Tax Compliance Failure Leads to Penalties

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Audit / Tax / Advisory

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Generally, tax compliance failure represents financial risk such as financial penalties and increase of tax charge. It also leads to business risk as the tax authority will view the taxpayers differently and conduct a tax audit in the future. The Malaysian tax authority has introduced the Monitoring Deliberate Tax Defaulters programme since 1 January 2014 to monitor the non-compliant taxpayers identified by them during tax audits. These taxpayers will be monitored until there are no repeated or new offences committed.

From the accounting perspective, it is true that the tax treatment does not always dovetail with the accounting treatment. The divergence between the accounting and tax treatments often increases the cost of doing business. As a result, more tax adjustments are required when furnishing income tax returns and a complicated accounting software will be necessary to facilitate tracking and retrieval of the business transactions for compilation of information purposes.

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As a good taxpayer, you must be aware of tax compliance issues such as filing of incorrect returns by omitting or understating any income or giving any incorrect information in relation to the chargeability of tax. Tax penalties will be imposed by the tax authority based on the preliminary findings and tax adjustments finalised during a tax audit.

There are many tax compliance issues found by the tax authority from tax audit cases. As the tax filing deadline for December year end companies approaches, let us look at four (4) common mistakes made by the taxpayers when submitting the income tax return form.

Accrual expenses vs. provision for expenses

For tax purposes, all outgoing and expenses must be wholly and exclusively incurred during that period by taxpayers in the production of gross income for that business source. Expense is incurred when it is paid, payable or becomes payable, the liability is certain and it is an obligation incurred in that basis period. You may refer to the following table to differentiate between accrual expenses and provision for expenses. However, due regard must be given to the facts of each case.

	Accrual	Provision
Amount	Certain	Estimate
Document	Agreement / contract / invoice	Not available
Legal liability to pay	Yes	No
Certainty	Definite and outgoing	Contingency

Capital expenditure vs. revenue expenditure

Section 39(1) of the Income Tax Act 1967 states that any capital withdrawn or any sum employed or intended to be employed as capital is not tax deductible. In view of the above, taxpayers are required to highlight the following to their tax agent for preparation of tax computation purposes:

- Any capital items which may be expensed off to the statements of profit or loss and other comprehensive income (e.g. upkeep and maintenance);
- Any initial expenditure which are not separately analysed (e.g. subscription fee, new tenancy agreement);
- Any replacement items or spare parts which are categorised as fixed assets; and
- Any expenses incurred prior to the commencement of business.

Withholding tax payments

Payments such as interest, royalty, special classes of income, contract payments and other gains or profits made to a non-resident person may be subject to the withholding tax provisions in the Income Tax Act 1967. Taxpayers are not allowed to claim tax deduction on the payments made to the non-residents until the withholding tax is remitted to the tax authority together with the late payment penalty of 10% on the unpaid tax. As a taxpayer, you need to take note of the following in respect of withholding tax payments:

- Is the payment categorised correctly?
- Are the supporting documents sufficient to be presented to the tax authority during future audit (e.g. services performed outside Malaysia)?
- Is the reduced rate under the Double Tax Agreement applicable?

Deferred income

Section 24 of the Income Tax Act 1967 provides that any sum received in the course of carrying out a business constitutes income which should be duly subjected to tax in that year (basis period). Based on this amended legislation, tax is paid upfront. From the business perspective, this will cause a negative impact on cash flow and takes away precious operating capital from the business. In view of the above, have you done the following?:

- Revised the estimate of tax payable to reflect the additional tax payable arising from the deferred income?
- Reviewed your clients' agreements / contracts, invoicing cycle and payment terms to assess the taxability of advance billing or deposit received?
- Highlighted to your tax agent on the deferred income?

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