division of the GDNT shall take a re-control on fulfillment of acts or comments issued by its inspectors.

SIX. PERSONNEL

- 6.1 The tax inspectors should be selected from the tax official who have more than 5-years working experience in the tax administration, high professional skill and expertise, ability to accurately perform the tasks by deadline, and maintain exemplary standards of conduct both professionally and morally.
- 6.2 The head of examination division or unit and the tax inspectors should be trained or further developed their skills by systematically placing them at domestic Universities or participating to the international trainings.

SEVEN. PROHIBITED ACTIVITIES

- 7.1 Except the prohibited activities set out by the Public service law, the inspectors are unauthorized to perform following tasks:
- 7.1.1 to commence or conduct an examination without the examination assignment;
 - 7.1.2 to produce the official forms of the inspector's act and comments on their own, and use false or invalid forms;
 - 7.1.3 to present the inspector's act, comments and reports when they have not officially finalized;
 - 7.1.4 to amend or change the acts, comments and reports that are verified and presented to the taxpayers;
 - 7.1.5 to distort the principle to respect the law and refrain any influences that could impair their objectivity;
 - 7.1.6 to disregard the taxpayer's legitimate right and interest;
 - 7.1.7 to infringe the code of conduct of the tax officials;
 - 7.1.8 to disclose taxpayer's secrecy or use it for its own personal benefit;
 - 7.1.9 to violate the provisions 3.1.7 and 4.9.10 of this procedure;
 - 7.1.10 to conduct an examination if the official has no tax inspector's entitlement;

EIGHT. EVALUATION

- 8.1 The performance of the tax inspectors shall be evaluated taking consideration into the increase or decrease of the following factors, as the same time comparing with achieved level of prior years and the objectives of the NTA set out in that accounting period:
 - 8.1.1 Correct application and interpretation of provisions of the tax laws;
 - 8.1.2 Quality and efficiency of the examination;
 - 8.1.2.1 Number of examinations undertaken;
 - 8.1.2.2 Amount of violations discovered;
 - 8.1.2.3 Amount of taxes, interest and penalties imposed;
 - 8.1.2.4 Amount of taxes budgeted /applies to the GDNT/;
 - 8.1.2.5 Resolution of taxpayer disagreements;
 - 8.1.3 Examination documentations to note pertinent examination evidence discovered during an examination;
 - 8.1.4 Responsibility bearing ability, state of being without any disciplinary or ethically immorality;
 - 8.1.5 Utilization of working hours /arrival, departure, and the deadline of the examination/

NINE. RESPONSIBILITIES FOR BREACH OF THIS PROCEDURE

In pursuant to the Public service law and other law, applicable responsibilities shall be imposed to the tax offices and the tax officials who infringed this procedure.



National Tax Administration

Examination form № 01

Tax Examination Assignment

1. Assigned date: YYYY/MM/DD/
Number: |_|_|_|_|
2. Tax administration: _____
3. State /senior/ tax official: _____
4. Name of a taxpayer, Form of ownership: |_|_|_|_|_|
5. Time to be examined: _____
6. Type of examination: Comprehensive () Partial () across tax
categories () other ()
7. Time of examination commencement, Duration of examination: YYYY/MM/DD/ |_|_|
days

Head of examination division/unit/ _____

Extended date: YYYY/MM/DD/
Duration of extension: until YYYY/MM/DD/ |_|_| days

Head of examination division/unit/ _____

_____ **Inspector** **Decision** **Statement**

8. Tax inspector's/senior inspector's/:

Date and Number of Act YYYY/MM/DD/ | |_|_|_|_|_|_|_|_|
 Date and Number of Comment YYYY/MM/DD/ | |_|_|_|_|_|_|_|_|
 Date and Number of Report YYYY/MM/DD/ | |_|_|_|_|_|_|_|_|

9. Time examined: from to, |_| years

10. Violations:

/in thousand tug/

Violation				Decision changes	
Code	Type	Content	Amount	Content	Amount
Total amount				Total amount	
From which passed to jurisdictional authorities					

11. Tax arrears re-imposed:

Re-assessment, interest, penalty				Changes					
Violation code	Tax		Interest and penalty	Dissolved		Added		Reduced	
	type	amount		Re-assessment	Interest and penalty	Re-assessment	Interest and penalty	Re-assessment	Interest and penalty
Total amount									

12. Tax arrears passed to jurisdictional authorities:

Re-assessment, interest, penalty				Changes					
Violation code	Tax		Interest and penalty	Dissolved		Added		Reduced	
	type	amount		Re-assessment	Interest and penalty	Re-assessment	Interest and penalty	Re-assessment	Interest and penalty
Total amount									

Passed to court Passed to police authority Other

The person made changes to this card : _____ YYYY/MM/DD/ Number

Kept by : State tax inspector: / _____ /

Stamp

State tax inspector: / _____ /

Card reviewed by:

Head of tax examination division/section: / _____ /

Stamp

Name of Tax Administration/
 YYYY/MM/DD/

EXAMINATION PLAN FOR 2000.

No	Type of taxpayer	Total sales	Number of taxpayers			Number of returns to be examined		Time required for examination		Time required for one examination per year/man/day/	Number of tax inspectors required per year	
			at the beginning of the year	taxpayers to be examined	covered percentage (2:1)	of one taxpayer	Total (2x4)	for one return	Total (5x3)		Total (7:8)	Potential increases
1	State enterprise	over 1000.0 million 100-1000.0 million tur 500.0-100.0 million tug up to 50.0 million tug Total	1	2	3	4	5	6	7	8	9	10
2	Shareholding company	over 1000.0 million 100-1000.0 million tur 500.0-100.0 million tug up to 50.0 million tug Total										
3	Company limited	over 1000.0 million 100-1000.0 million tur 500.0-100.0 million tug up to 50.0 million tug Total										
4	Partnership	over 1000.0 million 100-1000.0 million tur 500.0-100.0 million tug up to 50.0 million tug Total										
5	Cooperative	over 1000.0 million 100-1000.0 million tur 500.0-100.0 million tug up to 50.0 million tug Total										
6	Individuals											
7	Budgetary organizations											
8	NGOs											
	Total											

Head of tax examination division/section/

(Name of Tax Administration)

YYYY/MM/DD/

LIST OF TAXPAYERS TO BE EXAMINATED IN 200...

No	Taxpayer's		Reason for selection								
	Name	TIN	1	2	3	4	5	6	7	8	9
A	B	C	Time of new examination commences	Fail to pay taxes and avoid from taxes	submitted "X" return	according to instruction or guidelines from the superior authority	according to third party information	according to complaints or applications	Requested to deregister or liquidate	according to justification on statements	others

Notes:

Selected by: Leader of group members:

/Name of Tax Administration/
 YYYY/MM/DD/

EXAMINATION SCHEDULE FOR 200...

No	Taxpayer's		Months to perform examination												
	Type	Name	TIN	1	2	3	4	5	6	7	8	9	10	11	12
1	State enterprises														
2	Shareholding companies														
3	Shareholding companies limited														
4	Partnerships														
5	Cooperatives														
6	Individuals, sole-proprietors														
7	Others														
Total															

Head of tax examination division/section/

Name of Tax
 Administrators/
 YYYY/MM/DD/

EXAMINATION PERFORMANCE STATEMENT FOR 200.

No	Type of taxpayers	Total sales	Planned		Actual				Examined amount /in millions tug/		Recovered amount		Time /manday/		Total expenses /million tug/	revenue and expense ratio (14:9)	
			at the year beginning	To be examined	Number of taxpayers	Examination rate (2:1)	Examined	Percentage	Actual performance (4:2)	Violations detected	Amount re-assessed	Total /million tug/	Percentage (10:9)	planned			actual
A	B	C	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15

Head of tax examination division/section/

 /Name of tax administration/
 /YYYY/MM/DD/

RESEARCH ON TAXPAYERS EXAMINATIONED

No	Taxpayer's		Tax years									
	Name	TIN	2001	2002	2003	2004	2005	2006	2007	2008		
0	1	2	3	4	5	6	7	8	9	10		
1												
2												
3												
4												
5												
6												
7												
8												
9												
10												
11												
12												
13												
14												

Notes : In the column Tax Years, complete the year in which the taxpayer was examinationed
 Head of tax examination division/section/ _____

 /Name of tax administration and the examination/

DETAILED DESCRIPTION OF ADVANCED APPROACHES APPLIED IN DETECTION OF TAX VIOLATION

200...0.H

No	Taxpayer's		Time examination d	Content of violation	Approach applied in detection
	Name	TIN			
0	1	2	3	4	5

Notes: The approaches applied to detection of tax errors and illegal practices shall be noted here without duplicating with same kind of methods
 State tax inspector

INSTRUCTION MANUAL FOR UTILIZATION OF THIRD PARTY INFORMATION DATABASE

ONE. USERS OF THIRD PARTY INFORMATION DATABASE

1. User's principle

Users of the third party information database are basically classified into following 3 categories:

- Local operator 1
- Local operator 2
- Tax inspectors

Local operator 1

At Aimag tax offices, the Local operator 1 will be an economist, but in case of capital and district tax offices the research officials shall be the Local operator 1. The Local operator 1 performs the following tasks:

- to register all paper forms of third party information received by the tax administration in accordance with "Procedures for collecting and applying third party information to tax examination " approved by the GDNT Ordinance No 171 of 2002, and to transmit them to the GNDT;
- to receive new inputs of third party information database sent from the GDNT on WAN and import them to own database;
- to search for necessary information in respond to "Application for getting third party information" requested by the tax inspectors and submit them thereto; and
- to keep utilization record of the third party information database and send it on WAN to the GDNT on monthly basis.

Local operator 2

Local operator 2 will be the head of the tax examination division or unit of that tax department and undertake the following responsibilities:

- to supervise over the operation of the Local operator 1;
- to make analysis on database information and apply them to the examination selection;
- to control over utilization of third party information database and make efforts on full application of database information; and
- to give the head of the tax administration a briefing on collection and application of the third party information database on a monthly basis.

Tax inspectors

The tax inspectors are not the direct users of the database, instead, they request the local operator to retrieve necessary information upon filling the "Application for getting third party information".

The security and protection of the third party information database shall be regulated by a special procedure. The local operators, who are open to access to the database, shall be registered and assigned a special ID and Password from the GDNT. With application of such ID and Password, the local operators become able to access to the third party information database.

2. Registration of local operators

The third party information database administrator of the GDNT shall register the local operators and assign them a special ID and Password. Registration of local operators 1 and 2 should be made at time of installation of database system and each registered user shall be provided with "Registration card". The "Registration card" shall contain the user's ID and Password.

In each cases where the user was changed or user changed his/her ID, or new user was registered, the GDNT administrator of the third party information database shall make registration changes of ID and Password and deliver the updated information to the appropriate tax offices in accordance with provision 2.5 of this procedure.

As the same time, the user may change his/her password as stipulated by next provision.

3. Changing passwords to access to database

The local operator who has an open access to the third party information database should constantly change his/her password in order to prevent from any circumstance where other people have access to his/her computer (either physically or over the network).

The local operator may change his/her password or other security preferences choosing following menu:

1. Basic principles to set up third party information database

The central database of the third party information shall be created at the GDNT by centralizing the following types of information, that to be sent from all tax offices and other public agencies, and typing them into computer by the general operator:

- VAT invoice
- Withholding tax return TR-11.2
- Withholding tax return TR-11.3
- Third party information sheet
- Spirits distribution information
- Spirits sales information
- Customs clearance information

Based on TIN or Information number, inputs to central database of third party information are checked against each entry of the taxpayer registration database stored centrally, and once completed they should be sorted out according to the tax offices where the concerned taxpayer belongs.

Inputs centrally stored in the third party information database shall be sorted out according to the appropriate tax offices as follow:

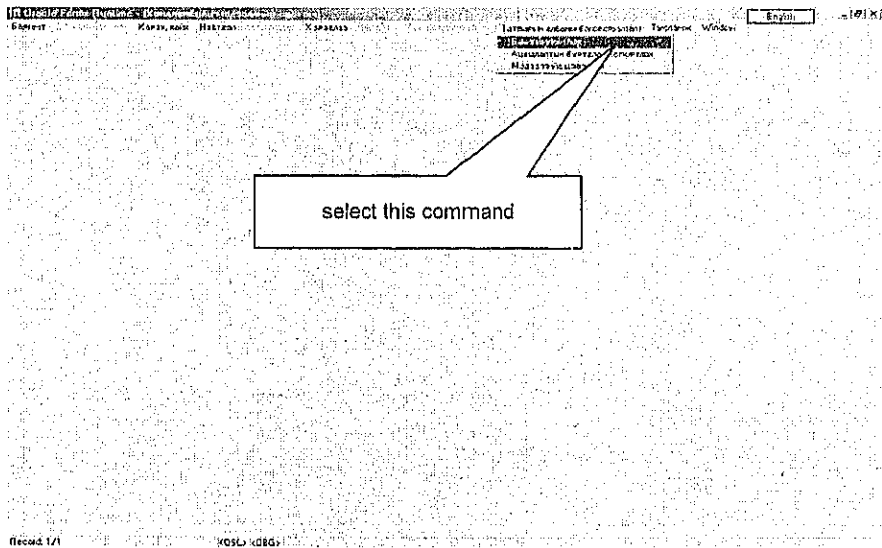
- VAT invoice- according to the tax office where the purchaser belongs to;
- Withholding tax return- according to the tax office where the income earner belongs to;
- Information on spirits- according to the tax office where the purchaser of spirits belongs to;
- Third party information sheet- according to the tax office of a person to whom such information relates; and
- Customs information- according to the tax office where the importer or exporter belongs.

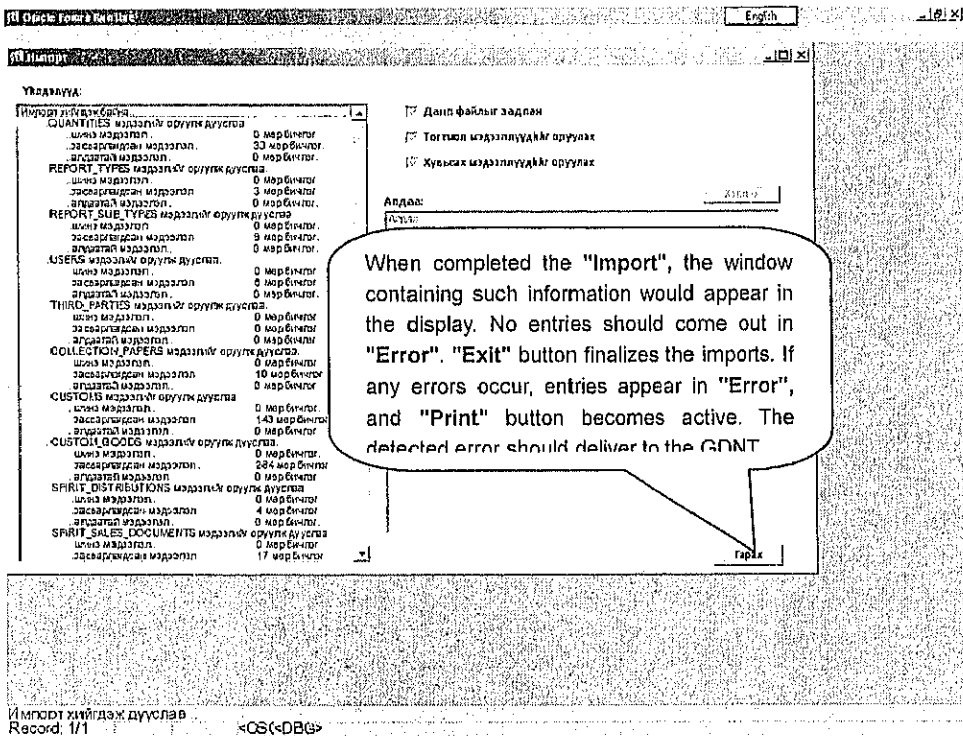
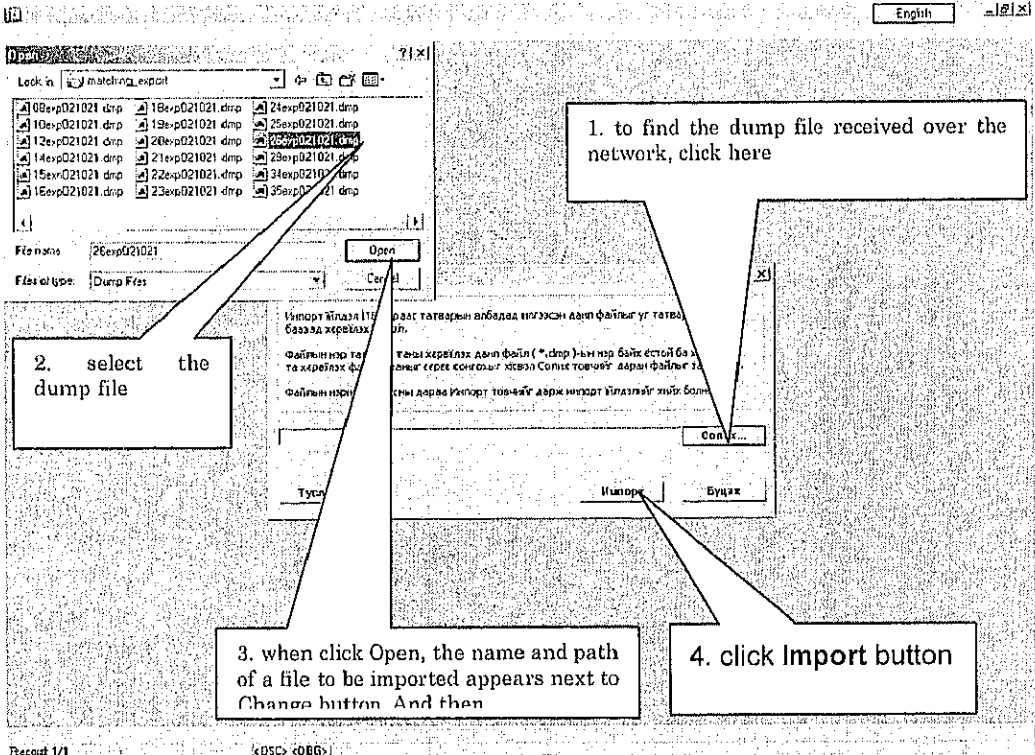
Dump file sorted out according to the tax offices shall be delivered to the corresponding tax offices once a month. Only new entries inputted after the last delivery into the central database shall be sorted out according to tax offices. The term "new entries inputted into the third party information database" can be construed as following:

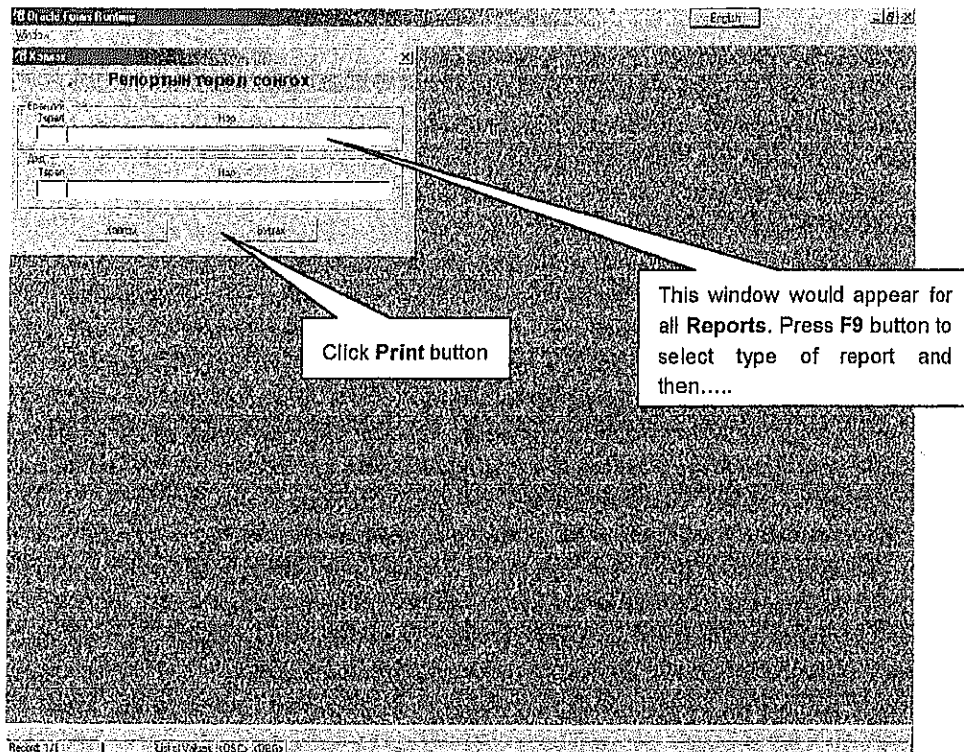
- Entries newly inputted into the third party information database since the previous file delivered to the tax office;
- Entries added to the previous file delivered to the tax office;
- Entries deleted from the previous file delivered to the tax office
- Entries that transmits all inputs of central database to the new office if the taxpayer changes his/her jurisdiction of the tax office.

2. Importing new information sent by the GDNT

As specified in provision 2.4 of this procedure, the local operator 1 receives the dump file sent from the GDNT over the WAN and imports them to the third party information database. One should bear in mind that the dump file is created only in case of new entries. Provided that the new dump file is imported without simultaneously importing the previous dump file, all entries of previous dump file shall remain un-imported to the database. Therefore, the local operators should work with an utmost caution in performing such tasks. The following provides an assistance to accomplish this task:







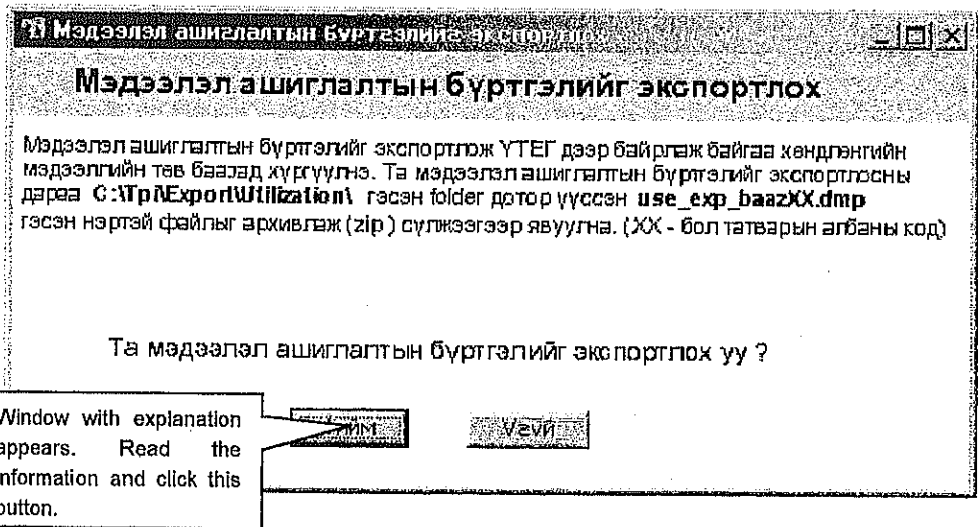
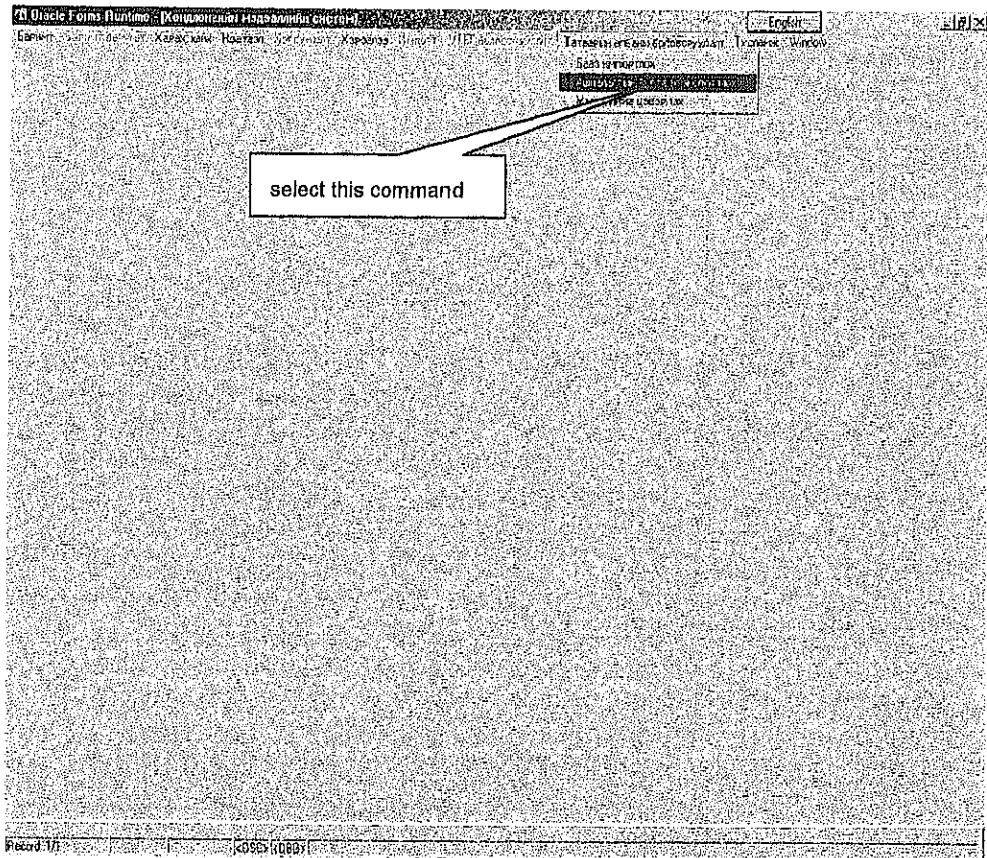
- quantity or size of information delivered from the GDNT;
- Utilization status of third party information database;
- Structure and content of the information unused; and
- Information on users who gain access to the Information database.

For obtaining the above information, select the following summaries:

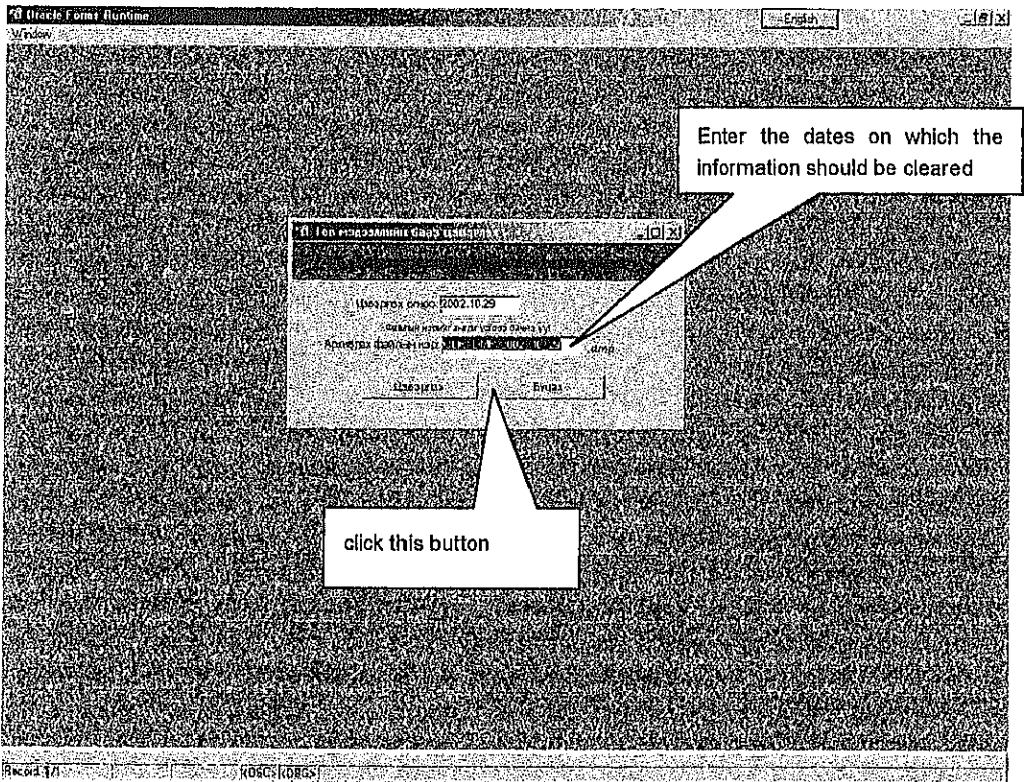
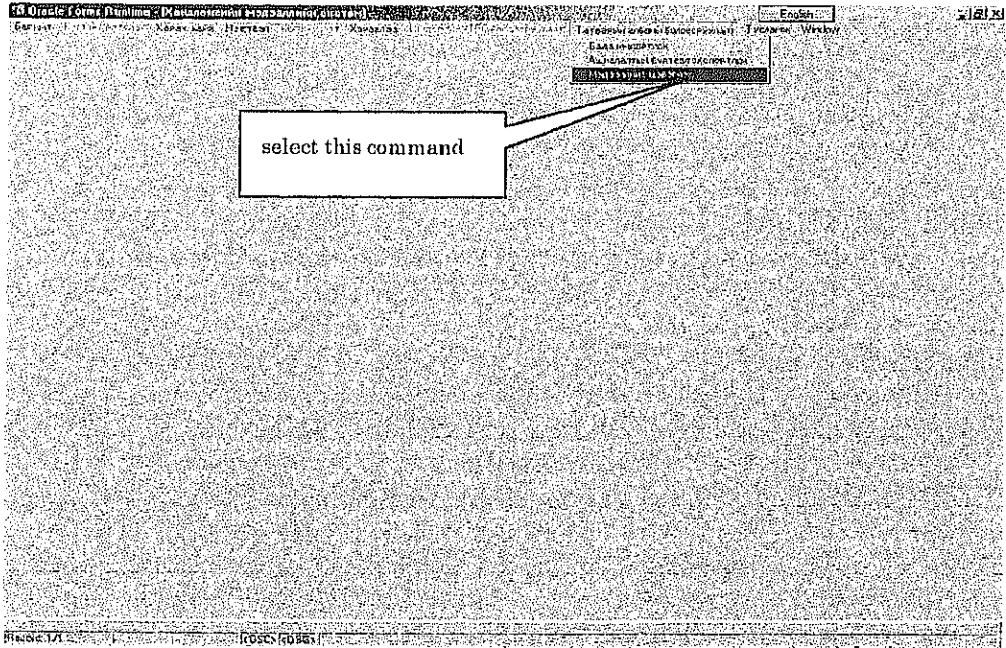
- Record of access to the database (main code-03, specific code-01);
- Utilization summary of the third party information (according to tax inspectors/ main code-03, specific code-02);
- Utilization summary of the third party information (according to types of information/ main code-03, specific code-03);
- Summary of unused information (main code-03, specific code-04);
- Summary of all inputted information (main code-01, specific code-01);
- Summary of customs information (main code-01, specific code-03);

FIVE. DELIVERING UTILIZATION RECORDS TO THE GDNT

Upon accomplishing the following tasks, the Local operator 1 exports and delivers the information utilization records over the WAN to the GDNT within 5th of every month.



Once completed with exportation, you will see "successfully exported". Then click the dump file and send it over the network to the Information processing division of the GDNT.



SIX. INSTRUCTIONS FOR DEFICIENCIES IN THE THIRD PARTY INFORMATION SYSTEM

If there seems to be some trouble or failure with Review, Find, Print, Import and Export tasks, run the "Recompile" on the Help menu. In cases where the numbers of imported dump file sent by GDNT were disordered, or the file missed, the request should be forwarded to the Information processing division of the GDNT to receive the dump file of the third party information. The complete file should be immediately imported.

In case of deficiency in the hardware or software of the database, the computers should be delivered to the GDNT for a new installation.

PROCEDURE FOR COLLECTING AND APPLYING THIRD PARTY INFORMATION TO TAX EXAMINATION

ONE. PURPOSE AND SIGNIFICANCE

- 1.1 The purpose of this procedure is to define outside sources to gather information on income and expense transactions of a taxpayer, establish legal or other conditions to collect the information there from, ensure uniform application of methods to exchange the information between tax offices and utilize them for examination purposes, and thus, to encourage impartiality and equality of the self assessment system.
- 1.2 Collection and Utilization of third party information to examination purposes is of great significance in as there:
 - creating possibility to grasp non-filers or those who intentionally reducing taxable sales and refraining them from such illegal practices and encouraging the self-assessment system which permeates the spirit of voluntary submission of accurate returns;
 - implementing efficient and effective selection of examination targets and supporting the tax offices and tax inspectors to modify or improve the examination work in a more sophisticated light by clarifying transactions with a sufficient degree of probability to contain errors or illegal practices.

TWO. TYPE OF THIRD PARTY INFORMATION

- 2.1 There are various kinds of information that can be obtained on voluntary or statutory basis from those who are business counterparts, customers or partners as regards income and expense or other transactions of the taxpayer. The information received from the individuals or entities on a confidential basis shall not be applied to it and be recorded separately in accordance with "Special procedure for securing and protecting the confidential information received by the tax administration from the individuals" adopted by resolution #31 of the Director General, GDNT in 2000.
- 2.2 The third party information on taxpayers could be classified into the following four types:
 - Information from Government organizations
 - Information from individuals and entities
 - Information from internal source of the tax administration
 - Information from newspaper articles, radio and television and other press media

THREE. COLLECTION OF THIRD PARTY INFORMATION

3.1 Third party information officer

- 3.1.1 It is an official obligation of each inspector to take active part in collecting the third party information and the obligation as regards administration and management of the information system shall be imposed on the either tax examination division or the head of the Information section of the field offices/hereinafter referred to as "third party information officer"/.
- 3.1.2 In pursuant to the obligation set out in 3.1.1 of this procedure, the tax examination division of the GDNT shall undertake the following responsibilities:
- trace all sources to gather the third party information in the course of the tax examination, arrange the way to collect and observe by the tax offices, and if necessary, organize the campaign to collect such information;
 - supervise over the utilization of the third party information by the tax offices and tax officials, train or guide the inspectors on grasping new examination targets and applying for various examination purposes based on the third party information;
- 3.1.3 In pursuant to the obligation set out in 3.1.1 of this procedure, the Data processing and automation division of the GDNT shall undertake the following responsibilities:
- determine all potential sources to collect information from the Government organizations and take organizational actions such as concluding an agreement therewith to collect the information;
 - receive and keep records of the third party information sent by the tax offices
 - automatically process the third party information compiled by the Government organizations and tax offices and create central information database;
 - sort out those information which can not be processed by computer or inputted to the database and deliver them formatting in manual forms to the pertinent tax offices;
 - sort out the third party information, sent by the Government organizations and tax offices, according to tax offices and transmit to the pertinent office on a monthly basis;
 - control over or manage the utilization and security of the information database and receive the utilization records from the tax offices in order to create the united database throughout the country;
 - prepare reports on creation or utilization of the third party information and present to the superior each month;
- 3.1.4 In pursuant to the obligation set out in 3.1.1 of this procedure, the third party information officer of the field offices shall undertake the following responsibilities:

- determine all potential sources to collect information from the local authorities and take organizational actions so that the information is received on regular basis according to the agreement concluded therewith;
- receive the information, collected from the internal source of the tax administration from the appropriate tax official, in accordance with approved forms and supervise over correctness or accuracy of those forms and keep records of such receipt;
- receive the information, obtained during the third party information collection campaign or in the course of the tax examination, in accordance with the approved form and keep records of such receipt;
- receive the information collected by the tax officials from newspaper articles, radio and television and other press media and keep records thereof;
- deliver those information, which can not be processed by computer in spite of

stipulated by this procedure to process automatically, on the taxpayers who belong to the different tax office to the Data processing and automation division of the GDNT.

- receive the third party information database or tabular information sent by the GDNT, provide the tax inspectors who are assigned to conduct an examination as leads

from such information and keep utilization records thereof;

- make analysis on both computer- based or paper-based information compiled in the tax administration and participate in selection of examination targets;
- give a briefing on creation or utilization of the third party information to the head of the office;

3.2 Method, time and forms to collect third party information

Depending on the type of information, the method and forms to be used in collecting third party information shall be varied from one to another/see Table 1/. As the GDNT adds new type of information, the changes shall be done in this procedure towards the method and form of the information.

3.2.1 Information from Government agencies

The system shall be established under which the information is received from other Government agencies on a regular basis according to the agreement concluded therewith. The parties should agree on the content and forms of the information, and the way and time to delivery the information. The following kind of information shall be obtained:

- 3.2.1.1 The third party information officer of GDNT information processing division shall receive the following information from the respective Government

agencies:

- Customs information – from the General Department of Customs Administration;
- Spirits distribution information – from the Ministry of Food and Agriculture;
- Citizen's registration information – from the State center of citizen's registration and information;
- Immovable property registration and changes information – from the Immovable property registration agency;
- Gold sales information – from the Mongol Bank, other commercial banks, the Gold Standard and Control agency, the Mineral resource Authority;
- Mineral resource license information – from the Mineral resource Authority;
- Securities, Government bond, company bond information – from the Stock exchange;
- Bidding information – from the relevant authority announced the bidding;

3.2.1.2 The field offices shall obtain the following information from the pertinent public authorities:

- Information on social insurance claimants - from the local social insurance department;
- gun registration information – from the local police department;
- information on land lease – from the local land administration office;
- information on changes of transport facilities and vehicles – from the traffic police department;

3.2.2 Information from individuals and entities

3.2.2.1 In the course of tax examination, the tax inspector should take notes on transactions of the taxpayer with suspicious or unusual amount made with other taxpayers and other kind of information. The note should be supported by the "third party information sheet" and copies of the original document and be forwarded to the third party information officer.

3.2.2.1 The tax official who obtained such information during the examination shall be fully responsible for correctness of the information.

3.2.2.2 The third party information officer of the GDNT Data processing division shall obtain each month the spirits sales information from the producers. The information should be reflected in "Spirits sales information" form.

3.2.3 Information from internal source of tax administration

3.2.3.1 In compatibility with "Guidelines on VAT implementation", the taxpayers

should submit VAT return together with copies of VAT invoices received from other VAT payers for their purchases. Upon reviewing the accuracy of the VAT invoice items, the tax official shall forward them to the information officer of his/her own office.

- 3.2.3.2 In pursuant to the "Procedure for registering individuals for tax purposes and allocating their tax proceedings", the individuals and entities should quarterly file a withholding tax return (WR-11-2; WR-11-3) for each payer when granting an income to those who performed work and services under the temporary contract or sold goods and materials on a cash basis. Upon examining the correctness of such returns, the tax official shall forward them to the information officer of his/her own office.

3.2.4 Information from newspapers, radio, television or other press media

- 3.2.4.1 The tax official in charge of training and taxpayer service of the tax offices and the Press officer of the GDNT should be very curious keeping any information on newspapers or aired or broadcasted at the center of their attention and, if any unusual or suspicious information discovered, take notes thereon and deliver them information officers.

Table 1

**THE METHOD AND FREQUENCY OF COLLECTING
THE THIRD PARTY INFORMATION**

Type of information	Information sources	Information collected by:			Frequency
		GDNT	Information officers of field offices	Tax officials	
1. Information from Government agencies					
Customs information	CGA	○	-	-	monthly
Spirits distribution information;	the Ministry of Food and Agriculture	○	-	-	monthly
Citizen's registration information	the State center of citizen's registration and information;	○	-	-	quarterly
Immovable property registration and changes information;	the Immovable property registration agency	○	-	-	annually
Gold sales information	the Mongol Bank, other commercial banks, the Gold Standard and Control agency, the Mineral resource Authority	○	-	-	monthly
Mineral resource license information	the Mineral resource Authority	○	-	-	quarterly
Securities, Government bond, company bond information	the Stock exchange	○	-	-	quarterly
Bidding information	Bidding announcer	○	-	-	quarterly
Information on social insurance	The Social insurance department	○	-	-	each time
Gun registration information	The police department	-	○	-	quarterly
Information on land lease;	The land administration office	-	○	-	annually
Information on changes of transport facilities and vehicles;	The traffic police	-	○	-	quarterly
			○	-	quarterly
2. Information from individuals and entities					
Third party information sheet	Taxpayers who are being examined	-	-	○	During the examination
Spirits sales information	Producer of spirits	○	-	-	Monthly
3. Information from internal source of the tax administration					
VAT Invoice	VAT payers	-	-	○	Monthly
Withholding tax return 11(2)	Withholding payer	-	-	○	Quarterly
Withholding tax return 11 (3)	Withholding payer	-	-	○	Quarterly
4. Other information					
	Newspapers, publications, radio, television or other press media	○	-	○	Each time

3.3 Registering and Processing the collected information

3.3.1 Registration

3.3.1.1 The third party information officer of the GDNT Data processing division shall open "Information collection book" and register the information collected as described in to 3.2.1.1 of this procedure according to the following entries:

- type of information
- name of information sender
- way of sending information
- quantity of information
- date of receipt
- status of processing

3.3.1.2 The third party information officer of the tax offices shall open "Information collection book" and register the information collected as described in to 3.2.1.2 and 3.2.4.1 of this procedure according to the following entries:

- type of information
- name of information sender
- way of sending information
- quantity of information
- date of receipt

3.3.1.3 The third party information officer of the tax offices shall open special books for "VAT invoice", "Withholding tax return 11(2)", "Withholding tax return 11(3)", "Third party information sheet". Upon careful examination of accuracy of the information sent to them in accordance with 3.2.3.1, 3.2.3.2 and 3.2.2.2, they shall receive and register the information according to the following entries:

- name of the tax official who sent the information
- date of delivery
- number of pages
- date on which the information was sent to the GDNT
- way and documentations of delivery of information

3.3.2 Processing

3.3.2.1 Computer processing

3.3.2.1.1 The following kind of information should be centralized at the GDNT and computerized:

- Customs information
- Spirits distribution information
- Spirits sales information

- Withholding tax return 11(2)
- Withholding tax return 11(3)
- VAT invoice
- Third party information sheet

3.3.2.1.2 Upon receiving and registering the information as described in 3.3.1.3 of this procedure, the third party information officer of the tax offices shall mail them to the information officer of the GDNT Data processing division by 31st of each month.

3.3.2.1.3 The information officer of the GDNT Data processing division shall computerize the information sent by the tax offices according to 3.3.2.1.2 of this procedure and register to the third party information database. The sequences and procedures for processing the information shall be regulated by a separate guidelines approved by the GDNT.

3.3.2.2 Manual processing

3.3.2.2.1 The information other than described in 3.3.2.1 shall manually sorted out according to the tax official and the tax office.

3.3.2.2.2. The information officer of the GDNT Data processing division shall sort out the following information gathered from the Government agencies according to the tax offices where the taxpayer to whom the information relates and shall issue a tabular form:

- Immovable property registration and changes information;
- Gold sales information;
- Mineral resource license information;
- Securities, Government bond, company bond information; and
- Bidding information

/See table 1/

FOUR. EXCHANGING THE THIRD PARTY INFORMATION BETWEEN TAX OFFICES

- 4.1 Based on the processing described in 3.3.2 of this procedure, the following 2 kinds of information database specialized along tax offices shall be created at the GDNT:
- computerized database of third party information
 - paper-based information table
- 4.2 In case where the information to be processed by computer as set out in 3.3.2.1 of this procedure remains unprocessed due to the failure to meet processing requirements, the tabular form should be issued based on entries of original paper information.
- 4.3 The information indicated in 4.1 and 4.2 of this procedure should be delivered by the GDNT to the tax offices within 31st of each month and the delivery notes should be made in "Records of third party information dissemination" including following entries:
- type of information
 - date of information distribution
 - way of delivery
 - number of taxpayers to whom the information pertains
- 4.4 The information officer of the tax offices shall open a book on "Records of information sent from the GDNT" and make receipt notes on the information that delivered according to 4.3 of this procedure. The note shall contain:
- type of information
 - date of receipt
 - way of delivery
 - number of information
- 4.5 In cases where the taxpayer denies either computerized or paper based information in the course of applying them to the tax examination, the tax inspector may request the original copy of documents that contain such information from the information officer of the GDNT Data processing division. If necessary, the information officer of the GDNT Data processing division may perform tasks to obtain the copy of preliminary records from their first sources due to the absence thereof. Before confirming the information, the taxpayer should be previously explained or warned that if the information was confirmed by the prime documents, his action of denial could be construed as intentional evasion. As the same time, the inspector should avoid any action that the taxpayers deny the information by carefully examining relevant operations that could support in confirming that information.

FIVE. UTILIZING THIRD PARTY INFORMATION

- 5.1 The third party information shall be used for following 2 purposes:
- selecting the taxpayers to be examined;
 - conducting tax examination and detecting errors and illegal practices.
- 5.2 Using the information for examination selection
- 5.2.1 The third party information officer should constantly make analyses on information collected on his/her own or sent by the GDNT and submit his proposal to use those information to the examination based on comparison of the information with the following database inputs of the tax office in order to detect the taxpayers who commit tax violation:
- taxpayers who are not registered with the tax administration, or even registered, paid no taxes but conduct business operation;
 - taxpayers who deals with a sufficient amount of transaction or posses more assets compared with the declared income and assets.
- 5.2.2 The information could be effectively used for target selection in the case of examination along tax categories.
- 5.3 Using the information for conducting tax examination
- 5.3.1 The tax inspector who accepted the examination assignment shall issue "Request for information" and approach to the information officer once get reviewed this form by the head of the office.
- 5.3.2 The information officer of the tax officer shall search for the information requested among the computer-based or paper-based information and hand it over to the pertinent official. In this case, the "Information utilization records"
- which contain the following information should be kept:
- name of the tax official who received the information
 - date of receipt
 - name and TIN of the taxpayer to whom the information pertains
 - number or quantity of information
 - type of information
 - information recognition number

- 5.4 It is unauthorized to use the third party information for other than examination purposes and disclose them to the incompetent body;
- 5.5 Upon completion of the examination, the tax inspector who utilized the third party information shall make notes in the closing entries of the "Request for third party information" and return them back to the information officer. /see table 2/

SIX. SUPERVISING OVER UTILIZATION OF THIRD PARTY INFORMATION

- 6.1 The information officer of the tax officer should on monthly basis make detailed research study which contains the total amount of information collected or sent from the GDNT and the volume of used or unused information and present it to the head of the office. Any measures with respect to enhancing information utilization shall be taken by the head of the office.
- 6.2 The information officer of the tax offices shall send the "Information utilization records" to the GDNT over the network together with a report on information utilization and results, which should be forwarded, to the information officer of the GDNT Data processing division.
- 6.3 The information officer of the GDNT Data processing division shall consolidate the utilization and result report, and present it to the tax examination division or its head.
- 6.4 The information officer of the tax examination division of the GDNT shall bear the responsibilities to improve the utilization or utilization quality of the third party information based on regular analysis and provide the tax offices or tax officials with guidelines and instructions.

Form third-party inf – 02

REQUEST FOR THIRD PARTY INFORMATION

1. Requested by:
State tax inspector _____ Date: _____

2. To whom the information pertains:
Name of a taxpayer: _____ TIN: _____

3. Reason for request: _____

4. Permitted to give information by:
Head of the tax examination division/section/ /
/

5. Number of third party information: _____ Document
recognition number: _____

_____ Closing entries

6. Number of third party information confirmed during the examination: _____
7. Amount of tax violation discovered using third party information

8. Amount of re-assessed taxes, interest and penalties: _____

State tax inspector: _____ / _____

Form third-party inf – 03

**REPORT ON UTILIZATION AND RESULT OF
 THE THIRD PARTY INFORMATION**

Tax department: _____

Financial year/month: ____

№	Type of information	Total
1	Number of information sent by GDNT: - VAT invoice - Withholding tax return 11(2) - Withholding tax return 11(3) - Third party information sheet Number of "Request for information" filed by tax officials	
2	Number of third party information handed to tax officials	
3	Number of third party information confirmed during the tax examination	
4	Detected based on third party information:	
5	- Amount of errors (<i>in thousand tug</i>) - Amount of re-assessed taxes, interest and penalties (<i>in thousand tug</i>)	
6	Number of taxpayers selected for examination based on the third party information	

Prepared by:

Third party information officer

/

/

Date: _____

**MANUAL FOR EXAMINATIONS UTILIZING
THIRD PARTY INFORMATION**

(DRAFT)

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MANUAL FOR EXAMINATIONS UTILIZING THIRD PARTY INFORMATION (DRAFT)

1. *The Significance of Tax Examinations*

Tax examinations have the objective of ensuring that various tax laws and regulations had been observed by the taxpayer and at the same time, it confirms the veracity of the transactions that formed the basis of the income and tax amounts recorded in the corporate tax and various other tax returns. Through the verification process undertaken by the tax authorities, the taxpayers achieving fairness and equity in sharing the tax burden pay proper tax amounts. Moreover, social impartiality of taxation is maintained to assure that tax revenues (which is the core of fiscal policy) continue to grow. Therefore, in initiating tax examinations, the initial assumption is not to necessarily identify facts of underreporting but rather the objective in conducting the examination is simply, "to confirm whether or not the reported amount is correct".

2. *Types of Tax Examinations*

Tax examinations can be classified into various types depending upon the objectives and targets, methodology or timing and contents.

(1) *Compulsory Examination and Voluntary Examination*

"Compulsory Examination", under the Process Law, is a type of criminal examination designed to uncover evidence to support criminal proceedings against a taxpayer who

has committed serious breaches of tax laws, has concealed substantial amount of taxable income, or has committed acts to evade taxation. This process is sometimes referred to as an

"investigation".

In contrast, "Voluntary Examination" is a type of examination where the tax inspector, under the

authority vested by the General Tax Law, undertakes examination of accounting documents and seeks from taxpayer submission of supporting documents. Although it is classified as a voluntary examination, taxpayers who obstruct, resist or take actions harmful to the inspector are subject to the penalties under the provisions of the law. In general, tax examinations refer to "Voluntary Examination" and the procedures for "Voluntary Examination" with a particular emphasis on examinations utilizing Third Party Information will be described.

(2) *Form of General Tax Examinations*

With respect to the form of a general tax examination, although there are no legal or regulatory stipulated form but for the sake of facilitating the description of the content of examinations, the following classifications are made:

A. Preparatory Examination

Preparatory examination refers to examinations that determine examination targets based on the items recorded on the returns or information provided by third parties. Preparatory examinations can further be broken down into (A) Desk Examination and (B) External View Examination.

(A) Desk Examination

In desk examination, in addition to conducting an examination of the returns in the tax offices to determine the propriety of the return through reconciliation against Third Party Information, a determination is made of whether or not the particular taxpayer should be an examination target. Specifically, this will be performed from the following perspectives:

- (i) Make a comparison with the past year's return to determine any irregularities. In other words, determine existence of swings in income reported in the return or anomalies in gross margins or operating profit margins in comparison with peers in same industries.
- (ii) Has there been a substantial lapse in the number of years since the previous examination?
- (iii) Has there been prior history of committing illegal acts such as exclusion of revenues or padding expenses?
- (iv) Is the reported amount excessively low given the favorable state of the industry?

★ **Key** ... To determine whether the industry is in a boom or bust state, the National Tax Agency will need to disseminate to the tax offices information based on government economic reports or mass media reports but the inspectors-in-charge also need to make it a habit to collect information regarding the conditions in various industries for use in selecting the tax examination targets.

- (v.) Determine whether Third Party Information relating to sales, purchases and expenses are reflected in the return details.

★ **Key** ... From here on, collection of information from the Customs Agency relating to exports and imports, paper-based Third Party Information, VAT invoices, statutory receipts and information relating to taxation from other administrative agencies (part of which will be entered into the Third Party Information Database) are expected to

be enhanced and such information is expected to prove helpful not only in the selection of examination targets, but also as suggestive information in identifying taxable income in on-site examinations.

(vi.) Existence of other reasons for selection as an examination target.

If, after undertaking examinations as those listed above, suspicions of underreporting or other illegal acts are still raised, or even if no suspicions have been raised but reasonable grounds exist for examinations such as lack of examinations being performed over an extended period of time or the taxpayer is in a booming industry, the taxpayer shall be selected as an examination target.

(B) External View Examination

External examination is an examination that makes checking on the examination target from the outside. For example, prior to undertaking on-site examination, performing undercover work i.e. disguised as a customer and entering the premises to observe how the cash that was received from a customer is handled, whether sales vouchers are created, the number of customers, the number of employees, determining the business site (in a busy section of the city/town?), etc. in order to gather information that may be useful for the on-site examination. In some cases, actual purchases such as ordering of food or drinks may be made to receive a receipt, which may be used to confirm at the time of on-site examination whether the transaction has been properly recorded. In addition, by observing the store activity from an inconspicuous place, the tax inspector may await arrival of supplies to confirm the identity of suppliers.

B. GDNT In-Office Examination

In the process of examining the return or reconciling the information on the return, a simple mistake has been uncovered. Measures to correct the mistake either by questioning over the telephone or summoning the taxpayer to the tax office is needed prior to being selected as an examination target. Examinations carried out by summoning the taxpayer to the tax office is referred to as "GDNT In-Office Examination".

C. On-Site Examination

This is an examination where the inspector-in-charge makes an on-site visit to the premises of the enterprise (head office/branch/factory site/representative office) to conduct interrogative examination and can be considered as the principal form of examination for a tax inspector.

On-site examination is a tax administration procedure in which the tax inspector, in order to confirm the legality and propriety of tax returns filed for taxpayer's corporate tax, excise tax and withholdings are in accordance with the tax laws, visits the judicial entity's head office

or other premises to interrogate the officials responsible and to physically inspect accounting documents, receipts, invoices, and other records that formed the basis for the preparation of the return, as well as to confirm the inventory and usage of company assets including merchandise, products, and machinery and equipment. On-site examinations, depending upon the existence of prior notices given to the taxpayer, can be classified into the following:

(A) Status Examination

Status examinations are carried out without prior notice and are usually performed on industries where revenues are cash based or on enterprises suspected of illegal transactions. The objective of the status examination is to identify the true state of the enterprise that has not been revealed in the tax returns. Therefore, the examination methodology is weighed toward physical reconciliation to determine the consistency of values confirmed from accounting records at the site of the examination with the basic amounts reported in the return.

(B) Corroborative Examination

Corroborative examination is an examination undertaken with transaction counterparts in order to corroborate the details contained in the returns of the examination target. Among methods employed in corroborative examinations is (i) direct visitation to the transaction counterpart's premise to inspect related documents and (ii) make an inquiry via letter or telephone. The scope of corroborative examination is limited to the items related to the transactions with the examination target.

(C) Bank Examination

Bank examination is undertaken to confirm or inspect transactions (deposits/loans/ fund transfers, etc) with financial institutions including banks but with the scope of the examination being limited to transactions with the examination target, with a primary focus on deposits and withdrawals. At the time of examination, the inspector will present, in addition to his or her own identification, an application form (**warrant instead of application form?**) for examination of financial institutions' records especially issued by the head of each taxing agency.

Credit economy is expected to expand with the development of the economy and instances of enterprises using financial institutions including banks to settle the business transactions will show further expansion. Therefore, in future tax examinations, in order to identify the transactional values for each enterprise and clarify the flow of funds, corroborative examinations on financial institutions will become vital.

3. Basic Methodologies for On-Site Examinations

Various methods can be considered for on-site examinations, whose application depends upon the type of industry or business scale; however, what is described below is what may generally be considered the basic methodology. Therefore, in using this Manual, each inspector, while referring to the basic methods, always needs to practice creativity at his or her own initiative with respect to devising examination methods that would be effective and efficient given the special conditions of the examination target such as its industry type or business scale.

(1) *Items Requiring Confirmation at the Site*

**A. Confirmation of the Industry, Business Conditions and Organization Chart
(Obtain Overall Picture)**

General examinations, except for cases where status examination is required, normally begin with the issuance of an advance notice to the examination target. The initial tasks performed by an inspector upon arrival at the taxpayer's premise at the appointed date and time, if at the offices of an incorporated entity, is to confirm the type of industry the business is operating in. In addition, business conditions must be assessed and the organizational chart that describes the various departmental functions of the institution must be analyzed. By performing these tasks, an overall perspective of the examination target can be achieved.

Specifically, this involves confirmation of the details regarding merchandise or products handled by the enterprise and the workflow from the procurement of the merchandise to the point of sales or the production process from the procurement of raw materials to the finished product. In addition, identifying who in the organization is assigned to a particular operation

clarifies to whom queries should be directed to should questions arise during the examination.

B. Confirmation of Company Books

In parallel with the above tasks, a required task is to confirm the organization of the accounting books. For example, (i) how are the original documents such as vouchers, invoices and receipts and accounting books kept and stored, (ii) how are transactions posted in the ledger, how is cash managed, how are payments made, (iii) authorization process for expenditures of expenses such as entertainment expenses would be included. With respect to the bookkeeping system, presentation of the flow from the original record through to the preparation of financial statements using a flow chart should be considered.

**C. Confirmation of Preparation and Storage of Original Records
(Contracts/Invoices/ Receipts)**

Setting aside cash based industries where both sales and purchases are conducted in cash, normal transactions initially begin with the issuance of a purchase order and based on this order, merchandise is shipped or delivered. In the case of construction or provision of services, a contract is signed and executed when construction commences or services are rendered. In the case of construction work, invoices are sent to the designated party as the construction work progresses. Therefore, under normal circumstances, invoices and receipts should be stored together.

This being the case, in initiating the examination, the location of the files should be confirmed and the reconciliation of the invoices against the receipts will be performed as needed. With respect to receipts, inconsistencies may be found. For example, in the receipts file, the payment has been collected but on the books this has been recorded as suspense receipt or borrowings may be uncovered. In another case, although no invoice exists, a receipt has been issued, a case that may lead to discovery of exclusion of transactions from Sales Revenues.

Due to the above considerations as well as with respect to contracts, invoices and receipts, it is essential that the storage location is confirmed in the early stage of the examination.

D. Confirmation of Relationship with Financial Institutions

Lead banks with which the enterprise has major dealings with are normally listed in the return and it is possible to confirm the accuracy of the ending balances of the depository accounts and the revolvers reported on the return. However, an issue here arises if financial institutions other than those listed on the return are involved. If such unreported financial institutions exist, there is a possibility of unreported deposits and often the revenues that had been excluded from the financial statement reporting are pooled in such accounts. Thus, it is necessary, at the beginning of the examination to confirm with the Company Representative or the Controller as to the existence of relationships with financial institutions other than those listed on the return. If such financial institutions were being used for illegal activities such as concealing income, it would not be an easy task to obtain such information from the affected party. However, there may be cases where calendars or some other giveaway items given to them by a financial institution or from memos belonging to the Controller may provide clues. The inspector needs to pay attention and endeavor to discover any circumstantial evidence.

E. Confirmation of Employee Roster

An item that needs confirmation, along with the organization chart and the individual functions mentioned above, is the employee roster. By reconciling employee roster against work attendance records, fictitious personnel expenses may be uncovered. One such device to mask these types of expenses is through having ghost employees on the payroll.

F. Other Confirmation Items

In on-site examinations, it is important to take a walk around with the guide of the enterprise, head office premise, branch, and factory or retail outlet and observe the daily activities. During such tour, the inspector should confirm the books, documents and office equipment that are located on the desks of the offices, and apply such observations in confirming business processes or accounting operation procedures. Further, it is necessary to check whether factory equipment or other equipment have been newly installed, and query the site staff as to the state of product inventory, how inventory count is performed or existence of non-inventory items to ensure a complete examination.

(2) Methods to Identify Illegal Items

After completion of the confirmation tasks outlined in (1) above, the main body of the examination will begin. Below we discuss the principal examination items in order.

A. Books and Documents That Form the Basis of the Return

The inspector will check the reported items on the corporate tax return using books and documents submitted by the enterprise, but as a starting point, it is necessary to confirm whether the books and documents submitted are, indeed, those that form the basis of the preparation of the return. In order to confirm this, the relationship between the books and documents and the return must first be established with the Controller to confirm the consistency among the monetary figures.

If Third Party Information (i.e. customs information, Third Party Information Paper) with respect to sales, purchases or expenses had been brought along, based on the date of the transaction, perform reconciliation to confirm that it has been recorded onto the accounting records and also check to see whether the transaction can be confirmed by a contract, an invoice, a receipt or any other original records. If omissions in recording are found or otherwise an item cannot be properly reconciled, the credibility of the books will diminish. The inspector must then press the Controller with respect to other revenue exclusion or padding of expenses in order to expose illegal activities. With respect to purchases, personnel expenses and outside contracting fees, check against industry peers for existence of any unusual items and if there are suspicions of the existence of fictitious expenses, conduct corroborative examinations on its transaction counterparts or confirm the working status of employees and make a judgment as to the appropriateness of the expenses in question.

If intentional underreporting by using double set of books exists, determine the legitimacy of the book through analysis of handwriting or other means. For example, if the books are those that are used in daily recording, passage of time can be seen in the writing but if the books were rewritten after several months have lapsed, remnants of the prior entries will remain and the inspector must be meticulous to check for irregularities in the books.

B. Physical Confirmation of Cash and the Like

In conducting status examinations of cash based operators, first conduct a physical check of cash when visiting the premises. For example, if an inspector arrives for examination at the site in the afternoon, check the sales vouchers and cash balances for the sales during the morning. The cash related to that particular day's sales should be stored in the cash register or in a back office safe. By confirming this, the sales revenue for the half-day can be verified and in some cases may lead to uncovering exclusion of sales by not preparing sales vouchers for some of the sales; therefore, this task can be very important in making confirmations. The enterprise may explain that money other than sales proceeds are intermingled with the sales revenues, but by asking the source and nature of those funds, it may lead to facts that may lead to additional taxation. If cash is stored in a safe, with the enterprise's consent, have the safe opened and confirm the contents of the safe. In many cases, such confirmations provide a lead to further examinations. In other words, if the representative's personal bankbooks are intermingled with the enterprise's bankbooks, suspecting that it may be the enterprise's non-recorded deposits is not far-fetched. By clarifying the facts such as the opening of the account, deposits and withdrawals, and movement of funds, transaction counterparts that had not been made public may become known.

C. Examination of Financial Institutions

If financial institutions or transaction counterparts that have not been included in the return are uncovered from bankbooks from the safe, memo or other data from accounting documents, by undertaking corroborative examinations on those institutions, income that had been omitted may be identified. It is important to note that considering the recent economic growth and the accompanying expansion of the credit economy, it is natural to expect that increasing amounts of transaction settlements will be conducted through financial institutions. Therefore, by undertaking corroborative examinations on financial institutions, it facilitates the identification of off-the-book deposits and transactions making such corroborative examinations on financial institutions an indispensable component of examinations.

4. Case Studies of Examinations Utilizing Third Party Information

Case examples cited below are case studies that show the different ways of uncovering tax evasion using Third Party Information. These examples have been taken from among real-life examples of exemplary examinations that had been made public in Japan and which were thought to be applicable in the situation prevailing in Mongolia. They have been edited to be used as reference for inspectors in Mongolia. Although it may not exactly be directly applicable to Mongolian examination cases, we hope that it will serve as a useful tool in performing examinations.

[Case 1] Case in which an illegal transaction relating to purchases made that did

not match the amounts recorded on the books (otherwise known as falsification of records) was uncovered through information obtained from third parties.

Examination Target A Industry Electrical Cable/Electrical Materials Wholesaler
Reasons for its selection as an examination target
..... Although the industry was in the midst of a building construction boom, the company's declared income was considered low relative to its peers in the same type of industry.

Emphasis for the examination The ratio of cost of goods sold reported on the corporate tax return was higher in comparison with its peers, thus emphasis was placed on purchases (an
examination of the ratio of cost of goods sold was conducted during the preliminary examination at the time of the selection of examination targets).

Third party information obtainedThird Party Information Paper prepared by inspectors at other district tax offices.

☆Content of information

Transactional information relating to Sales (for Company A transactional information relating to purchases) collected from Company B and several other companies who are transaction counterparts (suppliers) of A.

Details of the Examination Upon reconciliation of purchase amounts recorded in A's books and purchase amounts from the Third Party Information Paper, inconsistencies were discovered in the case of several companies. An immediate corroborative examination was performed on one of the companies, which resulted in an admission that upon request from Company A, fictitious delivery slips were prepared and padded invoices were issued. Based on this discovery, Company A's representative was summoned for an explanation and to which he responded that due to the customer request, offsetting fictitious transactions were setup whereby a sale and a purchase would be recorded on the books. The

funds received as sales was then booked as cost of goods sold in purchases and paid as a rebate to the

customer.

At this point, in collaboration with other district tax offices, cash suppliers whose transaction information did not match the customers to whom the said goods were sold to, in addition to B, were selected to be targets of corroborative examination. The result of the examinations showed: (i) In the transaction affiliation including examination target A, a series of transactions were transacted with each performing illegal calculations such as each taking out some percentage off the margins at each step, and (ii) examination target Company A admitted to the fact that it received from the customer fees for the illegal participation in its off the book operations.

★ Key Because the Third Party Information Paper collected by an inspector in another tax district during the course of his or her examination had contained the true sales value of the customer, the illegal calculations relating to the purchases made by the examination target enterprise was able to be identified. This, in turn, led to collaborative examinations among several related district tax offices and ultimately resulted in uncovering fraud committed by several companies.

This is a prime example of how a little piece of Third Party Information can be of such importance in tax examinations.

[Case 2] **Case in which failure by an enterprise, who commissioned the building, to withhold taxes from compensation to the building architect was uncovered when the individual architect's name appeared on the building completion announcement.**

Examination target Company C Industry Apparel Retailer

Reasons for its selection as an examination target An advertisement for building completion placed by an incorporated entity (Company C) in a newspaper contained the name of an individual architect; however, upon further investigation, it was discovered that the incorporated entity had not paid the withholding tax on the Income and it was presumed that tax was

not withheld on the compensation paid to the architect.

Emphasis for the examination Confirmation of the fact that the compensation paid by Company C to the architect and others were subject to tax withholdings.

Third party information obtained ... Third Party Information Paper (investigative information) collected from a newspaper advertisement

☆ Information Content

In an advertisement placed by Company C in a newspaper announcing the completion of an apparel retail store, the name of the architect who undertook the design and supervision of the construction was listed alongside the name of the company that had the building commissioned, thus requiring confirmation of tax withholdings from the architect's compensation.

Details of the Examination..... In performing the examination, in addition to the interrogation with respect to the design/supervision relating to the construction and the payroll method, the following items were requested to be submitted to the tax authorities: agreements, invoices, and receipts. Based on these documents, payments made that were subject to taxation were brought to light. As a result, with respect to the compensation relating to the architect's design and supervision, it was determined that taxes were not withheld from the compensation paid and therefore, an agreement was reached whereby the entire tax amount owed was paid. With respect to this point, the company representative explained that he had been under the erroneous understanding that self-employed were not subject to withholdings as they declare their full income in their final tax returns. From the above examination, it was confirmed that taxes were not withheld off the architect's compensation due to a misunderstanding of the tax laws.

★Key This is a case where the failure to withheld the appropriate Income taxes were identified using

mass media information. Not only the inspectors but all taxation staff should always be on the lookout for any information that may lead to the prosecution of tax evaders. Measures such as the preparation of a Third Party Information Paper, data entry into the Third Party Information Database, or circulation of Third Party Information to the jurisdictional tax offices should be undertaken.

[Case 3] Case in which illegal acts committed by the inspected enterprise was uncovered from internal documents (Tax return and the attached supporting documents submitted by its transaction counterpart).

Examination target Company C Industry ...Contract Processing of Machine Parts

Reasons for its selection as an examination target ... In comparing past years' corporate tax returns and attached statements, there were variances in the proportion of material purchases to its revenues and in spite of substantial increases in entertainment expenses every year, this was not reflected in any increase in revenues, thus illegal calculation was presumed.

Emphasis for the examination Identification of examination target's customers and confirmation of transaction amounts with the customers (revenue amounts), identification of relationship with financial institutions, and confirmation of deposits and withdrawals.

Third party information obtained ... With respect to the transaction counterpart enterprise (customer), in reconciling purchase amounts garnered from the returns and the attached documents (internal documents) of several companies within the jurisdiction of the tax office and the sales revenues recorded in the returns and the attached documents filed by the examination target, substantial discrepancies were found. This discrepancy was then placed as a priority confirmation item in the on-site examination.

Details of the Examination At the time of on-site examination, the representative was questioned with regard to the discrepancies in the amounts reported by its

transaction counterparts and the amounts reported by the enterprise. The representative countered by insisting that he had not made any mistakes on his calculations and the investigation hit a dead end; therefore, corroborative examinations were performed on several of their transaction counterparts. From one of the corroborative examinations, a funds transfer made to a financial institution that had not been included in the return was discovered. Immediately, a corroborative examination was undertaken on that particular financial institution resulting in an identification of a savings account belonging to Company D to which numerous deposits had been made. From these deposits, revenues that had not been recorded in the returns and incomes that were underreported were uncovered

Based on these facts, when seeking clarification from the representative, it was confirmed that when preparing the true checking records, invoices, receipts, and another set of original records were created at the same time for tax purposes with the intention of excluding portions of revenues to evade taxes. The siphoned funds were used to purchase

a condominium and the full picture of the illegal acts unraveled.

★ Key In conducting on-site examinations, it is a normal procedure to reconcile accounting records with the original records. However, in this case, with the original records being tampered with (sales being underreported and expenses being overstated while at the same time bookkeeping records such as the sales ledger being recorded to match such manipulations, it would be difficult to detect illegal acts from a simple reconciliation alone. In such cases, by reconciling using returns and supporting documents that had previously been submitted by transaction counterparts against the enterprise's return, illegal activities can be uncovered. However, even using this methodology, if both enterprises collude and mirror the under-reported income, it would not be possible to uncover the illegal acts

and a separate investigation via corroborative examination on the financial institution is necessary. Nevertheless, it should not be forgotten that valuable information could be obtained from an internal source near at hand.

[Case 4] Case in which maintenance of double books was discovered through status examination using sales information that was collected from a Construction Material Wholesaler and current year books as clues

Examination target Company E Industry Steel Frame Construction

Reasons for its selection as an examination target ... In spite of the prevailing consensus of increases in big ticket constructions, the Income reported was relatively low.

Emphasis for the examination Confirmation of the sales revenues and purchases reported on the return.

Third party information obtained Third Party Information Paper collected from the Construction Materials Wholesaler, which is a trade partner of the examination target (sales data of the trade partner, vis-à-vis the examination target's purchase data)

Details of the Examination Upon paying a visit to the premises without any prior notice and performing an examination on the bookkeeping documents, in spite of the current year tax return showing substantial cash purchases, there were no purchases reported on prior tax returns. Also, when the transaction amount relating to material purchases recorded in

the Third Party Information (material at hand) and the books kept by Company E were reconciled, it was discovered that a portion of the transaction amounts were not recorded. In addition, when a cash examination was performed at the representative's own residence, many receipts relating to cash purchases for current and prior years within the statute of limitation were found from the safe. An explanation was sought for the receipts but due to the fear of self-incrimination, a clear answer could not be had. With the

representative's consent, a status examination was conducted and books (believed to contain the actual transactions) relevant to the investigation were found from the closet in the living room. Immediately, corroborative examinations were performed on the transaction counterparts listed in the books which resulted in the identification of substantial revenues and purchases that had been deliberately omitted and due to the conditions of the settlement, an examination of the banks used were performed yielding five accounts under false names. When confronted with the facts, the representative admitted to having excluded, at settlement time, non-repetitive transactions and reduced purchases accordingly, depositing the residual amount into false bank accounts

★ Key

In this case, an examination was conducted without prior notice to the offices of the enterprise in question and a status examination was made at the residence of the representative where it was discovered that a double set of books existed. It can then be inferred that the enterprise intended to underreport to evade taxes. Although it may be a dime in a dozen to discover the existence of double books, in an industry where cash transactions prevail, a surprise visit to the office or residence and performing a cash examination is an effective method. With the additional privilege of being able to open an in-house safe, other valuable information that may be used as the basis for additional taxation may surface. In this particular case, the transaction information that had been obtained in advance provided clues and the succeeding examination went well. Hopefully, this has provided an appreciation for the effectiveness of Third Party Information.

[Case 5] Case where using delivery slip collected from a garbage bin and a road construction sign as clues, through the attachment of the accounts receivable of the delinquent enterprise, achieved

successful collection.

History of tax arrears..... Company F was operating a steel mill but due to a dramatic decline in orders, the company's dealings with financial institutions were suspended. The company filed for bankruptcy with withheld income taxes in arrears.

Measures taken by the jurisdictional tax office • The responsible tax collection officer at the jurisdictional tax office, upon learning of the bankruptcy, rushed to Company F's premises. Unfortunately, the factory has closed its doors and its creditors had seized all its equipment. In addition, the whereabouts of the representative was unknown.

An asset examination was then made based upon Company F's financial settlement statements. The company did not own any real estate and the deposits were expected to be in flight. Account receivables and guarantees had already been recouped by the representative prior to the suspension of transactions with the financial institution and it is clear that this was a case of premeditated bankruptcy. In order to obtain some lead for collection purposes, after making a thorough check of the environs, a delivery slip issued to Company G and a transaction counter that was not recorded on its books was found from a garbage bin in front of the office. Immediately, a visit was made to Company G and after an examination, the account receivable was found to be unpaid. An attachment was immediately placed on the account receivable. In addition, several days hence, a road construction sign bearing Company F's name was seen by the inspector on his way to work. As it was a road construction, it was surmised that it was a contract work from a government agency. The inspector then proceeded to the division in charge of road construction contracts in the UB municipal office and discovered construction payments for land grading that exceeded the amount in arrears; this was also immediately attached.

Company F was subsequently declared bankrupt but due to the attachment to the receivables, the collection was completed.

★ Key This example is a case where prompt and meticulous examination after the bankruptcy led to the discovery of a previously unknown transaction counterpart which resulted to the successful collection of the tax arrears. Of particular interest is the methodology used

whereby the delivery slip found by the inspector from the garbage bin in front of the premises of the enterprise in question contained vital information that led to the discovery of a previously unknown transaction counterpart. Furthermore, through the clever work of the tax inspector who happened to chance upon a road construction sign, the discovery of a project that the enterprise in question was associated with identified account receivables that could be attached by the tax authorities to satisfy the tax arrears. This example is one that may be applicable to other corporate tax examinations and provides a lesson showing the importance of devotion and power of observation to tax examinations.

On another note, it is expected that various bid information will be collected from each administrative agency as paper information, and from the bid information, it would be possible to derive the contractor's incomes related to contracting the project. It is hoped that such information may be utilized not only in cases relating to collection, as in this particular case, but also in identifying incomes related to other businesses.

5. Forms Required for Tax Examination

Forms used in the course of performing "Preparatory Examination", "Hearing during On-Site Examination", and "Examination Results Report" is shown below.

(1) Preparatory Examination Examination Items

Preparatory Examination Examination Table						
Industry			Name			
Reason for Examination						
Ratio Analysis	Classification		Reported Amount	Actual Amount	Peers	
	Margin	%				
	SG & A Ratio	%				
	Computed Income Ratio	%				
	Inventory Turnover	Times				
	Sales Per Employee	Tg				
Efficiency Analysis	Annual Sales Per Employee × No. of Employees = Annual Gross Sales Sales per unit of electricity consumed × Electricity consumed = Gross Sales					
Use Third Party Information	Type of Third Party Info	Content	Utilization Results			
			Effective		Not Effective	
			Discovery	Other	Check	Other
	Information Paper	Transactional Information Relating to Sales				
	From Third Party Customs Info	Transactional Information Relating to Imports of Material				
Focus items in using Third Party Information	(Inspector)			(General Manager: Examination Dept)		
Other Items Of Special						

(2) Hearing Items during Site Examination

Business Summary Sheet

As of.....

1. Summary of the Business

Entrepreneur	Address		Telephone No	
			Telephone No	
	Individual	Name	Taxpayer Number	
			Taxpayer Number	
Company	Name	Taxpayer Number		
	Representative	Taxpayer Number		
Store	Location		Store Name	
Business Details (Products)	()		Date Established	• •
	()		Date Renovated	• •
	()		Business Hours	~
Employees			Personnel Expenses	
Owner • Family	Persons		Monthly Average	Tg
Employed	Persons	Annual Changes	Annual	Tg
Part Time	Persons		Part Time	Tg
Regular Holidays			Store Condition	
Per week Sunday		Per month Days	Excellent • Good • Satisfactory • Bad (Site conditions)	
Facility Conditions				
Counters	Persons		Machine • Equipment	Total
Tables	Total	Persons		
Rooms	Rooms	Persons		
Other	Persons			
	Persons			
Commercial Banks				
Name of Bank	/		/	/
Reference Items (Acct Name • No.)				

2. Method of Cash Control

Cash Register • Safe • Cash Box • Other ()	
Person-in-Charge	

3. Preparations and Storage of Original Records

Cash Register Roll	Receipts	Invoices	Memoranda		
Y / N	Y / N	Y / N	Y / N	Y / N	Y / N

4. Certificates Prepared and Received

	Time of Order (Time of Placing Order)	of Purchases	Time of Invoice Receipt	of Supply (Time of Payment)	of	Copy of items delivered to counterpart and items received. How are they sorted?
Sales						
Purchases						
Cost						

5. Types of Books on File and State of the Record

Books on File		Extent of Records	of	Books on File		Extent of Records
Cash Book	Y / N	(Until Y / N)		Purchase Book	Y / N	(Until Y / N)
Sales Book	Y / N	(Until Y / N)		Accounts Payable Book	Y / N	(Until Y / N)
Accounts Receivable Book	Y / N	(Until Y / N)		Cost Book	Y / N	(Until Y / N)

6. Check during Examination (i) (If appropriate mark with "O", if inappropriate mark with "x".)

Sale	Purchase	Cost
Recording Cash Sales	Recording Cash Purchases	Recording Personnel Expense
Recording One-time (Temp) Sales	Recording One-time (Temp) Purchase	Balance between the Sales and the Purchase related to that Sale
Recording of Remote Sales	Recording of Remote Purchases	
Recording of Settlements via Funds Transfer	Seasonality Changes	Existence of Costs not related to business
Recording of Sale Day Proceeds		Apportion household related Costs
Recording of Self-Consumed Amount		Exclusion of Household Cost
Seasonality Changes		
Recording of Sundry Income (Rebates, etc)		

Calculation of Depreciation Expense

Asset class		Acq. Price	Dep. Method		Calculated Dep Amount	Dep Period	Normal Dep. Amt.	(% dedicated) to business) Depreciation Business portion	Amount that had been expensed as depreciation	Over depreciation or under-depreciation	End of Year undepreciated Balance
Type	Date	Resid. Value	Dep. Life				Add (Special) Dep.				
& Detail	Date	Depreciation Base	Dep. Rate				Total				
		Tg	Str Line DBL		Tg		%	Tg	Tg	Tg	
			Year				Tg				
			%		12						
		Tg	Str Line DBL		Tg		%	Tg	Tg	Tg	
			Year				Tg				
			%		12						
		Tg	Str Line DBL		Tg		%	Tg	Tg	Tg	
			Year				Tg				
			%		12						
		Tg	Str Line DBL		Tg		%	Tg	Tg	Tg	
			Year				Tg				
			%		12						
		Tg	Str Line DBL		Tg		%	Tg	Tg	Tg	
			Year				Tg				
			%		12						
Total	-	-	-		-	-	-	-	-	-	

(Note) In the upper row in the date column of "Asset Class", enter the date on which the item was placed in or taken out of "business use".

Examination of Assets and Liabilities							
Assets				Liabilities			
Item	Beginning Balance (as of)	Ending Balance (as of)	Change (as of)	Item	Beginning Balance (as of)	Ending Balance (as of)	Change (as of)
Cash				Accounts Payable			Tg
Demand Deposit				Short/Long Term Debt			
Time Deposit				Unpaid Liabilities			
Other Deposit				Advances Received			
Accounts Receivable				Deposits			
Securities				Accrued Taxes			
Inventory							
Prepaid Amounts							
Loans							
Building							
Building Appurtenance							
Machinery				Allowance for Bad Loans			
Transportation Equip							
Equip. Tools							
Land							
Depreciation Expense (Δ)		①		Total		②	

Net Change (①-②) ③ Tg

Item	Amount	Item	Amount		
A D D	Living Expense	Tg	D E D U C T	Deposit Interest	Tg
	Disallowed Household-related Items				
	Income Tax				
	Other Taxes				
	Household Consumption				
	Total	④		Total	⑤

Income Amount (③+④-⑤) Tg

Income Amount from Examination Tg

Calculation of Product Manufacturing Cost				
	Class	Gross Cost of Manufacturing		Calculation Process for Actual Amount
		Reported Amount	Actual Amount	
Raw Materials Expense	(i) Beginning Balance – Raw Materials			
	((ii) Cash Purchase			
	((iii) Purchase on A/C			
	(iv) Returns & Discount			
	(v) Net Purchase			
	(vi) Sub Total ((i) + (v))			
	(vii) End of Period Balance – Raw materials			
	(viii) Raw Materials Expense ((vi) – (vii))			
Expenses Other Than Raw Materials Expense	(ix) Labor Expense			
	(x) Subcontracting Expense			
	(xi) Electricity			
	(xii) Water and Heating			
	(xiii) Repairs & Maintenance			
	(xiv) Depreciation Expense			
	(xv)			
	(xvi)			
	(xvii)			
	(xviii)			
	(xix)			
	(xx) Miscellaneous Expense			
(xxi) Total Expenses Other than Raw Materials Expense				
(xxii) Gross Manufacturing Cost ((viii) + (xxi))				
(xxiii) Beginning Work in Process Inventory				
(xxiv) Subtotal ((xxii) + (xxiii))				
(xxv) Ending Work in Process Inventory				
(xxvi) Product Manufacturing Cost ((xxv) – (xxvi))				

2 PRESUMPTIVE TAXATION

2.1 PURPOSES FOR PREPARING GUIDELINES FOR PRESUMPTIVE TAXATION

This chapter serves as the "Guidelines for Presumptive Taxation".

As stated below, a self-assessment tax system is adopted for individual income tax, corporate income tax and VAT in Mongolia. Therefore, taxpayers who operate enterprises must personally calculate taxable income and tax amounts based on bookkeeping documents that record operational revenues and expense, in principle.

In reality, however, it is extremely difficult to ask all taxpayers to calculate tax amounts based on actual figures recorded in accounting books.

Meanwhile, because it is a great principle of taxation for all taxpayers to bear taxes in an appropriate and fair manner, based on provisions of laws and ordinances, no taxpayer will be allowed to escape from tax payment for reasons of inability to implement accurate income calculations due to the lack of accounting book records. This is based on the viewpoint of establishing a fair balance with taxpayers who carry out appropriate tax returns based on accounting books.

Presumptive taxation means estimating income based on some indirect data, other than accounting documents, when bookkeeping records do not exist and, therefore, accurate income calculation is impossible. Accordingly, it is the right and obligation of tax administration that have the mission of implementing appropriate and fair taxes to carry out presumptive taxation.

In the examination of non-declarers or excessively small declares by the tax inspectors in charge, the practice of calculating income and expenditure based on talking to the taxpayers, examination of trade partners and data/information from the organizations concerned, and determining operational profits are actually implemented when accounting books related to operational transactions or original data/records are not available. However, we cannot disregard the current situation in which, when presumptive taxation is disputed at a court trial, tax imposition is canceled at a fairly high rate. Although many factors are conceivable for this state of affairs, particularly in the case of presumptive taxation, the biggest reason is considered to be insufficient verification of "need for presumption" or "reasonableness of presumption" based on objective evidence data.

"Guidelines for Presumptive Taxation" in this chapter are designed to provide a theoretical and systematic guide, regarding specific presumption methods in the case of presumptive taxation, to handle such situations. In addition, they would be useful in determining taxable incomes which are needed for calculating taxes such as individual income tax, corporate income tax or VAT.

Although this guide is an easy-to-understand summary of the basic thinking in the case

of estimating income, it should be first recognized that the methods stated herein cannot be used for all lines of business at any time and as they are.

Accordingly, in actual presumptive taxation, it is important for tax inspectors themselves to think deeply and devise the most reasonable and objective presumption methods, while referring to the methods and reasoning shown in the guidelines.

Further in the future, we would like to request that this guide be suitably added to, delete from, or otherwise revised to become better to meet the prevailing situation in Mongolia, based on actual examples of presumptive taxation.

2. 2 SELF-ASSESSMENT TAXATION SYSTEM AND PRESUMPTIVE TAXATION

2.2.1 Provisions Relating to Self-Assessment Taxation System

Article 9 of the General Tax Law 《Provisions for Tax Payment》 Clause 1 states that “tax shall be imposed based on income tax returns submitted by incorporated enterprises or income tax returns filed by individuals or through withholding at source”, and Article 10 of the same law 《Taxpayer’s Obligations》 Clause 2 provides that “calculations and returns regarding taxation and tax payment shall be submitted to the tax office by the due date.”, while Clause 3 of the same Article stipulates that “journals and ledgers shall be recorded in accordance with the rules and accounting reports shall be submitted”. Article 8 of the Law on Supervision of Tax Assessment and Payment and Tax Collection 《Records and Retention of Evidential Documents regarding Taxes and Accounting Documents》 provides that “the taxpayer shall prepare evidential documents that clarify items that are subject to taxation and the assessment amount in accordance with the laws.”, and again Article 15 《Calculation of Tax Amounts and Examinations》 Clause 1 stipulates that “taxpayers shall calculates its own tax amounts based on related documents and books and shall record such amount in the tax report...”

Therefore, under the Law it is intended that, in principle, taxable income and tax amounts for both the corporate and individual income tax are calculated by the taxpayer based on accounting records including journals and ledgers and other accounting documents. Accordingly, by submitting an income tax return that contains the results of such calculations and makes tax payments. In another words, for both the corporate tax and the individual income tax purposes, self-assessment system has been adopted for both corporate and individual income tax.

2.2.2 Provisions for Presumptive Taxation

The General Tax Law Article 24 《Authority of the Tax Administration and Tax Inspectors》 Clause 1(ii) stipulates that “taxes will be levied based on a model as determined by the Law in the case of taxpayers who do not maintain journals or ledgers and cannot define revenues and expenses”. Article 15 of the Laws on Supervision of

Tax Assessment and Payment and Tax Collection 《Calculation of Tax Amounts and Examinations》 Clause 1 provides that "if it is deemed that the taxpayer erroneously calculated tax amounts, the tax amounts shall be determined by an examination by the tax administration and tax inspectors". Along with this provision, Clause 2 of the same Article provides that "the tax administration and tax inspectors will determine tax amounts by calculations based on information and recorded documents, by examination or by approximating the amount in comparison with other taxpayers, if the taxpayer fails to file a return by due date or does not record tax amounts in the filed return." Furthermore, Article 17 of the same Law 《Calculation of Tax Amounts in Comparison with Others》 Clause 1 provides that "in cases where a taxpayer is engaged in production or service, or it is uncertain that the taxpayer is engaged in such activities, but does not maintain evidential documents relating to the business or maintain books or records that they keep are incomplete and has not submitted the documents and tax

reports necessary to file taxes, the tax administration shall perform calculation in comparison with others". Clause 2 of the same Article stipulates that "calculation of tax amounts in comparison with others means that if a taxpayer exists in the same region who are engaged in substantially the same production or service of substantially the same scale and conditions, such case shall be adopted, but if no such taxpayer exists, the tax amounts shall be determined based on the scale, revenues and expenses and other data of several taxpayers in the vicinity. If the taxpayer was engaged in the business for two consecutive years prior to this taxation year, tax amounts may be calculated based on the documents and books relating to those periods".

On the other hand, the latter portion of the Individual Income Tax Law Article 5 《Calculation of Taxable Income》 Clause 2 《Taxable Income of Self-employed Taxpayer》 provides that "the taxable income is undetermined or indeterminable, the tax administration shall determine tax amounts based on comparisons with other self-employed taxpayers in similar natural, climatic and market conditions and with similar products."

That is to say, in the case of incorporated and individual self-employed, if no books are kept or are incomplete if kept, or other evidential documents such as invoices, receipts, contracts, certificates, or memos (referred to collectively as "original records") necessary for the calculation of income are lacking, and thus rendering it impossible to calculate said taxpayer's income from business revenues and expense figures, it provides, in effect, for the determination of income based on comparisons with taxpayers who are engaged in the same production or provision of service of the same scale and under the same conditions in the same area.

The above provisions provide the tax administration with authority to recognize income that has been calculated based on the indirect methodology of comparisons when the calculation of income is not possible due to the lack of bookkeeping or other original records. From the perspective of fairness under taxation, it would not be tolerable to

forgo the imposition of taxation simply because of lack of necessary bookkeeping or original records, and this can be interpreted as providing for, in an instructional manner, the justly held authority of the tax administration in income certification.

Below, we refer to the calculation of income based directly on bookkeeping figures (actual amounts) relating to business revenues and expenses as actual amount taxation and, in contrast, income calculated indirectly such as through comparisons shall be referred to as Presumptive Taxation.

2.3 PROVISION OF DIRECTIVES RELATING TO PRESUMPTIVE TAXATION

A directive (the Director General of the GDNT Instruction No. 98 Dated September 3 1996 Attachment 2 "Rules Regarding Presumptive Taxation") was issued by the Director General of the GDNT, in response to the provisions regarding presumptive taxation in the General Tax Law, Laws on Supervision of Tax Assessment and Payment and Tax Collection and the provisions regarding the Individual Income Tax Law as described in 2.2 above. Under the rules, it provides that presumptive taxation methods may be applied if those engaged in manufacturing and provision of services do not maintain accounting documents relating to the business activities or if the books are not being kept in accordance with the Laws, and lists the following three alternatives as methods for presumptive taxation.

- (1) If there is a taxpayer who is engaged in manufacturing and the provision of services with the equivalent production capacity and in the same condition in the same area as the subject taxpayer, then presumptive taxation will be applied based on the revenues, profits, expenses and other items of account settlements of the manufacturing and service business of such taxpayer.
- (2) If said taxpayer has been engaged in similar business for at least two consecutive years prior to the current taxation year, presumptive taxation shall be applied based on documents and accounting books relating to those operations.
- (3) Presumptive taxation shall be applied based on operating records.

2.4 MATTERS FOR SPECIAL ATTENTION IN THE APPLICATION OF PRESUMPTIVE TAXATION

The significance of presumptive taxation, its basis and methods of estimation are described in sections 2.2 and 2.3 above; however, the following items must be borne in mind when applying presumptive taxation.

The method of presumptive taxation must correspond reasonably to the taxpayer to whom it is applied and, rather than a method that is predetermined by the business in which the taxpayer is engaged, the method of estimation should differ depending on such factors as:

- (a) the types of business in which the said taxpayer is engaged,
- (b) the facts had been uncovered in the course of the examination, and

- (c) the types of operating books or original records have been identified in the course of the examination of the taxpayer.

Thus, it is essential to adopt the most appropriate estimation method based on the said facts and data. The facts and data that are uncovered are varied and individually unique, and many different methods of estimation using such data are possible. Thus, the inspector must use originality and ingenuity, while adopting the generalized estimation methodology described below, when deciding upon the manner in which to calculate figures that are as objective as possible.

Presumptive taxation does not mean a special taxation treatment, but it is merely basing the calculation of income on indirect data such as comparisons (presumptive taxation) as opposed to calculating the income based on direct data such as accounting books relating to operating revenues and expenses (actual amount taxation). Thus, the difference between the two taxation methods is merely the difference in the way in which the income is recognized. Since presumptive taxation is applied when actual amount taxation cannot be implemented even with ordinary tax examinations that are thoroughgoing, there is an obvious need to improve the level of expertise in general examinations.

2.5 METHOD OF ESTIMATING INCOME

As stated above, the method of estimating income must be the most reasonably appropriate method selected from among many that are possible based on the taxpayer's business, facts identified during the course of the examination, and data relating to the business. Below we have attempted to outline methods that could be generally considered.

When displaying the method of estimation of income, the method of computation of the business profit (Editor's Note: in Japan this is generally referred to as "Business Profit")

must be made clear as a precondition, and the terminology used in the estimation needs to be made consistent. Thus, after a discussion of the formula and definition of terminology and classifying the estimation methods, detailed discussions on specific estimation methods will be made.

2.5.1 Formula for the Calculation of Gross Income and Business Profits

ℵ Sales - ℄ Cost of Goods Sold = ℹ Gross Income ("gross profit" in Japan)

(Revenue) (Cost of Procurement)

ℹ Gross Income - ℆ General Expenses = ⊗ Business Profit ("income" in

Japan)

[N.B.] General expenses are expenses (e.g., personnel expenses, rents and cost of consumables) that are authorized by Law as expenses, in addition to the Cost of Goods Sold (hereinafter "CGS").

2.5.2 Definition of Terminology

1) "Cost of Goods Ratio" is the proportion of the CGS in the Sales.

<Formula> Cost of Goods Sold Ratio = (ii)CGS ÷ (i)Sales

2) "Gross Income Ratio" means the proportion of Gross Income to Sales.

<Formula> Gross Income Ratio = (iii)Gross Income ÷ (i)Sales

3) "General Expense Ratio" means the proportion of General Expenses to Sales

<Formula> General Expense Ratio = (iv)General Expenses ÷ (i)Sales

4) "Expense Ratio" means the proportion of the sum of CGS and General Expenses to the Sales.

<Formula> Expense Ratio = ((ii)CGS + (iv)General Expenses) ÷ (i)Sales

5) "Business Profit Ratio" means the proportion of Business Profits to Sales.

<Formula> Business Profit Ratio = (v)Business Profit ÷ (i)Sales

2.5.3 Classification of Estimation Methods

(1) Estimation Method using the Ratio Method is a method for estimation

Business profits or the basis of its calculation, sales, CGS and others by the application of specified ratios to the amounts of revenues and expenses, production, sales of the taxpayer. The followings are four major types:

1) Peer Standards (editor's note: "Peer Ratio" in Japan)

The peer standards is a method of estimating business profit by selecting a number of companies in the same business (as many as possible would be preferable but a minimum of 2 to 3 if the number of similar business is limited) that share similarities in terms of characteristics such as the format and scale of the business and location ("similar peer"). The next step is calculating the average CGS Ratio, gross income ratio, expense ratio, business profit ratio

and sales per employee of the similar peers (these are referred to as the "peer standards", and the ratios referred to respectively as "CGS Standard", "gross income standard", "expense standard", "business profit standard", "per employee sales standard", etc.) and applying such standards.

[N.B.] This methodology is used when sales (including sales estimated using efficiency method described below), CGS or general expenses of the taxpayer are known (in such case sales, CGS, or general expenses that used as the base data for the estimation is referred to as the "basis for the estimation"). Furthermore, it has objectivity and the resulting estimate is considered to approximate actual income, which shall facilitate acceptance by the taxpayer. This is Method 2.3 (1) outlined in the Director General directive "Rules Relating to Presumptive Taxation". If a self-employed taxpayer wishes to use incorporated enterprises as similar peers in estimating income, the differences between individual and corporate income in calculation methods must be considered and the following formula, which converts corporate income to an individual income base, must be applied:

Equivalent Individual Income = pretax corporate income + (compensation paid to directors and, of employee wages, amounts paid to the representative and his family included in operating expenses) + (of interest paid and rents paid included in the expenses, amounts paid to representative and his family) – (of the amounts included in profit amounts income received from the representative and his family such as rent income, interest on loans, etc.)

[Formula for the Estimation Method using Peer Standards]

- (a) If sales of the inspected entity is used as the basis of the examination:
$$\text{sales} \times \text{similar peer's business profit standard} = \text{business profit}$$
- (b) If CGS of the inspected entity is used as the basis for the estimation:
$$\text{CGS} \div \text{similar peer's CGS standard} = \text{sales}$$
$$\text{sales} \times \text{similar peer's business profit standard} = \text{business profit}$$
- (c) If general expenses of the inspected entity is used as the basis of the estimation:
$$\text{general expenses} \div \text{similar peer's general expense standard} = \text{sales}$$
$$\text{sales} \times \text{similar peer's business profit standard} = \text{business profit}$$

[N.B.] See 2.5.4 (2) for an example of calculation using business peer

standard.

2) Own Ratios

The estimation methodology using own ratios estimates the business profits, etc. by calculating and applying the average CGS ratio, gross income ratio, expense ratio, business profit ratio, sales per employee from:

- (a) business performance or record for a specified period of time,
- (b) partial records and data,
- (c) records or examination results, etc, from the previous year or past years and,
- (d) ratio of omissions from the records (results are referred to as "own ratios").

[N.B.] This is applied when the taxpayer's bookkeeping records or transaction documents for the tax year in question or for past years is incomplete but usable.

However, records of past years can be only used if there have been no material changes in business conditions or format since the time of the past records. Own ratios have a higher level of similarity than similar peers and it is a reasonable method.

This is the method outlined in 2.3 (2) of the Director General directive "Rules Relating to Presumptive Taxation".

[Formula for the Estimation Method using Own Ratios]

- (a) If the estimation is based on the prior year's business results (base quantity (numerical value) for water usage fees, power usage fees):
$$\text{(prior year's revenues} \div \text{prior year's base quantity (numerical value))} \\ \times \text{(basic quantity (numerical value) of the year in question) = year's revenues}$$

Example:

prior year's income 10,000,000 Tg. \div prior year's water usage 400 liters \times year's water usage 500 liters = year's revenue of 12,500 Tg

- (b) If bookkeeping records for a specified period are used:

- a. $\text{(sales during a specified period of the inspected entity)} \times \text{(ratio of Sales of a similar peer during the same specified period to annual sales)} = \text{sales for the year for the inspected entity.}$

Example:

$\text{(sales of 4,000,000 Tg representing the inspected entity's sales from January through April)} \times \text{12,000/3,000 (ratio of similar peer's sales from January through April which was 3,000 compared to its annual}$

sales 12,000 Tg) = 16,000,000 Tg inspected entity's sales for the year

- b. (sales during a specified period of the inspected entity) × (ratio of annual procurements (consumption) to the procurement (consumption) of the inspected entity's principal product (expense) during a specific period) = sales for the year of the inspected entity

[N.B.] This formula is used when the sales for the inspected entity can

be determined only for a specific period but annual procurement of principal products can be determined.

Example:

5,000,000 Tg inspected entity's sales from January through April
× 3000/1000 (ratio of examined entity's annual procurement of its principal product of 3,000,000 Tg to 1,000,000 Tg representing procurement of the principal product for this period)
= 15,000,000 Tg the inspected entity's sales for the year

3) Examination Ratio

This is an estimation method that uses examination ratios to estimate business profit based on the results of field surveys of all business peers located within the jurisdiction of the tax office by calculating the average business profit standards and applying the business profit standard.

[N.B.] This method attempts to estimate income by using the average values of multiple taxpayers while the ratio method attempts to approximate actual income as precisely as possible. The tax office would need to compile data relating to the average value of the peers that are targeted in the examinations.

Example:

In the tax jurisdiction of S tax office, the ratio of business profits to sales for all restaurant operators examined in 1999 averaged (business profit standard) 40%. If the year's sales for R, the inspected entity, were 30,000,000Tg., the year's business profits would be 30,000,000 Tg. × 40% = 12,000,000 Tg.

4) Average Ratio

This is an estimation method that uses average ratio to estimate business profit (business profit standard) using a ratio that has been derived by taking average business profit ratios, that have been purged of abnormal values, based on examination results from a significant number of cases to which

actual amount taxation has been applied (not limited to the examination results from the jurisdictional area of the tax office but from all tax offices in the country)(this ratio is referred to as "average ratio").

[N.B.] The average ratio method is based on the same basic approach as the examination ratio method. While the examination ratio method limits the subject area of the business profit standard to the jurisdictional area, the average ratio method takes entire country as the subject area. Therefore, the examination ratio takes the regional peculiarities into account, enabling it thereby to provide a figure that more closely approximates the actual income than estimation using the average ratio. The average ratio is prepared at GGNP level based on tax examination results of all classifications of business; however, as a non-disclosed data, it would be appropriate to use it as an indicative level of business profit standards when conducting income examinations.

(2) Per-Unit Method (Per Unit Value Method)

With the estimation method using the per-unit method, indices of business activity or business scale data, for example sales (revenues) per unit of sales volume, raw

material unit volumes, number of employees, equipment, power and water are calculated when the taxpayer's sales, procurement account, etc., are unknown. Based on this data, the sales (revenues), CGS, business profits etc are estimated. In this case, it is used in tandem with the ratio method.

[N.B.] For specific examples see **2.5.4 (1)** below.

(3) Asset and Liability Fluctuation Method (Net Asset Comparison Method)

Instead of utilizing the profit and loss calculation method of revenues and expenses, the estimation method using asset and liability fluctuation uses net fluctuations in net assets, or the balance sheet method [(end of period assets – beginning of period assets) – (end of period liabilities – beginning of period liabilities) + consumption (living expenses etc.) – non-operating income = business profit] to directly estimate the business profit. It can be considered a reasonable methodology since the resultant business profit coincides with the business profit derived from profit and loss calculation based on the principle of double entry bookkeeping.

[N.B.] This method of estimation assumes that the amount calculated by deducting income derived from non-business sources from the sum total of the increase in net assets and household expenses, such as living expenses, is income derived from business without the need to know anything at all about operating revenues and expenses. The difficulty with this methodology is whether or not it is possible to

precisely ascertain all assets and liabilities at both the beginning and at the end of the term.

For specific examples, see **2.5.4 (3)** below.

(4) Consumption Method

This method, which should probably be considered a variation of the asset and liability fluctuation method, and estimates income from the taxpayer's living expenses and other consumption expenditures.

[N.B.] This method is based on the assumption that, if there is no change in the asset or liability and there is no inflow from sources other than business, there must be at least sufficient business income to apportion amounts to living expenses and other consumption expenditures.

2.5.4 Estimation Method by Case Studies

(1) Estimation of Sales (Revenues) by the Per-Unit Method

If there are no accounting books or original business records, it will be necessary to determine sales, procurement and general expenses by means of interviews with the taxpayer and employees, confirmation of the product volume and prices on the premises and checking with clients or suppliers; in many cases, however, it is difficult to accurately ascertain values for all items. This is especially true when all sales, procurement and general expense items are transacted in cash.

In such cases, one effective method would be to calculate business activity indices and business scale data, or formal factors ("efficient factors"), such as per unit revenues of the taxpayers or a similar peer ("efficiency coefficients") and estimate

revenues or business profit based on efficiency coefficients.

In using this methodology, the efficiency factor must fulfill the following conditions:

- (a) there must be a correlation exists with the value to be estimated and they must have a proportional relationship,
- (b) it must be a major component in ascertaining the taxpayer's revenues,
- (c) it must be accurately ascertained, and
- (d) it must be possible to collect the same item from similar peers.

Thus, it is important to select the efficient factors that most closely conform to the business and business format and, at the time of the examination, the business conditions and equipment capacity of the taxpayer must be ascertained accurately and concretely.

1) Types of Estimation Methodologies using Per-Unit Method

The following are some types of estimation methodologies using the per-unit method:

- (a) Estimation using the usage volume of raw materials
- (b) Estimation from the volume of usage of consumables
- (c) Estimation from the volume of consumption of electricity, water and fuels such as gasoline
- (d) Estimation based on size indicators such as number of employees and equipment
- (e) Estimation based on operating days and etc.

2) Efficient Factors and Efficiency Coefficients

The Table 2-1 outlines the efficient factors and efficiency coefficients thought to be reasonable for principal types of business.

3) Formula for Per-Unit Method

A. Estimating revenue using machinery, equipment and etc.

a. Per chair: e.g. bars, saloons, barber shops, beauty parlors, etc.

(similar peer's average revenue per chair) × (inspected entity's number of chairs) = revenue

Example:

Similar peer for a barbershop has an average revenue per chair of 500,000 Tg
× inspected entity operates 2 chairs = revenues of 1,000,000 Tg

b. Per machine: e.g., printing, etc.

(similar peer's revenue per machine) × (inspected entity's number of machines owned) = revenue

Example:

The similar peer of a printer has an average revenue per machine of 1,000,000 Tg
× inspected entity owns 2 machines = revenues of 2,000,000 Tg

Table 2-1 Efficient Factors and Efficiency Coefficients

Business Classification	Efficient Items	Indication of Efficiency Coefficient
Merchandise retailers	Number of employees	Revenue per employee
	Retail floor space	Revenue per 1 square meter of retail floor space
	Number of operating days	Revenue per operating day
	Inventory	Revenue per 10,000 Tg. of inventory
Eating and drinking establishments (Continued)	Number of employees	Revenue per employee
	Amount of liquor procured	Revenue per 10,000 Tg. of liquor procured
	Number of tables and chairs	Revenue per chair (table)
Eating and drinking establishments	Number of guest rooms	Revenue per guest room
	Consumption of electricity and water	Revenue per 1 unit of electricity and water consumed
Wholesalers	Number of employees	Revenue per employee
	Number of operating days	Revenue per operating day
	Inventory	Revenue per 10,000 Tg of inventory
	Packing and freight charges	Revenue per 10,000 Tg of packing and freight charges
Manufacturers	Number of employees	Revenue per employee
	Consumption of electricity and water	Revenue per 1 unit of electricity and water consumed
	Machinery and equipment	Revenue per 1 machinery and equipment
	Materials expenses	Revenue per 10,000 Tg of materials consumed
	Contracting expenses	Revenue per 10,000 Tg of contract expenses
Transportation	Number of employees	Revenue per employee
	Number of vehicles	Revenue per vehicle
Coffee shops and tea salons	Consumption of coffee beans	Revenue per kg. of coffee beans consumed
Automotive Service and Repair	Number of vehicles tested	Revenue per vehicle inspected
Beauty parlors and barber shops	Materials used	Revenue per 10,000 Tg of materials consumed
	Consumption of electricity	Revenue per 1 unit of electricity
	Number of chairs	Revenue per chair

c. Revenue per employee: e.g., bars, saloons, barbershops, beauty parlors,
etc.

- (similar peer's revenue) \div (similar peer's number of employees)
= similar peer's average revenue per employee
- (similar peer's average revenue per employee) \times (inspected entity's
number of employees) = revenue

Example:

- Saloon's similar peer's revenue 2,100,000 Tg \div similar peer's
number of employees 3 = similar peer's average revenue per employee
700,000 Tg
- Similar peer's average revenue per employee of 700,000 Tg \times
inspected entity's number of employees 2 = revenue 1,400,000 Tg

B. Estimating Revenue from Procurement (Consumed volume)

The consumed volume of the principal materials is first ascertained.

- a. Eating and drinking establishment, sellers of goods, manufacturers
(inspected entity's procurement of principal materials) \div (1 – similar
peer's ratio of procurement of principal materials to revenue) = revenue

Example:

Inspected entity's procurement of principal materials 30,000,000 Tg \div
(1 – similar peer's ratio of procurement of principal materials to revenue
40%) = revenue 50,000,000 Tg

b. Bread Bakeries

(number of bags of flour purchased in a year) \times (number of loaves per
bag of flour) = annual production volume of bread
(annual production volume of bread) \times (average price per loaf of
bread) = revenue

Example:

Number of bags of flour purchased in a year 30 \times average of 100
loaves of bread per bag of flour = annual production of bread 3000
loaves
Annual production volume of bread 3,000 loaves \times average price of
100 Tg per loaf = annual revenue 300,000 Tg

c. Bar Operators

(Number of bottles of beer purchased in a year) \times (similar peer's
average revenue per bottle of beer) = annual revenue

Example:

Inspected entity's annual purchase of beers of 3,000 bottles \times similar

peer's revenues per bottle of beer 5,000 Tg = annual revenue
15,000,000 Tg

C. Estimating Revenue from General Expenses (Consumed Volume)

- a. Estimating revenues from consumption of electricity: e.g., cleaners
(similar peer's annual revenue) ÷ similar peer's electricity

consumption) × (inspected entity's electricity consumption) = annual
revenue

Example:

Similar peer's annual revenue of 25,000,000 Tg ÷ similar peer's annual
electricity consumption 1,000 KWH × inspected entity's electricity
consumption of electricity 900 KWH = annual revenue 22,500,000 Tg

- b. Water Usage; e.g., public bathhouses, saunas
(Similar peer's average bath usage revenue per unit of water
consumption) × (inspected entity's water consumption) = annual bath
usage revenue

Example:

Similar peer's average bath usage revenue per 1 kiloliter of water
consumed 300 Tg × inspected entity's consumption of water 30,000
liters = revenues from bath usage 9,000,000 Tg

- c. Gasoline Consumption: e.g., transportation
(Inspected entity's annual expenditures for gasoline) × (similar peer's
transportation revenue per 1 kiloliter of gasoline ÷ similar peer's
expenditures per 1 kiloliter of gasoline)
= Annual transportation revenue

Example:

Inspected entity's annual gasoline expenditure of 1,000,000 Tg ×
similar peer's transportation revenue per kiloliter gasoline expenditure
30,000 Tg ÷ similar peer's average per kiloliter gasoline expenditure
15,000 Tg = Annual transportation revenue 2,000,000 Tg
• (Similar peer's average revenue per unit of gasoline consumed) ×
(inspected entity's volume of gasoline consumption) = revenue

Example:

Similar peer's average revenue per 1 kiloliter of gasoline consumed
30,000 Tg × inspected entity's volume of gasoline consumption

70,000 kiloliters = revenue 2,100,000 Tg

d. Number of Polyethylene Bags Used: e.g., cleaners

- Total X polyethylene bags purchased × revenues per X bag + total Y polyethylene bags purchased × revenue per Y polyethylene bag + total Z polyethylene bags purchased × revenue per Z polyethylene bag = revenue

[N.B.]

The classification of X, Y and Z polyethylene bags indicates differences in size and quality of the polyethylene bags used for different types of apparel each with a different cleaning charge.

e. Number of Packaging Cellophane Bags Used: e.g., socks finishing

- Number of cellophane bags used × finishing revenue per pair of socks = revenue

D. Estimation from Number of Operating Days

a. Fortunetellers

Monthly fortune telling clients (actual figure) × average fortune telling charge per customer (actual figure) × 12 months (operating months) = annual revenue

b. Shoe repairs

Repair revenue per day (actual figure) × annual operating days = annual revenue

c. Bars

Revenue per day (actual figure) × annual operating days = annual revenue

d. Grocery stores

Sales during a specified period (actual figure) ÷ operating hours during the specified period × operating hours per day × annual operating days = annual sales

[N.B.] When making estimations using operating days, estimate of per day or per month headcount and monetary amounts will be considered reasonable if they represent a general average value throughout the year; however, this method is prone to produce a variance in the estimate results, and, therefore, should be used only when other appropriate estimation methods cannot be applied.

(2) Estimation Business Profit by Peer Standard

In estimating the business profit using peer standard, if either sales (revenue), CGS (cost of procurement) or general expenses or if a major cost component of CGS or major component of general expenses can be ascertained, the business profit is estimated by applying CGS standard, general expense standard, business profit standard, etc., using the ascertained value as the basis of the estimation. The basic thinking behind the estimation and the method of calculation is explained below, using the example of a bar operation and hypothetical values.

[Case Study]

The inspected entity "X" operates a bar in a busy section of the city.

It was found upon visiting the bar that no bookkeeping records relating to business revenues and expenses were recorded or retained. With no other alternatives, interviews with the owner and onsite confirmation were conducted during nighttime operations and it was confirmed that there were three employees in addition to the owner who tended to the customers.

In following up with the owner, it was found that beer, wine, vodka and other liquor was purchased in cash from Store "Y" nearby and, upon checking with Y, Y had fortunately kept a record of sales made to X and confirmed that liquor procurements totaled 2,100,000 Tg. The procurement of snacks and hor d'oeuvres was unclear since the owner stated that he purchased them from vendors that came to the bar directly and he was not aware of their names or addresses; therefore, the precise figures were not ascertainable.

In order to estimate the business profit from comparison with similar peers, the inspector selected three entities A, B, and C in the tax office jurisdiction that were generally similar to in business scale, employee number and location. Of the similar peers, the figures used for A were first adjusted as the result of an examination to the reported amount and the reported amounts for B and C were also rather small but not thought to be out of the ordinary; thus, were adopted for the estimation.

The breakdown of business profits and the CGS Ratio are shown in the Table 2-2.

Table 2-2 Calculation Table of Business Profit

(Unit: 1,000 Tg)

Classification		Similar Peer		
		A	B	C
① Sales		18,000	16,000	10,000
③ Cost of Goods Sold	③ Procurement of liquor	2,700	2,300	1,800
	Proportion of liquor to sales (③÷①)	0.15	0.14	0.18
	④ Procurement of snacks and hors d'oeuvres	600	400	300
	⑤ Total (③+④)	3,300	2,700	2,100
	CGS ratio ⑤÷①	0.18	0.17	0.21
Personnel		5,500	4,600	3,500
⑥ Gross income (①-⑤)		14,700	13,300	7,900
Gross income ratio (⑥÷①)		0.82	0.83	0.79
⑧ General Expenses	⑧ Personnel expenses	5,500	4,600	3,500
	Proportion of personnel expenses to sales (⑧÷①)	0.31	0.29	0.35
	⑨ Other expenses	900	700	500
	⑩ Total (⑧+⑨)	6,400	5,300	4,000
	General expense ratio (⑩÷①)	0.36	0.33	0.40
⑪ business profit (⑥-⑩)		8,300	8,000	3,900

	Ratio of business profit to sales	(II) ÷ (I)	0.46	0.50	0.39
Notes	Number of employees		4	3	3

- Liquor procurement standard (average proportion of liquor procurement in the sales of similar peers) = $\{(A) 0.15 + (B) 0.14 + (C) 0.18\} \div 3 = 0.16$
 - Personnel expense standard (average proportion of personnel expenses to sales of similar peers) = $\{(A) 0.31 + (B) 0.29 + (C) 0.35\} \div 3 = 0.32$
 - Business profit standard (average ratio of business profit to sales of similar peers) = $\{(A) 0.46 + (B) 0.50 + (C) 0.39\} \div 3 = 0.45$
- Estimation using the proportion of liquor procurement to sales
- (Liquor procurement of inspected entity X) 2,100,000 Tg ÷ (similar peer's liquor procurement standard) 0.16 = (X's sales) 13,125,000 Tg
 - (X's sales) 13,125,000 Tg. × (similar peer's business profit standard) 0.45 = (X's business profit) 5,906,000 Tg
- If the liquor procurement cannot be ascertained but only the personnel expenses of 4,300,000 Tg can be ascertained.
- (Inspected entity X's personnel expenses) 4,300,000 Tg ÷ (similar peer's personnel expense standard) 0.32 = (X's Sales) 13,437,000 Tg
 - (X's sales) 13,437,000 Tg × (similar peer's business profit standard) 0.45 = (X's business profit) 6,046,000 Tg

[N.B.] Estimation using liquor procurement and personnel expenses as the basis for the estimation is allowable when a correlation is deemed to exist with sales.

(3) Estimating Business Profit Using Asset and Liability Fluctuation Methods

As it has been pointed out, asset and liability fluctuation method is not based on revenues and expenses but is a balance sheet method that uses fluctuations in the value of net assets [(end of period assets – beginning of the period assets) – (end of period liabilities – beginning of period liabilities) + consumption expenditures (living expenses etc.) – revenues from sources other than business = business profit]. Thus, in order to make estimations using this method, the accurate value of asset and liability items must be ascertained. The procedure for estimation using this method is explained below.

1) Ascertaining Net Assets

The balances of asset and liability items at the beginning and end of the period are accurately ascertained for the year subject to the examination. In this

case, care must be taken to assure that, if there has been an increase in an asset item, there is also an offsetting decrease in cash/deposits or an increase in a liability item. If there has been an increase in a liability item, it is necessary to check to see if there is an increase in an asset item acquired by the proceeds

A. Common Items

- (a) Accurately ascertaining the values of assets and liabilities items through taxpayer's financial statements, tax returns and interviews.
- (b) The beginning and end of the period can be treated as the same value in the case of items that are deemed to have been unchanged between the years such as Cash, Inventory, Merchandise, etc.

B. Deposits

Deposit amounts should be ascertained through examinations with financial institutions. In this case, deposits in the name of family members are also added as the basis for the calculation of income, but though it is necessary to confirm that family members do not have other sources of income such as wages since, if such exists, it would not be added to business profit and should be deducted. If there is a reduction in the balance of deposits, it is confirmed whether or not an asset was acquired with the proceeds.

C. Accounts Receivable, Accrued Receipts etc.

Accounts Receivable values should be ascertained by checking with customers

D. Building and Auxiliary Equipment

Acquisition Costs including construction costs and acquisition expenses are ascertained. Adjustments for depreciation should be made through the liability account accumulated depreciation

E. Vehicular Transport Equipment, Tools and Accessories

Acquisition expenses ascertain acquisition prices. Adjustments for depreciation should be made through the liability account accumulated depreciation.

F. Account Payables, Accrued payments etc.

Accounts payable should be ascertained accurately by checking with suppliers.

G. Borrowings

Borrowings should be confirmed with financial institutions. It is necessary in this case to confirm whether the borrowing is for business or personal use. If

there has been an increase in borrowings, it is necessary to check to see whether other assets have been purchased using the proceeds.

H. Accumulated Depreciation

Accumulated depreciation is calculated by adding the year's depreciation expenses to the outstanding balance as of the period end in the prior year.

I. Changes in Net Assets

Changes in net assets are calculated by deducting the balance at the beginning of the period from that at the end of the period for each asset and liability item and subtracting the aggregate changes in net liabilities from the aggregate value of the changes in assets.

2) Ascertaining Consumption Expenditures (Living Expenses etc.) to be Incremented

It would be reasonable to assume that consumption expenditures (living expenses etc.) are made out of the revenues from the business. It would thus be necessary to add such amounts to net assets, when calculating business profits. The following are some examples of what would be considered consumption expenditures.

A. Living Expense

In regard to living expenses, if data such as standard household living expenses surveyed by region and by family size is available, it should be used; however, if no such data exists, aggregate groceries, clothing, furniture purchases, normal educational expenses, rents, ceremonial occasions, travel and other expenses would be ascertained through interviews with the taxpayer or his family, and annual living expenses would be estimated.

B. Incremental Amounts Other Than Living Expenses

Money expenditures for purposes other than living expenses and not classified as business expenses would include the following:

- Taxes such as income tax, regional taxes
- Repayment of household borrowings
- Large one-time expenditures such as university entrance fees, marriage expenses, overseas travel etc.

C. Ascertaining the Amount to be reduced as Non Business Revenues

Revenues from sources other than business are not included in the business profit calculations, and must be thus deducted from net assets. Non-business revenues may include the following.

- Deposit interest
- Dividend income from stocks

Table 2-3 Calculation of Business Profit Using Asset and Liability Fluctuation Methods

(Unit: 1,000 Tg)

Item			① Beginning of period value (January 1)	② End of period value (December 31)	③ Change (②-①)
Assets	Cash	a	200	200	0
	Deposits	b	6,300	7,100	800
	Accounts receivable	c	1,000	1,000	0
	Inventory	d	3,000	3,000	0
	Buildings	e	6,000	6,000	0
	Equipment and motor vehicles	f	1,200	1,200	0
	Total	g	17,700	18,500	800
Liabilities	Accounts payable	h	420	650	230
	Borrowings	i	5,100	4,700	△ 400
	Accumulated depreciation	j	2,518	2,761	243
Total	k	8,038	8,111	73	

Value of net assets (g-k)		l	9,662	10,389	727
Addition	Living expenses	m			4,412
	Income tax	n			89
	Regional taxes	o			118
		p			
		q			
	Total	r			4,619
Deduction	Deposit interest	s			121
	Dividend income	t			0
	Total	u			121
Business profit (l+r-u)		v			5,225

Table 2-4 Presumptive Calculation of Depreciation

(Unit: 1,000 Tg)

Classification	Acquisition cost	Useful life	Depreciation expenses		
	Base value of depreciation	Ratio of depreciation using straight line method	Accumulated amount as of end of prior year (①)	Current period depreciation expense (②)	Accumulated depreciation expense (①+②)
Buildings	6,000	40years	2,160	135	2,295
	5,400	0.025			
Automobiles	1,200	10years	358	108	466
	1,080	0.100			
Total			2,518	243	2,761

[N.B.]

1. Since there are asset, liability and other items in addition to the above, they should be added as required.
2. If irregularities appear in annual business profits as a result of making estimations by the asset and liability fluctuation method but no changes have taken place in business conditions during the year, it may be due to the omission of some values, which will require a reexamination.

This method should be avoided if there are difficulties in ascertaining values, in which case it will be necessary to select another more appropriate estimation method to estimate business profit.

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