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### **Tax Audit Framework for the Finance and Insurance Industry**

The Inland Revenue Board of Malaysia (**IRB**) recently issued the Tax Audit Framework (Finance and Insurance), which is effective from 18.11.2020, to bring the IRB's audit framework for the finance and insurance industry up to date with the IRB's general Tax Audit Framework issued on 15.12.2019.

#### **Applicable persons**

As the name suggests, this framework is applicable to the finance and insurance industry, which has been revised to include:

##### *Industry*

- Financial/Islamic finance institutions licensed under the Financial Services Act 2013 (**FSA**), Islamic Financial Services Act 2013 (**IFSA**), or the Development Financial Institutions Act 2002
- Life insurance/takaful operators and general insurance/takaful operators licensed under the FSA or IFSA (*including reinsurance and retakaful companies*)

##### *Intermediaries*

- Financial/Islamic finance: financial leasing, factoring, credit card services, stockbrokers, operations and financial market control services and others
- Insurance/Takaful: insurance/takaful brokerage companies, insurance/takaful (loss adjuster) licensed insurance/takaful agent companies, registered and licensed by Bank Negara Malaysia

#### **Pertinent areas**

##### *Initial audit stage*



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The IRB will issue a “Request for Documents and Information Letter”, to which the taxpayer must provide feedback within 14 days. For field audits at the taxpayer’s premises, the IRB will issue a “Compliance Visit Notification Letter” outlining the particulars, at least 14 days before the visit. The taxpayer can apply for a postponement of such visit based on reasonable grounds and unavoidable circumstances.

For desk audits, a “Letter of Determination of Commencement of Case Settlement Period” will be provided to inform the commencement date of the audit case settlement period, i.e. the time period for the audit exercise to be resolved.

#### *Audit visit*

The audit officer is required to provide all relevant particulars to the taxpayer, including self-identification information, his or her right to have full and free access to the taxpayer’s buildings and documents, and the taxpayer’s rights and responsibilities. The review should not involve records for expired years of assessment.

For the collection of original documents, the audit officer must provide a list and an acknowledgment of receipt of the documents collected. This list shall be signed by the audit officer and the taxpayer. Although the framework is silent on the requirement of such list for copies of documents and records (either physically or electronically) collected by the audit officer, it is advisable for taxpayers to request for the list to be provided if possible.

#### *Audit settlement*

After the audit visit, taxpayers can provide clarification to the audit officers on the audit issues raised. Thereafter, the taxpayer will be notified of the audit issues together with the reasons and rationale through a *Surat Penemuan Semakan Kes*.

The taxpayer now only has 18 days (*previously 21*) to object to any findings by the audit officer.

Thereafter, a *Case Settlement Letter* containing the amount of income, tax and penalty adjustments (if any) will be issued, followed by the raising of assessments.

#### *Penalties*

Under the framework, the general penalty rate under s 113(2) of the Income Tax Act 1967 (**ITA**) is fixed at 45%, which can be reduced or waived based on the Director General of Inland Revenue’s discretion. Repeated offenders will be subject to a penalty rate of 55%.

Concessionary penalty rates for voluntary disclosures made before an audit commences, i.e. before the issuance of the “Request for Documents and Information Letter”, are fixed between 10% and 35.5%.

#### *Settlement period*

Audit cases are to be resolved within the following settlement period:

Finance/Islamic Finance &  
Insurance/Takaful Industry: **240** calendar days\*

Finance/Islamic Finance &  
Insurance/Takaful Intermediaries: **90** calendar days\*

*\*Field audits: starting from date of audit visit*

*Desk audits: starting from the date of “Letter of Determination of Commencement of Case Settlement Period”*

#### **Our observations**

In short, this framework is intended to inform the finance and insurance industry of the IRB’s updated practices and procedures in audits conducted on the industry, and to align it with the general audit framework issued in 2019. However, several key differences are noted:

- (a) The IRB may visit any of the taxpayer’s premises or related premises through advance notice;
- (b) The IRB may extend its audit examination to the taxpayer’s related/controlled business or companies;
- (c) For audits conducted on intermediary companies, the settlement period has been shortened to 90 days as compared to four months previously;
- (d) The IRB’s audit finding letter (*Surat Penemuan Semakan Kes*) may not contain the amount of proposed tax adjustments and will only be included in the final “Case Settlement Letter”; and
- (e) Taxpayers have a shorter time frame to object to the IRB’s audit findings, i.e. 18 days as compared to 21 days previously.

As can be seen, the IRB will be extending the exercise of its powers by seeking access to taxpayers’ related companies’ premises and records for the purposes of its audit. Further, taxpayers are given a relatively shorter period to formulate any response or objections to the IRB’s findings. Given the

complexity of the issues specific to the finance and insurance industry, as well as the volume of documents to be prepared, the removal of these three days is not without detrimental effect, especially when these responses may be used as evidence in subsequent dispute proceedings.

On this note, it is observed that any proposed tax adjustments will no longer be provided to taxpayers until the final stage of the audit, i.e. the issuance of a final “Case Settlement Letter” before the raising of any assessments. In this respect, taxpayers may be unfairly prejudiced as they are unable to scrutinise the workings or calculations by the IRB for any possible error while formulating their response. Therefore, it is important for taxpayers to be aware of their rights during an audit exercise: For more information on this, please see [“8 Key Considerations in Tax Audits and Investigations”](#).

## Conclusion

Prior to the release of this framework, the finance and insurance industry appeared to be a prime target of the IRB’s audit exercise due to the expected lower tax collections. In this respect, the IRB has adopted a restrictive interpretation of the relevant provisions of the ITA and raised numerous issues, including the disallowances of certain deductions specific to the industries and capital allowances for capital assets held by the companies. Therefore, it is foreseen that this trend will continue in 2021 and those in the finance and insurance industry should seek professional tax advice and adopt pre-emptive measures to mitigate any unnecessary exposure.

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