

## Asian Development Policy Review

ISSN(e): 2313-8343

ISSN(p): 2518-2544

DOI: 10.18488/journal.107/2016.4.4/107.4.143.149

Vol. 4, No. 4, 143-149

© 2016 AEISS Publications. All Rights Reserved.

URL: [www.aessweb.com](http://www.aessweb.com)

## TAX COMPLIANCE AUDIT: THE PERSPECTIVES OF TAX AUDITORS IN MALAYSIA



Gholam Reza Zandi<sup>1+</sup>  
Abdulrahman Sultan  
M Elwahi<sup>2</sup>

<sup>1</sup>Associate Professor, Business School, Universiti Kuala Lumpur, Malaysia.

<sup>2</sup>Ph.D. Candidate, Segi University, Malaysia.

(+ Corresponding author)

### ABSTRACT

#### Article History

Received: 19 November 2016

Revised: 22 December 2016

Accepted: 27 December 2016

Published: 30 December 2016

#### Keywords

Tax compliance  
Tax audit  
Quantitative method  
IRBM.

The objective of this paper is to provide an introduction to a tax compliance audit, its processes and problems. Based on the auditor's perspective regarding tax compliance audits in Malaysia the data gathered and was analyzed. The information collected was strictly based on the viewpoint of tax auditors in Malaysia. The data was gathered from a secondary source and the research methodology was done on a basis of quantitative research based methodology. The Malaysian Inland Revenue Board (IRBM) has significantly increased their focus on tax audits and tax investigations over the past few years. The IRBM recently issued a revised framework for tax audits which replaced the previous tax audit framework. Though the previous tax audit framework was still applicable for petroleum income tax and transfer pricing audits.

**Contribution/ Originality:** This study is one of very few studies which have investigated tax audit as a part of the compliance system under the SAS. The IRBM may rely on certain criteria such as industry focus, period since last audit, geographical location and other criteria in selecting companies for tax audits. This research study contributes in the existing literature that tax audit involves various interrelated parts that need to be well understood in order to deal with the entire tax audit process effectively and efficiently.

## 1. INTRODUCTION

A tax audit involves an independent test of the returns handed over by taxpayers to the tax office to represent the tax compliance. The role of an audit program in a modern tax administration extends beyond merely collecting tax revenue (Biber, 2010). Besides having a comprehensive legal framework, a well-defined organizational and management process, and a compliant taxpayer, the effectiveness of tax audit programs also depends on the actions and reactions of tax auditors to the actual tax audit environment (Long and Swingen, 1991; Bahl and Bird, 2008).

A tax audit under the provisions of section 44AB of the Income Tax Act, 1961 in Malaysia is defined as an equitable, fair and transparent tax administration by which the public's confidence enhanced in the tax governance.

Tax compliance regulations must be installed in a way any non-compliance and tax evasion should be prosecuted based on the Malaysian Income Tax Act 1967 (ITA). According to the Malaysian Self-Assessment System, the tax audit set as the critical task of the Inland Revenue Board of Malaysia (IRBM). The voluntary

compliance with the tax regulations is encouraged in the ITA. Tax audit include every taxpayer at any time and it does not present taxpayer who is under audit has done an offence. The IRBM has designed a framework to secure tax audits are run in a transparent, effective and fair way. It presents the duties and responsibilities of tax auditors, taxpayers. The concept will help tax auditor to perform their duties efficiently and will lead taxpayers for compliance.

Tax audit needs an examination of a taxpayer's personal and businesses transactions to ensure the fair amount of income is declared and the proper amount of tax is charged accordingly.

During a tax audit, the IRBM will check the taxpayer's financial issues to ensure the fair tax amount is paid and that the taxpayers are complying with the tax rules and legislation. With the introduction of the Self-Assessment System (SAS), taxpayers are expected to file their tax returns correctly and accurately while the relevant supporting documentation should be kept for future verification by the IRBM.

## **2. PROCESSES AND ISSUES IDENTIFIED UNDER A TAX AUDIT**

All companies will be tax audited at some points as tax audit is a part of the compliance system under the SAS. The IRBM may rely on certain criteria such as industry focus, period since last audit, geographical location and other criteria in selecting companies for tax audits.

### *2.1. The Audit Process*

#### *2.1.1. The Conduct of an Audit*

A tax audit involves various interrelated parts that need to be well understood in order for one to deal with the entire process effectively and efficiently:

#### *2.1.2. Prior to the Tax Audit*

Taxpayers' tax returns and tax files are allocated to the IRB auditor assigned to the case. The auditor may review the taxpayer's background and financial information to gather certain facts and data to enable them to identify some key focus areas. This data may be from the taxpayer's own records or from public sources. Closer to the tax field audit visit, the IRB may request for further financial or company information to be provided to them.

### *2.2. The Tax Audit*

The IRB will normally conduct an audit visit for 2 or 3 days at the taxpayer's premise and may extend the period in more complex cases. During the audit visit, the taxpayer's records are checked and interviews are conducted.

### *2.3. Post Tax Audit*

Following the audit visit, the IRB will review the documents obtained during the visit and may request for additional documents and information. The auditor may then document the audit findings or request additional information. Specific tax issues may be raised or clarification sought.

### *2.4. Some of the Common Tax Issues Identified by the Tax Auditors (From the Perspective of Tax Auditors)*

- Deductibility of expenditure: A common problem faced by taxpayers is the availability of documentation to support an expenditure.
- Incentive claims: Taxpayers need to ensure that they are eligible for the incentive, able to substantiate the incentive claims made over the period, and that the relevant documentation is available.
- Withholding tax: In managing withholding tax issues, taxpayers need to be aware of the position adopted on the payments to non-residents.

- Loss making companies: Companies making a loss may also be chosen for audits, especially if they show losses over several consecutive years.
- Taxpayers' disputes: If taxpayer disagrees with the result of audit, it can be first sent to the IRBM to review. The IRB will re-audit and if after the reassessment the IRB rejects the appeal, the taxpayer can raise the issue to the Malaysian Special Commissioner of Income Tax.
- Withholding documentation or information: Refusal and delay to provide the relevant documents and accounting books or other records that are required by the tax auditor, ignorance and a lack of assistance to the tax auditor are also an offense.

### *2.5. Discussion on the Issues Identified*

The length of time taken for a discussion with the IRBM could vary depending on the complexity of the issues raised and the availability of the supporting documentation. This step is crucial as it can lead to either a satisfactory conclusion for the taxpayer, or can result in differing opinions developing between the IRBM and the taxpayer. In order to achieve a satisfactory result, a taxpayer needs to understand the issues raised by the IRBM. The taxpayer should provide the necessary information and documentation needed to address the specific matters raised. It is also necessary to communicate the technical positions adopted by the taxpayer, supported with the relevant legislation. All incomes should be declared and all statements of income should be retained, as well as all expenditure receipts relevant to deduction claims for the last seven years.

### *2.6. Tax Developments*

#### *2.6.1. Public Rulings*

Public rulings are issued by the IRBM to provide guidance for the public and the officers of the Inland Revenue Board. In a tax audit, the IRBM will adopt positions that are in accordance with the Public Rulings as they are binding on the IRBM but not on the taxpayers, since Public Rulings are not legislation. However, taxpayers should have reasonable legal grounds to support their positions which are different from that of the Public Ruling.

#### *2.6.2. The Tax Audit Framework*

The Tax Audit Framework was first introduced on January 1st, 2007 and the updated Framework was issued on January 1st, 2009. The Framework was introduced to address concerns and questions raised by the taxpayers about the reasoning and the methods that the IRBM were conducting tax audits.

#### *2.6.3. Penalties*

Upon submission of the tax return, for any subsequent amendments which result in additional tax liabilities, a penalty will be equal to the amount of tax undercharged (100%) imposed. If there is a discovery of an omission and understatement of revenue, there will be an additional tax liability under Sec. 113(2) of ITA. The IRBM may charge a lower penalty rate of 45% for the first offence.

For repeated offences, the penalty rate will be increased by 10% with compared to the last penalty rate charged for the previous offence. This is however, limited to a sum of not above 100% of the amount of tax undercharged. A penalty of between 10% and 30% may be imposed for voluntary disclosure by the taxpayer prior to the case being selected for an audit. A penalty of 35% could be enforced before the commencement of the audit, but after the taxpayer has been informed. The question here is whether the penalty under Sec. 113(2) of ITA should be imposed in instances where the taxpayer has acted in good faith. During an audit, the burden of proof lies with the taxpayer and it is important for taxpayers to show that they have acted in good faith on the positions adopted in their tax returns.

Tax audits are a common event and are conducted by the IRBM in an organized and orderly fashion. The aim is to ensure that taxpayers pay their taxes correctly. However, there are instances where tax adjustments imposed by the IRBM can lead to differences in opinion resulting in appeals to the IRB or to the courts. It would be preferable that the IRBM be somewhat flexible, to listen to the viewpoints expressed by the taxpayers on their interpretation of the law, and to provide greater leeway in terms of documentation and evidence to support the positions adopted by taxpayers. Taking a rigid position may result in greater tax collection but in the long run such actions could be viewed by the business community and the general public negatively.

### 3. LITERATURE REVIEW

The way in which tax auditors interact with taxpayers during an audit may affect their compliance in the future. For example, if taxpayers are treated respectfully during an audit, taxpayers may have a more motivation to comply voluntarily and if taxpayers trust the tax auditors, taxpayers will likely comply voluntarily with the auditor's requirements (Isa and Pope, 2010). The particular impact of assessment audits alludes to an increase of intentional compliance by guaranteeing that audited taxpayers consent to the procurement of the present day laws and regulations. The unique deterrent effect of tax audits shows more voluntary compliance by leading taxpayers whom were audited, toward the current tax laws and regulations. Tax audits help the auditors to teach taxpayers on the application of tax laws and regulations. This will improve record-keeping and to identify areas of tax rules which taxpayers may be unaware of it Organization for Economic Cooperation and Development (2006). According to a survey in Malaysia, it showed that among business taxpayers more than 50 percent seemed to have a misunderstandings that tax audits were either set to recover more tax or noncompliance punishments (Choong and Ling, 2008). In addition, assessment audits permit and encourage auditors to educate the taxpayers on the utilization of duty laws, to identify changes needed for record-keeping, and to distinguish regions of expense laws on which taxpayers need illumination (OECD, 2006). However, a study of business taxpayers in Malaysia demonstrates that more than 50 percent of their respondents appeared to have been misguided. From their perspective, duty audits are either expected to identify assessment, to recover more duty, or to punish noncompliance (Choong and Ling, 2008). The route which instructs auditors to collaborate with taxpayers during an audit may impact the compliance and conduct of the taxpayers later. For instance, if taxpayers are approached with respect during an audit, taxpayers may be more motivated and likely to comply intentionally (Isa and Pope, 2010).

## 4. TAX PRACTITIONERS' PERCEPTION ON TAX AUDITS: SURVEY EVIDENCE IN MALAYSIA

### 4.1. Methodology

This study is based on secondary data which adopts a quantitative methodology as its research approach and is based on quantifiable data and extends its results. We also consider the prevalence of different opinions and views in our sample. A survey should include a pretest and a pilot test before being distributed to potential respondents (Hair *et al.*, 2007).

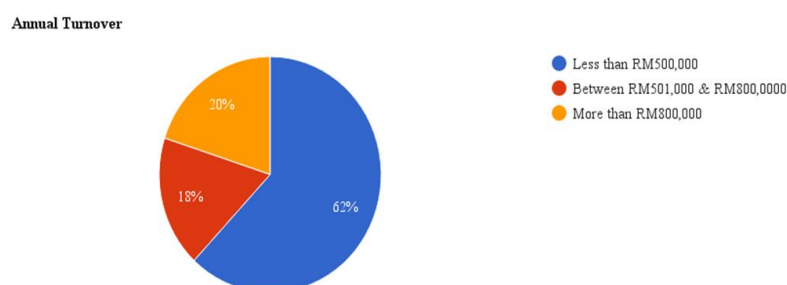


Figure-1. Annual Turnover

A questionnaire was designed to collect data involving three sampling methods of stratified random, random and snowball. A snowball sampling involves a series of referrals which are made within a circle of people who may know each other (Biernacki and Waldorf, 1981).

The 146 questionnaires were sent to the CFOs of different industries located in Selangor in August 2014. A total of 84 CFOs responded. The questionnaires filled by the CFOs included of 31% of service companies, 67% merchandizing and 2% manufacturing industries. About 62% of the companies indicated that their business' annual turnover was less than RM500,000. 18% of businesses earned between RM500,001 and RM800,000. The remaining 20% were generating an annual turnover above RM800,000.

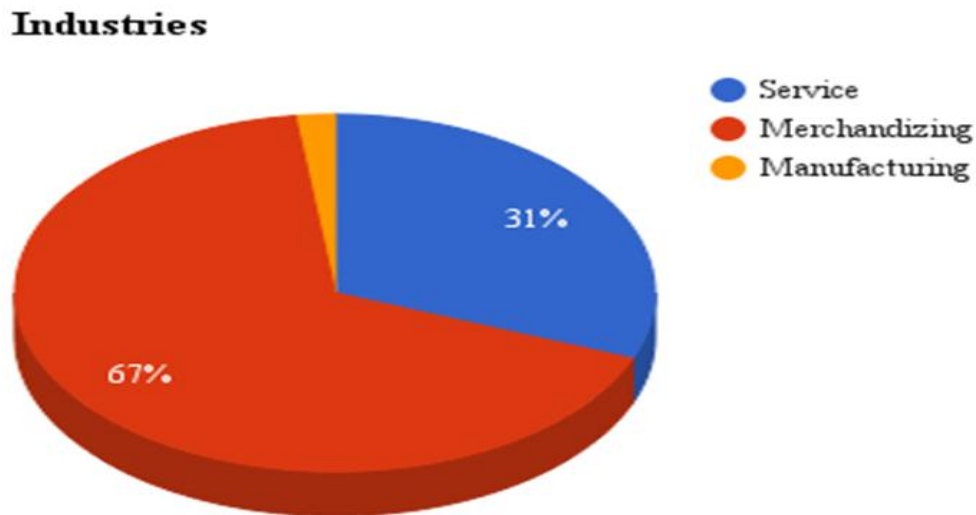


Figure-2. Industries in Selangor

#### 4.2. Observations and Findings

According to the survey's results, 70% of CFOs looked at tax audits as a process for more tax recovery or a threat. According to the CFOs, the tax auditors look at the clients as tax evasion doers and the audit is only to capture the fraudsters. According to Choong and Ling (2008) more educational tax campaigns in the mass media are needed to educate the Malaysian tax paying public on the primary objectives of tax audits.

Regarding the importance of bookkeeping and taxpayer emphasized by the IRBM, the survey found that 72.4% of the CFOs were not aware that businesses had to be collected and journalized in less than 2 months. This represents that SMEs taxpayers set their businesses' book keeping as the last priority. Some small businessmen employed part-time bookkeepers to do the record keeping and accounting (Choong and Ling, 2008).

All 84 CFOs, 100% agreed with the tax audits as a necessary tools for avoiding tax evasion. They were concerned of professionalism of tax auditors who did not act professionally in the course of the tax audit.

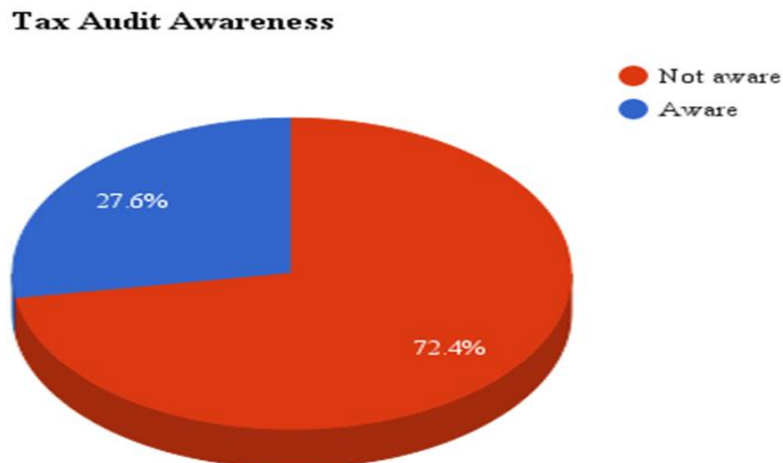


Figure-3. Tax Audit Awareness

## Tax Audit Perspective

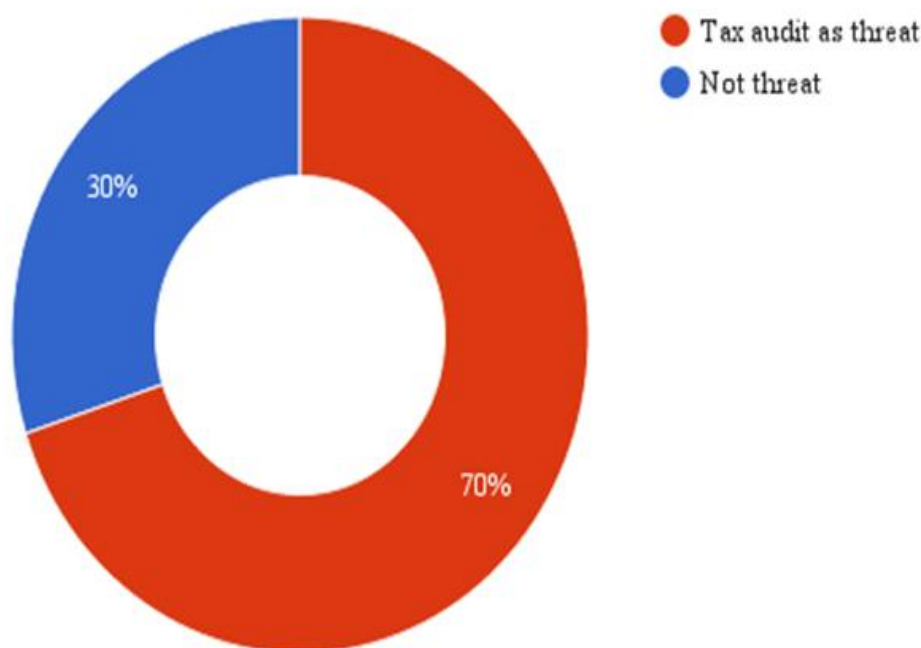


Figure-4. Tax Audit as threat

## 5. CONCLUSION

The IRBM should treat taxpayers equally but if finds any non-compliance from some delinquent taxpayers, it should track them down otherwise inequity treatment by IRBM will discourage majority who pay their taxes promptly and in full. If the IRBM administrates tax audits more effectively, it encourages many taxpayers toward full compliance if it brings fewer deadbeats who evades tax.

This survey found that the majority of the CFOs looked at tax audits as more tax recovery and a prosecution threat in case of tax evasion. It sounds that Malaysian CFOs are not well educated and ready for setting tax budgets and tax planning though the SAS started long time ago in 2001 in Malaysia. They may carry a low tax education and tax systematic planning and training. This calls for more improvements and requirements set to CFOs by the IRBM.

Funding: This study received no specific financial support.

Competing Interests: The authors declare that they have no competing interests.

Contributors/Acknowledgement: All authors contributed equally to the conception and design of the study.

## REFERENCES

- Bahl, R. and R. Bird, 2008. Subnational taxes in developing countries: The way forward. *Public Budgeting & Finance*, 28(4): 1-25. [View at Google Scholar](#) | [View at Publisher](#)
- Biber, E., 2010. Revenue administration: Taxpayer audit- development of effective plans. *Bulletin of International Monetary Fund Fiscal Affairs Department*.
- Biernacki, P. and D. Waldorf, 1981. Snowball sampling: Problems and techniques of chain referral sampling. *Sociological Methods & Research*, 10(2): 141-163. [View at Google Scholar](#)
- Choong, K.F. and L.M. Ling, 2008. Tax practitioners' perception on tax audit and tax evasion: Survey evidence in Malaysia. *The 8th International Business Research Conference*, Dubai.
- Hair, J.F., A.M. Money, P. Samouel and M. Page, 2007. *Research methods for business*. West Sussex: Wiley & Sons Ltd.

- Isa, K. and J. Pope, 2010. Corporate taxpayers' compliance variables: Findings from a study of focus groups in Malaysia. International Tax Administration: Building Bridges, K. Datt, B. Tran-Nam, and K. Bain, Editors, 132-152.
- Long, S.B. and J.A. Swingen, 1991. Taxpayer compliance: Setting new agendas for research. Law & Society Review, 25(3): 637-683.
- OECD, 2006. Strengthening tax audit capabilities: Auditor workforce management - survey findings and observations. Centre for tax policy and administration. Paris: OECD.

*Views and opinions expressed in this article are the views and opinions of the author(s), Asian Development Policy Review shall not be responsible or answerable for any loss, damage or liability etc. caused in relation to/arising out of the use of the content.*