



Risk-based tax audit Strategies, used by the Algerian tax administration for selecting taxpayers for an external tax audit.

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Abstract ;

This study aims to find out about the approach adopted for the selection of companies undergoing tax audits in Algeria. A critical analysis of the approach adopted was then drawn up in comparison with the results and recommendations set out in the articles examined during the compilation of this study. This study relies on an ethnographic method based essentially on semi-structured interviews conducted with tax administration staff in order to find out about the approach adopted for the selection of companies undergoing tax audits. A critical analysis of the approach adopted was then drawn up in comparison with the results and recommendations set out in the articles examined during the compilation of this study. We found that the Algerian tax administration is conscious that the most effective strategy to frightening taxpayers' tax evasion is a combination of risk-based and random audits.

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1. Introduction

Capitalists adopt an old definition of tax, which is the one put forward by Gaston JESE : *'Tax is a pecuniary benefit, required of individuals, by authority, definitively and without any counterpart, with a view to covering public burdens.'*

Taxes, which are at the heart of State policy because of their contribution to the financing of public expenditure, have a special character in that they are a mandatory levy with no counterpart. It is for this reason that taxpayers have a negative perception of tax and see it as a constraint or a penalty because they do not see the advantage of their contribution. This inevitably leads to tax evasion.

Another reason why taxpayers avoid paying tax is the declarative tax system. Hence the need for a tax audit system to detect taxpayers who fail to meet their tax obligations.

Algerian legislation (Tax procedures code) provides two main categories of tax audits, depending on the type of taxpayer and their income and activities. To sum up, there are two types of tax audit:

- ***Paper-based control or declarations audits***

Under articles 19 and 18 of the Tax procedures code: *"The tax administration controls declarations as well as the acts used for the establishment of any tax, duty, and royalty."*

This type of control consists on critical examination of tax declarations, taking into account the information contained in the taxpayer's tax file. The purpose is to ensure that tax declarations have been filed in the forms and deadlines prescribed by tax law and that no errors have been made.

- ***On-site (external) tax audits***

On-site (external) tax audits procedure is provided for by the provisions of Articles 20 of the Code of Tax Procedures for general accounting audit and 20a of the same code for spot accounting audit and 21 of the same code for the in-depth verification of the overall tax situation (VASFE).

Out of a tax population currently estimated at 592,900 taxpayers au 31/12/2023, information published by the national commercial registry centre (CNRC), the tax authorities have only approximately 700 auditors in charge of auditing this population nationwide. For this reason, tax audits are carried out by means of an annual audit program targeting certain taxpayers and certain activities.

In the past, taxpayers were targeted for tax audits using the traditional method of random selection based on certain criteria set by the tax authorities. The exponential increase in the

number of taxpayers and consequently in the tax data available has made it essential to move towards an automated risk-based approach.

In our study we focused on the external tax audits specifically general accounting audit and spot accounting audit and how the selection of taxpayers for this type of audit is conducted.

Research question:

Our study will focus on one main question, which is:

Are risk-based tax audit strategies, used by the Algerian tax administration for selecting taxpayers for an external tax audit, rewarded?

Main hypothesis:

The Algerian tax administration is conscious that the most effective strategy to frightening taxpayers' tax evasion is a combination of risk-based and random audits.

Interest of the study:

This study seeks, on the one hand, to illustrate the Algerian tax administration's strategy for selecting taxpayers for tax audits and, on the other hand, to situate it in relation to the techniques and approaches used in other tax administrations and analyzed in studies conducted by certain researchers.

2. Literature review

After a careful reading of the previous studies and a review of the literature on the definitions of tax risk, its typology and the importance of analyzing it in the context of a tax audit, we have decided to take a descriptive and critical look at the concepts described below:

The Robert dictionary defines risk in general as: 'A more or less foreseeable possible danger' or 'The possibility of an event causing damage' or 'The act of exposing oneself to danger (in the hope of obtaining an advantage)'.

From these definitions, it is clear that risk is generally linked to a danger or damage that may occur.

Several authors have taken this general definition and adapted it to the tax context, giving different definitions of tax risk based on different approaches.

The European Commission (EC) gives a definition of the risk of tax indiscipline based on the typology of the risk that may arise and the different stages at which the risk may occur '*the risks can be classified into four types: risks relating to the register, risks relating to the filing of returns, risks relating to payment and risks relating to the return*' (EC, 2004).

The connotation of danger in the definition adopted by the EC relates to the fact that the taxpayer may fail to meet his obligations at the various stages provided for by this definition and consequently the Public Treasury is harmed because a defaulting taxpayer is equivalent to lost revenue.

Another definition of the origin of tax risk is given by Rossignol., (2010), according to which this risk *‘encompasses two meanings: the first, classic, which concerns voluntary or involuntary non-compliance with tax provisions, while the second concerns inefficiency, which relates to a lack of knowledge of the rules that results in a loss of opportunity or may generate a loss of earnings’*.

In summary, several definitions based on different approaches have been given by different authors to define the concept of tax risk. A reading of these definitions leads to the conclusion that tax risk is directly linked to taxpayers' failure to comply with tax laws and regulations.

Khwaja et al., (2011) highlights the importance of risk management in a tax administration by saying : *“Risk management is an important element of effective and efficient management of compliance. First, it is impossible for any revenue administration to control and check every single taxpayer. Second, it is unnecessary to waste scarce enforcement resources on routinely examining low-risk, compliant taxpayers”*. In fact, the use, by tax administration, of strategies that emphasis on high-risk taxpayers to be selected for a tax audit increases collection and compliance.

The most conventional audit case selection methods consist of random selection of cases, manual screening/ case review by auditors, and risk-bases case selection (Khwaja et al., 2011).

In their study, Hashimzade et al. (2016) have used an agent-based model and simulation analysis for individual behavior, they find that, unlike random audits, risk-based audits precisely predictive analytics for audit enable tax administration to collect more revenue.

Risk-based tax audit strategies are not very known, especially for entities. An experimental approach has been used by Alm and McKee., (2004) to analyze tax behavior and find that the most effective strategy to frightening individual tax evasion is a mixture of risk-based and random audits.

Beer et al. (2020) in a study conducted in 2020, they used administrative tax data of self-employed US taxpayers, to prove that in order to rise current and future compliance, tax administration needs to apply an effective targeting audits of non-compliant individual taxpayers.

Using the Norwegian administrative data, in order to explore empirically the individual behavioral responses of high-risk wage earners to audits Loyland et al., (2019) find that the compliance consequence of audits based on risk scores (predicted by machine learning) grows meaningfully with the individual taxpayers' risk score.

Hsu et al., (2015) conduct a study to analyze the impact of risk-based audits on corporations which reveals that the efficiency of the audit selection process is increased by the use of datamining.

Eberhartinger et al., (2021) carry out an analysis of entities in countries using risk-based audits and entities in countries that never use risk-based audits, they find out that tax behavior of entities accurately reducing tax avoidance is impacted by the use of risk-based audit.

In the same study, it has been proved that tax administration, by the use of risk-based tax audits, can relates to lower cost of tax collection, to tax collection reaching its full potential, and to a disproportionately high increase in tax revenue as compared to GDP growth.

Eberhartinger et al., (2022) explore, on one hand, how risk profiling in different countries has an influence on the probability and the effectiveness of an audit of corporate taxpayers, on the other hand, if and how risk profiling is related to tax avoidance.

The results of this study show that corporate tax avoidance is on average negatively related to the adoption of risk profiling, irrespective of firm size. In other words, risk profiling could possibly discourage the strategic responses of taxpayers to audits and enhance audit effectiveness by mitigating aggregation below a certain threshold of revenue to avoid an audit.

Further, Hashimzade et al., (2016) and Loyland et al., (2019) explore the features of specific methods of risk-based tax audits (predictive modeling, risk profiling, and data mining) and their implications for tax revenues and individual taxpayer responses.

In a study carried out by the OECD in 2004 on several tax administrations in several countries concerning the application of techniques for managing the risk of tax indiscipline to procedures for selecting cases for tax audit, it emerged that the key condition for a procedure for selecting taxpayers for tax audit is the possibility of accessing the data declared by the taxpayer on monthly, quarterly or annual tax returns. The tax authorities in question attach major importance to the manual or machine processing of data used to detect tax risks and consequently to selection for tax audits.

According to the same study, as well as data taken from taxpayers' tax returns, other data may be essential for adopting an efficient strategy for selecting files for tax audit, such as:

- data and information available from outside sources, such as financial institutions and social security authorities, which can be cross-checked with the data declared by the taxpayer to confirm or refute it;
- the tax history of the taxpayers concerned;
- more general taxpayer/industry profiles.

Rezarta Shkurti et al., (2021), did research to analyze the association between the data extract from the financial statement declared by the taxpayers and the level of magnitude of tax risk. In

this study, a binary regression, on a data of 183 tax audited Albanian entities for 2015 and 2016, has been used to find the ratios calculated from the financial statement that reveal a tax risk.

Based on the results of this study, five ratios can specify exactly the high risk of a tax audit which are: “(1) liquid ratio, (2) ROE, (3) total debt ratio, (4) inventory ratio and (5) non-current assets ratio”.

According to Khwaja et al., (2011), most countries worldwide use risk-based tax audit strategies to determine their tax audit cases, combined with random selection.

In her research Khaldi, N. (2025), which examined the impact of tax audit in enhancing tax compliance, emphasizing on the Algerian tax system, she found out that the modernization of tax audit practices is important to encourage taxpayers' compliance and revenue collection. The study highlighted the importance of targeted risk-based auditing and specify that by using this approach, the tax administration can allocate resources more effectively and consequently improves the efficiency of tax audits.

3. Methods and tools

This study aims to expose whether the risk-based tax audit strategy adopted by the Algerian tax administration rewarded.

Most of the articles reviewed for this study use quantitative methods to reveal the impact of the risk-based tax audit strategy on tax compliance. We would have liked to follow the same approach and study the data and results of the audits carried out on the basis of the selections made using the risk-based strategy, but at the time this study was drawn up the results of the audits carried out were not yet available. The tax authorities did not start using this strategy until 2024.

This study relies on an ethnographic method based essentially on semi-structured interviews conducted with tax administration staff in order to find out about the approach adopted for the selection of companies undergoing tax audits.

A critical analysis of the approach adopted was then drawn up in comparison with the results and recommendations set out in the articles examined during the compilation of this study.

4. Results – strategy of selecting taxpayers to an external audit

The interviews conducted with the tax administration staff in charge of tax audit reveal that the Algerian tax administration combine the use of two methods, the first one is the traditional method called random method and the second one is the risk-based tax audit method using a risk analysis tool developed by the tax administration to automatize the process of selecting taxpayers for an audit.

4.1. Traditional method for selecting cases to be scheduled for an audit.

In order to conduct an effective and efficient tax audit and to detect any fraudulent maneuvers, a rigorous and delicate scheduling of tax files must be implemented.

In this section, we examined an in-house document and we conduct interviews with the staff of the Tax audit and investigation division of the General Directorate of tax in Algeria to present, in the first place, the criteria for selecting a tax file for an audit and in the second place, the process of scheduling files for an external audit.

a. Criteria for selecting a tax file for an audit

The General Directorate of tax especially the tax audit and investigation division has drawn-up a non-exhaustive list of criteria to take into consideration when selecting files to be audited. We can list the following criteria:

- Receipt of matching bulletin from various public institutions such as financial institution or social security institutions that show discrepancies with taxpayer declarations;
- Tax files that show signs of concealment, omissions, and serious errors during a paper-based audit that can only be detected by an on-site audit;
- Chronic deficit;
- Low gross margin compared to the usual margins applied;
- Significant labor force compared to the norms of the activity;
- Activities with a high level of fraud (wholesale sales, liberal professions, etc.).
- Non-identification of taxpayers (lack of location, number of changes of address since inception, assumed name, etc.);
- Change of legal form
- Non-compliance with tax declaration and payment obligations;
- Failure to file tax returns;
- Misappropriation of the tax benefits granted and non-compliance with related commitments;
- Non-compliance with commitments to reinvest profits taxed at the reduced rate;
- Expenses that appear exaggerated in relation to the nature of the activity carried out;
- Persistent or doubtful loss carryforwards;
- Structural or repeated VAT withholding;

- Request for VAT refund;
- Provisions that appear doubtful;
- Cessation of business or compulsory liquidation.

In addition, the selection of files to be audited must also take into account tax-related information and anomalies, as recorded in some reports such as :

- Reports on the final results of inspections carried out by members of the mixt unit of audit (Tax, Customs and trade);
- Reports of findings, drawn up by agents of the managing departments;
- Reports and statements of facts, drawn up as part of the implementation of the right of investigation and right of inspection.
- Reports drawn up by agents of the Province (Wilaya) Trade Department;
- Reports drawn up by management auditors;
- Reports from other control bodies (Court of accounts, etc.).

There are other criteria that are not related to the tax file (geographical and activity criteria):

- To ensure a balance between the different sectors of activity, but the emphasis is placed on activities reputed for fraudulent maneuvers;
- To ensure maximum coverage of the tax territory.

We would like to point out the following:

- the criteria listed above may change from a year to another according to the strategy adopted by the General Directorate of Tax;
- These criteria must be met regardless of the form of audit used;
- These criteria are not cumulative, that is to say that tax authority can select a file for an audit regarding only one criterion or the same file selected can gather some criteria.

b. Process of scheduling files for an external audit.

The preparation of the external tax audit program is decentralized by the tax audit and investigation division to different tax services of the districts (wilayas) (DIW) and the DIW also delegates the preparation of the audit program to the tax center (CDI).

Within the CDI, the audit program is carried out in collaboration between the main management service and the main control and research service.

Once the program has been completed, it is forwarded to the center manager, who must approve it and submit it to the DIW.

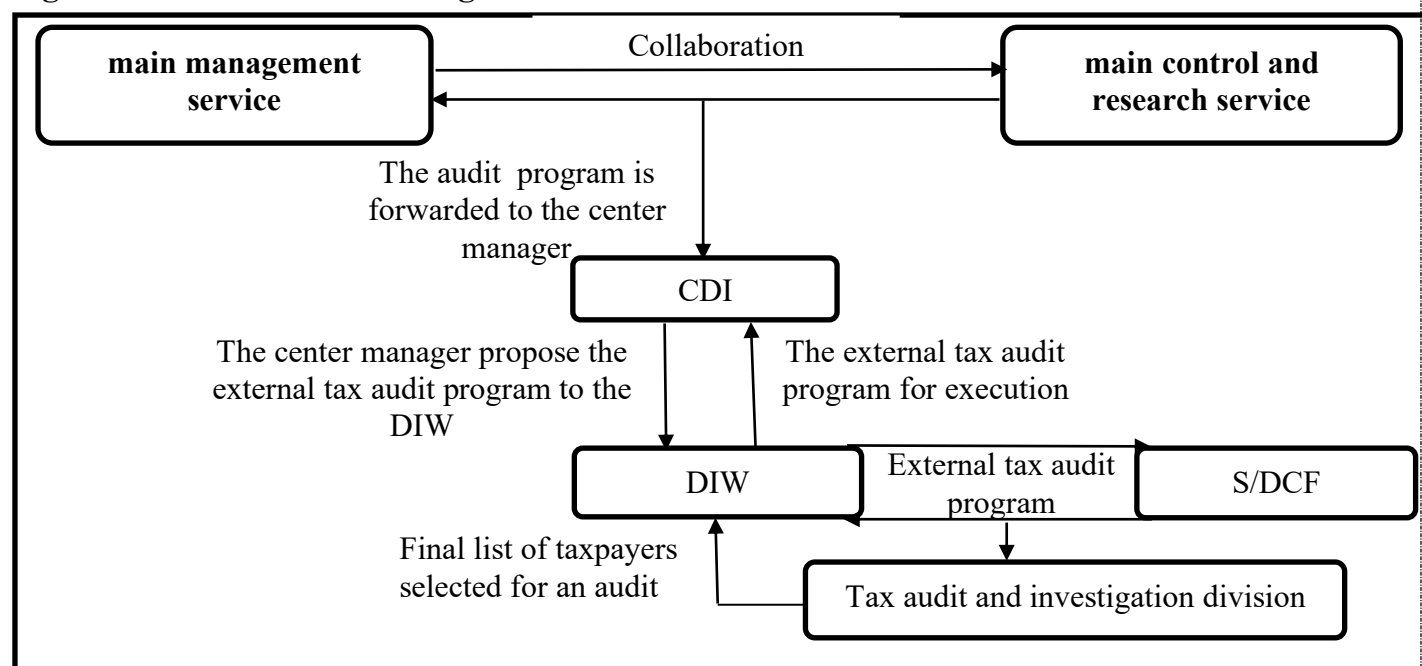
The Wilaya Tax Director, in collaboration with the Wilaya Tax Audit Sub-Directorate (S/DCF), draws up a definitive list of taxpayers to be audited. This list is sent to the tax audit and investigation division.

The tax audit and investigation division must approve and finalize the program, and forward it to the DIW, which must execute it within twenty (20) days of receiving the program from the tax audit and investigation division.

After approval by the tax audit and investigation division, the program follows the same path to reach the head of the CDI.

The audit program is passed on to the CDI's brigade chiefs, who in turn pass it on to the auditors, for execution. The program will be distributed among the auditors, maintaining a balance between them.

Figure I : Process of scheduling files for an external audit.



Source: Compiled by us after an interview with a tax administration

We choose in this point to detail the case selection for an on-site (external) tax audits because in the following points we will explain the use of a risk analysis tool, developed by tax administration, to elaborate an external tax audit program.

4.2. Risk analysis tool for selecting cases to be scheduled for an audit.

a. Machine Selection of taxpayers for audit- Annual summary statement - ERA -

The Tax audit Directorate has developed a tool to help with programming in external tax audit, allowing automatic processing of declared data according to an annual summary statement

"ERA", implemented in the information system of the General Directorate of Taxes «JIBAYATIC».

This statement was introduced by the provisions of articles 05, 16 et 21 of the Finance law for 2021, which amended and supplemented article 18 of the Directs Taxes Code and created articles 151 bis and 192bis of the same Code. It is filled in by the taxpayers, by means of a teledeclaration, and traces accounting data extracted from the annual income statement (declaration) and the statements annexed to it.

The Annual Summary statement (ERA), detailed in a circular of 21st of march, is an electronic table containing 22 items to be declared by taxpayers, as shown in the appendix I.

The data declared electronically in the ERA by natural persons and legal entities are used to calculate 18 potential risks, ranked and weighted, which will allow to generate a list of potentially verifiable taxpayers. These risks are then periodically updated by the tax administration based on the results of the analyses carried out.

The tool applies a single rule for identifying thresholds to all businesses and attribute a score for each risk from 1 to 3. The ratios are determined by the tax administration staff and calculated by the tool at the same the taxpayer is declaring his financial statement. It highlighted that the thresholds and how the ratios (risks) are calculated are confidential and the staff of the tax administration explained the strategy adopted to select taxpayers for an audit without revealing the confidential information.

b. Decisional process of the tax administration

The tax administration has adopted the following three steps to select taxpayers for an audit:

- Pre-selection using the risk analysis tool "ERA": generate a list of potentially verifiable taxpayers;
- Human validation: the high-risk taxpayers (high score) are reviewed by the staff in charge of the selection for tax audit;
- Strategic planning: selection of taxpayers to be audited.

c. Critics

We noticed that the Algerian tax administration in its risk-based approach for selecting taxpayers for an external audit uses only 22 items from the data extracted from the annual income statement (declaration) and the statements annexed to it to calculate 18 risks assuming that the annual income statement (declaration) and the statements annexed contains more information that can be used to calculate other risks.

As it is mentioned above, the risk analysis tool for selecting cases to be scheduled for an audit applies a single rule for identifying thresholds to all businesses and attribute a score for each risk from 1 to 3 without any sectoral distinction. A higher false positive rate can occur because businesses in certain sectors may naturally have more extreme values for some variables.

Another difference is that thresholds appear to be set *ex ante*, rather than based on (industry-specific) distributions of the variables. It is difficult to know how the thresholds were obtained and how they relate to the observed distribution of the variables. This can lead to thresholds that are too low or too high.

The risk analysis tool for selecting cases to be scheduled for an audit uses only the information extracted from the financial statements declared by the taxpayer and does not cross it with other data from other sources.

The traditional method for selecting cases to be scheduled for an audit is decentralized and involve the service in charge of the management of the file of the taxpayer who knows better the behavior of the taxpayer while the risk-based approach is centralized.

Also, there is no mention that the tax history of the taxpayers concerned are analyzed, only the data of one year is used, to study the behavior of the taxpayer and his tax discipline.

5. Discussion

Compared to what (OECD, 2004) (Khwaja et al., 2011), Hashimzade et al. (2016), Loyland et al. (2019), Beer et al. (2020), Eberhartinger et al (2021), Eberhartinger et al. (2022) , highlights in their studies the Algerian tax administration is aware of the importance of risk management in increasing collection and compliance and has develop the risk analysis tool “ERA” to target high risk taxpayers.

In comparison with the study of Alm and McKee (2004) and the (OECD, 2004), the Algerian tax administration is conscious that the most effective strategy to frightening taxpayers’ tax evasion is a combination of risk-based and random audits.

Hsu et al. (2015) find that the efficiency of the audit selection process is increased by the use of datamining. The Algerian tax administration does not reach this stage and is only using the data extracted form the financial statements declared by the taxpayers.

The Algerian tax administration follows the recommendations of (OECD, 2004), and uses as a criterion of the traditional method for selecting taxpayers for a tax audit using other essential data, such as data and information available from outside sources, such as financial institutions and social security authorities, which can be cross-checked with the data declared by the taxpayer to confirm or refute it.

As it is found in Rezarta Shkurti et al. (2021) study, the risk analysis tool “ERA” developed by the Algerian tax administration analyze the data extracted from the financial statement declared by the taxpayers and calculate ratios that reveal the high-risk taxpayers.

6. CONCLUSION

This study aims to find out about the approach adopted for the selection of companies undergoing tax audits in Algeria. A critical analysis of the approach adopted was then drawn up in comparison with the results and recommendations set out in the articles examined during the compilation of this study.

Our results indicate that the Algerian tax administration uses a combination of risk-based and random audits to select taxpayers for an external audit, which is recommended in different studies.

We also find that the approaches adopted by the Algerian tax administration to select taxpayers for an external audit have some limits and need to be reviewed and adapted. It is recommended to:

- adopt a sectorial distinction in determination of tax risks;
- enrich their risks, 18 risks are insufficient regarding the amount of tax data, assuming that the annual income statement (declaration) and the statements annexed contains more information that can be used to calculate other risks;
- adopt a flexible approach to calculate the thresholds of the risk and do not fix it ex ante, from one year to the next as the business climate changes;
- cross the information extracted from the financial statements declared by the taxpayer with other data from other sources;
- use the information about tax history of the taxpayers concerned, to study his behavior and his tax discipline.

To the best of our knowledge, it is the first study about the strategy adopted by the Algerian tax administration for selecting taxpayers to an external audit, especially the risk-based approach.

We tried to draw up a faithful and consistent picture of the strategy adopted by the Algerian tax administration for selecting taxpayers to an external audit. Particularly, we emphasis on its main advantages and its limitations.

We recognize that our study has its limitations. We can mention that we could not have access to the data related to the results of the adoption of risk-based approach for selecting taxpayers for an external audit.

We assume that our study enriches the debate on the strategies, used by the Algerian tax administration for selecting taxpayers for an external audit especially the risk-based tax audit. Our study is also inspiring curiosity among some researchers to continue their research into risk-based tax audit.

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8. Appendices

Appendix 1: Annual summary statement – ERA-

N° de champ	Désignation du champ	Source de l'information
01	Sales net of rebates, discounts, refunds	annual income statement - G2 - profit and loss statement-
02	Customer balances	annual income statement - G2 – Balance sheet (Assets)
03	Customer provisions	annual income statement - G2 -Table 8 - section « Impairment losses on receivables (1) »
04	Inventory provisions	annual income statement - G2 -Table 8 - section « Impairment of inventories» -Column « Accumulated provisions at year-end»
05	Inventories	annual income statement - G2 - Balance sheet (Assets)
06	Shareholders' equity	annual income statement - G2 - Balance sheet (liabilities)
07	Net income for the year	annual income statement - G2 - profit and loss statement-
08	Dividends distributed	annual income statement - G2 -Tableau 10 – section « dividends »
09	Sales	Declaration - G 04 ou G 11 - Table B – tax on professional activities - total ammount of realised turnover (1) + (2)
10	Operating income	annual income statement - G2 - profit and loss statement-
11	General subcontracting	annual income statement - G2 - profit and loss statement-
12	Consumables for the year	annual income statement - G2 - profit and loss statement-
13	Other consumables	annual income statement - G2 - profit and loss statement-
14	Other services	annual income statement - G2 - profit and loss statement-
15	Extraordinary items (Expenses)	annual income statement - G2 - profit and loss statement-
16	Ordinary income	annual income statement - G2 - profit and loss statement-
17	Financial income	annual income statement - G2 - profit and loss statement-
19	Financial fixed assets	annual income statement - G2 - Balance sheet (Assets)
18	Book loss	annual income statement - G2 – Tableau n°09
20	Tax result	annual income statement - G2 -Tableau 9 – section « fiscal Resultat »
21	Personnel expenses	annual income statement – G2- profit and loss statement-
22	Management compensation	annual income statement – G2- profit and loss statement-declaration of salaries and other emoluments paid during the year (G29)