

Who wins in a *tax audit*

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The Malaysian Inland Revenue Board (IRB) has significantly increased their focus on tax audits and tax investigations over the past years. This article intends to deal with each step of the tax audit process and also provide an overview of key areas for taxpayers to consider in preparing for and dealing with tax audits. During a tax audit, the IRB will check the

taxpayers' financial affairs to ensure the amount of tax paid is correct and that the taxpayers are complying with the tax rules and legislation. With the introduction of the Self-Assessment System (SAS), taxpayers are expected to file their Tax Returns correctly and accurately with the relevant supporting documentation being kept for future checks by the IRB.

What is a Tax Audit

According to the Tax Audit Framework issued in January 2009:-

“A tax audit is an examination of taxpayer’s business records and financial affairs to ascertain that the right amount of income should be declared and the right amount of tax should be calculated and paid are in accordance with tax laws and regulations. “

Who is chosen

All companies will be tax audited at some point as tax audits are part of the compliance system under the SAS. The IRB may rely on certain criteria such as industry focus, period since last audit, geographical location and other criteria in selecting companies for tax audits.



The conduct of an audit

A tax audit involves various interrelated parts which need to be well understood in order for one to deal with the entire process effectively and efficiently:-

1 PRIOR TO THE TAX AUDIT

Taxpayer's tax returns and tax files are allocated to an IRB auditor assigned to the case. The IRB may review the taxpayer's background and financial information to gather certain facts and data to enable them to identify key focus areas. This data may be from the taxpayers' own records or from public sources.

Closer towards the tax field audit visit, IRB may request for further financial or company information to be provided to them. Sec. 78, 79 and 81 of the Income Tax Act, 1967 (ITA) give the IRB



wide ranging powers to call for information and documents.

The IRB auditor will contact the taxpayer to arrange and confirm a date for the audit visit and subsequently a letter confirming the date, time, documentation required and names of the IRB officials attending the audit will be provided to the taxpayer.

2 THE TAX AUDIT VISIT

The IRB will normally conduct audit visit for 2 or 3 days at the taxpayer's premise and may extend the period in more complex cases. During the audit visit, taxpayer's records will be checked and interviews will be conducted.

The IRB may raise questions ranging from background of the company and other general information about the business to more specific questions about

a specific transaction or entry in the books.

Taxpayers need to understand the questions being raised to avoid any misunderstanding or misinterpretation and answer the IRB directly within the relevant facts and evidence. A senior official familiar with the taxpayer's business and its finance should be present to answer any such oral enquiries.

3 POST TAX AUDIT VISIT

Following the audit visit, the IRB will review the documents obtained during the audit visit and may request for additional documents and information. The auditor may then document the audit findings or request for additional or further information. Specific tax issues may be raised or clarification sought. The issues would depend on the taxpayer's transaction, the

industry they are operating in and the tax positions adopted. Some of the common tax issues:-

- **Deductibility of expenditure**
Common problems faced by taxpayers are the availability of documentation to support the expenditure.
- **Incentive claims**
Taxpayers need to ensure that they are eligible for the incentive, able to substantiate the incentive claims made over the period and that documentation is available.
- **Withholding tax**
In managing withholding tax issues, taxpayers need to be aware of the position adopted on the payments to non-residents.

• **Loss making companies**

Loss making companies may also be picked for audits especially if they show losses over several consecutive years.

4 DISCUSSION ON ISSUES

The length of time taken for discussion with the IRB could vary depending on the complexity of the issues raised and the availability of the supporting documentation.

This step is crucial as it can either lead to a satisfactory conclusion for the taxpayer or it can result in differences developing between the IRB and the taxpayer.

In achieving a satisfactory result, a taxpayer needs to understand the issues raised by the IRB and to provide the necessary information and documentation to address the specific matters raised and to communicate the technical positions adopted by the taxpayer supported with the relevant legislation.

5 NEGOTIATION AND SETTLEMENT

An audit settlement involves a final evaluation of all the findings. If there are no adjustments, a letter will be issued to inform the taxpayer that the audit is finalized with no adjustments made.

If there are adjustments, a tax computation with details of the proposed adjustments will be issued. The taxpayers will have approximately 14 days to revert on the issues raised in the tax computation, failing which the IRB will assume that the taxpayer is agreeable to the tax adjustments and an assessment will be issued together with the appropriate penalty.

If the taxpayer is not satisfied with the assessment raised, the taxpayer can make an appeal by filing a Form Q to the Special Commissioners of Income Tax within 30 days of the date of the notice of assessment raised. Notwithstanding the appeal, tax due as indicated in the notice of assessment must be paid within 30 days. Should the taxpayer disagree with the decision by the Special Commissioners, the case can be appealed to the High Court and subsequently to the Court of Appeal.



Other developments

1 PUBLIC RULINGS

Public rulings are issued by the IRB to provide guidance for the public and the officers of the Inland Revenue Board.

In a tax audit, the IRB will adopt positions that are in accordance with the Public Rulings as the Public rulings are binding on the IRB but not on the taxpayers since Public Rulings are not legislation. However, taxpayers should have reasonable legal grounds to support their position which are different from that of the Public Ruling.

2 THE TAX AUDIT FRAMEWORK

The Tax Audit Framework was first issued on 1 January 2007 and the updated Framework was issued on 1 January 2009. The Framework was introduced to address concerns and questions raised by

the taxpayers on the reason and the way the IRB conducts a tax audit. As stated in the Tax Audit Framework, generally the Framework aims to:-

- Assist audit officers to carry out their tasks efficiently and effectively; and
- Assist taxpayers in fulfilling their obligations

3 PENALTIES

Upon submission of the tax return, any subsequent amendment which results in additional tax liabilities, a penalty equal to the amount of tax undercharged (100%) will be imposed on the additional tax liability under Sec. 113(2) of ITA, if it is discovered during an audit that there has been an understatement or omission of income.

The IRB may impose a lower penalty rate of 45% (as stipulated in the Tax Audit Framework) for the first offence. For any

repeated offence, the penalty rate shall be increased by 10% as compared to the last penalty rate imposed for the previous offence but limited to a sum not more than 100% of the amount of tax undercharged. A penalty of between 10% to 30% may be imposed upon voluntary disclosure by the taxpayer prior to the case being selected for an audit and a penalty of 35% after the taxpayer has been informed but before the commencement of the audit visit.

The question here is whether penalty under Sec. 113(2) of ITA should be imposed in instances where the taxpayer had acted in good faith. During an audit, the burden of proof lies with the taxpayer and it is important for taxpayers to show that they have acted in good faith on the positions adopted in the tax returns.

Conclusion

Tax audits are a common event and they are conducted by the IRB in an orderly and organized way. The aim is to ensure that taxpayers pay their correct taxes.

However, there are instances where tax adjustments imposed by the IRB can lead to differences in opinion resulting in appeals to the IRB or to the courts. It would be preferable if the IRB is flexible to listen to the viewpoints expressed by the taxpayers on the interpretation of the law and to provide greater leeway in the level of documents / evidence to support the positions adopted by taxpayers. Taking a rigid position may result in greater tax collection but in the long run such actions could be viewed by the business community and the general public negatively.

In conclusion, greater dialogue between the IRB and the community is needed to strengthen this two-way relationship further. ■

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Five top audit survival tips

THE FOLLOWING ARE THE FIVE TOP AUDIT SURVIVAL TIPS

- Taxpayer should be able to handle and manage tax audits themselves. Taxpayers may consider engaging tax professionals who specialize in handling tax audits to assist on specific technical matters.

- Be ready to answer questions and provide the necessary information when requested by the IRB.

- Be polite and professional in dealing with the IRB officials.

- Do not underestimate the IRB officials as they are professionals with the relevant knowledge, training and experience.

- Finalise the tax audit within a short time and narrow down the list of issues to be dealt with to resolve the matter quickly.

