

# Tax Audits: Get Ready

The higher tax revenue target set by the Inland Revenue Board can be unsettling news to many corporations, but proper tax audits can help ease worries.

By Vivian New

**M**ost businesses fear the words “tax audit” as they are often associated with additional taxes and hefty penalties. Tax audits also tend use up a lot of resources of taxpayers such as additional costs involved in engaging tax professionals as well as the reallocation of resources for the purpose of gathering information needed and liaising with the tax authorities.

The Malaysian Inland Revenue Board (“IRB”) had expressed confidence of achieving a whopping tax collection target of RM130 billion in 2013, after achieving a tax revenue collection of RM124.7 billion in

2012, which is approximately a 13% increase from originally established target of RM110 billion. The IRB’s ability to surpass its targeted tax revenue collection in 2012 can largely be attributed to the increase in the number of tax audits conducted on taxpayers. With this in mind, businesses are increasingly trying to ensure that tax implications are well evaluated before effecting business transactions for fear of negative consequences in the event of a tax audit.

This article provides information on the types of tax audit typically conducted by the IRB, the audit process, the penalties involved as well

as how taxpayers should get themselves prepared – you will never know when the IRB decides to knock on your door!

## Malaysian Perspective

The Malaysian tax system follows the concept of self-assessment system (SAS) whereby taxpayers are required by law to compute their tax liabilities and submit their tax returns based on the prevailing tax law as well as various rules/guidelines issued by the IRB. This system was essentially implemented to transfer the responsibility of determining tax liability from the IRB to the taxpayers.

As the onus is on the taxpayers to ensure that the tax returns submitted are correct, tax audits are conducted by the IRB to examine taxpayers’ business records and financial affairs to ascertain that the tax reported and paid are indeed correct. To ensure that taxpayers are in compliance with the law, the IRB may impose severe penalties if it is found that the information disclosed in the tax return are incorrect.

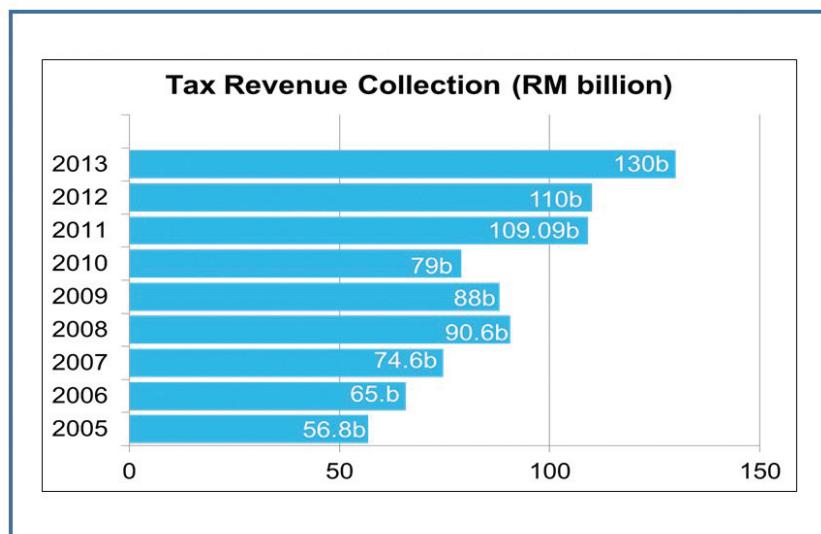
## How Are Tax Audits Administered In Malaysia?

The IRB generally carries out two types of audits, as follows:

**Desk Audit** – Desk audits are normally conducted at the IRB’s office and involve straightforward tax issues. The IRB would request for documents such as statutory accounts, tax computation and tax return of the taxpayer to facilitate its analysis. As the issues are usually straightforward, tax adjustments can be easily be dealt with via correspondence with the IRB without lengthy negotiations and discussions.

**Field Audit** – Unlike desk audits, field audits are normally conducted at the taxpayer’s business premises. The IRB will notify the taxpayer prior to the field visit, usually 14 days in advance. The documents that the IRB may want to review during a field audit are usually more extensive and they may include cash book, general ledger, trial balance, management accounts and audit

**Graph 1: Historical Values Of Targeted Malaysian Tax Revenue Collection**



Source: <http://www.thestar.com.my/News/Nation/2013/03/01/Infand-Revenue-Board-targets-RM130bil-tax-collection-for-2013.aspx>; The Star 5 April, 2012; Bernama 12 January 2012; NewStraitsTimes 20 February 2012, Lembaga Hasil Dalam Negeri Annual Report.

adjustments. As the issues are usually more complex, a series of discussions and negotiations may take place after the taxpayer is informed of the tax adjustments proposed by the IRB.

### **Basis Of Selection For A Tax Audit**

Businesses are often stressed over the possibility of an unexpected tax audit by the IRB. Whilst taxpayers may not know when the IRB decides to conduct a tax audit, in practice, there are certain characteristics which will likely trigger a tax audit, including the following:

- Companies within a group of which some entities have been audited
- Taxpayers with significant tax refunds due from the IRB
- Consistently low profits / losses
- Income / expenditure levels fluctuate significantly on a year-to-year basis
- Companies having financial ratios which are different from average industry levels
- Taxpayers enjoying certain tax incentives
- Prior tax audits which resulted in additional taxes being assessed

The IRB has also indicated that it will select taxpayers for tax audit purposes based on risk analyses, information from third parties and other factors such as specific industries and specific issues for certain groups of taxpayers.

### **The Tax Audit Process**

The tax audit process usually involves the following steps:

**(a) Kick-off meeting** – The taxpayer would usually be notified by the IRB of its intention to conduct a tax audit 14 days in advance. During the kick-off meeting, the taxpayer will be expected to provide an overview of its business activities, accounting and record keeping systems.

**(b) Examination of records** – During the course of an audit, the IRB is allowed to examine all business records of the taxpayer, including the physical inspection of stocks and equipment for verification

of claims made by the taxpayer.

**(c) Settlement of audit** – After the examination of the taxpayer's records, the IRB would prepare its audit findings report which summarises the audit issues, reasons for raising such issues and the proposed tax adjustments. The IRB may also prepare a revised tax computation for the relevant year to show the taxpayer the proposed additional tax payable or tax refundable for that year.

**(d) Notification of proposed adjustments** – In the event that there are tax adjustments to be made, a notification of proposed tax adjustments will be issued to the taxpayer. The taxpayer is allowed 21 days from the date of the notification to file an official objection against proposed tax adjustments. A notification of non-chargeability will be issued if the IRB is satisfied that no additional tax payable is due from the taxpayer after an audit.

**(e) Notice of additional assessment** – A notice of additional assessment would be issued to the taxpayer if no objection is filed within 21 days from the notification of proposed adjustments. Subsequent to the issuance of the notice of additional assessment, the taxpayer has the avenue to file a formal appeal against the said notice, usually within 30 days from the date of the notice. Upon the receipt of the appeal, the IRB may review further information and make a proposal to the taxpayer to settle the appeal. If an agreement still cannot be reached, the case will be forwarded to the Special Commissioners of Income Tax for determination.

### **Penalties**

One of the key concerns of being audited is the imposition of penalties, which increase the overall costs of doing business. Penalties, equivalent to 100% of the amount of tax undercharged, may be imposed in the event that an understatement or omission of income is found during the course of an audit. However, in practice, the IRB may exercise its discretionary powers to consider a lower penalty of 45% imposed for first offence.

Based on the Tax Audit Framework issued by the IRB, penalties can be

further reduced in the event that the taxpayer makes a voluntary disclosure regarding the understatement or omission of income (table below).

### **Taxpayers' Responsibilities**

Whilst tax audits cannot be avoided, good knowledge of the tax law coupled with a good record keeping system can most certainly reduce the negative consequences of a tax audit, e.g. good defence against audit findings, minimising tax audit adjustments and risk of additional assessments and minimising risk of penalties. It is also imperative for taxpayers to have robust documentation to support the positions adopted in the tax return so that they have a good defence against the IRB's proposed adjustments in a tax audit.

### **Conclusion**

As the IRB is placing greater focus on tax audits, it is important for taxpayers to be aware of how tax audits are typically conducted in Malaysia. Having a sound understanding of the tax law as well as robust documentation would also minimise the adverse consequences of a tax audit. Hence, it is never too late for businesses to evaluate whether appropriate actions such as strengthening the record keeping system or equipping the employees with sound tax knowledge should be taken to ensure that they are fully prepared in the event of a tax audit. ❗



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