CHAPTER 2

SELF-ASSESSMENT SYSTEM AND SECTION 114(1A)

Improving Tax Administration

The tax system of a country should reflect the social, economic and political aims of the Government, and the administrative machinery should be able to implement it equitably and efficiently. If the tax administration becomes more effective, the policy-makers in government can resort to a wider option and explore various combinations of measures. If the administration remains inadequate, the policy must of itself be inadequate in that only the less sophisticated alternatives are practically available. If the administration is so weak that the evasion rate is extremely high, then the policy decisions become basically an exercise in futility. Tax administration, therefore is the key to effective tax policy rather than the reverse (Singh 1999).

To realize the above objective, the Inland Revenue Board of Malaysia (IRB) introduced for the first time, a five year Corporate Plan for the period 1993 to 1997. In planning to achieve the objective of administering a tax system which is effective and fair, some of the strategic steps which were planned for the five year period include:

- The introduction of a Self-assessment System
- Clearing of backlog of assessment work
- Modernizing the collection system and reducing arrears of tax
- Simplifying tax laws

1 Jabatan Hasil Dalam Negeri, Malaysia, Perancangan Korporat 1993-1997 (Pencetakan Nasional Malaysia Berhad), 1993
Chapter 2: Self-Assessment System and Section 114(1A)

- Creating an effective data base system
- Setting up of new branch offices
- Greater usage of Information Technology.

The Present System

Under the present tax system, IRB adopts a Formal Assessment System, also know as the Official Assessment System (OAS), where taxpayers are required to submit their returns within 30 days from the date of service. The general issue of returns to all taxpayers is normally in February of each year. Upon submission of completed tax returns, the Director-General of the Inland Revenue has the option under the Income Tax Act, 1967 to accept the returns as per submission or if he has reason to believe that the returns do not reflect the taxpayers' true situation, reject them and make assessments based on the chargeable incomes determined to the best of his judgement. No penalties are imposed on the taxpayers for such assessments. Where a person who has not submitted a return is chargeable to tax fails to submit a return, the Director-General may raise a 'best judgement assessment' based on the information available. Such an assessment is also known as an estimated assessment where penalties will be imposed for non-compliance with the law relating to submission of returns. The making of such an assessment does not absolve the duties of the taxpayer under the law, i.e. a proper return must still be submitted by the taxpayer.

Objections to an assessment have to be made in writing within 30 days from the date of service of the notice of assessment. Failure to do so may render it final and conclusive. Upon an appeal, if the Director-General and the taxpayer cannot come to an agreement, the taxpayer can appeal to the Special Commissioners of Income Tax and then to the Courts.

Prelude to SAS
In view of the far-reaching implications of the self-assessment system (SAS), it was pertinent for the government to undertake serious evaluations of such systems in other countries. Self-assessment systems have been introduced in many developed countries. The government was unable to realize the corporate plan stated above within the five-year period. However policy studies must have continued as the seriousness of the government was reported by the Media\textsuperscript{2}. It was reported in 1997 "the government is seriously considering to implement the self-assessment system within the next two years to replace the arduous and uneconomic process of examining all returns and to simplify the work procedures".

Since then speculation was rife as to the mode and format of SAS in Malaysia. It was also opined that the SAS is, to all intents and purposes, a privatisation of the process of tax computations. Hence, the SAS will only work effectively with the assistance and the co-operation of tax return preparers. It was suggested, ideally for an effective implementation of the SAS, self-assessment should be introduced in stages, starting with companies followed by wage earners\textsuperscript{3}. Such a phased introduction has finally seen the light of the day.

**What is the Self-Assessment System?**

Self-assessment refers to the evaluation process undertaken by an individual by himself or herself. In respect to income taxation, self-assessment refers to the process undertaken by taxpayers to assess their own tax payable for a particular year of assessment. The functions of self-assessment have been outlined by Barr, et. al. (1977), as two fold, that is the primary and secondary functions. The primary functions, according to the authors are those that are logically essential to the operation of income tax, such as:

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\textsuperscript{2} The STAR, (24.7.1997)
\textsuperscript{3} Kasipillai, 1997
• The calculation of total income
• The calculation of total-tax free income
• The calculation of total taxable income, and
• The calculation of tax payable.

The above-mentioned primary functions are the responsibility of the taxpayers. In a self-assessment system, it is the responsibility of the taxpayers to compute the tax payable and remit the computed amount or wait for a refund. The tax administration must carry out its work efficiently in order to ensure the accuracy of the tax returns and make refunds (where necessary) promptly.

The secondary functions are not logically necessary for the implementation of the Income Tax Act, but are needed in practice as an aid to the primary functions. These secondary functions are the responsibilities of the IRB. In a self-assessment system, the taxpayer is required by law to calculate his own liabilities for a taxation year. A return must be forwarded to the tax authorities filed in accordance with the required standard of compliance by a due date or dates and the failure to furnish such returns and/or required information will attract penalties. Under the full self-assessment system, the taxpayer not only calculates the taxable income but also the tax payable and makes payment at the time of lodgement of the return.

A full self-assessment is a system based on minimum intervention by the tax authority. However, there is no such thing as an absolute self-assessment system (Kasipillai 1999). An absolute SAS would be one where the taxpayers' returns are not at all checked. Under the existing system, known as the Official Assessment System, every piece of information provided by the taxpayers is validated by the tax authorities. Countries that have introduced a SAS vary in the relative extent of responsibility between the taxpayer and the Revenue authorities in assessing the returns. Tax authorities too differ in the extent of
returns that are reviewed to detect for mistakes and the severity of random audits.

About 20 countries around the world have adopted the self-assessment system. The more recent ones being UK (1996-1997), New Zealand (1988) and Australia (1986-1987). Among the developing countries are Sri Lanka (1972) and Pakistan (1979) and Indonesia (1984). This move towards self-assessment system generally reflects a common tax administrative measure to overcome issues and problems facing the tax administrators.

The main objective for the introduction of the self-assessment system in many of these countries are namely:-

- To encourage greater voluntary compliance by taxpayers;
- Cost effective use of resources by the Revenue authority;
- To ensure greater uniformity of performance of assessment branches and;
- To improve and increase revenue collection

The change to self-assessment system in these countries, though initiated by similar reasons, may not necessarily be implemented exactly in the same manner. More often than not the self-assessment system is implemented in phases over a period of four to five years. Principally it covers the areas of assessment, collection and audit enforcement. The development of a self-assessment system very often takes place in an I.T. environment where computerisation of traditional core functions of the tax administration, plays an important role.
Weaknesses in the Official Assessment System

The main weaknesses of the existing tax system are reviewed under the following sub-headings:

- Low compliance level
- Backlog of unassessed cases
- Perception of fairness and taxpayer grievances
- Inadequate enforcement strategies

Low Compliance Level

Although the attributes of tax compliance are many fold, commentators on Malaysian taxation and the IRB have resorted to a narrow scope in reviewing tax compliance. For instance, the compliance level has been confined to aspects such as the percentage of taxpayers who are issued returns, submit the completed returns to IRB, number of taxpayers who are investigated or audited. The actual extent of non-compliance in Malaysia is difficult to estimate, but available IRB statistics provide some clues as to the magnitude of the problem (Kasipillai 1999). In recent years, the Malaysian IRB is experiencing several constraints in its effort to improve voluntary tax compliance among taxpayers. Voluntary tax compliance constitute the following:

(i) Submitting a tax return when legally obliged to do so.
(ii) Disclosing all taxable income on the return,
(iii) Making a proper claim for deductions on the tax return, and
(iv) Settling the assessed taxes by due dates.

The following statistics have been extracted from the available annual reports of the IRB. There are no statistics available with regards to the contents of the returns submitted, as extensive research is required to ascertain the
quality of returns in relation to understatement of income. Although the secrecy provisions of the Income Tax Act would prevent the publishing of such statistics of individuals, however there will be no breach of the law if such statistics are made available on a global basis without identifying the taxpayers concerned.

**Compliance Statistics**

<table>
<thead>
<tr>
<th>Year of Assessment</th>
<th>Returns Issued</th>
<th>Returns Received</th>
<th>Percentage of Compliance</th>
<th>Investigation Cases</th>
<th>Audit Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>2,969,146</td>
<td>2,000,326</td>
<td>67.37%</td>
<td>549</td>
<td>705</td>
</tr>
<tr>
<td>1997</td>
<td>2,629,933</td>
<td>1,828,126</td>
<td>69.51%</td>
<td>609</td>
<td>694</td>
</tr>
<tr>
<td>1996</td>
<td>2,628,000</td>
<td>1,866,982</td>
<td>71.04%</td>
<td>514</td>
<td>nil</td>
</tr>
<tr>
<td>1995</td>
<td>2,451,896</td>
<td>1,769,981</td>
<td>72.19%</td>
<td>504</td>
<td>nil</td>
</tr>
<tr>
<td>1994</td>
<td>2,363,711</td>
<td>1,794,715</td>
<td>75.93%</td>
<td>485</td>
<td>nil</td>
</tr>
</tbody>
</table>


The above statistics indicate that while the taxpayer population is increasing, the percentage of compliance from the perspective of return submission is consistently on a decreasing trend. Investigating cases showed a sharp decrease from 1997 to 1998. This is probably due to the economic slowdown experienced during this time. Investigation cases are carried out only on selected cases on a small minority of taxpayers. However the IRB of recent started a less extensive mode of investigating taxpayers' affairs in the form of field audits. This is expected to be stepped up in view of the introduction of the Self-Assessment System. A structured field audit will soon be a permanent and important feature.

In addition to the above statistics, the IRB published the number of cases that were compounded and number of cases fined in court up to the year 1997. The increase in compounds and fines imposed on taxpayers in relation to their failure to furnish return forms indicate that, efforts to improve compliance among taxpayers is given high-priority. The number of cases compounded increased to 16,340 in 1997 as compared to about 10,000 cases in 1992 (Annual Report,
1997). On the other hand the number of cases fined in court reduced to 2,842 cases in 1997 as compared to about 6,000 cases in 1992.

**Backlog of Unassessed Cases**

A significant proportion of the returns that are submitted by taxpayers remain unassessed at the end of each year. It is gathered from the annual reports of the IRB, that 10 to 15% of returns are not finalized by the end of the calendar year annually. A backlog of assessment cases would delay collection of taxes and also hamper post-assessment audit activities. In order to overcome the increasing workload, assessments are raised as per returns without any review or in some cases, a minimum review or examination. Furthermore, such a delay would be perceived negatively by compliant taxpayers as they remain uncertain of the correctness of their returns until confirmed otherwise (Kasipillai, 1999).

**Perception of Fairness and Taxpayer Grievances**

Existing literature on tax compliance has focused on the empirical findings of the extent of tax non-compliance in developed countries [Reinganum & Wilde (1985) and Long & Swingen (1990)]. These findings are useful for tax administrators to shape tax policies, especially in developing countries. For instance, Price (1992) revealed in his paper that there is a strong positive correlation between the perception of fairness and taxpayers' tax knowledge with the level of tax compliance. He suggested that the level of compliance could be increased by improving the taxpayers' perception of fairness and by improving taxpayers' tax knowledge through formal education or tax publicity. Other studies too have indicated that there would be higher levels of commitment to compliance with tax laws by taxpayers once they perceive: (i) favourable attitudes toward the government, (ii) fairness of the tax system and (iii) fairness of their treatment by the tax administrators [Roth et al. (1989), p.124]
Inadequate Enforcement Strategies

The effectiveness of any assessment and collection system would very much depend on the strength of enforcement strategies instituted by the Revenue authorities on tax defaulters. The existing Official Assessment System, however, is inhibited by the IRB’s inability to scrutinize all returns in a desired manner due to staff shortages. Between the years 1992 to 1996, the IRB had vacancies ranging from 550 to 702 posts at various levels (Annual Reports, 1992- to 1996). In 1997, it was reported that there were 702 vacancies and this worsen to 843 in 1998.

The current system is preoccupied with the issuance of notices of assessments, leaving minimal staff for post-assessment enforcement activities. Of equal significance is the question as to whether the existing system is lax in enforcement, thus exacerbating non-compliance. The following circumstances add credence to this view:

(i) New taxpayers do not come forward to request for tax returns and do not submit any return until they are issued with a return form. Although the Income Tax Act requires a taxpayer to notify chargeability within a specified period, this is often ignored, as there is very little enforcement on new taxpayers, i.e., there is a greater level of tolerance towards new taxpayers. The penalties for failure to notify chargeability to IRB are not severe enough to warrant urgent action by taxpayers. Tax dodgers continue to dodge to the extent allowed by lax law enforcement. Although imprisonment is an option, there is only one known case when this power was invoked.

(ii) No interest is payable to IRB for delay in settlement of tax liabilities by truant taxpayers apart from the late payment penalties of 15.5% for delays up to 60 days. Interest is only
imposed after obtaining a judgement against the taxpayer in court. The time period taken to bring a person to court is often not short enough to force compliance.

(iii) A sizeable portion of returns (15-20 percent) was not submitted on time, resulting in provisional estimated assessments being raised by IRB. Various reasons can be attributed for the delayed submission. If assessments are raised and issued to the last known addresses of taxpayers, these leads to further problems of non-delivery of tax notices to the taxpayers. If the notice is not returned undelivered, there is a presumption that it is deemed properly served. This could lead to problems in recovering those taxes. Although it is the taxpayers' responsibility to notify change of address, reliance on the old information can lead to further problems for the taxpayer and the Revenue. Perhaps, a major problem encountered in the Malaysian tax system relates not to tax evaders but tax "delayers". These "tax delayers" would finally settle their tax liabilities but only after much delay and considerable effort by IRB. Every effort should, therefore, be taken to eradicate these negative attitudes that would ultimately encourage other forms of non-compliance, particularly blatant tax evasion.

Introduction of Self-Assessment System in Malaysia

The increasing change and complexity of the tax environment has made it more difficult for an official system of assessment, such as that traditionally operated in Malaysia, to operate effectively. This official system relies on quick review of all tax returns in order to determine the appropriate tax liability. As such, it is dependent on adequate human resources. The Inland Revenue Board of Malaysia has staff strength of about 6,000 catering for a population of 22
million, out of which there are 2.2 million taxpayers as at 31 March 1999. Comparatively, Australia with a slightly smaller population has 3 times the staff strength at its Income Tax Office (ITO). It collects more than $74 billion of revenue each year. It has approximately 18,000 staff and a budget of more than $1 billion per year (Scott 1994).

With the expanding Malaysian economy and the increasing number of taxpayers, the IRB is unable to process tax returns on a timely basis (Wallschutzky 1999). Judging from frequent taxpayer complaints in the media, and the increasing taxpayer population that does not correspond with the increase in IRB staff, such a situation is evident. Such a view was echoed by a senior officer of the IRB, writing in the Journal of the Inland Revenue Board, as follows in her evaluation of the existing system:

"This formal assessment system that has existed for almost five decades had essentially focused on the issue of notices of assessment, or notice to pay tax. This system is effective since it involves detailed review and scrutiny of all returns submitted and the furnishing of other information to ensure that the incidence of non-declaration and under-declaration do not occur easily and that all claims are properly monitored to ensure that they are authentic and in accordance with the law.

However, as a result of the shortage of assessing staff a detailed review of all returns cannot be done. Furthermore with increased workload due to the increase in files, backlog of assessments has resulted. This delay is not well received by the taxpayers and revenue collection could in the long run be adversely affected."

The 1999 Budget

Malaysian taxpayers received their first reception to the Self-Assessment System in the 1999 Budget announcement. The following proposal with regard to the SAS was made in the 1999 budget:

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5 Wong Kim Seong, Assistant Director General LHDN, Self Assessment - The Malaysian Tax Administration, PERCUKAJAN, Journal of the IRB, Malaysia
6 See Appendix VI, The 1999 Budget Speech
Proposal

"As a measure to modernize and streamline the tax administration system, it is proposed that:

"the present assessment system that is based on the Official Assessment System be changed to the Self assessment System in stages as follows":

<table>
<thead>
<tr>
<th>Group</th>
<th>Year of Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies</td>
<td>2001</td>
</tr>
<tr>
<td>Business, partnerships and cooperatives</td>
<td>2003</td>
</tr>
<tr>
<td>Salaried group</td>
<td>2004</td>
</tr>
</tbody>
</table>

The announcement led to a great deal of speculation as commentators began to draw from the system and experience of other nations as to what the SAS will entail.

In view of the impending change to the self – assessment system with Companies taking the lead in year 2001, the *Income Tax (Amendment)(No.2) Bill 1999* was tabled in Parliament in October 1999. This Bill contained proposed amendments specific to self-assessment of companies. It was later enacted as *Act A1069 ,Income Tax (Amendment) (No. 2) Act 1999*, which brought about important amendments to the main Act, ie. *Income Tax Act, 1967*. The main aspects of this amendment were related to:-

**Areas of Legislation**

**I. Return of Income**

- Submission of returns within 6 months of the financial year-end.

Unlike in previous years when there is one date for issuing of return,
under this system returns will be issued at four different times of the year, while submission of the returns will depend on the companies financial year end. In other words, IRB will be receiving completed returns throughout the year.

II. Payment Procedures

- Payment of tax by monthly instalments
- Submission of estimates of monthly instalments before commencement of the basis period.
- Revision of estimates is allowed in the sixth month
- Payment of balance of tax at due date.

III. Assessments

- Deemed assessment, i.e. no notice of assessment to be issued. Companies no longer wait for the notices as they will be paying based on their own estimates. The day returns are filed, notices are deemed issued. Companies are required to estimate their tax liability and penalties will be imposed for underestimation. A tolerance level of 30% is allowed.

IV. Additional Powers of the DG

- Power of access to Buildings and documents, etc.
- Obstruction of Officers

V. Offences

- Failure to furnish estimates
- Understatement of tax liability [directly related to the subject of this study]
Self - Assessment System Explained

The official website of the Inland Revenue Board (IRB) of Malaysia, offers the following explanation of a self assessment system.

**Self Assessment System - A Guide for Companies**

**What is meant by Self- Assessment?**
Self- Assessment is the manner by which a taxpayer works out and pays his own income tax. It is not a new tax but a system whereby the taxpayer is given the responsibility to compute his own tax liability.

**Self-Assessment is a total process change from the previous formal assessment system. Under the former system, taxpayers are required to declare their income on the Return Form, submit the Return Form to the Inland Revenue Board (IRB) and IRB will then raise the assessment. A Notice of Assessment is sent to the taxpayer and based on the tax indicated in the Notice, payment is made accordingly.**

Under the Self- Assessment System, taxpayers are still required to complete and submit the Return Form by the required dates. However, no notice of assessment will be sent to the taxpayers. Instead taxpayers will have to compute their own tax and make payment of the full amount at the time of filing their tax returns. At the same time, taxpayers are also required to estimate the tax to be paid for the current year and make monthly payments during the year based on the estimate.

**Issues Under Self- Assessment System**

**Position of Returns and Assessments**

Since the assessment is initially based on the return and information submitted by the taxpayer, delays in processing of returns leading to the issue of notice of assessments as in the Official Assessment System will now be overcome. The system adopted by the IRB in Malaysia, unlike in several other countries has its own merits. Doing away with the issue of notice of assessments
overcomes the problem of delay in issuing notice of assessments which has been a long standing problem in the face of increasing numbers of taxpayers. However this does not mean that IRB does not issue any notice of assessments. For instance, following a field audit, which will be a feature of the SAS, the IRB may discover claims of excessive expenditure and certain types of income that are omitted and soon follow up with an additional assessment based on the deemed assessment. Since the returns are accepted at face value a return is deemed made and served on the taxpayer when he submits his returns. This does not preclude the IRB from issuing returns where there is a delay in the submission of returns within the stipulated time.

Delays in Notice of Assessments

Under the previous system, taxpayers will have to wait for confirmation of their tax positions. This is usually achieved by reviewing the return submitted and issuing the notice of assessment where there is tax payable or refund due. In the case where there is no tax, due to losses, the taxpayer’s position is unclear in the absence of a notice of assessment or written confirmation from IRB. In the absence of such confirmation the tax position is unclear and the balance in the section 108 dividend franking account is not determined without IRB’s confirmation.

Under the SAS, and following the amendment to Section 91, of the Income Tax Act (w.e.f. from 1.1.1999) taxpayers need not wait any longer then six years. As the IRB is not empowered to raise an additional assessment based on the returns submitted provided there is no wilful neglect or omission of any income in the returns submitted.

Scope of Work

The nature of work of assessment officers of the IRB now shifts from that of desk review of tax returns to field audits of the taxpayers’ records. This not
only affects the approach taken by the IRB but also that of the taxpayers record keeping responsibilities. This entails that revenue officers training, is enhanced to cover such tax audits to verify the authenticity and correctness of the returns submitted based on the documentation and record keeping requirements of the law. It will be necessary to retrain staff and relocate resources of the IRB. Under the present system, the work of revenue officers is centred on reviewing returns, engaging in correspondence with taxpayers leading to the issuance of notice of assessments. However under the SAS, as the issuance of original assessments is dispensed off, work will now be centred on audit activities. The skill required to carry out audit activities will differ from desk examination of returns and tax computations.

Structured Audit Programs

A policy decision based on existing resources must be made with respect to the percentage of returns to be audited. Following this a selection criterion for audit cases must be devised. This could be based on the type of industry, analysis of the financial statements, reporting pattern of taxpayers, etc. For instance in Pakistan, for year of assessment 1998/1999 a computer ballot selects 10% of all returns filed for Special Audit. There is also a provision for immunity from Special Audit on condition that the tax paid or assessed is more than 20% of the tax paid or assessed for the preceding year. Besides there is also permission to make lump sum additions to the declared income, otherwise there could not be any increase in the payment of tax.

The success of the self-assessment system would to a large extent depend on the system of balanced and systematic tax audit. This audit system would form the mainstay of any self-assessment environment (Wong 1998). From the experience of developed countries notably Australia and New Zealand, the starting-point in the audit process will involve the application of high speed computers to list cases that meet the audit criteria predetermined by the National
Office. Then all the returns that have been identified by the computer will be routinely checked by the Return Classifiers to determine their accuracy. Systems of tracking erroneous returns and measuring the audit potential of all businesses, properties and professional taxpayers' returns are employed.

In the US, while the IRS depends primarily on voluntary compliance with the self-assessment system, it also examines and audits returns. The audit programme of the IRS takes approximately one-third of the resources and the success of the self-assessment system depends very much on the success of this audit programme. For many taxpayers, the possibility that the IRS will examine and audit their returns encourages voluntary compliance. It is a general perception that many individuals would not comply with the tax laws if some risk of being caught and punished were not involved\(^7\). Punishment may take the form of fine or imprisonment or both.

The returns which are selected through the audit selection program will be subjected to either one of the following audits depending on the seriousness of the individual case, viz\(^8\):

- Correspondence examination
- Office Audit;
- Field examination; or
- Research audit

The more serious cases that entail fraudulent tax returns are subjected to criminal investigation.

In New Zealand the primary purpose of the audit programme is to improve voluntary compliance by detecting and bringing into account those who do not pay the correct amount of tax. The self-assessment system allows scope for wider coverage of audit activity as well as concentration of resources on areas of

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\(^7\) Internal Revenue Service, IRS Conference on Tax Administration and Research, page 29, 1987.
known non-compliance. This is expected to generate a greater deterrent effect resulting in improved compliance.

Tax Legislation

The change to self-assessment system has to be provided for very clearly under the law. This pre-condition is evidenced by the major legislative amendment undertaken by the UK tax authorities in preparing for the move to the "file and pay" system. The UK authorities announced their intention in 1993 but the actual implementation of the self-assessment system took place only in 1996-1997. In Malaysia, the cautious development is no different. After including such a vision in the first-year Corporate Plan (1993-1997), legislation was finally introduced in 1999, with the law taking effect in the year 2000 for the Year of Assessment 2001.

The SAS inherently adopts a very legalistic approach to assessment. The tax law has to be transparent and simplified so that the taxpayer (and the tax agent) are fully aware of the taxpayers' obligations as well as their rights. Essentially the powers of the Revenue particularly in respect of the audit enforcement should be transparent to the public. The penalty provisions and tax consequences upon detection of non-compliance have to be specifically provided in the legislation. Guidelines and rulings on specific tax treatment have also to be issued to facilitate the implementation of the tax provisions. IRB has since published 15 public rulings, eight in 2000 and seven in 2001 at the time of writing. These are a series of rulings issued in respect of various aspects of taxation law. In these rulings, the IRB set outs its interpretation of the particular area of law or sets parameters within which it will accept interpretations of the law.

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8 IRS(USA), Internal Revenue Manual on Audit, Part iv, IRM 4230-4236.
Although there is no clear policy on private rulings, this too is expected to be implemented if the developments in other countries are anything to go by. This is considered a natural development as when there is uncertainty in the law or difficulty in interpreting the law to suit the many scenarios that may arise in practice a private ruling from the IRB will help in avoiding the risk of penalties of any particular taxpayer. Under a private ruling system, the taxpayer may seek an opinion form the tax office in relation to a taxation matter. For that purpose, the taxpayer is required to set out all facts relevant to the matter in question. The ruling subsequently issued by the Director General of Inland Revenue is binding on the IRB only so far as the applicant taxpayer is concerned. Other taxpayers are not entitled to take advantage of the ruling even though their facts may be identical or similar to those of the applicant taxpayer.

Decisions made under a private ruling are subject to judicial review, i.e. they may be taken to a court of law as though they were, in fact, an assessment. It is for this reason that the information to be provided in the request for ruling must be complete. Private rulings are also confined to the particular situations and circumstances set out in the application, eg. Any material change in the actual carrying out of the steps, which are subject of the ruling, may result in the decision in the ruling being reversed.

Private rulings also apply only to the specific period stated in the ruling. In more recent times a concept of “Product Rulings” has also been introduced in Australia (Cowdroy.P.J., 1999). This enables classes of taxpayers who have similar interests in the same product to seek a class ruling in relation to that matter which is binding for all of them against the Commissioner. Such would be the situation where taxpayers invest in a syndicated movie project.

Taxpayer Awareness
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As the SAS requires taxpayers and tax agents alike to have an understanding of the law and requirements of the authorities, the successful implementation will then depend on the level of awareness and knowledge of the tax laws. One way of dealing with this is to simplify the law. Simplification has been a fruitful exercise in making the SAS successful in other countries. Increasing taxpayer awareness through taxpayer education and services should also be emphasized. Creating a matured taxpayer base, via concerted taxpayer education plan, trusted to determine and pay their own taxes will be among the challenges facing the IRB. It is envisaged that with the introduction of SAS, the voluntary compliance rate will increase.

Increased Penalties

With the increased responsibility placed on taxpayers there are also increased penalties, which may be imposed on the taxpayers if they breach the requirements of the income tax law. This includes late lodgement of returns, late payment, lodgement of incorrect return and understating income as a result of negligence, recklessness or wilfully evading taxes.

The concept of self-assessment proceeds on the basis that the taxpayer is aware of his rights and obligations and responsibilities under the income Tax Act. These extend to the lodgement of his returns and what is to be included within it and his obligations to pay his tax when it falls due.

Penalties are imposed where there is a "tax shortfall" i.e where the amount by which the taxpayer's stated tax for that year is less than the amount of "proper tax" for that year. The term "proper tax" in the Australian context is defined to mean the tax properly payable by the taxpayer in respect of the year on his taxable income after allowing for all credit properly allowable to the taxpayer (Cowdroy 1998).
The Australian Position on Penalties

Penalties arise in the following situations:

- A 25% rate is imposed where a tax shortfall is caused by failure on the part of the taxpayer to take "reasonable care".

- A 25% rate is also imposed where the tax shortfall exceeds a certain threshold and the taxpayer's position was not "reasonably arguable".

- A 25% rate is imposed where the shortfall is caused by a disregard of a private ruling.

- A 50% rate is imposed where the tax shortfall is caused by the taxpayer's "recklessness".

- A 50% rate is impose where the shortfall is caused by the taxpayer entering into a "tax scheme".

- A 75% rate is imposed where the tax shortfall is caused by the taxpayer's "intentional disregard of the Act or Regulation".

Section 114(1a) Income Tax Act 1967

The amendment to section 114 came into effect from Year of Assessment 2001, which marks the start of the implementation of the self-assessment system in Malaysia. Probably no other development in the Malaysian tax legislation has ever brought about such anxiety and apprehension to tax agents and tax professionals who provide among other tax related services, assistance and advice to taxpayers in the preparation of tax returns. The section reads as follows:
“Any person who assists in, or advises with respect to the preparation of any return where the return results in an understatement of the liability for tax of another person shall, unless he satisfies the court that the assistance or advice was given with reasonable care, be guilty of an offence and shall, on conviction, be liable to a fine of not less than two thousand ringgit and not more than twenty thousand ringgit or to imprisonment for a term not exceeding three years or to both.”

Increased penalties as seen in other jurisdictions that have adopted the self-assessment system appears to be a significant feature in almost all countries. As the system not only transfers the burden of computing taxes to the taxpayer himself, it places upon him a greater expectation of trust. Not every return submitted will be examined under a self-assessment system as in the previous Formal Assessment System. As such non-compliance of this trust is reciprocated with heavier penalties. Assuming such an additional level of assurance is not in place, taxpayers will adopt an attitude that will allow tax dodging while it is still possible, i.e. until the long arms of the law catches up. To taxpayers and citizens who are law-abiding, this would even seem to be an inequitable situation.

Additional Information under SAS

Under the new self-assessment regime, a company is required, in addition to furnishing a return in the prescribed form to the Director General of Inland Revenue, to comply with subsection (1C) of section 77 which requires the return to:-

“a) specify the chargeable income and the amount of the tax payable (if any) on that chargeable income for that year; and
b) contain such particulars as may be required by the Director-General in respect of that company”

Onus of Determining Chargeable Income

As explained earlier, the onus is shifted to the company (taxpayer) to “specify the chargeable income and the amount of tax payable” whereas under
the Formal Assessment System, this would be undertaken by the IRB, although it is customary for the taxpayer to submit his own tax computation.

Deemed Notice of Assessment

Additionally, the new section 90(1A) and 90(1B) provide that where a company has furnished a return under section 77(1A) to the DGIR, the DGIR shall be deemed to have made the assessment on the same day. The Return shall be deemed to be a notice of assessment. As such no notice of assessment will be issued. Previously the taxpayers anxiously await such a notice that determines their tax bill.

Is it Confined to Tax Agents Alone?

Section 114(1A) does not single out tax agents, as it refers to "any person who assists or advises in respect to, the preparation of any return...of another person". Broadly speaking it includes employees of the taxpayer companies, employees of tax agents, investment bankers, financial consultants and tax agents themselves. However since it is the "tax professional" who is often directly engaged in such work, thus the concern by this group of people. It is this group of professionals who are referred to by many names as discussed in Chapter One, such as tax advisers, tax agents, tax practitioners, tax professionals, tax consultants, tax accountants, tax lawyers or tax preparers who act as intermediaries to the authorities and taxpayers who decipher and interpret the complexities of the law in relation to a layperson's responsibilities under the Income Tax Act. If not for the existence of such intermediaries, the tax compliance level would be even more worrying. What more the constantly changing and dynamic tax laws present taxpayers with an additional annual burden?
For instance in Australia, the voluminous tax legislation, in all amounting to about 5,000 pages is a major stumbling block to any taxpayer in fully understanding the tax laws, and what more complying with it. It cannot be denied that with such complexities, tax agents may also contribute to non-compliance by aiding and abetting taxpayers' to understate liabilities.

The Concept of "Reasonable Care"

Section 114(1A) introduces the concept of reasonable care to be undertaken by the adviser or assistance provider in relation to return preparation. It has been said that there is a presumption that the adviser is guilty unless he satisfies the court that the assistance or advice was given with reasonable care. Such a presumption imposes an onerous duty on tax agents. At the outset, IRB acknowledged that it "understands the anxiety of the public on penal provisions introduced under the Income Tax [Amendment](No 2) Act 1999". The IRB Deputy Director who chaired the meeting clarified that,

"the SAS is a new tax system and as much as IRB needs the full cooperation of the tax practitioners and taxpayers, he assured that IRB on its part will not be very strict in invoking the penal provisions in the early stages of the implementation of the SAS. To alleviate the difficulties faced by the tax practitioners and taxpayers under the SAS, a Consultative Working Committee will be set up to look into the problems that may arise."

The professional bodies made the following observations on section 114(1A):

- It imposes an onerous burden on tax practitioners;
- Tax agents have no basis to verify the accuracy and authenticity of information provided them by taxpayers;
- There is no "Rulings System" in place for taxpayers to seek clarifications;
- They are many "grey areas" that the IRB has yet to clarify;

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6 Minutes of Meeting held on 28.1.2000 between IRB and MIT/MIA/MACPA/MAICSA
The law does not define “reasonable care” and the standard of reasonable care required;

There is a presumption that the tax agent is guilty unless he satisfies the court that the advice or assistance is provided with reasonable care;

The section covers advice given on tax savings schemes;

Tax agents’ engagement does not include verifying information provided by taxpayers;

Tax agents’ duty is to the client and not to the IRB;

The scope of the provision is very wide;

Tax agents are merely service providers, intermediaries who facilitate assessment and enhance compliance by providing taxpayers tax information required to comply with the revenue law and by assisting them in preparing relevant information and tax computations;

Existing legislation [the original section 114(1)] is wide enough to deter such activities. It is specific in its objectives. It is aimed at any person who wilfully and with intent evades or assists any other person to evade tax;

Does not take into account any wilful intention to evade tax;

There is no definition of “understatement of tax liability”

Guidelines should be issued to define the parameters;

An opportunity must be provided to suspected offenders to be heard before any prosecution;

At another meeting held on 25 August 2000 the professional bodies reiterated their concern of the wide ambit of the new Section 114(1A) and again appealed for some form of guidelines/practice notes be issued by the IRB. It was felt that the mere wording of section 114(1A) might encompass situations not envisaged by the legislative body.

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10 Minutes of Meeting between IRB and MIT/MIA/MACPA, Source – MIA website
The professional bodies appear to have mellowed in their strong views against the new section 114(1A). The following minutes of the meeting, in the writer's opinion reflects this:

"MIT does acknowledge that the ethos behind the new Section 114(1A) is good. Nevertheless tax preparers and taxpayers are concerned that, if no proper framework is instituted on its ambit, there may arise future abuses in its implementation".

Understatement of Tax Liability

At the January 2000 meeting, IRB clarified that understatement means:

"paying less than what is due under the law, for example, under declaration of revenue, overstatement of expenses, etc."

It has been assured that the assistance provided by tax advisers to minimise tax in accordance with the law is not within the ambit of the provision. Pure oversight will also not be penalized. IRB agreed to issue circulars laying down the scope of the provision and the broad principles under which this provision will be invoked. A brief account is given below on what constitutes tax evasion and tax mitigation or tax avoidance within the precincts of the law.

As regards to penalties, IRB assured that it will take into account the taxpayers' willingness to voluntarily amend an incorrect tax return. The type of offence and the penalty will also be made public. It also assured that persons suspected of contravening the law will be given an opportunity to explain before being taken to court.

Tax Evasion and Tax Avoidance

Tax evasion is usually defined as an attempt, whether successful or not, to reduce or totally eliminate tax liability by illegal means. It has been used
synonymously with tax fraud or tax cheating, both of which connote an integration of three factors, namely:

(i) The end to be achieved which is the payment of less tax than that known by the taxpayer to be legally due;

(ii) An accompanying state of mind which is variously described as being evil, in bad faith, deliberate or wilful;

(iii) An unlawful course of action tinged with the element of deceit, misinterpretation, trick, device, concealment and dishonesty (SGATAR, 1997).

Tax avoidance on the other hand is the achievement of a similar end by means that are within the law. It involves an intelligent analysis and choice of schemes, which bring about less tax impact than the more commonly used methods. The process, which is referred to as tax planning, starts even before the tax liability accrues. Tax avoiders are able to use to the best advantage the existing tax laws particularly their inherent faults and loopholes. Tax avoidance can be:

"within the letter of the law and within the spirit of the law or it can be within the letter of the law but against the spirit."


In other words, tax avoidance maybe of the acceptable or unacceptable kind. Although different from a legal point of view, tax evasion and avoidance have, in fact, similar results as both cause a reduction in government revenue. Cross and Shaw (1982) suggest a joint analysis of the two activities owing to the insignificant degree of substitutability and possible complementarity between the two activities for the taxpayers, and singularity of their implications on the revenue maximising goal of the government. Wallschutzky also noted that the difference between evasion and avoidance may also be temporal. A method may
presently be referred to as tax avoidance but once it is detected and prohibited by legislation, it becomes a tax evasion scheme.

Section 114 which is titled "Wilful evasion" cites the following situations under section 114(1), as amounting to evasion provided it is done wilfully with intent to evade or assist any other person to evade tax—
- omission of income in a return;
- false statement or entry in a return;
- false answer to a question or request for information;
- preparation of false accounts and records;
- falsifying or authorizing the falsification of accounts or records; or
- making use of or authorizing the use of any fraud, art or contrivance.

Compounding of Section 114(1A) Offence

Section 124 gives the power to the DGIR to compound any offence under this Act. As a prerequisite the taxpayer must admit in writing that he has committed an offence and request the Director General to deal with the offence under this section. Where the DG compounds an offence committed by any person and makes an order accordingly, that person shall not be liable to any prosecution. In such an instance, the tax agent need not show any exercise of reasonable care that he has taken. The element of "reasonable care" only arises if the person is prosecuted in court and it is left to the courts to determine whether the required standard of reasonable care has been exercised by the alleged offender, to avoid conviction. As most of the offences under the Act may be compounded by the IRB, a policy decision must be made for a uniform application throughout the assessment branches of the IRB.
Draft Public Ruling on Section 114(1A)

It has also been learnt that the professional bodies met Treasury officials to make representations regarding the implementation of section 114(1A) and requested the authorities to issue guidelines or rulings that will reflect the practice direction by the IRB. Following this the IRB issued a Draft Public Ruling No. 8/2000 on Assistance or Advice in the Preparation of a Return Resulting in Understatement of Tax Liability. The brief 3-page draft was made available to the professional bodies for comment. The MIT, MIA and MACPA made a joint representation and commented on the Draft Ruling promptly. In this draft, the IRB gave its interpretation on the nature of "assistance or advice" and the consequences of giving such assistance or advice referred to in the section. Five examples were given to illustrate the application of section 114(1A). It is pertinent to note here that there was gross disagreement between the professional bodies and IRB with respect to the interpretation of section 114(1A). The professional bodies disagreed on the interpretation of all five hypothetical situations claiming they do not provide sufficient grounds for holding the tax agents liable. Furthermore the professional bodies claimed that the existing legislation, particularly section 114(1) could be evoked to cover some of the hypothetical situations. Certain definitions such as "any person", "reasonable care" and "understatement of the liability for tax" were also briefly explained in the draft ruling.

The apparent confusion and misconception can be seen on both sides, that of the IRB and the professional bodies. For instance the professional bodies, in commenting on the third example of the draft, claimed that the taxpayer is the one who must be charged under section 114(1A). In the writer's opinion, section 114(1A) does not cover taxpayers but others who assist or advice in the preparation of returns i.e.
114(1A) "any person who assists in, or advises with respect to, the preparation of any return where the return results in an understatement of the liability for tax of another person .... be guilty of an offence."

On the other hand the existing section 114(1) can be used against taxpayers as well as others who provide assistance in relation to wilful evasion. Section 114 begins as follows:

114(1) Any person who wilfully and with intent to evade or assist any other person to evade tax--

The professional bodies mentioned above commented on and highlighted the following aspects in relation to the scope of duties of Tax Agents.

- This development is expected to discourage new entrants to the profession.

- The terms of engagement of a tax agent cannot be equated with that of the auditor, as the terms of engagement do not include the reviewing and verifying of correctness of the information provided by clients. Unlike the extensive powers given the auditor under the Company Law, such power of access to accounting records are not available to the tax agent.

- Existing law does not give tax agents the access to audit working papers or clients records or to verify transactions recorded therein. The concepts and methodology of an audit such as materiality and sampling are not applicable for the purposes of tax compliance.

- An extension of the responsibilities envisaged by the section will increase current tax compliance costs, which taxpayers will be reluctant to bear.
The draft ruling only illustrates the situations where the tax agents are liable and alternative illustrations are not provided where they will not be liable. A more balanced ruling is needed.

Creates a perception that the tax agents now have a heavier responsibility or duty.

The examples imply that tax agents are and will be accountable for all forms of understatement of taxes, irrespective of the circumstances.

The liabilities of employees of tax agents who do not act in good faith is not considered.

In view of the delay in drafting the ruling, the retrospective enforcement of the ruling should be amended and it should be made effective from 1.1.2001. Since the amendments are deemed to have taken effect from the introduction of the Income Tax (Amendment) Act 1999, application of section 114(1A) should be limited to tax cases submitted on or after 1 January 2000.

There is ambiguity as to whether or not an employee or staff of a tax agent/consultant may be liable to prosecution under Section 114(1A), if the employee had assisted in the preparation of the tax computation/return and there is an understatement of taxes. What defence do employers have against the acts of malicious employees? It was illustrated by the professional bodies that where an employee is acting under the instruction of the employer or the superior, he should not be held liable, i.e using a "control test". If the employee is in a position to control the decision making process, then the employee can be held answerable.
Illustrations should include the treatment of "understatement" as a result of human errors and mistakes. The professional bodies even proposed several examples to be incorporated in the Ruling. Two such proposed illustrations concerned misrepresentation by the taxpayer and "mistake or error" situations.

The professional bodies also voiced their disagreement on the definitions of "reasonable care" as follows:

"reasonable care means the exercise of due diligence that is expected of a normal person in a similar situation"

The following definition adopted by the Australian Tax Office was suggested:

"Reasonable care means the care that a reasonable person would be likely to have exercise in a similar situation to fulfil his obligations"

Summary of differences
Both IRB and the professional bodies differed in their opinions in respect to the following issues:

- The role and duties of tax agents.
- Interpretation of classifying the offence under existing legislations or the new section 114(1A)
- Liabilities of employees who are not in control
- Liability of agents when returns are prepared from incomplete records
- Liabilities of accountants who prepare accounts not knowing that it will be used for filing tax returns.
- Interpretation of "reasonable care" concept in the absence of any law specifying duties of tax agents under any law.
Public Ruling No. 8 / 2000

Introduction

After about a year since enacting section 114(1A), IRB issued the long awaited ruling dated 30 December 2000. A copy of the ruling is appended as Appendix B in this dissertation. This ruling gave the official interpretation of the provisions concerning the penal provisions against those who aid and abet taxpayers in under declaring their income. As some of the related offences illustrated in the draft ruling, do not come precisely under the new section 114(1A) as rightly pointed out by the professional bodies, IRB took the opportunity to broaden the scope of the originally intended Ruling. The Ruling now is entitled, "Wilful Evasion of Tax and Related Offences". The Ruling consists of the following four titles:

1. Tax Law

2. The Application of this Ruling

3. How the Tax Law Applies

4. Interpretation

The Application of this Ruling

Part 2 of the Ruling outlines the broad ambit of the provisions: It is reproduced as follows:

"The Ruling considers:

a. What constitutes or amounts to wilful evasion or intent to evade or to assist any other person to evade tax under section 114(1) of the Income Tax Act 1967.

b. The nature of assistance or advice given by any person in the preparation of a return that can be regarded as an offence under section 114(1A) of the Act; and"
c. The consequences of such wilful evasion, intent to evade tax or to assist any other person to evade tax, and of giving of assistance or advice in the preparation of a return which results in the understatement of liability for tax.

How the Tax Law Applies

Presumption of Knowledge

Where an act such as omission, false entry, false statement etc, is within the control of a person, it is presumed that the person has knowledge of such acts and did it with the intention to evade tax.

Wilful evasion

In addition to repeating the acts listed under section 114(1) that amount to wilful evasion, the explanation seeks to broaden the scope by clarifying "wilful evasion" as follows:

3.2 "Wilful evasion

Wilful evasion of tax means any action or deed deliberately performed or done with the purpose or intention of evading or assisting any other person to evade tax, and (without necessarily displacing or superseding the general meaning of this statement) would include any of the following:

3.2.1 deliberate omission of any income from a return;

3.2.2 making a false statement or entry in a return;

3.2.3 giving a false answer (orally or in writing) to a question asked or to a request for information made for the purposes of the Act;

3.2.4 preparing or maintaining false books of account or other records, or authorizing the preparation or maintenance of false books of account or other records;
3.2.5 falsifying books of account or other records, or authorizing the falsification of books of account or other records; and

3.2.6 making use of any fraud, art or contrivance, or authorizing the use of any fraud, art or contrivance”.

Assistance In, Or Advice With Respect To, The Preparation Of Return

"3.3.1 Where a person assists in, or advises with respect to, the preparation of a return and as a result of that assistance or advice there is an understatement of the liability for tax of another person, the person giving that assistance or advice may be liable for prosecution if it can be construed that there is dishonest intention on his part to assist the other person to evade tax."

The following elements can be deciphered from the explanation given in the Ruling:

- some positive action, such as assistance or advice
- it must be in relation to Returns
- there must be present a dishonest intention
- inferences of dishonest intention can be made except if the following can be shown:
  - act was done with reasonable care
  - interpretation was based on the Act
  - interpretation was based on any tax case
  - interpretation was based on a ruling

- Such an interpretation must not differ from that of another person had he acted in a similar capacity given the similar level of knowledge and experience (reasonable man test).

- The person must have acted in good faith after:-
  - In the light of all information available
• Making the necessary inquiries (reasonable man test again)

The Ruling clarifies under what circumstances particular situation as listed below will be interpreted:

❖ Examination of specific claims for deductions, allowances, reliefs or rebates
❖ Differing position or stand
❖ Examples of circumstances
  • Omission of income;
  • Preparing or maintaining false books of account or other records;
  • Final Accounts prepared from estimated or fictitious figures;
  • Claim not supported by documents;
  • Claim for deductions or incentives not supported by documents;
  • Non-disclosure by a person on whose behalf a return is prepared;
  • Mistake or error in return;

Examination of Specific Claims for Deductions, Allowances, Reliefs or Rebates

This would mean that there is an expansion of the scope of work of a tax agent. He cannot merely be satisfied with the explanation and information provided by the taxpayers. He must now sight and scrutinize proper documentation, written analyses or detailed statements where there is a likelihood that expenses which are not allowable or partially allowable are grouped or categorized collectively.
This is probably aimed at the practice of lumping together expenditure such as general, miscellaneous, sundry expenses, management expenses, legal or professional fees, repairs etc. Such a practice would not enable the IRB to treat it according to the law. Under self-assessment system, the taxpayer and tax agent will have to ensure that proper breakdown of the above-mentioned expenses are given. The defect in such an expectation is that such a duty on the taxpayer is not provided for under the law. In view of the new development, it will be in the interest of the taxpayer to make such information available to the tax agent he engages.

The taxpayer is required to certify or provide written confirmations and provide such analyses, statements or other relevant information, which might affect his liability to tax, whether requested or not by the person giving the assistance or advice. Such a move may even pre-empt any action against the taxpayer. Where the taxpayer has discharged this duty, the blame may now shift to the tax agent if he has not provided such information in the tax return, thus resulting in an understatement.

**Adverse Inference**

An adverse inference may be drawn under the following circumstances:
where there is:
- failure to call for further information;
- failure to provide such information
- failure to disclose the required information;
- failure to draw attention to any matter affecting liability to tax.

**Differing Position or Stand**

Where the person making a return or the person giving assistance or advice in the preparation of a return adopts a position that is not in accordance with a ruling, guideline, practice statement, statutory or prescribed form or depart
from his normal practice and is able to justify such a stand there is no action recommended in the Ruling. However there must be a written disclosure of the position and grounds for it and how it affects the person's tax liability.

Application of the Ruling – Examples

The Ruling provides seven illustrations by way of applying the relevant law to the hypothetical situations or circumstances as mentioned earlier.

Example One: Omission of Income

This is a clear example of a scenario that comes under the purview of section 114(1).

Example Two: Preparing or maintaining false books of account or other records

This example illustrates a situation where an accountant on the instruction of a director of a company reclassifies a non-allowable expense (entertainment) to purchases of goods. The Ruling provides that the company, the director and the employee (the accountant) can all be prosecuted for various offences. The company may be liable for prosecution for wilful evasion [section 114(1)] or for making an incorrect return [section 113]. The director Mr. C may be liable for prosecution for assisting another person (the company) to evade tax by authorizing the preparation or maintenance of false books of account or other records [section 114(1)]. The accountant Mr. B may be liable to prosecution for assisting another person (the company) to evade tax by preparing or maintaining false books of account or other records [section 114(1)].
Example 3: Final Accounts Prepared from Estimated or Fictitious Figures

In this illustration, a taxpayer engages a bookkeeper to prepare the final accounts and to complete the income tax return. It is alleged that after a tax audit, it was discovered the final accounts are not substantiated by proper records and many of the figures are either estimated or fictitious. IRB is of the view that the bookkeeper may be liable to prosecution for assisting in the preparation of the taxpayer’s returns that resulted in the understatement of his liability to tax under section 114(1A). As for the taxpayer, he may be liable under section 114(1) for making a false statement or entry in a return as well as for failure to keep sufficient records, an offence under section 82.

The Ruling also states that the bookkeeper can be absolved of blame if there was proper disclosure in the final accounts that are prepared from incomplete records and are based on justifiable estimates. Similarly the taxpayer should have also made a disclosure in his tax computation. Failure to make a disclosure on the part of either person may be regarded as indicative of dishonest intention. However, there is no specification in the law compelling an assistance provider to make such disclosure as he is engaged by the taxpayer not the Revenue.

This illustration does not inquire into the issue of any “reasonable care” that may be raised as a line of defence. Is the “standard of care” expected from a bookkeeper the same as that of a qualified auditor or tax agent? The definition of reasonable care adopted in this Ruling is that of an “ordinary person” acting in a similar situation. In this case, the expectation should be the same as what another bookkeeper would have done in his place and not compared against an auditor or a professional accountant. As there is no Law requiring the financial statements of an individual to be audited, the authorities do not have a third party opinion of the accounts unlike in the case of companies. The Income Tax Act too
Chapter 2: Self - Assessment System and Section 114(1A)

does not provide for the accounts to be audited by a qualified auditor in every case.

However the IRB has powers vested in it under section 82(5) to call for audited accounts if there is doubt on the veracity or sufficiency of the accounts. Section 82(5) reads as follows:

"82(5) The Director General, if he is of the opinion that any accounts or records produced by any person to the Director General for the purpose of ascertaining the income of a person are insufficient or in adequate for that purpose, may by notice under his hand require that person to produce, in respect of any period or periods specified in the notice and within a time so specified (that time not being less than thirty days from the service of the notice), accounts audited by a professional accountant, together with a report made by that accountant which shall contain, in so far as they are relevant, the matters set out in section 174(1) and (2) of the Companies Act 1965".

The companies Act 1965 provisions referred to the audit of accounts of companies. The operation of subsection (5) is not confined to companies and may need to be modified for a non-company business. This seems to be contemplated by use of the words 'in so far as they are relevant'. (Thornton, 1998). There is no clarification in the Ruling as to the circumstances where this provision may be evoked to properly determine the taxpayers' income.

As the Revenue recognizes that assistance to prepare returns can even come from bookkeepers, in accepting or rejecting the accounts prepared by the bookkeeper, the Revenue does not clarify the issue of qualification of the assistance provider. Will returns prepared by those who are not qualified as tax agents be accepted?

Example 4: Claim Not Supported by Documents

This example concerns an offence under section 114(1) for making a false claim in the return or for a making an incorrect return or an offence under section 113 where the taxpayer may be held liable. Here the tax agent is absolved of
blame as he wrote to the taxpayer calling for the receipts for donation made by the company and advising the company as to the requirements of the law and the understatement arises primarily because of his reliance, in good faith, upon the written confirmation given by the company.

Example 5: Claim for Deductions or incentives not supported by documents

In this example the tax agent is absolved of blame as he appears to have acted in good faith and the understatement of the company's liability to tax essentially arises from the misrepresentation on the part of the company's director.

However it is also mentioned that the director may be liable for prosecution for assisting in the preparation of a return that has resulted in the understatement of the company's liability to tax under section 114(1A). The company may be liable for prosecution for making a false claim in the return under section 114(1) or for making an incorrect return under section 113.

If the director is charged under section 114(1A), he may raise the defence of reasonable care exercised by him depending on the circumstances that led him to provide such information unless there is dishonest intention to understake the companies tax liability by the use of unacceptable means such as falsifying, or defrauding.

Example 6: Non-Disclosure by Persons on Whose Behalf a Return is Prepared

In this example, the taxpayer himself is liable for evasion of tax by deliberate omission of income in the return under section 114(1). Although the tax agent relied on the verbal confirmation of the taxpayer, no action is recommended against the tax agent, as no inference of dishonest intention should be drawn against him.
Example 7: Mistake or Error in Return

Even where an innocent error has been made, the taxpayer may be liable under section 113 for making an incorrect return. Section 114(1A) is considered against the tax agent in the case of errors in a return only if there is evidence to indicate that the understatement is made other than innocently. In this example, there is some explanation as to what such circumstances are. For example, previous or subsequent incidences of a similar nature in the same case and / or a pattern of frequent occurrences of a similar nature in a number of other cases.

Legal Effect of a Ruling

The IRB in dialogues with the professional bodies clarified that rulings are only binding on the Revenue and are not binding on taxpayers\(^{11}\). There is some confusion on the legal standing of rulings issued by the Board, claimed the MIT, as the IRB has not issued any clarification/practice note on the legal position of Private and Public rulings. The Malaysian Institute of Taxation (MIT) proposed that some form of practice note/position paper be issued of the legal standing of Private and Public Rulings. This is strange in the light of the fact that it is the professional bodies that have been clamouring for such rulings often drawing comparisons from other countries that have adopted the self-assessment system.

As discussed in Chapter One, a rulings system must be in place to assist taxpayers to understand their responsibilities and to extricate the complexities of the statutes. From the standpoint of the professional bodies, first it was the call for a rulings system. Next the professional bodies pointed out - “that the Act does not contain any provisions on the ruling process.” Later there was a call for the IRB to be bound by the Rulings – In order for the IRB to be bound by its

\(^{11}\) Circular No 8/2000, Malaysian Institute of Taxation (MIT), 5 Oct
rulings, there needs to be legislations to that effect\textsuperscript{12}. The actual position of a Ruling under Administrative Law will be discussed in the concluding chapter.

**Summary Of Chapter 2**

This chapter explains what a self-assessment system (SAS) is and was understood to be prior to implementation. The experiences of other countries who have implemented such a system is also discussed. The development of SAS as a response to meeting the challenges of an efficient tax administration is elaborated. The background of the introduction of self-assessment system too is analysed in the light of the existing system.

The second part of the chapter discusses the enactment of section 114(1A) as part of the self-assessment system. A detailed explanation of the meaning and explanation is given. The response of the professional bodies to events leading to the issuing of a draft public ruling for comments from the professional bodies and a discussion on the shape of the eventual Public Ruling No 8 of 2000 issued on 30.12.2000 is included.

\textsuperscript{12} Report on Dialogue between IRB and MIT / MIA / MACPA / MAICSA dated 28.1.01-Source-MIA Website