

Non-traditional methods of determination of the tax base used during the tax control in developed countries



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Abstract

Purpose - the possibility of using unconventional methods to determine the objects of taxation based on current practice in developed countries.

Design/methodology - comparison, system analysis, synthesis, analysis and synthesis of data.

Findings - systematically studied and non-traditional methods of determining the objects of taxation in developed countries to decrease the risk of tax evasion and investigating the possibility of Azerbaijan foreign practices in the definition of tax base.

Research limitations - require more extensive and detailed analysis.

Practical implications - ability to use research as a research source in the indirection of improvement of tax legislation and administration.

Originality/value - studied the problem for the first time introduced into the scientific revolution at the present stage of development of tax administration.

Keywords: *tax audits, tax liabilities, equity method of analysis, the definition of tax liability on the basis of cost.*

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1. Introduction

As it is known, there are taxpayers not executing the tax legislation and concealing their wages with the aim of evasion of tax in all countries. At the result of that, considerable differences arose amongst the amount of the tax and tax amount that has to be paid by taxpayer. In modern world, one of the main measures implemented by tax administrators of the major developed countries considered to be the definition of the base of tax deduction and the use of the new mechanisms for prevention of the tax evasion.

In accordance with the Article 67.1 of the Tax Code of the of the Republic of Azerbaijan, tax bodies have the right to account the amount of the tax by using the following related information in the case it the tax payer does not present the account report that is necessary for the account of tax during 5 days after the notification of tax bodies, does not present documents during itinerant tax control, does not allow the entrance to the territories and buildings (*except residential buildings*), does not conduct the accounting by defined rule, in the case of loss of account documents:

- ❖ Tax declaration presented for the previous account periods to tax bodies by taxpayer;
- ❖ Official information on the wages and income aside the sales of tax payer;
- ❖ Information on expenses of tax payer, at the same time expenses to goods (*real asset*), works and services;
- ❖ Official information on material and non –material property being under the property and use of taxpayer;
- ❖ Official information on the physical value of produced and (*or*) presented goods (*works, services*) by taxpayer;
- ❖ Official information on import and export operations;
- ❖ Official information on means of taxpayer at bank accounts, as well as movement of means on bank account;
- ❖ Results of timekeeping observation conducted by the taxpayer;
- ❖ Any other information the source of which is tax bodies available for

By the aim of definition of taxes that has to be paid by taxpayer in accordance with the related information, the information being at the tax body engaged with analogical activity to the occupation of the taxpayer by implying the below mentioned criterion is used [1]:

- Manufacture of goods with the same peculiarities or the same kinds;
- Presentation of goods with the same peculiarities or the same kind, display of works and services;
- Territory where the activity is carried out.

At the same time, account rules of taxes that has to be paid on different tax kinds in accordance with the related information is defined by article 67.3 - 67.12 of the Tax Code of Azerbaijan Republic [1].

As it seen, several methods that are necessary for the account of taxes found their reflection in Tax Code of the Republic of Azerbaijan. But analyses of the indirect method of the definition of taxation base applied in developed foreign countries from the point of view of improvement of the tax legislation and valuation of the apply possibilities of them in our Republic is sufficiently important in perspective.

2. Essence and field of application of indirect methods for tax liabilities estimation

2.1. Essence of indirect methods: applied by Tax Authorities Information sources.

In developed countries, Tax Authorities have sufficiently extensive rights, allowing to reveal the volume of “dirty money”, when there are no any reliable “direct” sources of information on accurate estimation of taxation base, reduced amounts of taxes and volume of tax payers’ profits [2, 3]. Thus, in most German lands Fiscal Police bodies are considered to be parts of regional Ministry of Finance and they are subordinate to appropriate Financial institutions, engaged with control over taxation matters. As a whole, Fiscal Police activity is regulated by tax legislation. This standard Statement is called as “A Law on General Taxation Regulations”. According to this Law, Tax Police main duties include investigation on tax felonies and cases on tax determination and payment violation as well as estimation of a taxation base and disclosure of “unknown” tax felonies and circumstances, causing arise of taxation liability.

Conditionally evaluation of tax liabilities quantity on the basis of the estimation methods called as “indirect” are extensively applied in taking tax control measures with regard to natural persons and enterprises too. As mentioned before, in case considered by German legislation, the “estimated taxation base” expression is understood as any transaction closings with relatively low level solidity.

So indirect methods of tax liabilities estimation is based on use of information, intended for purposes, not come across in standard accounting documents and mostly not related with taxation. In particular, they are as follows [5]:

- ❖ statistic information (*for instance, information on living costs, consumer expenditures structure of different component families and etc.*);
 - ❖ detailed statistics on economic sectors;
 - ❖ data of commercial survey booklets;
 - ❖ data of banks and insurance companies;
 - ❖ salary data of trade unions;
 - ❖ information of mass media;
 - ❖ information about large-scale purchases, registered by appropriate authorities.
- In France, Tax Authorities have right to get acquainted with documents, limitedly

listed in a Tax Code. In accordance with the Law, the following persons are obliged to report [5]:

1. All employees (*of state offices, private sector enterprises and private businessmen*) are obliged to report Tax Administration about paid salary, fees and other payments;
2. Persons, paying dividends from securities and their participation as enterprise shareholders;
3. Bank reports Tax Authorities only about establishment of accounts. The quantity of accounts, which an enterprise wants to open, is not limited. Annually Banks have also to report Tax Authority about some transactions, closed by Clients, including acceptance of dividends and interests as well as incomes from sale of securities. Thus, while transactions Banks are compelled to open special accounts.
The information on tax payers' accounts is placed in Bank archives and in most cases - in electron carriers. Tax Authorities can not receive this information from Banks directly. Sum of deposits is disclosed only on survey or on the basis of a definite procedure, for instance while implementation of mobile tax audit.
4. Custom authorities systematically report Tax Authorities.

In addition to these mandatory information, any other information could be obtained in the result of a written request, directed to third parties by Tax Authorities.

In accordance with French legislation, mostly if there is a mismatch between tax payer's information and information of Tax Authorities, the information obtained from third parties is taken as a basis [5]. A tax officer prepares a Notification on tax payment on the basis of this information and sends it to a tax payer. Surely, it is impossible to except Tax Authorities' faults here. A tax payer has a right to announce his objections and proofs. The relation between a tax payer and Tax Authorities is of a dialogue character. In this case, if there is a contradiction regards to a tax amount or if a Bank or an employer submits false information, no any sanctions are imposed on a tax payer.

2.2. Application range of indirect methods

- 1) These methods are first of all applied in economic sectors, related with a cash turnover, which is as difficult as it is important to realize their registration and control over them. So, in some small enterprises, in most cases, no internal control over cash flow is implemented and economic transactions are not registered in a due course. The payment of purchases and hired employees' salaries by cash is not duely reflected in corresponding schedules and tax reports. Before being recorded as received, obtained sum of money is used by an owner for his own purposes and only a small amount remains for turnover with a Bank.

Grave violations on implementation of recording and reporting procedures are characteristic to these enterprises - not full reflection of sales volume and benefits as well as not application of a grave internal control over cash flow. Some part of acquired benefits are used for tax payers' personal expenditures and it is impossible to determine amounts of cash, used for hold of economic activity on one part and for personal purposes on other hand.

2) These methods could also be used while submission of information, not sufficient and not full for determination of tax payers' obligations as well as false information during violation of defined regulations on accounting. In addition to this, mentioned methods could be also applied in cases of noncorrespondence disclosure between different rates of tax payer's reports and under below-listed situations [5, 6]:

- ❖ noncorrespondence between turnovers or financial instruments, reflected in a Statement and tax payer's other information on economic activity, for instance quantity of production expenses (*inefficiency to be compared*);
- ❖ announcement of unimportant volume benefits or losses during several report periods;
- ❖ making a lot of transactions (*operations*) by cash;
- ❖ not correspondence of announced benefit to tax payer's life level and expenses.

As a rule, these methods are applied to small and medium enterprises. So, there it is possible to cover all spheres of the enterprise activity. Thus, mentioned methods can also be applied even to accounting cases, just seeming to be hold in accordance with defined regulations.

In accordance with a Code of USA on Internal Profits, in cases when no tax accounting is hold or it is hold not in a regular course, or when it is impossible to estimate a taxation base with the help of documents, submitted for audit, Tax Authorities have right to apply methods, allowing to estimate it more exactly [5].

Analogous regulations are reflected in German legislation too: "Estimation methods" are applied when a tax payer can not submit a detailed explanation on his activity or avoids from submission of further comments and does not perform his obligations (*duties*) on provision of assistance to Tax Authorities. In case of false determination disclosure, a tax officer can hold partial (*additional*) estimation of taxation base by stopping accounting method, applied in the enterprise. When the violation are importantly large-scaled and accounting data can not be used in general or information, submitted by a tax payer's is not sufficient for estimation of taxation base, a taxation base is wholly determined according to nontraditional methods.

In UK, a tax officer has a right to demand tax payers' documents as well as demand renovation of documents on the fact of their absence or even demand making a completely new document, confirming a definite fact or transaction (*bargain*). As a result, if a tax payer decisively refuses from collaborating with Tax Authority, a

tax officer can make his own special “logical” (*applicable, efficient*) estimation regards to retained amount. If a tax payer does not agree with such estimation, he will have to prove not correct and legal determination of his tax liabilities.

As tax services specialists of some countries say, it is not practically possible to disclosure tax evasion cases without estimation of enterprise activity main economic indicators (*profit, turnover, property, ownership income*).

3. The method of enterprise special capital analysis

This method is based on Hige Saymons’s classical profit conception [4].

According to the above mentioned conception, the benefit of juridical entities having liabilities on accountingholding and balance making in accordance with theses on commercial (*trade*) right is estimated by comparison of the enterprise property cost at the beginning of a definite term and at the end of it. For determination of a profit, it is necessary to know exact quantity of a real cost growth and this, in its turn, requires making complex estimation of profits and expenses year quantities.

Any growth of economic benefit in the result of assets entering and (*or*) payment (*cancellation*) of liabilities, causing growth of a special capital are considered as a tax payer’s benefit. But expenses are understood as a decrease of the economic benefit in the result of assets leave and (*or*) arise of liabilities, causing a special capital growth. A method of a special capital analysis is based on such a theoretical postulate: within a definite period of time increase or decrease of the enterprise capital real cost reflects in profits quantity or profits quantity, respectively imposed by tax.

This method is recommended to be used in the following cases:

- If accounts and records and accounting books of tax payer are not in good standing or if they are not carried out in general, as well as if it is reasonable to conclude that they do not reflect the real state of the businesses;
- While tax payer’s reports of some years are being checked, there observed considerable changes in the quantity of tax payer’s assets and liabilities within analysis period.
- Private equity analysis method may be used not only as a major method of verifying the accuracy of declared taxable income, but also for the assertion of the results achieved with the help of other methods. .

During the application of this method, the quantity of assets and liabilities of the enterprises as of beginning and end of accounting period (*year*), also the amount of funds spent for the personal needs of the enterprises owners appear as the main primary data. The changes in the quantity of net assets are defined according to net assets formula with the comparison of tax payer’s property value as of beginning and end of accounting period.

After defining net increase and profit of the property value of the enterprise, in

accordance with the tax legislation its adjustment is made: incomes and concessional costs of the company which are not subject to income tax; the costs considered expenditure from the point of accounting, but not recognized in terms of tax legislation, that is not related to the costs deducted from income and etc. are taken into account.

The figure appeared reflects itself technically taxable income (*profit*) and then such amount is compared with the information provided by tax payer.

Private equity analysis method allows to define taxable income of the enterprise during any method of carrying accounting (*cash, calculation, combined*). The applied accounting method only influences the processes of including one indicator to the calculations and excluding others. As the changes in the value of the net equity of the enterprise during a certain period are estimated with the comparison of figures of this indicator, it is important to define the amount of initial value of the equity and its increase can be calculated on the basis of this amount. Thus, main attention of tax authorities is focused on the obtainment of all information regarding assets and liabilities of tax payer in certain “starting point”.

This is mainly due to the following situation. In accordance with the influence of principle of succession or principle of identity of initial and final balance, if within a certain period the final balance of tax payer’s property has been reduced, this will lead to a rise in net increase of its property in next period, otherwise it will lead to a reduction.

The completeness and accuracy of relevant information with regard to property status of tax payer as of a certain date is considered one of major factors defining the efficiency of the analyzed method.

According to the recommendation of United States Supreme Court, public authorities shall comply with the below mentioned requirements in the application of private equity analysis method [5]:

- Define the initial value of net equity with the admissible accuracy;
- Take explanations (*evidences*) of tax payer into consideration;
- Define whether the increase of net equity relates to such taxable income.

4. Determination of tax liabilities on the ground of generalized indicators and costs of tax payer’s mode of life

As it is known, in developed western countries the bulk of budget revenues comprises of the taxes deducted from natural persons, the income tax is first. Any activity (*business*) not registered causes great damage to the budget. Thus, according to German researchers, in Germany private employment volume is approximately 17% of GDP or 370 milliard Euros. For example, 98% of those who help (*employees*) in housekeeping, work illegally.

“Property increase calculation” method, i.e., way of changing of property status

of tax payer in a certain period in relation to natural persons essentially means that the incomes of tax payer are defined according to its expenses. This method can be viewed as modification of private equity analysis method. The essence of the method in simple way can be imagined as follows in case of Germany.

If there appear reasonable doubts in financial institutions regarding concealment of income, then according to German legislation, it becomes necessary to calculate increase in property as a rule, auditing all wealth of tax payer within 3 years period for the clarification of factors.

Tax authorities consider that increase in the wealth of tax payer within a certain time period may occur only on the account of the following incomes:

- Taxable incomes and incomes of which tax is paid;
- Amounts hidden from tax deduction;
- Lump sum cash incomes, for instance, obtained inheritances.

To define the amounts hidden from tax deduction, tax authorities implement the following consistent actions [5, 6]:

I. During a certain period, approximate amount of tax payer`s costs is calculated.

Costs, in its turn are divided into the following main groups:

- Costs directed to the obtainment of property;
- Costs necessary for the provision of consumption of vital importance and other current (*private*) expenses;
- Funds directed to collection, payment of debts;
- Other money transactions.

As of beginning and end of period, the property of tax payer is estimated at the same price. If a tax payer had built a house, then the financing sources of the building are analyzed in detail. The defined property increase, as a rule is distributed equally over the years during the period of analysis.

The costs necessary for the provision of consumption of vital importance are as follows: costs directed to treatment (*if such costs have not been paid by third parties*), upbringing and education of children, keeping housekeepers, trips of private character, purchase of clothes and household goods, as well as getting and maintenance of private vehicles, expenses spent on housekeeping.

In this case, minimum costs with respect to the provision of consumption of vital importance may be defined according to official statistic data concerning the cost of living of blended families.

Reasonably, officers of tax authorities pay special attention to considerable money expenses spent on entertainment and very expensive purchases.

Different money (*financial*) transactions of tax payer, including borrowed amounts, gifts received from individuals, especially parents and respectively costs for the gifts presented to individuals, prizes, incomes from casino games and others, as well as private legal costs, fines and etc. are taken into account. Tax officer also

focuses his/her attention to the amount of “related” funds which is impossible to freely spend, for example, tax payments, different insurance fees, payments on loans, housing costs, alimonies and etc.

Besides this, during calculation of property increase, only incomes (*for instance, rental fee of flat*) of which are considered income in terms of tax law, but actually have not been regarded as specified are taken into account.

During the period of analysis, to the amount of the costs (*including, collections, payment of debts and other transactions*) spent on the current (*personal*) expenses of tax payers property increase value of such period is added (*reduced amount of property value is excluded*). Namely, this amount itself will be approximate amount of the expenses (*respectively, incomes*) of tax payer within a certain period.

II. Non-taxable incomes are excluded from this amount. They are as follows:

- Incomes received from the obtainment of inheritances and gifts from third parties;
- Other non-taxable incomes;
- Rate profit obtained;
- Received insurance payments, housing loans, deposits.

III. The expenses concerning the obtainment of incomes are deducted from the received amount. Thus, total amount of taxable incomes is defined.

IV. The amount of which taxes are paid is deducted from the total amount of taxable income and consequently, the amount of which taxes are not paid appears.

The determination of tax payer’s property value as of a certain date allows to compare the total amount of the incomes specified in return with the real financial position of payer. In this case, the increase in the property value and individual consumption being higher than the amount of which taxes are paid proves that there are incomes hidden from tax deduction. Even in the cases where the amount of the “related” payments are higher than the total amount of expenses for the personal needs of tax payer, tax officer can easily prove that the funds spent by tax payer on clothing, food, entertainment and other personal needs have not been reflected in income tax return.

During the calculation of increase in property personal consumption rate is considered to be the important factor. High consumption rate of tax payer can prove the existence of non-taxable incomes and low consumption rate the obtainment of property not reflected in return.

During the application of the calculation method of money circulation being the modification of the determination method of property increase, the amount of all incomes and expenses of tax payer is compared. The main idea of the method is that a tax payer may not spend more than the incomes received from different sources or deposit money with account during the analysis period.

By comparison of moneys spent by tax payers with money under their disposal,

the determination of the rate to meet expenses is considered to be a simple version of calculation of money circulation. If expenses exceed the amount of funds available, it shows that the amount of the shortfall has been covered on account of other sources, for example, additional “secret” incomes.

In lack of information on detection of profits described in declaration especially on income status of payer, this method is often used in Germany. As per Tax Code of France tax bodies have right to calculate expected expenses of tax payer depending on character of life style. As an example for life style peculiarities, number of vehicles, yachts and other vessels, tourist palnes, tour and runing, right for paprticipation in gloc clubs, hunting as well as (*for last two case - fee for participation or subscription fee*).

Taxable value is belonged to defined quantity of its value while bying of new vehicle, existence of other kind of prepoerty is taken into account by including of concrete amount of property that lost its value. As in Germany, value of accomadation is taken into account:

Five-fold amount of annual rent of home or apartment included in cadastral is added in taxable income.

If tax payer has above-mentioned kind of property or things, in this case relevant amounts are collected. In existence of definite conditions tax base is increased up 50 %. So tax bodies determines approxiamte amount of person’s income for not submission of declaration. As well as according to collaborators of Ministry of Economy, Finance and Budget of France this method is not always effective property is often registered in the name of other persons. Court practive of USA and Germany confirm unconditional approval of quantity of basis of taxation beased on indirect methods by the court of evidence. While looking through the issues in Tax Court of USA, prezumpiya of “correctness” of decision of tax bodies on incomes indicated in notification on debts of tax payer is presently functioning. “Important minimum evidence” or “any realiable evidence approving incomes of tax payer” are required by court tax body for application of prezumpiya. Such as reliable evidence, it may be bying of expensive thing, furniture, apartment, home tha are not compared with income amount indicated by tax paper in declaration. It’s clear taht tax payer is not responsible for submission of detrails on how to finance his housekeeping. As a rule tax bodies haven’t righth to obtain detailed information on personal consumption of citizens. In disparity of incomes declared during calculation of growth of trade turnover, property value with real situation, in this case payer should explain its reasons (*if he doesn’t want to make extra payents*). At the same time, it’s important to pont that significant part of delas made by non-cash settlements in developed countries. Declaration of payers are compared with details from details of banks, tarde centers, companies and etc that incomes of tax payers would play open source role for control meassures.

5. Internal and external comparative analyse of enterprise' activity

5.1. Internal Comparative Analyse

Internal comparative analyse means comparison of entrepreneur's activity during consecutive time intervals. Starting point of internal comparative analyse is determination of business turnover of enterprise. It's calculated under entrepreneur's balance and income and losses by taking into account individual methods, factory installations, location, employe's number, kinds of manufactured or delivered goods. The same indicator bying raw materials and materials, expenses directed in salary of main employees in industrial enterprises as well as common manufacture expenses, output of finished products in several entrepreneurs. Main part of calculation is goods turnover, in this case it's important to clarify size of price attachments under group of goods for calculation attentively. Mostly only details of accounting aren't satisfactory for analyse of business turnover. Tax payer is responsible for submission of extra details under appeal (*request*) of tax collaborators. Amount of main conceptions to be considered simply for the same kind of activity.

This method means two main aspects:

- 1) Comparison of peculiarities under tax body and tax payer's details. Turnover indicator defined by tax collaborators is compared with indicator declared by tax payer under appropriate period (*year*). If calculation's result isn't significantly differed from information of tax payer, in this case correctness of tax base' determination is accepted. If significant variation is detected, in this case more detailed verification is held. Regularly, variation is allowed in 10% limits, but mostly smaller variation may be satisfactory evidence for conducting of verification (*exp. for little enterprises*). If control calculation is precise detected variation is considered more important. It's necessary to take into account that existing difference can be related to not only conceal of incomes, but also price change, losses, possessions and etc.
- 2) Comparison of dynamics of important financial-economical indicators of enterprise. Accounting and report details are compared under the same enterprise in different periods during "Internal" comparison in enterprise. So, one of conditions of analyse' effectiveness is considered as approximate stability of manufacture' conditions during a long period. Main analysed peculiarities are considered incomes, also profit and losses obtained by enterprise in absolute and relative expression.

Such comparative analyse means variation in common profit under compared periods is evidently clear and investigation of its reasons is purposeful. In this case impact of external factors (*inflation, structure changes, tax legislation' amendments*) should be eliminated. For example, increase and decrease of sale or purchase prices,

also factors like substitution of sale period in other period impacts level of business turnover. It's possible to investigate dynamics of net profit under internal comparative analyse. In this case differentiation of stable expenses (*for example, rent fee, percentages, amortization charges, allocations for reserve funds*) and varied expenses (*manufacture and repair charges*) makes a great importance. So varied expenses depend on turnover and influences dynamics of net profit. Growth of stable expenses is mostly explained with expansion of enterprise. For instance renting of new buildings by enterprise is accompanied by significant growth of rental fees.

As a rule, appropriate (*equal*) dynamics means existence of favourable condition. Significant variations from previous years points serious violations in accounting and indicates the need for more detailed verification. If payer isn't able to make convincing explanations on significant changes existing in business turnover, in this case we observe assumptions on tax evasion in tax bodies. Details on the course of internal comparison is submitted in Table form. In addition, new method (*in this case establishemtn of curves in sublogarithmic network*) by name "graphic sequence of comparison" is used that it allows to observe variation from proportionality immediately (*in this case the curves aren't paralel each other*).

Main shortcoming of mentioned method means that if any peculiarity that impacts dynamics of important indicators and takes place in definite period during comparison is detected, it makes difficult analyse. In this case comparison of verified entrepreneur with another analogical entrepreneur is reliable method.

5.2. External comparative analysis

During external analysis the main factors of the analyzed enterprise are compared with the same factors of the analogical enterprises within both the scale of are and structure. Such comparison may be made by comparison of separate entities or "control figures".

- 1) During the comparison of separate entities, the main analyzed indicators are considered to be incomes, expenses and also special economic indicators. Here namely the comparison of formation of purchase-sale conditions and expenses in the compared entities assumes great significance. In this case, standard entity of which indicators are basis for comparison, may be either a certain or a conditional (*for example, when use of information of a certain entity contradicts to the principle of protection of commercial secret*) entity.
- 2) The comparison of control figures (*norms*) is considered an auxiliary method and in the absence of other documents, with the help of this method checking of circulations and profit on the activity of entity is carried out.

The standards for different types of entities are defined according to the results of activity of a number of entities, information from financial and statistical autho-

rities, business alliances involving a wide range of facts. For this purpose, a few thousand companies comparable with the audited entity either on scale (*on sales scope, expenses*) or activity type are involved.

In the field of separate entity groups standards are defined annually by tax authorities and are published in a special handbook. Like in internal comparison, here also focus is directed to business turnover, gross and net profit indicators.

Area standards for gross and net profit are determined with percent by comparison with business turnover. It includes good, average and poor type of norms for different economic conditions (*good, average, and poor*). Average norm expresses average rate indicator on separate results of the audited entities of the same type.

Norms comes forward from the condition in a standard entity. Therefore, during the preparation of norms the results of the audited entities are standardized, that is made comparable.

Federal Statistics Office of Germany quarterly publishes the calculation of expenses structure (*special weight of expenses in turnover*) on separate activity types, including for independent qualified persons. For example, such calculation has been devised for qualified doctors on 12 directions. Such information is used during tax audits. If there are serious divergences from norms in the audited entity, tax officer clarifies its reasons (*of differences*).

For the application of external comparative analysis, it is required to have sufficient database on the spheres of economy, also the accurate method for the estimation of profitability of enterprise. In this case, it is necessary to take geographical location of the entity, economic conjuncture of the region, also business strategy applied by a tax payer into account.

6. Supervision to the cost by tax bodies in western countries and in Azerbaijan

The main field of regulation of legislation on transfer costs in economic collaborator and Development Organization countries considered foreign economic contracts implemented amongst mutually depended entities. In relation with this contract “stretched hand rule” act herein.

The essence of it consisting of state not trying to regulate costs on contracts, but tries to accurate tax paying amount in the way, that contract seems not implemented amongst not depended partners.

It is implied in foreign legislative document on transfer costs that both parties try to get advantage during contract. The benefit of mutual depended company could be less in comparison with the simple case during put of economic risk to the liability of the head company, but complete inbeing of benefit of any companies is considered non-accepted. During existence of contract amongst dependant entities, costs have

to be severely differed from marketing cost. However, tax bodies have the right to account additional tax amounts on taxes by taking into consideration marketing prices, at the same time advantage tax in the case of important differences.

Commencing from 2001, regulation of cost by tax bodies for taxation purposes conducted by Tax Code of Azerbaijan Republic and is considered one of the indirect methods of definition of tax liabilities.

Article 14 called “Marketing price” of Tax Code of Azerbaijan Republic, equality and differences amongst norms of legislation of foreign countries found its reflection as following:

Items of Article 14 of Tax Code	Corresponding norms of the foreign legislation
<p>Tax bodies implement account of taxes by implying the marketing cost in the following case:</p> <ul style="list-style-type: none"> o During barter (<i>goods exchange</i>), and import-export operations; o In the case of implementation of economic contract mutually amongst dependant persons; o The level of prices applied to good of taxpayer from the same kind and the same peculiarities modify more than 30 percent; o In the case, the property of the company is insured more than remainder amounts of the company. 	<p><i>The main field of Transfer costs in ECDO countries is foreign economic contract mutually implemented amongst dependant entity.</i></p>
<p>Tax bodies define the market price until the sale of goods, but until 30 days after the present of goods (<i>previous and late</i>) according to prices formed during corresponding operations for the same goods (<i>analogical</i>).</p>	<p><i>The prices are sufficiently differed from market prices during implementation of contracts of mutually dependant entities. In the case of severe differences of prices, companies have the right to account additional amounts on profit tax by implying tax prices of tax bodies.</i></p>
<p>The following valuation factors are applied in the case of impossibility of collection of information on market price of these goods from official and open sources in the case of non-lead any operation to cases with the same peculiarities and kinds in corresponding commodity market:</p>	<p><i>As in Azerbaijan. Redistribution of the profits amongst mutually depended entities is defined on the base of principles defined by legislation.</i></p>

<ol style="list-style-type: none"> 1) On the base of the last sale prices, the last price valuation in the market price is defined by deduction of applied additional; 2) In accordance with the collect factors of the amounts market price commodities are accounted by collection of based expenses and profits of presented; 3) In the case of non-definition of the price market by these two factors, expert involved on the base of contract defines it. 	
<p>The price defined by parties in operations accepted during definition of market prices of goods (<i>works, services</i>).</p> <p>While defining the market price, operations amongst mutually dependant entities only implied in the case, if their relations are not reflected to the result of the same operations. Market price is defined until the sale of goods, but until 30 days from the date of present of goods and near date according to prices, formed during corresponding operations for the same commodity.</p> <p>During definition of the market price official information resource and other corresponding information is used information of advertising.</p>	<p><i>In accordance with the recommendation of the applied cost applied in the operation is compared with prices denoted in any concert contract concluded in relation with the same peculiarities amongst free entities in compared case</i></p>
<p>The following factors are implied during the imply of the market price: capacity of send commodities (<i>done and sent services</i>); modification of demand and suggestions; liabilities execution and repayment terms; goods origin country; goods send location (<i>works, services</i>); level of goods quantity, other production indicators and other terms effecting prices.</p>	<p><i>As in Azerbaijan</i></p>
<p>In the case of definition of goods market prices to the last selling price, the deductions applied from the last selling price is taken.</p>	<p><i>During the apply of the last selling method, the market price is defined as differences amongst amounts of expenses (including risks fell on seller and its actives) by implying usual profit of seller together with the last selling market.</i></p>

<p>In the case the market price of the goods, service and works is defined according to the amount collection factors, the based expenses and profits of service presented is collected.</p> <p>In such case, the usual profits (<i>receive prices or remainder amounts</i>) to the production (<i>work, service</i>) and present of goods, transportation, preserve, insurance and other same profits, additional collection and deduction in accordance with the demand and suggestion during operation amongst free entities are taken into consideration.</p>	<p><i>It is important correctly define the amount of usual profit for the same activity field during apply of amount collection method. It is defined by implying the profit received by the same and other subject of the market.</i></p> <p><i>In such case, it is important take into consideration the differences in the character of the activity of subjects.</i></p>
<p>Items not implied in the Tax Code of the Republic of Azerbaijan.</p>	<p><i>During demanded contract both parties wishes to receive profits. Inbeing of profit of any group of companies considered unacceptable.</i></p>

Picture: Comparative analyze of article 14 of Tax Code of Azerbaijan Republic and corresponding norms of external legislation.

Nevertheless, item of article 14 of tax Code form correspondence with the legislation of USA and Europe countries on transfer costs and some kind of problems arose in its apply.

1. Severe rules defined in article 14.2 of tax Code: “...costs of goods for taxation aims are accepted as costs applied in operation of parties” [1].

Tax bodies have the right to control the accuracy of the apply of costs on contract. Tax bodies account taxes on marketing costs, in the case the cost is modified more than 30% from the degree costs applied to goods from the same peculiarities and the same kind. One of these situations is considered 30% shun from the degree of costs applied to identical (*same peculiarity and kind*) goods (*services and works*) from taxpayer during short term of the cost on contract.

In such cases, the facts of modification of costs on contract is not sufficient for the account of taxes by implying marketing cost, so the decision of the tax body has to be fundamental. The legal practice denotes that, by the aim of account of taxes regularly, tax body has to prove not only modification of costs more than 30% but also lower of these costs from marketing prices.

2. By the aim of correct definition of the market price of goods, prices are com-

pared not only on analogical contracts, but also identical goods and in similar economic case. Compare of prices on goods of different profile companies producing similar products is not correspond with purposes.

3. In accordance with the article 14.6.1 of Tax Code, the following methods effecting prices during the definition of market prices are taken into consideration: volume of sent goods (*done works, denoted services*), liabilities execution term (*capacity of the commodity party*), repayment terms, modification of request and suggestions (*seasonal increase and decrease of the production demand*), origin country of goods, received or presented location; send terms of goods (*works, services*), level of indicators of goods and other production indicators; marketing of new goods (*works, services*) having no analog in relation with the marketing society; lead of new goods to market, present of good samples by the aim of acquaintance of producers and etc. [1]. The position of legal in connection with it is as following:

The followings are implied during the definition of market price of buildings on lease agreement: the region where these are buildings settled; floor where the apartments settled, number of rooms of the apartment, total space of such apartment, lease term of apartment, including additional services to lease price, at the same time its supply with necessary things and equipments depending on peculiarities of the apartment.

While defining the market prices of goods the quantity the goods and sent volume, execution term of liabilities and repayment terms, as well as origin country of goods are certainly taken into consideration.

7. Conclusion

By generalizing the theoretical points of the held research, the following solution of problems in the field of definition of taxation base could be displayed: use of information not meeting with the account documents and implied for aims not related with taxation; valuation of the main economic indicators of the activity of the company for clearing cases of tax deviation; definition of the quantity of the increase of the net amount of the capital of the company by the help of the special capital analyze method; definition of tax liabilities of taxpayer on the base of the generalized indicators of life manner of taxpayer.

The apply of indirect method is recommended during the following cases:

- in economic field related to cash turnover where implementation of supervision is sufficiently hard;
- unsatisfactory and incomplete information for the definition of tax liabilities by taxpayer, at the same time presentation of incorrect information

As it seen from investigations, non-traditional method of definition of taxation objects is relatively new approach and there are differences in these fields. The dif-

ferences arose out of official, legal and modern factors, at the same time differences can be caused by the behavior of tax bodies. Nevertheless, some developed countries possess successful practice in the field of definition of taxation bases on the base of indirect methods and their practice couldn't be used in this field by our republic.

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