



## IRB TAX AUDITS AND INVESTIGATIONS

**Tax audits and tax investigations are conducted by all tax authorities to examine or review taxpayers' financial affairs. How can you or your company prepare for this?**

**T**he Inland Revenue Board of Malaysia (IRB) conducts tax audits to ensure that taxpayers have declared the right amount of income in their income tax returns in accordance with current tax laws and regulations.

There are two types of tax audits that can be carried out by the IRB, namely, desk audits and field audits.

Desk audits are conducted on the supporting documents requested by the IRB from selected taxpayers in relation to the taxpayers' business transactions and income tax paid. As the name suggests, field audits are usually carried out at the taxpayers' premises. However, during the Covid-19 pandemic, the IRB officers have been mainly conducting desk audits to comply with the standard procedures enforced by the Malaysian government.

The period of review for the tax audit ranges from three to five years

of assessment. Cases selected for tax audits are mainly based on risk assessment, third party information, specific industries targeted by the IRB, specific issues related to taxpayers, etc.

A tax investigation is another approach adopted by the IRB to examine documents relating to taxpayers' business and financial matters, including their personal documents. While there is a limited period of review for tax audits, there is no limitation as to the investigation period, but it normally covers five years of assessment based on the IRB's current practice.

The modus operandi of the IRB investigation officers is to carry out an inspection visit to taxpayers' business premises, residences, tax agents' premises and other related premises. Taxpayers may be chosen through a random selection and computer screening process. The basis of selection of investigation

cases includes risk analysis, insider information, intelligence information and information from other law enforcement agencies. During the Covid-19 situation, the IRB investigation officers have cancelled inspection visits. As an alternative, desk investigations which are similar to desk audits are carried out.

Taxpayers should be aware that a tax audit is merely an examination of records and does not imply that taxpayers have intentionally made errors in their income tax returns. Having said that, one should be prepared for a potential tax audit or investigation by keeping in mind the following information.

### **KEEP SUFFICIENT RECORDS FOR SEVEN YEARS**

Taxpayers are required to keep sufficient records for a period of seven years from the end of the year to

**A comparison between tax audits and tax investigations conducted by the IRB officers is as follows:**

TAX AUDIT APPROACH	DESK AUDIT	FIELD AUDIT	DESK INVESTIGATION	INVESTIGATION
REVIEW / EXAMINATION	Information relates to income and expenditure	Business records	Documents related to business and financial matters, including personal documents	Documents related to business and financial matters, including personal documents
VENUE FOR VERIFICATION OF DOCUMENTS	IRB offices	IRB offices, taxpayers' premises or other premises agreed upon	(i) IRB will issue letter to request for documents and information from taxpayers, tax agents or third parties  (ii) IRB will pay an inspection visit with written notification prior to the visit	Inspection visit in taxpayers' business premises, residences, tax agent's premises or other premises without notice in advance
NOTICE FROM IRB TO VISIT PREMISES	Yes	Yes	Yes	No
MINIMUM NUMBER OF IRB OFFICERS	1	2	2	2

Source: Crowe KL Tax Sdn Bhd.

which any income from the business or operations relates. This means keeping records in manual or electronic form to explain each transaction, that have enabled a true and fair profit and loss account and balance sheet to be prepared. Although tax audits or investigations may only involve examination of accounting records for a period of three to five years of assessment, it is mandatory for taxpayers to keep sufficient records to avoid a penalty of RM300 to RM10,000, or imprisonment of up to a term not exceeding 12 months, or both.

**SUPPORTING DOCUMENTS FOR ANY PAYMENTS MADE**

During a tax audit or investigation, the IRB officers will request for supporting documents for expenses incurred or payments made. Invoices, purchase orders, receipts or any proof of payment are essential to

substantiate the expenses claimed in the tax computation. Otherwise, the expenses claimed will be disallowed for deduction.

**PAYMENTS MADE TO NON-RESIDENTS**

The payments made to non-residents such as royalty or contract payments may be subject to withholding tax. If the payment is subject to withholding tax but no withholding tax had been deducted and remitted to the IRB previously, taxpayers are not allowed to claim tax deduction for these payments. As such, taxpayers are advised to determine the withholding tax implications for any payments made to non-residents.

**ACCRUALS OR PROVISIONS FOR EXPENSES**

The deductibility of expenses depends on the nature of expenses. If an expense is an accrual amount (an

amount set aside for a known expense) and taxpayers are able to provide the relevant invoices or other supporting documents, i.e. the final amounts are ascertainable, the expense will be allowed as a deduction. However, if the amount is merely an estimate and no supporting documents from a third party are available to prove the expense, the expense may be disallowed.

**SEGREGATION OF EXPENSES BETWEEN SEPARATE BUSINESS SOURCES**

If a business entity carries out several business activities which are distinctly different from one another and therefore treated as separate business sources for tax purposes during a year of assessment, taxpayers should be able to segregate the expenses incurred in respect of the different business sources with proper justifications. Taxpayers should take note that

different expenses may be allocated by using different bases of apportionment to ensure that allocation of expenses between different business sources is fair and reasonable.

### CAPITAL VS REVENUE

Tax authorities and taxpayers frequently have major contentions about whether a receipt is capital or revenue in nature. If a taxpayer has received a large lump sum of income during a year of assessment, it is important for the taxpayer to determine the taxability of the income received or obtain a tax opinion from a reputable tax consultant as to its tax position. An assessment of the income received based on the badges of trade or other tax principles may provide the relevant indications as to the taxability of the receipts.

### ALLOWANCE FOR DOUBTFUL DEBTS OR BAD DEBTS

It is common for business entities to make provisions for doubtful debts or write off bad debts if the trade debtors fail to settle their amounts owing due to various commercial reasons. Based on Public Ruling No. 4/2019, Tax Treatment of Wholly or Partly Irrecoverable Debts and Debt Recoveries, taxpayers are required to take reasonable steps to recover the doubtful debts or bad debts, e.g. issue letters of demand, reminder letters or other correspondences. Otherwise, the IRB may disallow the doubtful debts or bad debts recorded in the financial statements.

### DIRECT EXPENSES INCURRED IN RESPECT OF OTHER INCOME


Taxpayers may receive other income in addition to the business income from their business operations. To gain maximum deduction, taxpayers may need to identify the direct expenses incurred to generate the other income as these expenses are not allowed for



**“Taxpayers should be aware that a tax audit is merely an examination of records and does not imply that taxpayers have intentionally made errors in their income tax returns.”**

set-off against business income. Any adjusted loss (income less allowable expenses) derived from the other income is a permanent loss for taxpayers. Taxpayers will need to keep the supporting documents for direct expenses incurred because the IRB may verify these documents during a tax audit or investigation.

If the above cannot be properly substantiated during an IRB's tax audit, any adjustments made by

the IRB would result in additional tax payable and penalties being imposed under Section 113(2) of ITA. Therefore, taxpayers should consult their licenced tax agents on the taxability or deductibility of income or expenses prior to the transaction taking place or prior to submission of income tax returns. 



*Dr. Voon Yuen Hoong is an Executive Director of Crowe KL Tax Sdn Bhd.*