8 Key Considerations in Tax Audits and Investigations

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2019 was a record-breaking year for the Inland Revenue Board (IRB) as it collected RM145 billion in direct taxes. This propelled the government to set a higher target of RM155 billion for 2020. However, this was before the COVID-19 outbreak, the crash in oil prices and the increasing emergence of global trade wars and tensions.

The COVID-19 outbreak led to the implementation of the Movement Control Order (MCO) and the Conditional MCO. With most companies having minimal or no business activity during the MCO, declining profits are to be expected, which in turn will lead to a direct hit on tax revenue to be collected by the IRB. Similarly, oil-related revenue will be affected by the sharp drop in Brent crude prices, thereby resulting in a lower collection of petroleum income taxes. In addition, with the global decline in demand for goods, a net exporter like Malaysia will be deeply impacted. Taxes to be collected from manufacturers will most likely also see a sharp decline in 2020.

Consequently, these events will likely spur the IRB to intensify tax collection efforts, leading to an increase in tax audits in the foreseeable future in order to meet its revenue collection target. This article will discuss the key considerations that taxpayers should be aware of in tax audits and investigations.

1. Submission of Documents During Audit

It is always prudent to cultivate the mindset that any document submitted to the authorities could be presented before the courts for tax litigation purposes in the future. Therefore, prior to handing key documents over to the IRB, taxpayers should firstly verify the accuracy and authenticity of such documents. Taxpayers should also always attempt to furnish the documents requested within the deadline given by the IRB as failure to do so may result in an assessment being issued.

The IRB has allowed extension of time where the deadline for submission of documents falls within the period of 18 March 2020 until 15 May 2020. However, this means that where the submission deadline is after 15 May 2020, taxpayers are still expected to compile and submit the documents requested by the IRB on time.

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1 Question 4 of the IRB’s “Frequently Asked Questions on Tax Matters During the Movement Control Order and the Conditional Movement Control Order Period” (18 March 2020 to 12 May 2020), updated on 29 May 2020 (IRB’s FAQ).
may be challenging for taxpayers as they would not have had access to their documents during the MCO and some businesses may still be adopting a “work from home” policy. A similar challenge may arise when the IRB requests for documents from the last three to five years, which may be voluminous.

In such circumstances, taxpayers can request for an extension of time by clearly setting out the documents requested by the IRB and the reasons for needing the extension of time to submit such documents, for example, the inability to access business premises during the MCO, or the voluminous amount of documents requested. The IRB has generally been understanding in granting extensions of time for the submission of documents, and in view of the restrictions under the MCO before they were eased, it is hard to see why such applications for extension would be refused.

It is important for taxpayers to obtain an extension of time in the event that they are unable to meet the deadline imposed by the IRB. In a tax appeal, the onus is generally on the taxpayer to prove that the IRB has failed to take into consideration all the necessary information and documentary evidence in arriving at its assessment. The courts have dismissed taxpayers’ appeals on the ground that they had not been responsive to the IRB’s queries during the course of the audit without any justification. This is notwithstanding the fact that the documents requested by the IRB may be voluminous.

2. **IRB’s Power to Request Documents**

The IRB has the power to issue a notice to request documents and information from taxpayers for audit purposes. Such power, however, is exercisable only for the purpose of ascertaining whether a person is chargeable to tax or for determining his tax liability.\(^2\) Failure to comply with a notice by the IRB to produce the documents or information without reasonable excuse is an offence punishable with a fine or imprisonment, or both.\(^3\)

There may be instances where taxpayers are unable to secure or obtain the document requested by the IRB. In such circumstances, it is imperative that they explain the reasons clearly to the IRB and outline the efforts made to obtain the documents or information. It would also be helpful if taxpayers could suggest alternative documents which may contain the information required by the IRB (e.g. a confirmation letter by a third party) when they are unable to obtain the document requested. This is to demonstrate that full cooperation had been given to the IRB and that the documents and information could not be produced for reasons beyond the taxpayer’s control.

Taxpayers have a duty to keep business records and documents for seven years, including books of accounts, invoices, vouchers and receipts. If these cannot be produced, the IRB would use the best method or approach available to determine

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\(^2\) Income Tax Act 1967 (ITA), s 78
\(^3\) Ibid, s 20
whether income has been properly reported. The method or approach adopted may, of course, be subject to challenge in court.

3. **Correspondence During Audits**

Taxpayers should be mindful of the content of their correspondences with the IRB, regardless of the form of their responses. In the event of a dispute, correspondences with the IRB will form a key part of the evidence used in court, even if a response is provided informally through email. In view of this, taxpayers should always take care to accurately set out the facts of their business or affairs and to state clearly the reasons for adopting a particular tax treatment in response to letters from the IRB. Correspondences should, therefore, be drafted in such a manner that a third party who is reading the responses alone would understand the taxpayer’s position. In particular, it is helpful to set out the legal basis when disagreeing with the IRB’s position. If multiple issues are raised, taxpayers should also address each issue clearly and separately.

Taxpayers may encounter difficulty in responding to the IRB’s letters, such as an audit findings letter or letters from the Dispute Resolution Department, within the time frame prescribed in the letters due to the complexity of the issues or the number of documents needed in order to prepare an accurate response. In such circumstances, given that responses to the IRB should be carefully drafted, taxpayers should consider applying for an extension of time to respond if they are unable to meet the deadline set by the IRB. In respect of audits during the MCO period, the IRB had previously announced that deadlines to respond to their letters which fall after 15 May 2020 will be maintained. Notwithstanding that, the IRB would likely allow an extension of time to taxpayers to provide their response if valid reasons are given.

There may be various exchanges that may take place orally between taxpayers and the IRB during the course of an audit. However, as a matter of good practice, taxpayers should always attempt to put the oral exchanges into writing so that they may be used as evidence in court should the need arise. This is because it is more difficult for taxpayers to prove a factual allegation or agreement in court in the absence of written evidence.

4. **Digital Correspondences**

As many taxpayers would likely be working from home or employing flexible working arrangements during the MCO period, correspondences with the IRB would likely be through email instead or even through messaging services such as WhatsApp. Many would also employ the use of digital or electronic signatures in such correspondences to the IRB.

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4 IRB’s Tax Audit Framework 2019 (dated 15 December 2019), para 7.4.9
5 IRB’s FAQ, supra n 1, Question 5
Taxpayers should note that electronic correspondences such as emails and text messages are all generally admissible as evidence in court. For example, s 90A of the Evidence Act 1950 provides that a document produced by a computer or the statement of facts contained therein shall be admissible as evidence of any fact stated therein, regardless of whether the person tendering the same is the maker of such document or statement, if the document was produced by the computer in the course of its ordinary use. The Special Commissioners of Income Tax (SCIT) also have wide powers to admit evidence and can admit evidence even when it may be inadmissible under the provisions of the Evidence Act 1950.\(^6\)

Hence, while emails and text messages tend to be more informal than letters, care should still be taken when responding to the IRB as these could be produced as evidence in court in the event of a tax dispute. If taxpayers are negotiating settlement with the IRB during this period, they should also ensure that their emails state that such settlement proposals are without prejudice to their right to appeal (discussed further in Items 6 and 7 below).

5. **Meetings with the IRB**

On 18 March 2020, the Royal Malaysian Customs Department (Customs) announced that all meetings pertaining to customs matters during the MCO period would be postponed unless both taxpayers and Customs agree to conduct the meeting virtually.\(^7\) The IRB did not issue a similar announcement pertaining to meetings for income tax matters. Nevertheless, the IRB officers have clarified that, similar to Customs, they would only be conducting virtual meetings during the MCO period.

Taxpayers should be mindful of the position taken during meetings with the IRB as it will be difficult to change their position in the future if the dispute proceeds to the courts. Any argument raised by taxpayers in court which is inconsistent with the position taken during the meetings may be regarded as an afterthought and, consequently, be rejected by the courts. It is therefore vital for taxpayers to ascertain the legal strategy prior to meetings with the IRB to ensure consistency in the approach towards a tax audit. It is also equally important for taxpayers to be careful not to convey any inaccurate information which may prejudice their legal position during the meetings. Whenever possible, taxpayers should minimise the number of unnecessary admissions.

Given that the answers given during the meetings may be used as evidence in the future, taxpayers should only provide answers that they are absolutely certain of. In the event that taxpayers are unsure of the question being asked or need more information to formulate an answer, they should request additional time to revert on the queries in a second meeting or via a follow-up email. It is not necessary to provide an answer there and then during the meetings when the queries were posed.

\(^6\) Paragraph 19(f), Schedule 5 of the ITA

6. Considerations for Settlement Proposals

There are various matters that taxpayers should consider when proposing a settlement offer to the IRB. For instance, to increase the likelihood of achieving a settlement with the IRB, taxpayers could set out their legal position in the settlement offer and include case law or legal authorities to support their position, as the IRB would often assess a settlement offer based on the strength of their case in the courts.

A legal position that is unsupported by case law or legal authorities would generally be less persuasive, as it is unlikely to be accepted by the courts. The legal authorities referred to in the settlement offer may be local or foreign cases. While foreign cases are not binding, they are persuasive in nature and would be given due consideration by the IRB (and the courts).

On a similar note, it is insufficient for taxpayers to set out the accounting treatment alone of a particular expenditure, receipt or asset in the settlement offer to support its tax position. While accounting principles are relevant, the proper tax treatment will depend on the legislation itself as well as case law and legal authorities.

A settlement offer may be proposed even after an appeal has been filed against an assessment issued by the IRB. However, to preserve their rights and interests during the course of the negotiations, taxpayers should ensure that the settlement offer is crafted in a way that does not amount to admission of any liability. The settlement offer should also be made on a “without prejudice” basis to ensure that it would not be used as evidence against the taxpayers in the event that negotiations are unsuccessful.

7. Effect of Settlement Offer on Other Taxable Periods

A settlement offer will generally only cover settlement of the sum payable for the taxable period specified under an assessment issued by the IRB. Depending on the manner in which it is drafted, a settlement offer will not preclude the IRB from issuing further assessments based on similar issues for other taxable periods. This is particularly when the settlement offer is made on a “without prejudice” basis.

In the circumstances, it would be prudent for taxpayers to obtain the IRB’s agreement to the legal position adopted when negotiating a settlement. This further underlines the importance for taxpayers to set out the relevant case laws and legal authorities in the settlement offer. Once the IRB has accepted the taxpayers’ legal position, it is unlikely that they would raise similar issues again in the future. The wording of the settlement proposal should also be couched in a manner which brings finality to the issues at hand.

Nevertheless, in the unfortunate event that the IRB raises the same issue in respect of other taxable periods after a settlement agreement has been finalised, taxpayers may attempt to challenge the assessment on the basis that they should not be subject to repeated audits for the same issue.
8. Preliminary Audit Findings

The tax authorities would generally conduct various meetings with taxpayers in the course of an audit. During the meetings, it is important for taxpayers to understand the basis and factual circumstances upon which the tax authorities may issue an assessment. If possible, taxpayers should request a preliminary audit finding to be issued by the IRB during the course of an audit. A preliminary audit finding is merely a statement by the IRB setting out the discrepancies (if any) identified during the course of the audit — it would not give rise to any tax liability in itself.

There are advantages to receiving a preliminary audit findings from the IRB. Firstly, it is a good indication of the tax authorities’ position on whether an assessment will be raised. It therefore allows taxpayers to attend to the necessary (such as seeking professional advice) in anticipation of an assessment being issued. Secondly, the findings enable taxpayers to present their explanation and arguments (preferably from the legal standpoint) on the discrepancies identified by the IRB prior to any assessment being issued. This is important as once an assessment is issued, taxpayers would generally only have 30 days to make payment of the amount assessed, regardless if there is an appeal, unless a stay order is obtained from the courts.

If you have any queries, please contact the authors or Tax, SST & Customs partners, Dato' Nitin Nadkarni and Jason Tan Jia Xin, at tax@lh-ag.com