

-RESEARCH ARTICLE-

## THE ROLE OF TAX AUDITS IN REVEALING THE TRUE INCOME OF TAXPAYERS

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### —Abstract—

This empirical investigation explores the pivotal function of tax audits in identifying inconsistencies between declared income and actual earnings, thereby enhancing compliance and improving tax revenue collection. Conducted as a field-based case study, the research focused on the corporate and tax audit divisions of the National Revenue Authority, specifically examining Company A—a publicly listed contracting enterprise established in 2008 with an initial capital investment of 2 billion dinars. The analysis reviewed the tax audit processes carried out for the fiscal years 2017,

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2018, and 2019. Findings reveal that tax audits significantly contribute to accurately estimating taxpayers' actual income level. In Company A, substantial differences were realized with the level of Disallowance for expenses ranging from 80 to 100 percent due to inadequate documentation and poor conformity to specified standards. The auditing led to an amount of additional tax amounting to 249,733,530 dinars within the three-year period and establishes the substantial fiscal gains realized through vigilant audit exercises. These findings establish the significance of tax audits in ensuring taxpayers are in statutory compliance and do not under-state revenues. The field implications of this study reveal that tax administrations should have effective audit procedures capable of detecting and mobilising liable taxes. The empirical validation also establishes the usefulness of tax audits in revealing taxpayers' actual monetary position.

**Keywords:** Tax Audit, Taxpayer, Tax Base.

## INTRODUCTION

Tax examination and audit mechanisms constitute the mainstay of contemporary fiscal management and are centrally important in emerging markets, where revenues have long been a challenge (Chan & Song, 2021). In Iraq, while the tax administration has introduced various reforms after 2003, the system still continues to grapple with underperformance and non-compliance in generating revenues (Garcia et al., 2020). Tax audit procedures have roles to play both in connection with the revenues-raising agenda and furnishing fiscal discipline in a broader context. They are intended to ensure taxpayers' compliance while keeping the approach balanced in terms of both enforcement and taxpayers' right protection (Ogungbesan, 2023). In the context of Iraq, where the informal sector dominates various sectors of the country, the role of audit becomes critically important in uncovering previously unmonitored business activities (Alao, 2021).

Existing auditing procedures in Iraq use various procedures aimed at checking differences between stated and actual revenues. Such procedures usually comprise intensive examination of accounting records, verification of backup documentation, and checking claims of expenditures with regulatory limits (Hashimzade & Myles, 2017). Such procedures' effectiveness largely depends on the accuracy of the accounting data provided by taxpayers and the technical competence of the auditing staff. Companies in the construction industry, contracting business, and services industry often struggle to prepare complete accounting records, especially those related to cash dealings or informal purchase links (Kiptum et al., 2024). Examination of documentation for expenditures is a mainstay in the audit procedure in Iraq. The areas for expenses like fuel, raw material purchase and use, maintenance, entertainment, rentals, bank charges, insurance cover, and legal costs require extensive and verifiable backup support to prove their authenticity (Mersha et al., 2022).

Despite advancements in the technological infrastructure of Iraq's tax system, significant constraints persist in deploying sophisticated audit methodologies. The continued reliance on manual auditing procedures, while thorough, remains inefficient and insufficient in addressing the growing complexity of modern commercial operations (Belahouaoui & Attak, 2024). Although digitalisation and the application of data analytics offer promising avenues for reform, institutional limitations hinder their practical implementation. Nevertheless, empirical observations suggest that improved auditing mechanisms have a measurable positive effect on national revenue outcomes. Historical audits have revealed substantial underreporting in certain sectors, with discrepancies frequently exceeding 50 percent of the originally declared income (Slemrod, 2019).

Additional complexity to the state– taxpayer relationship is added by historical inheritances, cultural perceptions, and changes in regulatory systems. While various initiatives have been launched to build confidence and enhance transparency, fractions of the taxpayer community are still cautious. Auditors then have to walk a fine line in balancing rigorous inquiry with successful communication (Garcia et al., 2020). Differences in compliance level across industry sectors also pose specific difficulties. Diverse industry sectors like construction, contracting, services, and manufacturing demand industry-specific audit strategies appropriate to their structure and operations (Kiptum et al., 2024). Organisational and varying financial reporting norms add to the need for adaptable audit methods sensitive to the context in each industry sector (Alao, 2021). Long-term tax audit implications extend beyond generating revenues in that enhanced compliance allows for greater fiscal transparency, decreases informality, and strengthens institutional fiscal legitimacy (Ogungbesan, 2023). These effects are in line with general economic developmental initiatives to build equitable market regimes (Chan & Song, 2021).

Agency Theory provides a useful conceptual lens through which to analyse the principal-agent dynamics inherent in the relationship between tax authorities and taxpayers within Iraq's fiscal framework. This theoretical perspective clarifies how discrepancies in interests and information between tax authorities (principals) and taxpayers (agents) can result in strategic misreporting and information concealment (Alkausar et al., 2021). In this context, taxpayers possess superior knowledge regarding their financial activities, business operations, and expenditure structures, while tax authorities rely on declared data and audit processes to verify its authenticity (Garcia et al., 2020; Hashimzade & Myles, 2017).

The perceived level of audit intensity has direct implications for taxpayer behavior. As taxpayers expect extensive scrutiny, the risks and costs of evading compliance grow and frequently induce increased voluntary compliance with tax obligations (Slemrod, 2019). Relaxed supervision may encourage aggressive tax avoidance and opportunistic practices. The availability and quality of accounting documentation play

a crucial role in determining audit outcomes. Numerous Iraqi enterprises struggle to preserve proper records detailing essential expenditures like fuel, raw materials, repairs, entertainment services, and professionals' fees (Mersha et al., 2022). The accuracy and completeness of these records are essential in helping the tax authority recognize abnormalities and make credible assessments (Belahouaoui & Attak, 2024). Incomplete documentation or documentation intended to mislead adds complexity to the audit exercise (Garcia et al., 2020).

Agency Theory also introduces the concept of signalling in that companies try to transmit their compliance in practices and documentation meant to signify tax regulation compliance. Effectiveness in this signalling is dependent upon the competence of the audit authority to interpret and verify their validity (Chan & Song, 2021). In cases where procedures in an audit are perceived to be fair, predictable, and transparent, they are more successful in encouraging truthful reporting and voluntary tax compliance among taxpayers (Ogungbesan, 2023). In any case where partial or arbitrary compliance is perceived, trust necessary in collaborative engagement is undermined (Alao, 2021).

Monitoring costs constitute another essential component in the agency model. Tax administrations in Iraq have to allocate limited resources in auditing activities to achieve optimum compliance with minimum administrative cost. This is a decision regarding audit selection, depth of investigation, and penal policies (Hashimzade & Myles, 2017). Choosing the optimal level of monitoring intensity is not easy because both costs and revenues have to weigh in its determination. Risk assessment instruments help to focus audits based on a better-targeted approach. Taxpayers exhibiting specified risk factors like late compliance, unusual cost patterns, or large year-to-year income differences are liable to be included in audits (Slemrod, 2019). These focused techniques enable the tax department to use its resources in a manageable and effective way while still providing a deterrent environment to the taxpayer base (Alkausar et al., 2021).

The deterrent aspect addresses the consistency and reasonableness of sanctions placed on errant parties. The tax codes in Iraq offer a systematic system of punishment in the form of late payment surcharges, assessment in addition to the due amount, and proportionally related fines to the extent of deviation from norms with the intention to induce compliance (Slemrod, 2019). The deterrent power of these punishments lies in their probable use and their magnitude with respect to the gains perceived in deviation from norms. Day-to-day interactions between the tax authority and taxpayer determine reputational consequences that affect future compliance. Companies facing rigorous auditing tend to adapt their reporting patterns to shun similar scrutiny and attain mutual learning and improved audit effectiveness (Ogungbesan, 2023).

Informational advantages remain prevalent among taxpayers, particularly within

sectors that rely heavily on cash transactions, informal supplier networks, or complex operational structures. The construction and contracting industries, for example, often possess superior knowledge regarding actual project costs, subcontractor arrangements, and material procurement processes. These advantages can be used to strategically reduce taxable income through selective reporting (Garcia et al., 2020). While technological upgrades offer the potential to mitigate these issues, implementation costs and privacy concerns may deter compliance and provoke resistance from taxpayers.

It is important in bringing to the fore the tax audit as a key vehicle through which the tax administration safeguards the public purse. Through the examination in fine details of taxpayer returns, tax audits assist in the identification of proper tax obligations, paving the way for recovery of significant revenues and encouraging large-scale tax compliance.

### **Problem Statement**

Systematic failure to upgrade the tax examination and audit system in Iraq points to a crucial disconnect between governance initiatives and administration execution. Even though a full legal and procedural system already exists in place, widespread underreporting among most business communities remains a crucial challenge to tax administrations (Alao, 2021). This paper contends that advanced auditing frameworks are essential at this point and should not only continue to maintain tough enforcing objectives but also ensure taxpayer protections while employing latest technologies to add to verification and detection methods (Belahouaoui & Attak, 2024). Limited success with modern auditing methodologies has largely occurred due to three interrelated deficiencies. First, substantial gaps in-between reported and audit revenues in most business cases show that auditing methodologies in use accomplish little in uncovering advanced tax avoidance schemes and do not reveal widespread patterns in income understatements (Hashimzade & Myles, 2017). Existing audit results show that adjusted taxable revenues end up being higher than initial reports by 200 to 300 percent in certain cases and uncover how much loss in revenues has occurred due to insufficient audit cover (Slemrod, 2019).

Secondly, the resource-intensive nature of traditional audit practices imposes limitations on both the frequency and breadth of audits, thereby enabling many non-compliant entities to evade detection. Manual examination of financial records demands significant time and specialised expertise, which may be lacking within the current system (Mersha et al., 2022). These challenges are exacerbated in relation to intricate expense categories such as fuel, maintenance, professional fees, and rental services, where documentation is often incomplete or ambiguous (Kiptum et al., 2024). Thirdly, technological constraints within the present audit infrastructure hinder the adoption of data analytics and automated verification systems, which could

otherwise enhance detection capabilities while simultaneously lowering administrative costs. These limitations not only pose risks to immediate revenue collection but also raise broader concerns related to fiscal stability, corporate transparency, and sustainable economic development.

## Research Objectives

This study aims to accomplish several key objectives:

- To explore the concept of tax auditing and examine its principal purposes within the framework of fiscal oversight.
- To analyse the different methodologies used to estimate the tax base applicable to taxpayers.
- To assess the effectiveness of tax audits in uncovering the actual income of taxable entities, using a practical case study involving the audit of a corporate tax file.

## LITERATURE REVIEW

### Tax Audit: Conceptual Framework and Empirical Evidence

Tax audits form a key instrument in encouraging tax compliance through the systematic compilation and assessment of evidence related to economic activities in an effort to determine their accuracy. This definition is in line with broader conceptualizations of auditing as a string of judgments through which auditors offer unbiased and technical remarks upon the accuracy of fiscal data provided by taxpayers (Araújo Marques et al., 2020). Progression in audit professionalism has mirrored progressive enhancement in administrative capabilities in tax administrations. Current tax administrations also have more advanced auditing skills and have learned to recognize the substantial similarities between tax auditing and traditional financial auditing (Mu et al., 2022). Consequently, the employment of ‘commitment audits’ as a description has become recurrent for tax examinations, and incorporation into professional auditing bodies of tax auditors with standardised tasks and fieldwork norms.

Large-scale empirical investigations affirm the effectiveness of tax audits in fulfilling multiple regulatory and administrative objectives. Primarily, these audits are designed to thoroughly examine financial records to detect instances of fraud and tax evasion, uphold equitable enforcement of tax laws, and deter negligence or manipulation. Findings indicate that tax audits enhance broader tax management strategies and contribute to the efficiency of revenue collection processes. Notably, audits serve to increase public confidence in the tax regime by uncovering illicit activities and educating taxpayers on issues related to tax evasion. Thus, tax auditing extends beyond mere compliance verification (Nikolova, 2022). Empirical studies underscore that audits are indispensable for ensuring that individuals pay taxes commensurate

with their financial capacities. Evidence shows that a well-structured and systematic auditing framework safeguards both taxpayer and governmental interests while contributing to greater fiscal revenue. Additionally, audits are seen as mechanisms that foster trust in the taxation system by exposing non-compliance and clarifying the repercussions of failing to meet tax obligations (He et al., 2023).

Recent empirical developments have examined the impact of technological innovation on the modernisation of tax audit procedures, particularly through the application of machine learning. Quantitative analyses demonstrate that incorporating taxpayer network data into audits significantly enhances operational efficiency. Advanced technological solutions are proposed as a supplement to traditional auditing, offering improved precision in identifying non-compliant behaviours (Baghdasaryan et al., 2022). The literature identifies various audit classifications, creating a detailed framework for categorising audit types based on their scope (comprehensive or partial), location (office-based or field-based), and timing (pre- or post-submission). This classification has been widely adopted in subsequent academic work and practical applications. Tax auditing has become a prominent subject of empirical inquiry, with particular focus on its procedural dimensions. Additionally, scholarly attention has grown regarding the reciprocal relationship between audit practices and taxpayer conduct (Francis, 2004). Empirical findings reveal that audits function as educational interventions and facilitate information exchange between tax officials and taxpayers. The audit process has been shown to clarify disputed tax matters and improve transparency within the tax system (Senn & Giordano-Spring, 2020).

### **Taxpayer's Tax Base: Theoretical Foundations and Empirical Analysis**

Tax base of a taxpayer forms the center of both tax system design and administration aspects. Literature in this area consists of theoretical models, empirical observations, and their implications in practice. Contemporary tax scholarship necessitates a general classification of taxpayers. Here, Iraqi tax code delineates an exact description with regard to determining individuals and legal entities liable to pay income tax as taxpayers irrespective of nationality or residency (Naji Ahmed, 2023). Natural and legal persons are both involved in this classification. Empirical experience suggests that how taxpayers are classified has much to do with delineating the tax base and the extent of anticipation regarding compliance (Jacobs, 2021).

Besides this, various extensive empirical analyses have investigated the divergence between final tax payers and tax payers owing tax to reveal concealed inequalities (Larrimore et al., 2021). Distribution analysis of tax liabilities based on household income data shows significant tax burden distributions differences among various population cohorts to reveal concealed inequalities (Larrimore et al., 2021). Cognately associated with this matter is the dimension of the tax base being referred to in the scholarly literature as the 'tax container', and this denotes the entire gamut of

economic activities, services, and sources of income to which governments have the legal entitlement to tax (Clayton et al., 2021). Literature in this domain highlights the strategic importance of taxing a large tax base to limit tax evasion and raise government revenues through the official integration of informal economic activities in the tax base.

Further empirical analyses, carried out in the context of various European countries, emphasize the essential importance tax base decision has in forming state tax policy. In their results, procedural tax equity and the justice in the distribution of revenues significantly depend upon how the base is defined and that substantial cross-country variation are observed while defining the base (Andrejovská & Glova, 2023; Jesus et al., 2024). Another strand that repeatedly emerges in the literature is the distinction between taxable and accounting profits. Analyses used with listed corporations in the MBI10 index demonstrate that the accounting figures have to be adjusted in accordance with tax codes in order to calculate the tax base and frequently register substantial differences in the financial and taxable profits (Deari & Osmani, 2015).

Statistical analyses also indicate that proper determination of the tax base is crucial to both sustainable revenues and equitable income distribution. Evidence also suggests growing tax authority use of sophisticated methodologies to refine tax base estimations (Closs-Davies et al., 2024). Studies comparing single and multiple taxation models indicate that multiple-tax models are better attuned to modern taxation norms and better able to discourage tax evasion (Bastani & Waldenström, 2020). Studies in fiscal policy design have shown that progressive tax systems are still dominant due to their correspondence with equity values and their abilities to adapt to individual situations. Progressive tax systems have consistently managed to eliminate income gaps and ensure economic resilience, especially in cases of economic turbulence (Al-Taweel & BenMabrouk, 2024). A great deal of analysis has also been devoted to direct taxation with particular interest in capital taxation and wealth redistribution. Studies have validated that fiscal policies with a redistributive approach have in the past contributed to and continue to ensure equitable wealth distribution. Direct taxing of income and capital have come to light as key instruments in ensuring wealth equality and sustaining economic stability (Cohn et al., 2023).

### **Methods of Tax Base Determination: Empirical Evidence and Practical Applications**

Existing scholarship presents a number of complex procedures in estimating and measuring the tax base both directly and indirectly. Because calculating taxable data is complicated, various methodological procedures have emerged with virtues and disadvantages. Another common pattern is presumptive taxation in which tax agencies estimate taxable income in line with exterior signals and visible conduct. Though this system is a success at instances in its use, otherwise this system has garnered criticism

for being inaccurate and unfair. Empirical data in Bulgaria both exemplify propriety and weakness in these estimating procedures (Pashev, 2006).

Critical analysis with the assistance of extensive literature provides further empirical views regarding these methodologies. As illustrated by (Bucci, 2020) .the administrative estimation technique whereby tax administrators apply taxpayers' accounting records with powers of investigation has generally exhibited inefficiencies when documentation proves unreliable or when evasion in misdeclaration has been deemed possible. Empirical research confirms the argument that presumptive tax can prove an effective tool for revenues when proper quantitative backing confirms its usefulness in diverse national contexts. In addition, the direct estimation method through taxpayer self-reporting has undergone rigorous scholarly scrutiny. Studies explain that when tax regimes rely on self-disclosure with good faith in correspondence by taxpayers to tax offices, base tax accuracy is usually improved substantively. In this method, successive verification procedures fortify reported number integrity and instill taxpayer confidence in responding positively to tax administrations (Jiang, 2024). In addition, reputation mechanisms through third-party verification have come to fore prominently as ways to improve tax accuracy and limit evasion. Empirical works suggest that third parties rather than taxpayers themselves can form credible fiscal sources to improve tax assessment accuracy. The employer–employee system is one third-party system based upon institutional and legal mechanisms to provide systematic and verifiable data to improve overall integrity in tax administration procedures.

## Literature Gap

Despite the growing scope of academic work on tax auditing, several notable gaps remain in the literature. Although existing studies have advanced the understanding of audit practices, they have yet to offer conclusive insights into the evolving relationship between technological innovation and the effectiveness of audits, particularly regarding their optimal intensity (Baghdasaryan et al., 2022). underscore the potential of machine learning in detecting fraudulent activity, yet current findings lack sufficient empirical validation regarding the long-term applicability of such tools across diverse tax frameworks and jurisdictions. While evidence confirms that tax audits serve as deterrents against evasion, the psychological and behavioural mechanisms underpinning this effect remain underexplored. The interaction between audit frequency, audit intensity, and sustained taxpayer compliance requires more comprehensive investigation. Moreover, the academic discourse lacks a thorough, coordinated comparative analysis of existing methodologies for tax base estimation, particularly in the context of diverse economic systems operating at different stages of development. Most case-based studies are limited in scope, often focusing on isolated examples rather than enabling systematic comparisons between advanced and emerging economies.

Conventional tax research continues to centre predominantly on traditional economic activities, with limited attention to emerging challenges related to digital transactions, cryptocurrencies, and cross-border digital services. As digital economies expand, the relevance and applicability of conventional audit models are expected to decline. Another underdeveloped area in the literature concerns the broader social and economic implications of varying audit regimes. While technical aspects of audit efficiency are often discussed, the broader effects of intensive auditing on private sector investment, macroeconomic stability, and social well-being are generally overlooked. These gaps present valuable opportunities for future research to develop a more holistic understanding of tax audit systems and their broader societal consequences.

## **METHODOLOGY**

The theoretical framework of this research employed a descriptive inductive approach, drawing from a wide range of sources including textbooks, peer-reviewed Arab and international scholarly publications, relevant legislative texts and regulations, and the characteristics inherent to the study variables. Given that the research population comprised financial statements submitted by companies to the General Authority for Taxation's corporate division, the empirical component was based on data derived from those tax returns. A sample was selected consisting of corporate financial statements from the fiscal years 2017 to 2019. These statements fulfilled the criteria for a practical case study and were officially recorded within the corporate section of the tax administration. The inductive method applied in this research aligns with accepted scientific inquiry standards.

The research involved an assessment of the tax records of companies that had submitted financial statements to the tax authority, focusing on the effectiveness of the audit and examination units in identifying deficiencies, inconsistencies, and errors within these tax filings. This included an examination of how these units uncover undeclared or concealed financial data. The fieldwork was carried out at the corporate department and the audit and examination section of the tax authority, concentrating on their procedures for reviewing Company (A)'s tax declarations. This evaluation enabled the determination of the company's actual taxable income. For confidentiality reasons, the company's identity has not been disclosed in the case analysis, in order to preserve the integrity of sensitive information shared between the company and tax authority departments. The practical aspect of this study focuses on Company (A), a limited liability public contracting firm, and its interaction with the audit and examination procedures undertaken by the Department of Warning and Examination. The objective was to analyse its tax reporting practices in relation to the research aims. Company (A) was officially registered under certificate number (43521), dated 15 July 2008, with a declared capital of 2 billion dinars. Its operational goal is to invest in sectors that contribute to the development of the national economy, primarily

through engagement in public contracting activities. The company submitted its tax declarations for the fiscal years 2017, 2018, and 2019 to the corporate division of the tax authority. The results of the examination of these submissions are presented in the following section.

Table 1 indicates that the company failed to submit its financial accounts within the prescribed timeframe. Instead, it provided the tax declarations for three consecutive years in a single submission. This delay can be attributed to the lack of field inspections by the tax authority, which resulted in the company not being adequately monitored, thereby contributing to its failure to adhere to the annual deadline of 31 May for tax declaration submission. Consequently, the company became liable for penalties associated with late filing. Under prevailing tax regulations, taxpayers who do not submit their income statements on time, or who delay the completion of their income assessments, may incur additional financial penalties.

**Table 1: Accounts of Company (A) for General Contracting Ltd.**

No.	Details	Year 2017 (Dinars)	Year 2018 (Dinars)	Year 2019 (Dinars)
1	Revenue	745,690,000	15,346,215,000	8,264,220,000
2	Expenses	716,420,000	14,172,550,000	7,614,300,000
3	Excellency (Profit or Loss)	29,270,000	1,173,665,000	649,920,000

Source: Prepared by the researcher, based on the profit and loss report submitted by the company.

## Reserve Appreciation of Income from the Delegated Company's Department of the Company (A)

### Fiscal Year (2017)

Table 2 presents the amount of tax assessed for the company for the fiscal year 2017, as determined by the examination unit within the corporate division of the tax authority. This amount includes a penalty for late submission, imposed due to the company's failure to file its tax declaration within the legally specified timeframe.

**Table 2: Tax Accounting for the Company (A) for the Year 2017**

No.	Details	The Amount (Dinars)	Notes
1	The taxable income under the accounts	29,270,000	The profit rate constitutes (3.9%) of revenues
2	The tax due on income	4,390,500	Taxable income 15%
3	Delayed fines	439,050	Delaying fines 10% of taxable income, not exceeding (500,000) thousand dinars
4	Total tax due for the year 2017	4,829,550	

Source: Prepared by the researcher, based on the estimation memorandum submitted by the relevant companies.

### Fiscal Year (2018)

Table 3 outlines the tax liability assessed for the company for the fiscal year 2018, as calculated by the examination personnel within the corporate division of the tax authority. This assessment includes a penalty for late submission, resulting from the company's failure to provide its tax declaration within the legally mandated period. The table also reflects an increase in the company's taxable income compared to the 2017 fiscal year.

**Table 3: Tax Accounting for the Company (A) for the Year 2018**

No.	Details	The Amount (Dinars)	Notes
1	The taxable income under the accounts	1,173,665,000	The profit rate constitutes (7.6%) of revenues
2	The tax due on income	176,049,750	Taxable income 15%
3	Delayed fines	500,000	Delaying fines 10% of taxable income, not exceeding (500,000) thousand dinars
4	Total tax due for the year 2018	176,549,750	

Source: Prepared by the researcher based on an informed assumption.

### Fiscal Year (2019)

Table 4 presents the tax liability calculated for the company for the fiscal year 2019, as determined by the assigned official within the corporate division of the tax authority. This amount includes a penalty for late submission, arising from the company's failure to submit its tax declaration within the prescribed legal timeframe.

The corporate division summoned the company's manager to finalise the tax assessment in accordance with established regulations. However, the manager refused to accept or comply with the findings derived from the submitted accounts. As a result, the department referred the case to the Department of Audit and Examination.

**Table 4: Tax Accounting for the Company (A) for the Year 2019**

No.	Details	The Amount (Dinars)	Notes
1	The taxable income under the accounts	649,920,000	The profit rate constitutes (7.8%) of revenues
2	The tax due on income	97,488,000	Taxable income 15%
3	Delayed fines	500000	Delaying fines 10% of taxable income, not exceeding (500,000) thousand dinars
4	Total tax due for the year 2019	97,988,000	

Source: Prepared by the researcher based on an informed estimation.

Following approval, the Audit and Examination Unit formally requested that the company submit all necessary records and documentation to facilitate the auditing process. In response, the head of the audit and examination division established a

dedicated committee to carry out a detailed review of the company's financial accounts. Upon completion of the audit, the committee disallowed certain expenditure items, leading to an upward revision of the company's tax liability. The primary reasons cited for rejecting these expenses included the absence of supporting documentation. Although some costs were reported in the profit and loss statement, they lacked proper evidentiary backing to confirm their legitimacy. Additionally, the company was found to have entered into contractual arrangements with external entities that were not accredited or recognised by official authorities. These and other related concerns led the audit committee to dismiss various expenses reported by the company.

Furthermore, [Table 5](#) reveals that the proportion of disallowed expenses ranged between 80 percent and 100 percent, representing a significantly high rejection rate. For instance, the entire amount claimed under the rental account was disqualified, as the company submitted a contract that lacked certification from recognised official authorities. Similarly, the full amount recorded under the hospitality expenses account was disallowed due to the absence of supporting documentation to validate the expenditure. An additional observation from the revenue account for the fiscal year 2019 indicates that the company undertook road paving works valued at 20,512,350 dinars. In response, the tax authority imposed an additional tax assessment, with the resulting payable tax amounting to 16,315,000 dinars. Moreover, due to the violation identified, a further penalty of 32,630,000 dinars was levied. Consequently, the total tax liability incurred by the company rose to 130,618,000 dinars.

**Table 5: Expenses that were Rejected After the Tax Audit of the Company's Accounts (A)**

No.	Statement	Referred Amounts (Dinars)			Rejection Ratio	Reasons for Rejection
		2017	2018	2019		
1	Fuel and Oils	422,880	10,000,000	4,800,000	%80	Unseen estimates for the lack of documentary reinforcement of some expenses.
2	Supplies and Tasks	5,940,000	18,960,000	9,600,000	%80	
3	Services and Research	364,000	3,250,000	15,000,000	%100	
4	Transfer and Dispatch	5,982,500	16,800,250	7,500,000	%50	
5	Maintenance	845,000	4,500,000	2,500,000	%100	
6	Hospitality	2,188,000	5,400,500	1,500,000	%100	Contracts are not approved by an official authority
7	Renting Buildings	12,000,000	12,000,000	12,000,000	%100	
8	Rent Assets	31,134,000	23,000,000	-	%80	Because there is no documentary reinforcement of some expenses.
9	Other Service Expenses	10,282,400	14,000,000	6,400,000	%80	
10	Insurance Premiums	2,694,000	-	-	%100	
11	Banking Services	9,820,000	-	-	%100	
12	Legal Services	850,000	-	-	%100	
	Total Expenses	82,522,780	107,910,750	59,300,000		

**Source:** Prepared by the researcher, based on the report issued by the Department of Exact and Examination.

Following the rejection of the financial data reported in Company A's tax return by the Tax Audit and Examination Department for the stated fiscal year, as outlined in [Table 6](#), the disallowed expenses for the year 2018 totalled 107,910,750 dinars.

**Table 6: Extracting Taxable Income After the Tax Audit for the Fiscal Year (2017)**

Details	Amount (Dinar)
Taxable Income	29,270,000
Add Rejected Expenses	82,522,780
Adjusted Taxable Income	111,792,780

**Source:** Prepared by the researcher based on findings from previous audit results.

This amount was subsequently added to the previously declared financial results, as authorised by the two relevant agencies referenced in [Table 7](#).

**Table 7: Extracting Taxable Income After the Tax Audit for the Fiscal Year (2018)**

Details	Amount (Dinar)
Taxable Income	1,173,665,000
Add Rejected Expenses	107,910,750
Adjusted Taxable Income	1,281,575,750

**Source:** Developed by the researcher based on results from prior audit assessments.

As indicated in the same table, the Tax Audit and Examination Department disallowed the financial data submitted in Company A's tax return for the specified fiscal year. As a result, the rejected expenses for the year 2019 totalled 59,300,000 dinars. This amount was subsequently incorporated into the revised financial outcomes, as validated by the two authorised agencies referenced in [Table 8](#).

**Table 8: Extracting Taxable Income After the Tax Audit for the Fiscal Year (2019)**

Details	Amount (Dinar)
Taxable Income	649,920,000
Add Rejected Expenses	59,300,000
Adjusted Taxable Income	709,220,000

**Source:** Prepared by the researcher using data derived from earlier audit findings.

The tax audit process resulted in the imposition of a financial penalty on the company as a punitive measure for failing to disclose a road paving contract in its 2019 fiscal year declaration. An additional tax of 16,315,000 dinars was assessed based on the undisclosed contract value. In response to this non-compliance, a penalty equivalent to twice the amount of the owed tax—totaling 32,630,000 dinars—was enforced. This sanction aimed to deter the taxpayer from providing inaccurate tax submissions in subsequent periods. Furthermore, the audit and examination procedures led to an increase in the company's taxable income, owing to inconsistencies uncovered during the review of financial records across all audited years. [Table 9](#) presents the discrepancy between the income reported by the company and the revised income as

determined through the audit process.

Table 9 shows how the procedures for tax examination and audit added tax revenues to the tune of 249,733,530 dinars during the three fiscal years under examination. This addition to tax liability was not arbitrary but was a direct outcome of the improvement in the accuracy in accounting data submitted in tax returns by the company. This enhancement was obtained after the tax audit department sought supporting documentation in an effort to authenticate previously submitted data. Another major conclusion obtained from the in-practical case study undertaken in Company A is the important contribution made by tax auditing and examination in imposing late-filed return penalty on parties that did not file their tax return within the period legally specified for doing so. Furthermore, the auditing procedure was key in imposing penal measures on tax payers that withheld vital information that ought to have been provided and thus enforcing greater compliance and encouraging greater transparency in tax administration.

The research was grounded in a central null hypothesis, which stated that: "The tax audit department within the tax administration does not have an effective and efficient role in uncovering the actual income of taxpayers and in increasing tax collections." The outcomes of the practical case analysis provide clear evidence refuting the null hypothesis. The findings affirm that the tax audit department played an active role in enforcing penalties on non-compliant taxpayers who failed to submit their tax declarations annually. Additionally, the audit procedures contributed significantly to identifying discrepancies and gaps within the reported financial accounts. The department also improved the informational quality of tax declarations, which led to more accurate tax assessments and an increase in tax revenues collected by the state. Therefore, the study concludes that the null hypothesis must be rejected in favour of the alternative hypothesis, which asserts that: "The tax audit department in the tax administration performs an active and efficient role in identifying the true income of taxpayers and in enhancing tax revenue collection."

**Table 9: Comparison of Taxable Income Before and After the Audit for the Years Under Audit**

Statement	Fiscal Year 2017 (Dinar)	Fiscal Year 2018 (Dinar)	Fiscal Year 2019 (Dinar)
Taxable Income Before Audit	29,270,000	1,173,665,000	649,920,000
Taxable Income After Audit	111,792,780	1,281,575,750	709,220,000
Difference	82,522,780	107,910,750	59,300,000

Source: Compiled by the researcher based on prior audit outcomes.

## CONCLUSION

The study concludes that tax audits serve as a fundamental mechanism in promoting taxpayer compliance. An analysis of deterrent measures and their enforcement

indicates that the combined threat of audit and potential penalties compels taxpayers to give due consideration to their fiscal responsibilities, thereby countering patterns of tax avoidance. Consequently, tax audits remain central to tax administration due to their role in rigorously examining financial records to determine actual taxable income. Among the available approaches, accounting-based audits emerged as the most effective in uncovering understated tax liabilities. Furthermore, as evidenced in this study, the imposition of penalties for late filing positively influenced both the accuracy and timeliness of tax return submissions. Audit interventions also enhance the informational value of returns by recalculating taxable income, correcting previously understated liabilities, and ultimately contributing to increased government revenue.

In order to encourage voluntary compliance, the government and civil society institutions need to cooperate in organising widespread tax-awareness campaigns. Such campaigns must revolve around the nation and morality of tax fulfillment and tax compliance with fiscal rules. Social solidarity-based promotion of tax as a citizen duty can help build a positive attitude toward tax and stimulate voluntary tax compliance. Creating greater deterrence value also necessitates taxpayers to deem the chances of being checked as reasonable and its implications as higher than its fiscal advantage. This instills proper reporting and thwarts conscious under-reporting. Insuring that corporations prepare their accounts in collaboration with acceptable codes of accounting and legality brings in greater openness, minimizes tampering, and instills the efficacy of checking. In addition to this, tax checking professionals' technical competence also plays a significant part. Investment in long-term exercises in capability-building and providing domestic and external schemes of training shall enhance technical competence among examiners. Such long-term exercises shall help upgrade the quality of checking, maximize operational effectiveness as well as minimize differences among taxpayers and government.

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