INLAND REVENUE BOARD OF MALAYSIA

TAX AUDIT FRAMEWORK

- FINANCE AND INSURANCE

EFFECTIVE DATE: 01 JUNE 2015

TABLE OF CONTENTS

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 the primary activity of the Inland Revenue Board of Malaysia (IRBM) which aims at enhancing voluntary compliance. 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 the IRBM to ensure that tax audit on taxpayers in the Finance and Insurance industry is carried out in a fair, transparent and impartial manner. This framework outlines the rights and responsibilities of audit officers, taxpayers and tax agents. 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.

1.4 This framework applies to the following industries:

1.4.1 Finance Industry

a. Finance Industry / Islamic Finance
Divided into two - financial institutions / Islamic finance such as commercial banks, investment banks, Islamic banks, international Islamic banks, and non-financial institutions such as development banks, agricultural banks and import – export banks.

b. Financial Intermediaries / Islamic Finance
Comprising of financial lease, factoring, credit card services, stock brokers, stocks and bonds, operational and financial control market services and other financial intermediaries.

1.4.2 Insurance Industry

a. Insurance Industry / Takaful
Consisting of composite, life and general insurance.

b. Insurance Intermediaries / Takaful
Consisting of broker, insurance adjusters (loss adjuster) and a licenced insurance agent.

2. STATUTORY PROVISIONS

2.1 The provisions of the ITA which are applicable to tax audits on the Finance and Insurance Industry are as follows:

2.1.1	Subsection 39(1A)	:	Deductions not allowed if information not provided to Director General
2.1.2	Section 60	:	Insurance business
2.1.3	Section 60A	:	Inward re-insurance: chargeable income, reduced rate and exempt dividend
2.1.4	Section 60AA	:	Takaful business
2.1.5	Section 60AB	:	Chargeable income of life fund subject to tax
2.1.6	Section 60B	:	Offshore insurance: chargeable income, reduced rate and exempt dividend
2.1.7	Section 60C	:	Banking business
2.1.8	Section 78	:	Power to call for specific returns and production of books
2.1.9	Section 79	:	Power to call for statement of bank accounts, etc
2.1.10	Section 80	:	Power of access to buildings and documents, etc
2.1.11	Section 81	:	Power to call for information

2.1.12	Section 82	:	Duty to keep records and give receipts
2.1.13	Section 99	:	Right of appeal
2.1.14	Section 100	:	Extension of time for appeal
2.1.15	Section 101	:	Review by Director General
2.1.16	Section 102	:	Disposal of appeals
2.1.17	Section 113	:	Incorrect returns
2.1.18	Section 116	:	Obstruction of officers
2.1.19	Section 119A	:	Failure to keep records
2.1.20	Section 120	:	Other offences
2.1.21	Section 138	:	Certain material to be treated as confidential
2.1.22	Section138A	:	Public rulings
2.1.23	Section 140	:	Power to disregard certain transactions
2.1.24	Section 141	:	Powers regarding certain transactions by non-residents

2.2 Statutory provisions relating to tax audits on the Finance and Insurance Industry are not only limited to the above provisions but 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 the IRBM.

3. WHAT IS TAX AUDIT?

3.1 A tax audit is an examination of a taxpayer’s business records and financial affairs to ascertain that the proper amount of income should be declared and the proper amount of tax should be calculated and paid are in accordance with tax laws and regulations. For the purpose of a tax audit, the IRBM carries out two (2) types of audit, namely desk audit and field audit.

3.1.1 **Desk Audit**

A desk audit is conducted at the IRBM's office. A taxpayer may be called for an interview at the IRBM's office if further information is required.

3.1.1.1 Desk audits involve examination on all information relating to the income, expense and various types of deductions claimed by a taxpayer in his income tax return form.

3.1.1.2 In certain circumstances, 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 how the normal process of commencing a field audit is carried out.

3.1.2 **Field Audit**

3.1.2.1 A field audit is one that takes place at a taxpayer's premises. It involves the examination of the taxpayer's business records. A taxpayer will be notified prior to the exercise of a field audit.

3.1.2.2 This framework is applicable to both types of audit, namely desk audits and field audits with the exception of visit to premises and examination of records which are only applicable to field audits.

4. OBJECTIVE OF A TAX AUDIT

4.1 The main objective of a tax audit on the Finance and Insurance Industry 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 proper amount of income has been reported and the proper amount of tax has been paid in accordance with the tax laws and regulations.

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

5. COVERED YEARS OF ASSESSMENT

5.1 Generally, a tax audit covers a period of one (1) to three (3) years of assessment, depending on the audit issues which have been identified.

5.2 However, the tax audit may be extended to cover a period of up to five (5) previous years of assessment, depending on the issues uncovered during an audit. 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. 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.

Among the basis used in selecting audit cases are as follows:

6.1.1 selection based on risk analysis;

6.2.1 information received from third party; and

6.3.1 selection based on specific issues.

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 premises.

7.1.2 Where the business premises are not suitable to carry out an audit, the taxpayer may suggest a suitable alternative with the IRBM's agreement.

7.2 Commencement of an Audit

7.2.1 A taxpayer who is selected for an audit will be notified by the IRBM through a letter of notification of audit visit. 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 the IRBM. Confirmation of 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 of notification will also indicate the records that should be made available by the taxpayer 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 Audit Manager / Director of Finance and Insurance Unit, Large Taxpayer Branch (LTB), / Director of LTB, IRBM to confirm the audit visit.

7.3 Audit Visit

7.3.1 An audit visit is only applicable to a field audit activity. The field audit visit normally starts off with a briefing regarding the company's background, business activities, accounting and record keeping system. During the briefing, the audit officer will have a clearer picture through a question and answer session.

7.3.2 During the audit process, the person responsible for handling the 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 physically examine all business records and inspect the business equipments to verify the claims made by the taxpayer. Records pertaining to the years of assessment which are already subject to limitation of time will not be examined.

7.4.2 The audit officer will not search for or take possession of any of the taxpayer's 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.

7.4.3 However, under circumstances where the work place provided by the taxpayer is not suitable or conducive to carry out the audit or where a 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 computed.

7.4.4 The documents and records to be brought back will be listed and the taxpayer may check the documents and records and make a copy of the list, if necessary.

7.4.5 Where records and books of accounts are kept in electronic form, hard copies of such records should be made available to the audit officers for examination. If at the time of the audit visit, the taxpayer is unable to provide the hard copies for examination, audit officers should be given permission and assistance to access the computer system and copy the electronic records onto tapes, hard disks or diskettes.

7.4.6 The audit officers will examine all relevant documents and records to ascertain that the correct amount of income has been reported. Generally, records consists of the following:

7.4.6.1 Business Records

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

Public ruling in relation to record keeping has been issued in the IRBM's Public Ruling No. 4/2000: Keeping Sufficient Records (Companies & Co-operatives).

7.4.7 Sections 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 Public Ruling No. 4/2000, the meaning of "records and documents" includes the following:

7.4.7.1 books of accounts which record receipts and payments or income and expenditure;

7.4.7.2 financial statements;

7.4.7.3 invoices, vouchers, receipts and other documents which are required to verify entries in the books of accounts;

7.4.7.4 documents, objects, materials, articles and things which are maintained and kept in the form of electronic medium; and

7.4.7.5 any other record as may be determined by the DGIR.

7.4.8 Failure 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 Field 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 given by the taxpayer.

7.6 Settlement of Audit

7.6.1 After concluding the audit work, the audit officer will prepare an audit findings report and acquire the Audit Manager's approval in respect of the audit issues identified.

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 the 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 through a Letter of 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; and

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, the adjustments made will be specified in the letter issued. The taxpayer will be given the opportunity to state his views and give clarifications on the audit findings and the proposed tax adjustments forwarded.

7.6.6 A taxpayer is given 21 days from the date of notification of proposed tax adjustments to file an official objection if he is dissatisfied 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 the 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 within the stipulated period as follows:

Finance / Islamic Finance	
Business Activities	**Settlement Period**
Commercial banks, investment banks, Islamic banks, International Islamic banks, and non-financial institutions such as development banks, agricultural banks, import – export banks	8 months (240 calendar days) from the commencement of the audit visit
Financial lease, factoring, credit card services, stock brokers, shares and bonds, operational and financial control services markets and other financial intermediaries	4 months (120 calendar days) from the commencement of the audit visit

Insurance / Takaful	
Business Activities	**Settlement Period**
Business Insurance and Takaful including Re-Insurance and Re-Takaful	8 months (240 calendar days) from the commencement of the audit
Business as brokers, agents and adjusters	4 months (120 calendar days) from the commencement of the audit

If there are cases which exceed the period specified above, the taxpayer will be informed by the IRBM.

7.6.10 Once the audit case is completed, 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.

8. RIGHTS AND RESPONSIBILITIES

8.1 IRBM

8.1.1 An audit officer must adhere to rules and codes of ethics drawn up by the 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 the taxpayer to give responses on issues raised; and

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 authentic identification of audit officers.

8.1.2.3 Taxpayers are advised to check with the Director of Finance and Insurance Unit, LTB if they have doubts on the authentic identification 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 who is being audited;

8.1.3.2 recommending to the 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 To be co-operative, well-mannered, fair, honest and have 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 the audit officer access to his business premises, providing information and making available documents and records required for examination;

ii. giving explanation regarding the business, 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 tools, electrical equipments, office space, furniture and providing facilities for copying of electronic records onto tapes, hard 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; and

ii. 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 A 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 / Taxpayer Representative

8.3.1 A taxpayer can request for his tax agent / representative 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 the IRBM based on the principles of integrity, accountability, transparency and social responsibility.

8.3.4 In carrying out his duties, a tax agent shall:

8.3.4.1 act professionally, be fully conversant with tax laws and practices and have integrity;

8.3.4.2 be honest, trustworthy, transparent and give fullest co-operation when dealing with the taxpayer and the IRBM such as informing the IRBM on ceasing to be the tax agent of a taxpayer and adhere to rules and guidelines laid down by the 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 (section 138 of the ITA).

8.3.5 A 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

The IRBM will ensure confidentiality of all information obtained from the taxpayer during an interview, discussion, through correspondence or examination of records and that such information 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 accordingly 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%). However, the DGIR in exercising his discretionary powers 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 Director of LTB, IRBM.

10.3 Where a taxpayer who furnishes an income tax 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 and the taxpayer 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 the Income Tax 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%
Field Audit Voluntary disclosure after the taxpayer has been informed but before commencement of examination of documents during an audit visit. **Desk Audit** Voluntary disclosure is made after a Letter to Request for Documents is	Not applicable	35%

	issued to the taxpayer and within 21 days the taxpayer has taken the following action: i. voluntarily disclose that the income, claim, relief and rebate which have been declared are false and accordingly provide the correct information together with supporting documents as evidence; and ii. voluntary disclosure is made either in writing, via the electronic media or from the interview notes at the office.		

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 Director of Finance and Insurance Unit, LTB / Director of LTB / Director of Compliance Department / Deputy Director General of Inland Revenue (Compliance) / DGIR.

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

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

11.4 The 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 Accountants / Bar Council, if tax agents or their representatives do not co-operate or behave unprofessionally, 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 the IRBM.

12.2 A taxpayer is required to make full payment of any additional taxes and penalties arising out of an audit.

12.3 If the taxpayer is unable to make full payment of tax, the IRBM may consider the taxpayer's application for settling the additional tax liability including penalty by way of instalments, for a predetermined period.

12.4 An application for payment by way of instalments must be submitted to the Director of LTB, IRBM for approval.

12.5 Where a taxpayer fails to adhere to the instalment scheme agreed upon, late payment penalty on the balance of tax outstanding will be imposed.

13. APPEALS

Sections 99 to 102 of the ITA provides an avenue for taxpayers to appeal against the assessment raised by the IRBM.

13.1 A taxpayer can appeal using Form Q against an assessment as a result of a tax audit.

13.2 A taxpayer may appeal 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 up to the highest level of appeals.

14. EFFECTIVE DATE

This framework is effective from 01 June 2015.

Director General of Inland Revenue
Malaysia

June 2015