



INLAND REVENUE BOARD OF MALAYSIA

TAX AUDIT FRAMEWORK

EFFECTIVE DATE: 01 FEBRUARY 2015

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1. INTRODUCTION

- 1.1 A fair, transparent and equitable tax administration system will enhance public confidence in the tax system. Compliance with tax laws must be strictly enforced and tax offences such as non-compliance and tax evasion should be penalized in accordance with the provisions of the Income Tax Act 1967 (ITA).
- 1.2 Under the Self-Assessment System, tax audit is a primary activity of the Inland Revenue Board of Malaysia (IRBM). It is aimed at enhancing voluntary compliance with the tax laws and regulations. A taxpayer can be selected for an audit at any time. However, it does not necessarily mean that a taxpayer who is selected for an audit has committed an offence.
- 1.3 This framework is issued by IRBM to ensure that tax audit is carried out in a fair, transparent and impartial manner. This framework outlines the rights and responsibilities of audit officers, taxpayers and tax agents in respect of a tax audit. Generally, this framework aims to:
 - 1.3.1 Assist audit officers to carry out their tasks efficiently and effectively; and
 - 1.3.2 Assist taxpayers in fulfilling their obligations.

2. STATUTORY PROVISIONS

- 2.1 The provisions of the ITA which are applicable to tax audits are as follows:
 - 2.1.1 Subsection 39 (1A) : Failure to give information within the specified time.
 - 2.1.2 Section 78 : Power to call for specific returns and production of books.
 - 2.1.3 Section 79 : Power to call for statement of bank accounts, etc.
 - 2.1.4 Section 80 : Power of access to buildings and documents, etc.

- 2.1.5 Section 81 : Power to call for information.
- 2.1.6 Section 82 : Duty to keep records and give receipts.
- 2.1.7 Section 99 : Right of appeal.
- 2.1.8 Section 100 : Extension of time for appeal.
- 2.1.9 Section 10 : Review by Director General
- 2.1.10 Section 102 : Disposal of appeals.
- 2.1.11 Section 113 : Incorrect returns.
- 2.1.12 Section 116 : Obstruction of officers.
- 2.1.13 Section 119A : Failure to keep records.
- 2.1.14 Section 120 : Other offences.
- 2.1.15 Section 138 : Certain material to be treated as confidential.
- 2.1.16 Section 138A : Public rulings.
- 2.1.17 Section 140 : Power to disregard certain transactions.
- 2.1.18 Section 141 : Powers regarding certain transactions by non-residents.

2.2 Statutory provisions relating to tax audit are not limited to the provisions cited above. Statutory provisions also include the ITA as a whole, Real Property Gains Tax Act 1976, Petroleum (Income Tax) Act 1967, Promotion of Investments Act 1986, Stamp Act 1949, Labuan Business Activity Tax Act 1990 and other acts administered by IRBM.

3. WHAT IS A TAX AUDIT?

3.1 A tax audit is an examination of a 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. IRBM carries out two (2) types of audit, namely desk audit and field audit.

3.1.1 Desk Audit

3.1.1.1 A desk audit is held at the IRBM's office. Desk audits are normally concerned with straightforward issues or tax adjustments which are easily dealt with via correspondence. A taxpayer may be called for an interview at IRBM's office if further information is required.

3.1.1.2 Generally, a desk audit involves checking all information on income and expenses as well as various types of claims made by a taxpayer in his income tax return.

3.1.1.3 Specific desk audit cases can be referred for field audit action. Under such circumstances, the taxpayer will be informed through a field audit notification letter as part of the normal process of commencing the field audit.

3.1.2 Field Audit

3.1.2.1 A field audit is one that takes place at a taxpayer's premise. It involves the examination of the taxpayer's business records. In the case of a sole-proprietorship or partnership, if the taxpayer's business records are incomplete it may involve the examination of non-business records such as personal bank statements, etc. A taxpayer will be given notice prior to a field audit.

3.2 In general, this tax audit framework is applicable to both types of audit, namely desk audit and field audit with the exception of visit to premises and examination of records which are only applicable to field audit.

4. OBJECTIVE OF TAX AUDIT

4.1 The main objective of tax audit is to encourage voluntary compliance with the tax laws and regulations and to ensure that a higher tax compliance rate is achieved under the Self Assessment System. In this regard, the audit officer is required to ensure that the correct amount of income has been reported and the right amount of tax has been paid in accordance with the tax laws and regulations.

- 4.2 For the purpose of achieving voluntary compliance, the tax audit activity is one of the measures undertaken by IRBM to educate and create awareness of taxpayers towards their rights and responsibilities under the provisions of the ITA.

5. YEARS OF ASSESSMENT COVERED

- 5.1 Generally, a tax audit covers a period of one (1) year of assessment, determined in accordance with the audit focus criteria of the department.
- 5.2 However, the tax audit may be extended to cover a period up to five (5) years of assessment, pursuant to the issues uncovered during an audit. Further, this 5 year time limit is not applicable to cases involving fraud and tax evasion whether intentional or unintentional.

6. SELECTION OF CASES

- 6.1 Cases for audit are selected through the computerized system based on risk analysis criteria. However, the selection of audit cases is not confined to the selection by the computerized system only, as cases can also be selected based on information received from various sources.
- 6.2 Audit cases are selected in the following manner:
- 6.2.1 Selection based on risk analysis;
 - 6.2.2 Information received from third party;
 - 6.2.3 Selection based on specific industries;
 - 6.2.4 Selection based on specific issues for a certain group of taxpayers;
and
 - 6.2.5 Selection based on location, etc.

7. HOW A TAX AUDIT IS CARRIED OUT

7.1 Audit Venue

- 7.1.1 A desk audit is carried out at the IRBM's office whereas a field audit is carried out at a taxpayer's business premise.

- 7.1.2 Where the business premises are not suitable, the taxpayer may suggest a suitable alternative for IRBM's agreement.

7.2 Commencement of an Audit

- 7.2.1 A taxpayer who is selected for an audit will be notified by IRBM through a letter of notification of audit. The period between the date of notification of audit and the audit visit is 14 days. However, with the agreement of the taxpayer, a shorter period of notification may be fixed by IRBM. A letter confirming the visit is usually preceded by a phone call.
- 7.2.2 A taxpayer may request for the audit visit to be deferred due to unavoidable circumstances and reasonable grounds.
- 7.2.3 Other than the intended date of the visit, the letter will indicate the records that should be made available for audit, the years of assessment to be audited and the names of audit officers who will conduct the audit as well as the expected time frame required for the audit visit.
- 7.2.4 A taxpayer may contact the Branch Audit Manager or Branch Director of IRBM for the purpose of confirming the audit visit.

7.3 The Visit

- 7.3.1 An audit visit is only applicable to the field audit activity. The audit normally starts off with an interview.
- 7.3.2 The purpose of an interview is to enable the audit officers to meet the taxpayer, obtain an overview of the taxpayer's business activity and to discuss the audit.
- 7.3.3 The taxpayer will be asked to explain his business activities, accounting and record keeping system. During the audit process, the person responsible for the handling of taxpayer's business records will also be interviewed.

7.4 Examination of Records

- 7.4.1 During the course of an audit, the audit officer should be allowed to examine all business records and to inspect stock and equipments physically for verification of the claims made. Records pertaining to the years of assessment which are already time barred will not be examined.
- 7.4.2 In certain circumstances, there may be a need to examine records other than business records where it involves the audit of sole-proprietorships and partnerships.
- 7.4.3 The audit officer will not search for or take possession of any record. Examination of records will only be carried out at the taxpayer's business premises. If it is deemed necessary, the audit officer should be allowed to make copies of relevant documents.
- 7.4.4 However, under circumstances where the work place provided by the taxpayer is not suitable or conducive to carry out the audit or where copier facility is not available, the audit officers, with the consent of the taxpayer, may obtain records for examination at the IRBM's office. In such a case, the documents will be returned to the taxpayer once the examination is done.
- 7.4.5 The documents and records to be taken back will be listed and the taxpayer may check the documents and records and make a copy of the list, if necessary.
- 7.4.6 Where records and books of accounts are kept in electronic form, hard copies of such records should be made available for examination. If at the time of the audit visit, the taxpayer is unable to provide the hard copies for examination, the taxpayer should facilitate and assist the audit officers to access the computer system and copy the electronic records onto tapes, disks or diskettes.
- 7.4.7 The audit officers will examine all documents and records necessary to ascertain that the correct amount of income has been reported. Basically, records consists of:

7.4.7.1 Business Records

Taxpayer can obtain guidance in relation to record keeping from the guidebook and public rulings issued by IRBM.

Pursuant to section 138A of the ITA, the Director General of Inland Revenue (DGIR) is given the power to issue public rulings on the interpretation of any provision of the ITA.

The following public rulings and a guide book in relation to record keeping have been issued;

- i. IRBM Public Ruling No. 4/2000: Keeping Sufficient Records (Companies & Co-operatives);
- ii. IRBM Public Ruling No. 5/2000: Keeping Sufficient Records (Individuals & Partnerships);
- iii. IRBM Public Ruling No. 6/2000: Keeping Sufficient Records (Persons Other Than Companies, Co-operatives or Individuals); and
- iv. STS-BK4: Self-Assessment – A Guide to Record Keeping For Business.

7.4.7.2 Records Other Than Business Records

In the audit of cases other than companies such as sole-proprietorships and partnerships, the audit officer may need to examine records other than business records as follows:

- i. Personal bank account statements;
- ii. Credit card statements;
- iii. Records relating to the ownership of assets;
- iv. Records relating to the taxpayer's personal / family expenses; and
- v. Other statements as may be required under section 79 of the ITA.

7.4.8 Section 82 and 82A of the ITA requires every person to keep and retain sufficient records when carrying on a business in order to enable the income or loss from the business to be readily ascertained. As stipulated in the Public Ruling Nos. 4/2000, 5/2000 and 6/2000, the meaning of “records and documents” includes the following:

7.4.8.1 Books of accounts for recording receipts and payments or income and expenditure;

7.4.8.2 Financial statements;

7.4.8.3 Invoices, vouchers, receipts and other documents that are required to verify entries recorded in the books of accounts; and

7.4.8.4 Documents, objects, materials, articles and things which are maintained and kept in the form of electronic medium.

7.4.8.5 Any other record as may be specified by the DGIR.

7.4.8 Failure to comply with paragraphs 82(3)(a), 82(3)(b) and subsection 82(5) of the ITA to keep sufficient records is an offence under section 119A of the ITA. In relation to this, the audit officer may apply alternative approaches or indirect methods for the purpose of ascertaining whether the appropriate amount of income has been reported.

7.5 Audit Time frame

7.5.1 The time required to complete an on-site examination of records is between one (1) to three (3) days. However, the audit time frame may be extended depending on the following factors:

7.5.1.1 The size of the business and the complexity of business transactions;

7.5.1.2 The form in which records are kept; or

7.5.1.3 The extent of co-operation from the taxpayer.

7.5.2 The audit time frame is applicable only to field audits.

7.6 Settlement of Audit

- 7.6.1 After concluding the audit work, the audit officer will prepare an audit findings report for approval by the Branch Audit Manager.
- 7.6.2 Under certain circumstances, the taxpayer is required to be present at the IRBM's office for discussion on the proposed tax adjustments. The audit officer, together with at least one senior audit officer, shall discuss the proposed adjustments with the taxpayer.
- 7.6.3 The taxpayer, without being called by the IRBM, may be present at IRBM's office to seek clarification regarding the progress of the audit process or to give further information to expedite the settlement of the audit.
- 7.6.4 The taxpayer will be informed of the audit findings which will cover the following areas:
 - 7.6.4.1 Audit issues raised;
 - 7.6.4.2 Reasons and rationale for raising the audit issues;
 - 7.6.4.3 The amount of proposed tax adjustments (if any) and the years of assessment involved.
- 7.6.5 If there are tax adjustments to be made, a notification with details of proposed tax adjustments and rationale for making such adjustments will be issued. The taxpayer will be given the opportunity to state his views and give explanations on the audit findings and the proposed tax adjustments forwarded.
- 7.6.6 A taxpayer is allowed 21 days from the date of notification of proposed tax adjustments to file an official objection if he disagrees with the proposed tax adjustments. Additional information and copies of evidence should be provided to support his objection.
- 7.6.7 If no objection is made within 21 days from the date of notification of proposed tax adjustments, the taxpayer shall be deemed to have agreed to the proposed tax adjustments or where an objection is found to have no basis in accordance with the provisions of the ITA, the taxpayer will be informed accordingly.

- 7.6.8 Subsequently, a notice of additional assessment with appropriate penalty imposed under subsection 113 (2) or paragraph 44B (7) (b) or subsection 112(3) of the ITA or a notification of non-chargeability to tax will be issued. However, if there is no adjustment, a letter will be issued to inform that the audit has been finalized without any adjustment.
- 7.6.9 The time frame for settlement of a tax audit should be 4 months (120 calendar days) from the commencement of the audit. IRBM will inform the taxpayer on the progress of the audit in the event that the case needs more than 4 months to settle.
- 7.6.10 Once the audit case is settled, the audit should not be repeated on the same issues for the same year of assessment. However, if there are new issues to be pursued or new information is received, an audit can be repeated for the same year of assessment.

7.7 MDTD Programme

The Monitoring Deliberate Tax Defaulters Programme (MDTD Programme) has been introduced to strengthen and enhance the effectiveness of existing tax audit activities.

This programme is designed to monitor taxpayers identified as non-compliant in accordance with the existing rules and income tax laws. Non-compliant means taxpayers committed offences in furnishing their Income Tax Return Forms (ITRF). Field audit cases with findings and / or taxpayers who fail to furnish or provide the incorrect business code in the ITRF will be listed in the MDTD list. In addition, this programme also seeks to encourage voluntary tax compliance through continuous education and monitoring activity.

The concept and implementation of MDTD Programme are as follows:

- 7.7.1 From the outcome of audit activities, non-compliant taxpayers will be listed in the MDTD list for continuous monitoring;
- 7.7.2 Non-compliant taxpayers will be informed by official letter upon listing in the MDTD list;
- 7.7.3 Taxpayers will be delisted if found to have not committed the offences in the following year of assessment.

8. RIGHTS AND RESPONSIBILITIES

8.1 IRBM

8.1.1 An audit officer must adhere to rules and codes of ethics drawn up by IRBM and is required to carry out his duties in the following manner:

8.1.1.1 Professional, well mannered, trustworthy, honest and with integrity;

8.1.1.2 Always ready to give explanations on the objectives of the tax audit and the rights and responsibilities of the taxpayer;

8.1.1.3 Knowledgeable and fair in administering tax laws;

8.1.1.4 Co-operative and always ready to give advice and guidance to the taxpayer;

8.1.1.5 Ensure that the audit is carried out smoothly with minimal disruption to the taxpayer;

8.1.1.6 Request for documents, books of accounts and information that are relevant to the audit only;

8.1.1.7 Explain the proposed tax adjustments and provide reasonable time for taxpayer to give responses on issues raised;

8.1.1.8 Ensure the rights and interest of taxpayers and tax agents as well as documents of taxpayers are safeguarded;

8.1.2 Identification of an audit officer

8.1.2.1 Each audit officer is issued with an authority card bearing his name and photograph. The card also carries

a statement that the officer is authorized to examine books of accounts, documents and records at the taxpayer's premises;

8.1.2.2 Taxpayers are advised to view the authority cards in order to verify the authenticity of audit officers; and

8.1.2.3 Taxpayers are advised to check with the Branch Director of IRBM if they have doubts on the authenticity of audit officers.

8.1.3 An audit officer is prohibited from:

8.1.3.1 Having any personal or financial interest in the business of a taxpayer being audited;

8.1.3.2 Recommending to taxpayer that a certain tax agent be appointed as the tax agent for the audit case; and

8.1.3.3 Abusing his position or power in carrying out his duties as provided under section 118 of the ITA.

8.2 Taxpayer

8.2.1 Responsibilities of a taxpayer

8.2.1.1 Be co-operative, well mannered, fair, honest and with integrity;

8.2.1.2 Provide reasonable facilities and assistance to enable the audit officer to carry out his duties as outlined in Public Ruling No. 7/2000 which includes the following:

- i. Giving access to the audit officer to his business premises, providing information and making available documents and records required for examination;
- ii. Giving explanation regarding the business, the accounting and information systems;
- iii. Giving permission to examine and make copies of records, documents and books of accounts whether in the physical and / or electronic medium;

- iv. Assisting in the provision of or providing access to records, documents and books of accounts in the physical and / or electronic medium; and
- v. Allowing the use of copiers, telephone or other communication equipment, lighting and power, office space, furniture and providing facilities for copying of electronic records onto tapes, disks or diskettes.

8.2.1.3 Co-operate in providing complete responses to all queries:

- i. If questions posed are ambiguous, he may seek clarification from the audit officer;
- ii. Questions posed normally relate to the business carried out. However, in the case of a sole proprietorship or a partnership, the taxpayer may also be queried on personal matters such as personal expenses, savings, bank account, assets, etc; and
- iii. If a taxpayer fails to co-operate and provide the required information, he shall be deemed to have committed an offence under the provisions of the ITA.

8.2.2 The taxpayer is prohibited from:

8.2.2.1 Giving any form of gifts to the audit officer and transacting any business with the audit officer during the audit process;

8.2.2.2 Making any form of payments to the audit officer; and

8.2.2.3 Obstructing or hindering the audit officer in the exercise of his functions. Such obstruction is an offence under section 116 of the ITA. Obstruction includes the following:

- i. Obstructing or refusing an audit officer from entering lands, buildings, places and premises to perform his duties in accordance with section 80 of the ITA;

- ii. Obstructing an audit officer from performing his functions and duties under the provisions of the ITA;
- iii. Refusing to provide books of accounts, or other documents in the custody of or under his control when required by the audit officer;
- iv. Failing to provide reasonable assistance to the audit officer in carrying out his duties; and
- v. Refusing to answer or give responses to questions raised during the course of an audit.

8.3 Tax Agent / Representative

- 8.3.1 The taxpayer can request for his tax agent to be present during an interview. The taxpayer is allowed to bring an interpreter to an interview or discussion session if the taxpayer is not conversant in Bahasa Malaysia or English.
- 8.3.2 If a taxpayer appoints a new tax agent to handle his audit case, he should submit a copy of the letter of appointment.
- 8.3.3 The conduct of a tax agent is governed by the code of ethics formulated by IRBM based on the principles of integrity, accountability, transparency and social responsibility.
- 8.3.4 The tax agent is required to carry out his duties in the following manner:
 - 8.3.4.1 Professional, be fully conversant with tax laws and practices and with integrity;
 - 8.3.4.2 Be honest, trustworthy, transparent and give fullest co-operation when dealing with the taxpayer and IRBM such as informing IRBM on ceasing to be the tax agent of a taxpayer and adhere to rules and guidelines laid down by IRBM;
 - 8.3.4.3 Refrain from misusing information acquired or abusing his position as a tax agent for his own personal advantage;

- 8.3.4.4 Always give complete and accurate feedback relating to the progress of an audit and advise the taxpayer accurately based on the true facts of the audit case; and
- 8.3.4.5 Safeguard the confidentiality of all information and ensure that the information is not disclosed to any unauthorized party (subsection 138 (5) of the ITA).

8.3.5 The tax agent is prohibited from:

- 8.3.5.1 Giving wrong advice to taxpayers and collaborating with taxpayers to avoid paying the correct amount of taxes;
- 8.3.5.2 Delaying the work of a tax audit or acting irresponsibly towards his entrusted duties; and
- 8.3.5.3 Offering any form of gifts to the audit officers.

9. CONFIDENTIALITY OF INFORMATION

IRBM will ensure confidentiality of all information obtained from the taxpayer during an interview, discussion, through correspondence or examination of records and that it is utilized for tax purposes only.

10. OFFENCES AND PENALTIES

- 10.1 If it is discovered following an audit finding that there has been an understatement or omission of income, a penalty will be imposed under subsection 113(2) or paragraph 44B(7)(b)* of the ITA in which the penalty rate is equal to the amount of tax undercharged (100%) accordingly. However, the DGIR in exercising his discretionary powers under subsection 124(3) may impose a lower penalty of 45% on the tax undercharged.
- 10.2 The concessionary penalty rates may be imposed in cases where the taxpayer makes a voluntary disclosure. As such the taxpayer is encouraged to make a voluntary disclosure regarding the omitted income before the commencement of an audit. This disclosure must be made in writing to the relevant Branch Director of IRBM.

- 10.3 Where a taxpayer who furnishes a return form on or before the due date and the Director General has made an assessment for that year of assessment under subsection 91 of the ITA subsequently makes a voluntary disclosure after the due date but not later than 6 months from the due date, the penalty rates are as follows:

Table I

Period of making voluntary disclosure	Rate
Within 60 days from the due date for furnishing the return form	10%
More than 60 days but not later than 6 months from the due date for furnishing the return form	15.5%

* Paragraph 44B (7) (b) is deemed to have effect for the years of assessment 2008, 2009 and 2010.

- 10.4 The concessionary penalty rates for voluntary disclosure other than cases mentioned in paragraph 10.3 are as follows:

Table II

	Period from the due date of submitting return form	Rate
Voluntary disclosure before case is selected for audit.	Up to 6 months	Table I applies
	> 6 months to 1 year	20%
	> 1 year to 3 years	25%
	> 3 years and above	30%
<u>Field Audit</u> Voluntary disclosure after taxpayer has been informed but before commencement of examination of documents during audit visit.	Not applicable	35%

Desk Audit

Voluntary disclosure after letter of request for documents is issued to taxpayer and within 21 days taxpayer has taken the following action:

- i. Voluntarily disclose that the income, claim, relieve and rebate which have been declared are false and furnish the true documents for evidence; and
- ii. Voluntary disclosure is made either in writing, via the electronic media or from the interview notes at the office.

10.5 For MDTD cases, a penalty of subsection 113 (2) of the ITA will be charged 100% of tax loss if taxpayers for the second time of audit are found to have not complied despite having been issued with the letter of Managing Deliberate Tax Defaulter.

11. COMPLAINTS

11.1 If the taxpayer is dissatisfied with the manner in which an audit is being carried out, including the behaviour of an audit officer, he may make an official complaint to the IRBM Branch Director / State Director / Director of Compliance Department / Deputy Director General of Inland Revenue / Director General of Inland Revenue.

11.2 IRBM will act fairly, objectively and impartially on all complaints received.

11.3 IRBM will not entertain any complaint which is found to have no basis and not made in good faith.

- 11.4 IRBM will take action and file a complaint with the relevant authority such as Ministry of Finance / Malaysian Institute of Taxation / Malaysian Institute of Accountants / Malaysian Institute of Certified Public Accountants / Malaysian Association of Tax Agents / Bar Council, if tax agents or their representatives do not co-operate or behave unprofessionally which is inconsistent with their code of ethics.

12. PAYMENT PROCEDURES

- 12.1 Any taxes and penalties to be paid arising out of an audit must be made to the DGIR through any appointed bank or any Collection Branch of IRBM.
- 12.2 The taxpayer is required to make full payment of taxes and penalties arising out of an audit.
- 12.3 If the taxpayer is unable to make full payment of tax, IRBM may consider the taxpayer's application for settling the total tax liability by installments, for a predetermined period.
- 12.4 Application for installment payment scheme should be submitted to the relevant Branch Director of IRBM for approval.
- 12.5 Where a taxpayer fails to adhere to the installment payment scheme agreed upon, late payment penalty on the balance of tax outstanding will be imposed.

13. APPEALS

Section 99 to 102 of the ITA lay the ground rules for appeals relating to assessment raised by IRBM.

- 13.1 A taxpayer can appeal against an assessment as a result of a tax audit.
- 13.2 The appeal must be made to the Special Commissioners of Income Tax within 30 days after the service of the notice of additional assessment.
- 13.3 Should either party be dissatisfied with the decision of the Special Commissioners of Income Tax, the aggrieved party may apply to have the case heard in the High Court and further the Court of Appeal.

14. EFFECTIVE DATE

This framework is effective from 1 February 2015 and not applicable to audit cases involving transfer pricing, thin capitalization and advance pricing arrangement. This tax audit framework shall replace the tax audit framework dated 1 April 2013.

**Director General of Inland Revenue
Malaysia**

February 2015