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NO GUESSING IN ASSESSING: HIGH COURT HELD THAT REASONS MATTER IN TAX AUDITS

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In a recent decision, the High Court in ***Chiong Kiau v Director General of Inland Revenue & 2 Other Cases*** quashed notices of additional assessment issued by the Inland Revenue Board (“IRB”) against three taxpayers in respect of alleged under-declared income.

The decision is significant for taxpayers because it reaffirms a practical but important point: where the IRB rejects a taxpayer’s explanations and supporting documents during an audit, it must identify the specific concerns, explain the basis of its position, and give the taxpayer a meaningful opportunity to respond. It is not sufficient for the IRB to rely on broad assertions that transactions are “suspicious” or that documents are insufficient without explaining why.

Background

The Applicants were shareholders and directors of several companies in the oil palm and related businesses. They had received dividends from these companies which were

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exempt from tax in their hands under Section 127(1) of the Income Tax Act 1967 (“ITA”) read together with paragraph 12B of Schedule 6 to the ITA.

During the audit, the Applicants submitted capital statements, dividend warrants and supporting documents to explain the source of the disputed receipts. However, the IRB rejected the explanations and proceeded to issue notices of additional assessment for the years of assessment 2018 to 2022.

High Court’s Decision

The High Court held that the IRB’s decision-making process was procedurally unfair and in breach of natural justice.

A key point in the judgment was that the IRB had not identified the specific transactions which were allegedly objectionable, nor explained why the supporting documents provided by the taxpayer were inadequate. Instead, the IRB merely stated that the adjustments were based on “estimation”, that there were insufficient supporting documents, and later concluded that the transactions were “meragukan”.

The Court held that this fell short of the standards expected of a statutory decision-maker exercising coercive powers under the ITA. Procedural fairness is not measured by the volume of correspondence exchanged. What matters is whether the taxpayer was given a genuine opportunity to understand and answer the case against him. On the facts, the taxpayer had repeatedly sought clarification and expressed his willingness to provide further documents, but the IRB proceeded to issue the assessments without identifying the specific matters requiring explanation.

The High Court also held that the IRB cannot, through an administrative assessment, bring exempt income back within the tax net. Where Parliament has expressly exempted a category of income from tax, the IRB has no jurisdiction to assess that income as taxable. In this case, if the receipts were indeed single-tier dividends falling within paragraph 12B of Schedule 6 to the ITA, the exemption operated as a matter of law.

Accordingly, the High Court quashed the notices of additional assessment and granted declarations, among others, that the IRB is required to comply with procedural fairness when exercising its statutory powers under the ITA, including the duty to provide adequate reasons and to afford affected taxpayers a meaningful right to be heard.

Why This Matters to Taxpayers

This decision is a useful reminder that a tax audit should not be a guessing game.

Where the IRB takes issue with a taxpayer’s explanation, the taxpayer should be told, with sufficient clarity, what the alleged issue is. A taxpayer cannot meaningfully respond if the IRB does not identify the specific transactions in dispute, the alleged deficiencies in the documents provided, or the basis on which the IRB proposes to make an adjustment.

For taxpayers undergoing an audit, the decision highlights the importance of:

1. maintaining proper supporting documents;
2. submitting explanations and documents in writing;
3. requesting the IRB's reasons where explanations or documents are rejected;
4. asking the IRB to identify the specific transactions or issues in dispute; and
5. keeping a clear record of all audit correspondence.

This decision affirms that when exercising audit and assessment powers, the IRB must engage with the taxpayer's explanations in substance, not merely in form.

LHAG Comments

The decision is a timely affirmation that procedural fairness remains an important safeguard in tax administration. The IRB is not prevented from conducting audits or raising assessments where justified. However, where serious adverse consequences are imposed on a taxpayer, the decision-making process must be fair, reasoned and grounded in the material before the authority.

In practical terms, taxpayers should not be left to guess the basis of an assessment. If the IRB considers a transaction to be suspicious, unsupported or taxable, it should say why. A broad statement that documents are insufficient, without more, may not be enough.

The decision is also a reminder that judicial review remains available in appropriate tax cases. While taxpayers are ordinarily expected to pursue the statutory appeal route, judicial review may be invoked where the complaint concerns the legality of the IRB's decision-making process, such as breach of natural justice, lack of jurisdiction, error of law or irrationality.

The Grounds of Judgment are accessible [here](#).

The taxpayers were successfully represented by our Consultant, **Dato' Nitin Nadkarni**, our Partner, **Jason Tan Jia Xin**, and our Senior Associate, **Jay Fong Jia Sheng**.

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