VAT Audit Procedures
An Approach to Avoid Non-Compliance & Penalties
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Background to VAT Compliance

• The scope of the workshop
• The role of VAT Audit
• Elements essential to a VAT compliance system
• Auditor’s & Taxable persons’ Powers and Responsibilities
• Overall responsibilities
• Classification of Audit
• General Audit
• Refund Audit
• Specific Audit
• Undertaking the Audit
• Guidance for keeping good notebooks
• Preparation for the Audit visit
• Pre visit checks
• Interviewing the Taxable person on an audit visit
• Structuring the interview
  – Establish the normal
  – Question the abnormal
• Basic Questions
• Use of audit cross-checking system
• Conducting the Audit
• Auditing of Inputs
• Auditing of Outputs
• Potential VAT risks
  – Disaggregation
  – Absence of Taxable person records
  – Failure to produce tax Invoices
  – Failure to produce commercial and official evidence of export
  – Failure of Taxable person to attend to an apportionment for a VAT audit
  – Failure to register for VAT when required to do so

• Refund Audit
• Post Audit controls
  – Actions to be taken
• Audit cases where potential fraud evasion is suspected
  – The role of Internal Auditor in fraud investigation
• Administrative penalties arising in an audit
• Fraud & Tax Evasion penalties arising in an audit
The scope of the workshop
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• This workshop is intended to assist the Taxable person (taxable person) to have a basic understanding of how a VAT audit could be conducted

• It helps also to identify areas where VAT legally due has been under declared
The Objective of VAT Audit
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The objective of a VAT audit is to close the gap between the tax declared by a taxable person and the tax legally due.

To achieve this objective, auditors should be required to:

1. Confirm the taxable person is correctly registered
2. List the activities undertaken by the business
3. Note the accounting records used by the taxable person
4. Ensure records correctly reflect the business activities
The Objective of VAT Audit - contd.

To achieve this objective, auditors should be required to:

5. Assess the level of risk posed by the taxable person and identify the appropriate counter measures.

6. Educate the taxable person and give him the opportunity to ask questions which the auditor either answers on the visit or seeks guidance at the office.

7. Ensure that unsatisfactory features discovered on an earlier visit have been corrected and that return and other statutory filings are timely done.
Risk Based Audit
The use of a Risk Based Audit

Using a risk based audit selection system should be able to fulfill the dual purpose of:

– Maximizing payment of due tax and to
– Ensure voluntary compliance by the taxable persons

by providing a reasonable chance that defaulters will be identified and undeclared tax, interest and penalties are collected by the Federal Tax Authority (FTA).
The effectiveness of a Risk-Based Compliance Audit

The effectiveness of a risk-based compliance audit has been enabled by, and depends fundamentally on, the use of automated systems to:

1. Gather third-party information and match with taxpayer reporting using reliable databases and a unique taxpayer identification number;

2. Undertake selective checks based on risk analysis;
The effectiveness of a Risk-Based Compliance Audit

(3) Standardize payment processes (e.g., payments through banks) and accounting requirements;

(4) Provide assurance that the legislation and procedures are being applied uniformly; and

(5) Provide adequate, timely information to support management decision making and tax policy formulation.
VAT REGISTRATION

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Elements Essential to a VAT Compliance System

Registration of VAT Taxable persons

- This identifies the persons who have the obligation to account for VAT and bring them under control and administration.

VAT Return

- This important form provides the basis for the audit and the means of collection of the tax. It is essential that the taxable person is using the correct tax return elements and the filing of those returns is strictly enforced and the tax declared is paid.

Keeping books of accounts and records

- VAT is levied by reference to financial transactions of the business, books of account and records which must be kept for a minimum of 5 years to enable the auditor execute his work.
Elements essential to a VAT compliance system – contd.

Tax invoices

• Article 59 of the Executive regulation explains the components of a tax invoice which is a crucial document in the operation and control of Output and Input tax under a VAT system.

• Tax invoices provide an audit trail for taxable persons involved in both the sale and purchase of taxable goods.

Access of auditors to books, records and documents

• The VAT taxable person is required to keep his accounts, registers and documents at the place of business specified on the tax registration certificate.

• Records could be scanned and kept electronically.
Auditors’ Powers, Legal Provisions

• Art. 18 of the Tax Procedure Law says that whilst conducting a tax audit the tax auditor may:

  • Obtain original records or
  
  • Copies of the original or
  
  • Take samples of the stock, equipment or other assets from the place where the person subject to tax carries on his business or are in his possession.
Inspection of Premises and Tax Audit

- The tax auditor has the right of entry to any place where the taxable person subject to the tax audit carries on his business, stores goods, or keeps records, and, as the case may be, it will be temporarily closed in order to perform the tax audit for a period not exceeding 72 hours without prior notice in any of the following cases:

  - THE AUTHORITY has serious grounds to believe that the person subject to the tax audit is participating or involved in tax evasion;

  - THE AUTHORITY has serious grounds to believe that not temporarily closing the place where the Tax Audit is conducted will hinder the completion of the tax audit;

  - The person who has been given notice of the tax audit, attempts to hinder the tax auditors access to the place where the tax audit is to be performed.
Inspection of Premises and Tax Audit – contd.

- In addition, the tax auditor must obtain prior written consent of the Director General prior to entering into any place, and if the place to be accessed is a place of residence then a permit from the Public Prosecutor must also be obtained. (Art. 17(5) of the Tax Procedure Law)

- If the taxable person’s place will be temporarily closed in order to perform the tax audit. The place must be reopened within 72 hours, unless THE AUTHORITY obtains a permit from the Public Prosecutor to extend the closure time limit for a similar period, prior to the expiry of the preceding 72 hours.

- A criminal case can be initiated only upon an application from the Director General.
Auditors’ Responsibilities

- The auditor authorized to conduct audit should adhere to the instructions contained in the approved Audit Manual.

- The auditor should identify himself and show his authorization to the Taxable person before commencing his audit.

- The auditor should be impartial and apply the law and rules in a uniform manner.

- The auditor should ensure that any information obtained in the course of that audit relating to the Taxable person is treated in strict confidence.
Auditors’ Responsibilities – contd.

• The auditor should ensure that in the areas covered on the audit visit, tax has been properly accounted for declared and discharged.

• The auditor should ensure that the Taxable person is treated in a courteous manner and is provided with the opportunity to respond to queries raised by the auditor.

• The Taxable person should be provided with a full and proper explanation of any under declaration of tax identified.

• Where there is a lack of cooperation, failure to provide information or any unusual circumstances the auditor should consider about referring the case to the investigation section.
Classification of Audit
Classification of Audit

Audits can be divided into 3 Main Categories:

a) General Audit

b) Refund Audit

c) Specific Audit
General Audit

- General Audits form the majority of audits to be completed by the authority.

- The objective of general audits should be to provide broad audit coverage of all Taxable persons within five years with additional audits for larger, more complex VAT Taxable persons and those with identified under-declaration risks.

- The selection of the Taxable persons for general audit will be discussed later today.
Refund Audit

• A VAT refund for registered entities is where their input tax is higher than their output tax.

• Any refund will only be paid out once the verification process has been completed.

• The verification/audit process often requires the taxpayer to submit the VAT input and VAT output detailed report, copies of the largest supplier tax invoices and detail of any assets purchased including tax invoices as chosen by the auditor.
Specific Audit

Specific audits include:

• Audits resulting from the receipt of urgent references

• Late registrations

• Cancellation of registration where large amounts of revenue are deemed to be at risk

• Audits emanating from credible information regarding suspected major tax evasion from intelligence resources
• Audits resulting from the receipt of routine references were the Taxable person is not registered for VAT

• Audits resulting from existing audits where the auditor is of the view that there is possibility of tax risk, even if the Taxable person is registered

• Audits resulting out of market related information from various sources received by any auditing official.
Structured Approach to Audit

• The level of audit activity and frequency of audit will be decided by the staff resources available related to the VAT registered Taxable persons population.

• It will always be necessary to ensure that the available staff resources are deployed to achieve the twin objectives of maximizing both revenue collection and voluntary compliance by VAT Taxable persons.
Structured Approach to Audit – contd.

Work must be planned in such a way so that an audit takes full account of available information, assesses the actions required and is scattered out systematically.

The auditor should routinely:

- Plan the audit program
- Arrange the appointment with the Taxable person
- Carry out the pre-visit/audit preparation
- Perform a detailed and structured initial interview with the Taxable person
Structured Approach to Audit – contd.

The auditor should routinely:

• Record the information obtained from the Taxable person in the interview, and subsequently from the Taxable person’s records, in the auditor's notebook

• Assess the information and identify potential risks, these will help the auditor to decide the checks to be applied when carrying out the audit of the records

• Examine business activities and records, and test and verify, where possible the information found and where not possible, question the Taxable person for clarification
A structured approach to the audit ensures that the **Taxable person:**

- Sees the audit as an opportunity to develop a relationship with the authority and enable him to meet his legal obligations

- Resolves any uncertainties regarding his VAT liabilities in a satisfactory manner

- Has a formal and transparent way of recording what has been undertaken on the audit and has a permanent record of any under-declarations and has the opportunity to challenge the auditor's findings
Organizing and Staffing

• The auditor will allocate the staff numbers to each team broadly by following a percentage that sees 80% for General audits and 20% for Specific audits.

• Audit teams responsible for refunds will have their own separate location
Selection of Audit visits - In the initial years of the VAT

• Till the time the system is fully and completely operational and the audit criteria are evolved for generating audit cases, the cases should be selected at random from the database of the Taxable person.

• Such cases are to be limited to maximum 20% of the total general audits.
Selection of Audit visits - In the initial years of the VAT

- Where significant credible information is received, including urgent references from other audits concerning the possibility of evasion, an audit should be carried out at the earliest opportunity.

- Taxable persons who have consistently failed to file VAT returns and have been issued with one sided assessments should receive an audit where it is considered that is a significant revenue risk.
Selection of Audit visits - In subsequent years of audit

Specific Audits

• These audits may include those which are undertaken in response to certain specific information generated through market or through other visits of the auditors.

• The selection of specific audits can also be made manually by the Chief Audit Officer.

• The cases in which investigation branch has conducted visits, business audit should be taken, compulsorily in such cases for the next three years.

• However the specific audit should not normally exceed 20% of the available audit capacity.
Selection of Audit visits - In subsequent years of audit

**General Audits**

- The selection of general audits should be based on a points system directly related to the level of compliance and the amount of Output and Input Tax of the taxable persons.

- The highest number of points equates to a higher level of deemed risk and therefore priority for audit.

- 20% of the general audit cases should be generated through random selection method from the total list of VAT Taxable persons, after excluding the cases already selected for audit for that particular year.
Complexity of VAT Taxable Persons

Taxable persons whose business involves:

- International exports
- International imports
- Branches in other Emirates
- Work Contracts
- Exempt Goods
- Several Activities
Management of Audit Activity
Management of Audit Activity

The Chief Audit Officer should:

• Ensure the audit programs are satisfactorily completed
• Maintain control register for the cases allocated to his section
• Review overall audit results achieved and the reasons of under-declarations to focus the activity to maximize revenue collection
• Conduct quarterly staff meetings to exchange views on risk areas and audit techniques
• Quarterly select one audit case where there was no under-declaration / over-declaration for detailed scrutiny
• Approve extension of time allotted for audit cases allocated to Audit Managers
Control of Audit Cases

• It needs to be insured that Audit officials complete their allocated physical quota of Audit Visits in the time stipulated.

• Any case not completed in the audit month should be carried forward in priority order to the next month, or alternatively reported with the reason for the inability to complete the audit.

• In case the delay is more than three months then the permission should be sought to extend the job.

• The allocation of audit cases should be recorded on a computerized listing with the date of allocation, the date of commencement and the date of finalization.
Potential VAT Risks
Administrative Penalties  
Article (25) of the UAE Law No 7

- THE AUTHORITY is empowered to issue administrative penalties assessments against a Taxable Person and must notify him of such within 5 business days should the said person be in violation of an administrative procedure listed in Art. 25 of the Tax Procedure Law.

- Such administrative assessments carry specific administrative penalties in respect of each violation, which shall be no less than AED 500, but shall not exceed three times the amount of tax due in respect of which the administrative penalty was levied. (Art. 25(3) of the Tax Procedure Law)
Tax Evasion Penalties

- In addition to the administrative penalties, THE AUTHORITY can impose a tax evasion penalty, in the form of a prison sentence, a monetary penalty (not exceeding 5 times the amounts of tax evaded) or a combination of the two, with respect to the following instances, when:

  - A taxable person deliberately fails to settle any payable tax or administrative penalties;

  - A taxable person deliberately understates the actual value of his business or fails to consolidate his related businesses with the intent of remaining below the required registration threshold;

  - A person charges and collects amounts from his clients claiming them to be tax without being registered;

  - A person deliberately provides false information, data and incorrect documents to THE AUTHORITY;
Administrative Penalties

• A person deliberately conceals or destroys documents or other material that he is required to keep and provide to THE AUTHORITY;

• A person deliberately steals, misuses, or causes the destruction of documents or other materials that are in the possession of THE AUTHORITY;

• A person prevents or hinders THE AUTHORITY’s employees from performing their duties; or

• A person deliberately decreases the payable tax through tax evasion or conspiring to evade tax
Invoice vs. Cash Accounting for VAT

• The UAE VAT law has adopted the Invoice Accounting Approach to reporting VAT.

• This means that VAT is payable when an invoice is issued and is recoverable upon receipt of the invoice from the supplier (subject to the intention to pay it within 6 months).

• Under Cash Accounting, VAT is reported in the return upon receipt of cash or payment of cash for invoices issued and received respectively.
Failure to Register within the Timeframe
Article 7 of the Executive Regulation

• The failure of the taxable person to submit a registration application within the timeframe specified in the Tax Law - 20,000.

• The auditor will check the documents submitted by the taxable person when registering.

• The auditor will also check the financial statements of the taxable person to confirm that registration was timely.
Failure to De-Register within the Timeframe - Article 14 of the Executive Regulation

A registered Taxable person is supposed to monitor his the value of his supplies and apply for De-registration:

• When the value of the supplies drops below AED 167,500, or

• When he stops supplying taxable supplies, or

• When he stops supplying

• If this is ignored for 20 days after he is aware, an administrative penalty of AED 10,000 is applied.
Upon receiving the provisional approval, the Taxable person is responsible to submit a final tax return to the Authority.

The auditor will check this return to confirm whether the Taxable person still has in stock any items for which Input tax has been recovered.

The auditor will audit the return to confirm that proper output VAT has been reported.
Absence of Taxable person’s Records

Art. 78 of the VAT Law & Art 71 of the Executive Regulation state that the taxable person should keep the records for a minimum of five years.

The failure of the person conducting business to keep the required records and other information specified in Tax Procedures Law and the Tax Law

- AED 10,000 for the first time,
- AED 50,000 in case of repetition

Moreover, the failure of the person conducting business to submit the data, records and documents related to tax in Arabic to the authority when requested - AED 20,000.
Absence of Taxable person’s Records - contd.

- The auditor will calculate the output tax due from the best information available.

- Banking records should be used to calculate the output tax due.

- Only inputs for which a tax invoice can be produced should be allowed as creditable input tax.

- The auditor will attempt to reconstruct the Taxable person’s VAT records, but should advise of the tax calculated on the information available.

- If the Taxable person is unable to provide supporting documents, an assessment will be issued based on that calculation.
Failure to produce Tax Invoices

- Failure by the taxable person to issue the tax invoice or an alternative document when making any supply – AED 5,000 for each tax invoice or alternative document.

- There are some taxable persons proposing to make a sale without an invoice.

- In case the authority suspects tax evasion or a fraud, then the penalty could be a prison or 5 times the tax assessed by the auditors.
Failure to Produce Input Tax Invoices

- Where input tax credit has been claimed in any return and the Taxable person is unable to produce a tax invoice at the time of audit visit and even after communicating the audit result for non available tax invoices, fails to file a revised return thereby reducing the said input tax credits for which the tax invoices are not available.

- The AUTHORITY can issue an estimated tax assessment when it has not been possible to determine the amount of tax deemed to be payable or refundable tax that was not due to be refunded, as the case may be. (Art. 24(2) of the Tax Procedure Law)
Failure to display Tax Inclusive Prices

• Retailers are supposed to display prices as tax inclusive

• Auditors will be checking displayed prices / price lists and menus. Prices should be displayed inclusive of tax.

• Moreover, retailers have to print the price on their invoices inclusive of tax and state at the bottom of the invoice the amount of tax and the taxable amount.

• Failure to do either of the above is leading to AED 5,000 penalty.
Failure to produce Commercial and Official Evidence for Export

• In case of an export supply, the taxable person charges tax at the rate of 0%.

• The auditor will look for Official and Commercial evidence to support the transaction. (Article 24 of the Executive Regulation)

• In the absence of this evidence, the taxable person has to, after 90 days from the date of invoice, consider the supply as taxable at standard and should report the output tax in his return.
Commercial and Official Evidence for Export

Commercial evidence: shall include any the following:

- Air Waybill
- Bill of lading
- Consignment note
- Certificate of shipment

Official evidence: shall include

- Export documents issued by the local Emirate Customs Department in respect of goods leaving the State.
Gifts (Article (5) of the Executive Regulation)

A Taxable person may give a gift of AED 500 per person per year with a maximum of AED 40,000 of gifts.

The gift should be given to a person who is a third party to the business for promoting the business.

The auditor will be looking in the accounts to trace any gifts exceeding this limit.
Deemed Supplies

These are supplies purchased for the business and for which input VAT is claimed but their use has been diverted to personal. (Article 5 of the Executive Regulation)

The auditor will check the stock and confirm that none is missing without an explanation.

Any missing items from the stock for which input tax has been claimed is considered a deemed supply.

VAT should be calculated on deemed supplies and reported as output VAT.
Disaggregation

• If a business can split into separate entities for particular aspects of the business the turnover for each part of the business can be maintained below the VAT registration threshold and the liability to VAT avoided.

• Businesses with common owners, which claim to be separate entities for VAT registration purposes, should be checked in the following aspects.

• It is important that the following checks are applied to ensure disaggregation of the business is not used as a means to avoid accounting for and payment of VAT
Factors taken into consideration include the following:

**Economic practices:**
- A common economic objective
- One part of the business benefits another part
- Different parts of the business serve the same customers

**Financial practices:**
- One part of the business financially supports another part
- One part of the business is not financially viable on its own
- Proceeds are shared
Factors taken into consideration include the following:

**Regulatory practices:**

- Shared management
- Employees in common
- Common ownership
- Shared equipment

Compulsory grouping prevents the related parties splitting the business artificially to avoid VAT registration.
A voluntary disclosure is the process adopted by taxable persons to revise a previously submitted return(s).

- If the tax payable in any single return is under – declared by more than AED 10,000 the taxable person must submit a voluntary disclosure.

- If it is under – declared by AED 10,000 or less the taxable person may submit a voluntary disclosure.
Voluntary Disclosure – contd.

• The voluntary disclosure by the person/taxpayer of errors in the tax return, tax assessment or refund application pursuant to Art. 10(1)-(2) of the Tax Procedures Law - two penalties are applied:

• Fixed penalty of:
  - 3,000 for the first time;
  - 5,000 in case of repetition.
Percentage based penalty shall be applied on the amount unpaid to THE AUTHORITY due to the error and resulting in a tax benefit as follows:

- 50% if the person/taxpayer makes a voluntary disclosure after being notified of the tax audit and THE AUTHORITY starting the tax audit or after being asked for information relating to the tax audit, whichever takes place first;

- 30% if the person/taxpayer makes the voluntary disclosure after being notified of the tax audit but before the start of the tax audit;

- 5% if the person/taxpayer makes voluntary disclosure before being notified of the tax audit by THE AUTHORITY.
Voluntary Disclosure – contd.

The auditor will check for any corrections made by the taxable persons.

While checking, the auditor will aggregate the corrections, made by the taxable persons, related to under – declaration of output tax or over – declaration of input tax, by return, in order to find out whether a voluntary disclosure was due for submittal.
Voluntary Disclosure – contd.

• A taxable person may try to under – declare output tax by excluding invoices issued, or advance payments received.

• The auditor will check for the unique sequence of invoices to check for any invoices not reported in the return.

• The auditor will also cross check invoices between taxable persons’ records.
Voluntary Disclosure – contd.

• A taxable person may try to over-declare input tax by including fake invoices or by claiming input tax prior to its due date.

• The auditor will check for the date of the invoices reported in the return.

• The auditor will also cross check invoices between taxable persons’ records to confirm whether the invoices are genuine.
Reverse Charge Mechanism

A taxable person importing services or goods is supposed to report the VAT under the reverse charge mechanism where those services or goods were incurred for business purposes.

When a taxable person uses the services of a foreign supplier, it is his duty to report the value of the supply and the related VAT under box 3 of the Tax return. (Article 48 of The Executive Regulation).

In case the supply is related to the business, the taxable person can claim it back under box 10 of the return.

Invoice of the supplier along with the proof of relation to business is needed by the auditor.
Reverse Charge Mechanism – contd.

When importing goods, the VAT under the reverse charge mechanism is conveyed by the customs authority to the FTA and is automatically populated in box no 6 in the tax return.

The taxable person is allowed to reverse the VAT under box 10.

The auditor will look for a commercial and official proof such as the customs declaration form and the supplier’s invoice.

Invoice of the supplier along with the proof of relation to In case the taxable person can provide those documents along with a proof of relation to business, reversal is authorized.
As of May 17, 2018, the Central Bank of the UAE started issuing daily rates for foreign currency exchange.

In case the Taxable person is issuing invoices in foreign currency, it is his duty to convert those invoices into AED using the exchange rate provided on the UAE Central Bank’s website and to calculate the VAT accordingly.

The rate should be used when receiving invoices for imported services which are usually issued by the foreign supplier in foreign currency.
Profit Margin Scheme

• Failure by the taxable person to notify THE AUTHORITY of applying tax based on the margin - 2,500.

• Under the profit margin scheme, the VAT to be paid to THE AUTHORITY is based on the profit margin earned on the taxable supplies rather than being based on the value of these supplies. (Article 29 of the Executive Regulation)

• The goods supplied under the profit margin scheme are:
  – Second-hand goods.
  – Antiques, for these purposes meaning items over 50 years old.
  – Collectors' items, meaning stamps, coins and currency and other pieces of scientific, historical or archaeological interest.
Audit Cases where a Fraud/Evasion is Suspected

• The investigation of fraud is a vital element in the administration of VAT.

• The purpose behind a VAT fraud investigation is to deter Taxable persons from knowingly making fraudulent VAT returns

• A distinction is to be drawn between innocent errors made on VAT returns and false declarations made with the intent to defraud.
Audit Cases where a Fraud/Evasion is Suspected – contd.

The following cases should be regarded as an illustrative list of evidence of fraud:

• Use of false tax invoices
• Alternation/amendment of tax invoices
• Tampering with/misuse of statutory forms such as waybills, Customs forms etc.
• Suppression of taxable Turnovers/Material information such as not disclosing place of business/closing of business.
• False claim of exports
• False description and False classification of goods
Role of Auditor in Fraud Investigation

The main role is to visit Taxable persons and audit their VAT returns.

The three key elements of the auditors’ responsibilities are to:

- Identify potential fraud
- Quantify the fraud in order to give the investigators an idea of what revenue has possibly been evaded
- Contain the situation when at the taxable persons’ premises
Inspection of Premises and Tax Audit

• The tax audit can be completed either at the office of THE AUTHORITY, the place of business of the taxable person or any other place the taxable person carries on business, stores goods or keeps records.

• If THE AUTHORITY decides to perform the tax audit at the place of business of the taxable person or any other place where the taxable person carries on his business, stores goods or keeps records, THE AUTHORITY must inform him at least five business days prior to the tax audit. (Art. 17(2)-(3) of the Tax Procedure Law)
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The tax auditor has the right of entry to any place where the taxable person subject to the tax audit carries on his business, stores goods, or keeps records, and, as the case may be, it will be temporarily closed in order to perform the tax audit for a period not exceeding 72 hours without prior notice in any of the following cases:

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• If the taxable person’s place will be temporarily closed in order to perform the tax audit. The place must be reopened within 72 hours, unless THE AUTHORITY obtains a permit from the Public Prosecutor to extend the closure time limit for a similar period, prior to the expiry of the preceding 72 hours.

• A criminal case can be initiated only upon an application from the Director General.
Thank you for your attention

Q&A