

## **MINUTES OF THE DIALOGUE WITH THE TAX AUDIT AND INVESTIGATION DIVISION OF THE INLAND REVENUE BOARD (IRB) HELD ON 2 OCTOBER, 2003**

### **1. Demarcation between “Field Audit” and “Tax Investigation”**

With the implementation of the Self Assessment System, tax audits become the IRB’s routine activity in promoting voluntary compliance with the tax law and regulations. The Professional bodies would like to acknowledge the IRB’s effort in the issuance of the booklet titled “IRB Guide on Tax Audits” which is intended to help taxpayers understand better the procedures and requirements of tax audits and the rights and responsibilities of taxpayers.

In previous dialogues, the IRB has emphasised that a “Field Audit” and a “Tax Investigation” are distinguishable. However, in practice, it was highlighted that in some tax audits, the IRB has applied procedures similar to those for tax investigations, e.g., non-issuance of official notifications of audit, insisting upon upfront tax payment, admission of income understated or even requesting the director’s personal bank details, etc.

Hence, with the intention of initiating greater co-operations, the professional bodies proposed that the IRB to issue more comprehensive guidelines, distinguishing the scope and procedures between “Field Audits” and “Tax Investigations”.

The guidelines would be expected to serve as a reference tool during the course of an investigation/tax audit for relevant parties involved as follows:-

- I. To serve as a guide to reiterate the role & rights and responsibilities of both IRB officers and taxpayers;
- II. A written form of “code of conduct”;
- III. To serve as a tool to solve any unpleasant occurrences, etc.
- IV. To ensure consistency in the application of procedures and policies, among the branches and the Headquarters of the IRB;

The professional bodies too indicated willingness to allocate resources to assist the IRB in the drafting of such guidelines.

*The IRB confirmed that the “field audit” and “tax investigation” are distinguishable. The IRB informed that taxpayers will be issued with an official notification of a tax audit. The IRB also indicated that it is uncommon for their tax audit officers to not inform the taxpayers about the visit, and therefore emphasized that this matter shall be communicated to their branches.*

*The IRB also clarified that their tax audit officers are not to request for upfront payments from taxpayers. However, taxpayers are encouraged to make payments as early as possible provided that the IRB has established finding and has deemed that an additional assessment will be raised. The IRB assured that the practice of early payment of instalments is to ease the burden of payment for the taxpayers.*

*The IRB also clarified that it is common for their tax audit officers to request for the director's personal bank details where the transactions are on a cash basis, involve the director(s) and the documents are insufficient.*

*The IRB also indicated that there is no necessity to issue a booklet on a code of conduct as IRB believes that the existing guide books are clear guides on how tax audits should be conducted. Nevertheless, the professional bodies are welcome to forward and discuss with the tax audit and investigation division on any proposals or recommendations to further enhance the said guide book.*

## **2. TAX AUDITS**

### **2.1 Scope of a Tax Audit**

It is indicated in the booklet "IRB Guide on Tax Audits" that an audit is a routine activity of the IRB under the Self Assessment System i.e. from Year of Assessment 2001 onwards. We note that at present, the IRB has conducted tax audits which covers years of assessment prior to the implementation of Self Assessment System.

As such, the Institutes sought confirmation as to the number of years to be covered in a tax audit bearing in mind that taxpayers are required to keep records for seven years under Section 82 of the Income Tax Act.

The Institutes are of the view that the taxpayers should be notified prior to the commencement of a tax audit about the number of years to be audited. In the event where the IRB would like to go beyond the specified number of years notified during the course of the tax audit, the taxpayers should be informed of the reasons and given a reasonable timeframe to produce the records required.

*The IRB confirmed that the scope of tax audits under the Self Assessment System normally covers a period of one or two years, unless the IRB officer believes that there are valid reasons for them to go beyond that period of time. The IRB also clarified that taxpayers are notified prior to the commencement of a tax audit about the number of years to be audited.*

## 2.2 *Time Frame for a Tax Audit*

The IRB has informed in the previous dialogue held on 26 May 2000 that audit cases should have a specific timeframe for completion. However, there is currently no clear time frame for tax audits conducted by the IRB. There have been situations where the cases audited have been outstanding for more than a year and the taxpayers have not received any feedback / comments from the IRB since the initial visits.

The Institutes requested:

- I. the IRB's clarification on the time frame for conclusion of a tax audit;
- II. the IRB to give some form of indication/feedback to the taxpayers on the progress of the tax audit where the tax audit has been completed and there are no further issues;

It's proposed that notification of conclusion be issued to the taxpayers within six months from the date of the commencement of the audit.

Meanwhile, the Institutes also sought clarification as to whether there is some form of "agreement on settlement" to be signed by the taxpayers upon completion of tax audit.

***The IRB clarified that the time frame for conclusion of a tax audit is within 3 months.***

***The IRB acknowledged that there are still some cases that have yet to be finalised. The IRB informed that the delay may be due to the non-cooperation from taxpayers/tax agents or the inefficiency of the IRB's officers. Nevertheless, Branches will be instructed to finalise the tax audit cases within the stipulated time frame.***

***In addition, the IRB further clarified that there is no "agreement on settlement" for tax audit cases. The IRB notified that if during the settlement of cases there were some concessions agreed upon, the IRB will then issue letters confirming the final figures to be agreed by the tax payers before issuance of notice of additional assessment. However the taxpayer may still appeal against an assessment after a notice of assessment has been served on him . This appeal must be made to the Special Commissioners of Income Tax within 30 days through the prescribed Form Q. Notwithstanding the appeal, tax due as indicated in the notice of additional assessment must be paid within the stipulated time.***

## 2.3 *Notification of Visit*

We understand that prior to the commencement of a tax audit, it is the IRB's practice to notify the selected taxpayer within a specific time frame via a letter setting out the following details:-

- I date and time of visit

- II details of the officer-in-charge
- III list of the document to be made available

However, there are instances where the taxpayers were only informed verbally by the IRB officers via telephone just a few days before the commencement of the tax audit. Under such circumstances, the taxpayers were not given sufficient time for the preparation.

As such, the Institutes sought confirmation whether the above-mentioned policy (i.e. written notification) is still being strictly enforced. Meanwhile, the Institutes also reiterated the suggestion proposed earlier in previous dialogues that the taxpayers be notified, at least 2 weeks prior to the commencement of an audit considering that there is a valid concern on the effectiveness of our mailing system.

*The IRB confirmed that taxpayers are given notification of about a week prior to the commencement of a tax audit. The IRB further stated that normally, the taxpayer would be notified verbally via a telephone call, and this would be followed up with an official letter via mail/fax.*

## 2.4 Request for the Presence of a Representative

The Professional Bodies are made aware that there are instances where the IRB officers insisted on liaising with the taxpayers despite their request for the presence of their tax agent. We wish to reiterate that a tax agent is appointed by the taxpayer to liaise on behalf of the taxpayer with the IRB in relation to all taxation matters. Therefore, it is the tax agent's obligation to be fully aware of any taxation matters arising between the taxpayers and the IRB.

The Institutes sought confirmation that the taxpayer would be allowed to request for the presence of the tax agent to facilitate discussion/liaison with the IRB during the course of the tax audit. This is also to ensure that any "unreasonable conduct" by relevant parties could be monitored and avoided.

*The IRB confirmed that taxpayers are allowed to request for the presence of tax agents during the course of a tax audit. The IRB also indicated that it is uncommon for their tax audit officers to disallow the presence of the tax agents during the course of the tax audit.*

*The IRB also advised that if taxpayers encounter such problems during the course of the tax audit, they should inform the Director of the Tax Audit Unit at the head office, Kuala Lumpur.*

## 2.5 Time Frame for Replying to Tax Queries

It is normal for IRB to raise queries for tax audit purposes. Taxpayers are usually granted a two weeks period to respond. However, at times it may be difficult to furnish the relevant information as requested within such a short time frame.

The Institutes requested the IRB to give due consideration to the facts of each

case and allow adequate time for taxpayers to provide the information required.

*The IRB indicated that the taxpayers are given a reasonable time frame, i.e. fourteen (14) days from the date of the letter to provide the information required. Nevertheless, the IRB may allow an extension of time in providing the information required if there are valid grounds/reasons.*

## 2.6 Penalty Structure – Voluntary Disclosure

Taxpayers are encouraged to make voluntary disclosure regarding any income omitted by way of writing to the IRB. The penalty rates spelt out in the booklet “IRB Guide on Tax Audits” under Self Assessment System are as follows: -

	<u>Period</u>	<u>Rate</u>
Voluntary Disclosure before case is selected for audit	< 1 year	15%
	1 year - < 3 years	25%
	3 year - < 5 years	40%
	5 year and above	50%
Voluntary disclosure after being informed of case selection but before commencement of audit		50%
Non-disclosure (Discovery of omission during audit)		60%
Repeated offences		60% + 10%

As mentioned earlier in item 2.1, the IRB also conducted tax audits which also cover years of assessment prior to the Self Assessment System. In the event where there is an understatement of income, penalties are imposed accordingly.

As such, the Institutes sought clarification as to whether the above penalty rates apply solely for the Self Assessment System i.e. YA 2001 onwards or retrospectively to the years of assessment prior to YA 2001 or whether there is a separate penalty structure for the years of assessment prior to YA 2001.

*The IRB clarified that penalty under Section 113(2) of the ITA is imposed for culpability. In this respect, the penalty imposed under Section 113(2) of the ITA applies to both prior and after the year of assessment (Y/A) 2001. In addition, the IRB informed that the tax penalty structure has been made more transparent in the booklet titled ‘IRB Guide on Tax Audits’ under Self Assessment System 2001.*

Mistakes may occur in completing a tax return. Considering that one of the objectives of a field audit is to promote voluntary compliance with the tax law

and regulations, the Institutes are of the opinion that certain penalty rates are too severe especially in the event that the taxpayer voluntarily discloses the mistake or error.

The Institutes are of the opinion that as long as the taxpayer has no intention to evade tax, the IRB should be lenient towards genuine or certain types of mistakes such as a mathematical errors, etc. Therefore, the Institutes suggested that the IRB to review the penalty structure to further promote voluntary disclosure by the taxpayers whom are acting in good faith.

Meanwhile, the Institutes proposed that the imposition of penalties for the first two years of Self Assessment System (i.e. YA 2001 and YA 2002) be exercised leniently in order to assist the taxpayers in the transition from the official assessment system to the Self Assessment System.

*The IRB indicated that penalty would not be imposed for simple or minor mistakes such as mathematical error, etc. However, a penalty may be imposed if the IRB deemed the mistakes to have been intentionally made, e.g. simple mistakes that are repeated numerous times.*

*In addition, the IRB informed that taxpayers may appeal against a penalty imposed in certain circumstances on a case to case basis.*

## 2.7 Penalties Arising from Tax Audit

Our members have noted that penalties have been imposed when taxpayers are found during a tax audit to have under declared their tax liability e.g., where expenses are wrongly claimed resulting in lower tax liability.

The Institutes sought clarification on the following:-

- I. Will penalties be imposed if the audit adjustments made by the IRB result in a higher tax payable as compared to the estimate or revised estimate submitted by the taxpayers vide the Form CP204 or CP204A?
- II. What are the consequences if the taxpayers are found to have failed to self compute the penalties for late payments / under estimation of tax payable?

*The IRB clarified that any penalty for underestimation would be imposed upon comparison with the tax liability per the deemed assessment and the estimate or revised estimate submitted by the taxpayers vide the Form CP204/CP204A.*

*The Chairman proposed that the above issues be raised and discussed with the Operations Division of the IRB.*

## 3.

**TAX INVESTIGATIONS****A. Finalisation of Tax Investigation Cases**

The professional bodies understand from members in Johor that some of the investigation cases finalised at the IRB's Johor Bahru office have not been approved by the HQ in Kuala Lumpur after more than a year.

Some members from Sarawak also faced the situation where the IRB Investigation Officers have finalized the investigation and the taxpayers have signed the agreements for backduty settlements. However, the taxpayers have yet to receive copies of signed agreements and the taxpayers' documents/books are still retained by the IRB. The members have been informed by the Investigation Officers that the cases have not been reviewed nor approved by the IRB headquarters. Meanwhile, the taxpayers' documents/books cannot be returned to them giving rise to inconveniences.

In this regard, the Institutes sought clarification on the above matter. In addition, the Institutes requested that the IRB to expedite the finalisation of tax investigation cases for the outstanding years of assessment and if possible write to the taxpayers to arrange for meetings to resolve any outstanding matters.

In addition, the Institutes proposed that where settlement has been reached, the agreement should be signed within a reasonable time frame upon completion of the investigation.

There are also many cases whereby investigation officers visited the taxpayers' premises and took away the taxpayers' records for the purpose of conducting an investigation. However, no news has been heard from the investigation officers thereafter.

We are of the opinion that it is patently unfair for the IRB not to revert to the taxpayer concerned indefinitely. There should be a reasonable time frame (say within 6 months after the date of inspection) for the investigation officers to revert to the taxpayer concerned as to whether there is any issue arisen out of the investigation which have to be answered for or the case should be closed as "no case" accordingly. Furthermore, the records taken away should also be returned to the taxpayer instead of "held in suspense".

***The IRB clarified that they are in the process of expediting the finalisation of tax investigation cases. The IRB noted that there are still some cases pending finalisation, and the delay may be due to the non co-operation from taxpayers/tax agents.***

***The IRB acknowledged that there are still some cases where settlement has been agreed but these are pending finalisation due to the delay at the Headquarters level. In this respect, the IRB is in the process of finalising these cases as expeditiously as possible.***

*The IRB also indicated it is intended that tax investigation cases are to be finalised within 3 months (as per the recent announcement by the DGIR). In respect of old outstanding cases, the IRB appealed to taxpayers to provide co-operation to the IRB to expedite the finalisation of these cases.*

### **3.2 Time Frame for Returning Non-essential Documents**

It was proposed in a previous dialogue that the IRB should return all non-essential documents to the taxpayer within 6 month from the date of commencement of the investigation to ensure that the business processes of the taxpayer can proceed without hindrance from the investigation process. We would appreciate it if the IRB could consider the above suggestion.

*The IRB noted the comment. In this regard, the IRB stated that taxpayers are able to request for the IRB to return all non-essential documents except for those relating to the tax investigation issues.*

### **3.3 Penalty Structure under Tax Investigation**

Currently, we note that there is a lack of consistency with regards to the tax investigation procedures, including the imposition of penalties by the IRB. There were many cases whereby penalties had been imposed on one company but not in another case on the same issues or there were instances where the penalty rates imposed were different. As such, taxpayers are somewhat concerned about the lack of transparency about the IRB's procedures.

In the context of Self-Assessment System, the Institutes highlighted that a more transparent system will induce greater cooperation by the taxpayers. We suggested that the IRB to release tax investigation guidelines including the penalty structure. This is to ensure that the taxpayers are fully aware of the consequences for non-compliance of tax law and regulation.

*The IRB stated that effective from YA 2002, the penalty has been structured to be in line with the period taken for the case to be settled and the number of instalments requested. Nevertheless, the IRB informed that the said structure shall be reviewed to take into consideration the time frame within 12 months, i.e. settlement and payments made within a 12 month period.*

### **3.4 Request for Advance Payment**

During the course of a tax investigation, it is not unusual that the IRB may request the taxpayer to settle an upfront payment (the amount could be substantial in certain cases) even on the first day of the IRB's visit to the taxpayer's premise. There were instances whereby taxpayers were not informed by the IRB officers of the basis for requesting such advance payments.

The Institutes are of the opinion that such a practice should not be encouraged as it appears that the IRB is taking advantage of the situation. The IRB should clearly inform the taxpayer of the basis of requesting for whatever amount of



such advance payment and give sufficient time for the taxpayers to arrange for the payment and also to seek professional advice instead of being required to issue a cheque on the spot.

*The IRB clarified that where there is already a basis/information available to the IRB, then the IRB will request that the taxpayer make an upfront payment as this will assist the taxpayer in settling the eventual tax liability earlier.*

### 3.5 Criminal Investigation Unit

We understand that there is a new division being set up by the IRB recently, namely the “Criminal Investigation Unit”. The professional bodies would like to enquire more about this Unit as to the functions and roles of the Unit.

*The IRB informed that the Criminal Investigation Unit’s main function is to handle tax evasion cases. The IRB further stated criminal investigation is not entirely a new practice but an expansion of the role and function, i.e. the IRB may step up more cases for prosecution.*

*In addition, the IRB also indicated that under the SAS, it is crucial for the IRB to prosecute tax evasion cases.*

*The IRB also clarified that the special unit’s main function is to look into cases and procedures involving tax evasion that can be prosecuted in courts. The cases are also referred to the Attorney General (AG)’s office before proceeding for prosecution.*

## OUTSTANDING ISSUES

### 1. Section 113(2) of the ITA (17 June 2002 Technical dialogue refers)

We are of the opinion that, as a matter of principle, penalties should not be imposed on technical adjustments made on tax computations prior to YA 2001 (i.e. prior to the implementation of the self assessment system). However, some members had encountered situations whereby a tax deduction which initially claimed on repairs and maintenance was later classified as capital expenditure by the IRB subsequent to field audit. We understand that a penalty under Section 113(2) was imposed by the IRB in such a situation.

Prior to the implementation of the self assessment system (i.e. prior to YA 2001), as the onus of determining the taxpayer's tax liability lies with the IRB, it has been the practice of the IRB in the past not to impose penalties on technical adjustments made subsequent to a field audit by the IRB.

However, we understand that some IRB officers have recently deviated from this practice by imposing penalties on technical adjustments made subsequent to a field audit by the IRB on tax computations prior to YA 2001. We are of the opinion that penalties should not be imposed on technical adjustments made on tax computations prior to YA 2001 and we are also of the view that there should be some guidance given to all IRB officers on how tax audits should be conducted with regards to tax computations prior to YA 2001.

*Comment:*

*A technical adjustment generally arises due to a differing interpretation of the tax legislation by the taxpayer, either due to a provision not being clearly defined or due to the existence of conflicting case law.*

*The IRB confirmed that no penalty will be imposed on the event of a pure technical adjustment as this would not involve an intention to evade taxes.*

*However, whether a transaction is merely a technical adjustment or an intentional act to evade tax will very much depend on the circumstances of each case and will vary on a case to case basis.*

**Please also refer to the following examples:-**

***Example 1 – Non-Compliance with the IRB's guideline***

The IRB has, in the past, issued certain guidelines. One of these is the computation of interest restriction under Section 33(2). We wish to highlight that the guideline does not reflect the underlying principle held in the cases of Pernas Securities and Multipurpose Holdings.

Under such circumstances, in the event that a tax return is submitted based on the principle stated in the above-mentioned case together with a disclosure of the non-compliance with the guideline, would there be a technical adjustment by the IRB? Would a penalty be imposed if there is additional tax due arising from the adjustment?

***Example 2 – Income and Expenses Recognition***

***There is always a concern where certain accounting policies adopted by the taxpayers (which in accordance with the Accounting Standards) may not be concurrent with the income and expenses recognition concepts for income tax purposes. In practice, the IRB has been liberal in accepting the taxpayers' accounting policies so long that the applications are consistent and reasonable. In the event where there is a change in the accounting policies, proper documentation is required for justification purposes. The IRB's leniency on this matter eases the taxpayers' burden in reducing the cost of tax compliance.***

In many cases, the adoption of accounting policies to adhere with Accounting Standards has resulted in a deferment of income / expenses when computing chargeable income for tax purposes. As such, we sought the IRB's opinion pertaining to this matter.

***The IRB confirmed that no penalty will be imposed on the event of a pure technical adjustment as this would not involve an intention to evade taxes. The IRB further clarified that where the taxpayers have consistently followed certain guidelines/principles acceptable or approved by IRB i.e., matching income and expenses recognition, the adjustments are treated as technical adjustments, and therefore no penalty will be imposed.***