Tax Audit & Investigation Update

Capital Statements: Do Your Assets Match Against Your Declared Income?

By Wong Yu Sann

How does the Inland Revenue Board know you under-declared your profit or income? This is the question asked by everyone when it is time to file their income tax returns.

Basically, there are only two things a person can do with the money they earned-spend it or save it. This is the principle behind capital statement where income = spending + saving. If both do not reconcile, then profit or income is not declared properly. Clearly you are exposing yourself to the local tax authority's scrutiny by under-declaring your income.

Generally, every company, limited liability partnership, trust body or co-operative society must submit their tax returns within seven months from the date following the closing of their accounting period. As such, income statement and balance sheets are required for tax compliance purposes. Individual taxpayers such as directors of companies are not required to prepare income statement and balance sheets but they need to keep proper record of all their income and expenditure. These records must be kept for seven years beginning from the year they filled their Income Tax Return Form (ITRF) with the Inland Revenue Board. Keeping track of daily spending, purchase of land, properties, furniture or even investment in unit trusts is not the normal practice of every individual. But all of these records are needed for the computation of a capital statement.

Since the introduction of self-assessment for individuals in 2004, individual taxpayers are required to assess their own tax liabilities. The local tax authority will conduct a full examination on individual taxpayer's records to test the accuracy of the information supplied by way of tax audit or tax investigation. Capital statement is one of the methods used in exercising a tax investigation on an individual taxpayer.

Capital statement is the most common investigation method used by the Inland Revenue Board in detecting income of an individual taxpayer. In Malaysia, capital statement is applied to individuals who include directors of companies and the self-employed to ascertain their actual income received. This is an alternative approach to the profit and loss account to arrive at the income statement and balance sheet of an individual taxpayer. It is a series of balance sheets embracing assets and liabilities of an individual taxpayer on a cash basis.

This method compares their expenses and savings with their earned income, which is termed as available income. Available income simply refers to individual taxpayer's income which has been disclosed in his tax returns and other private incomes. Some examples of available income are business income, salary, rental income, dividend and interest. This also includes lottery winnings, betting profits etc. Even though lottery winnings are capital gain not liable to income tax, it is still your available income as you can spend or save it.

For example, if you earn RM80,000 per year, how can you afford to buy a house priced at RM450,000 if you did not apply for a housing loan? The money for the transaction must come from somewhere, either from personal savings, inheritance income, capital income or other income. This is where the question of "Do your assets match against your declared income?" comes into the picture. If an individual taxpayer does not have the source of monies, how can he buy the house of RM450,000 with his annual earnings of RM80,000?

The monies used to finance the purchase will be incorporated into the capital statement. Capital simply means money or anything that can be converted into cash for spending such as savings, loans, business capital and so on.

Furthermore, the capital statement will demonstrate an individual's lifestyle and spending habits. Credit cards or debit cards are good indicators of an individual taxpayer's spending habits. Capital statement can even reveal the existence of capital, income or assets undisclosed previously.

According to a report in *The Star* on 16 January 2017, The Inland Revenue Board aims to collect RM127 billion direct taxes in line with the amount set by the government in the Budget 2017. Thus, it is important that your assets are matched against your declared income every year.

Wong Yu Sann is the Senior Tax Manager of Deloitte Malaysia that specialises in tax audit and investigation.

How Deloitte Malaysia's Tax Audit & Investigation can help you

Deloitte's Tax Audit & Investigation (A&I) 6 member team is headed by Chow Kuo Seng, who has more than 30 years' experience in tax audits and back duty investigations.

The team focuses on providing value-added services to its clientele which includes local and multinational companies spanning various industries as well as high net worth individuals. Focus is also put on bringing the tax authorities and taxpayers together for early engagement, settlement negotiations, facilitation and amicable resolution of disputes through the Dispute Resolution Proceeding at the local tax headquarters.

In applying his extensive experience to assist clients, Chow's approach is to take a respectful and educative methodology to the tax authorities, while meticulously protecting a taxpayer's rights and responsibilities both at law and in adherence with local practice and policies.

Deloitte has experience in servicing various industries in tax field audit. We enjoy working with these clients and have formed mutually beneficial relationships through quality services provided and client needs insight for clients within similar industries.

Our services
Preparation and submission of the Client's Capital Statements (C.P. 103) and statement of personal and private expenses (C.P. 102), and the review of the Client's personal financial records.
- Review, analyse and extract from all personal files, documents, bank records, accounting records, invoices bills and other source documents.
- Analyse and trace the movement, transfer, and withdrawal of your funds and those of your spouse and children, from bank and deposit accounts, savings passbook or any investment accounts.
- Identify and trace the movement of funds in and out of the director's accounts and capital/drawings accounts in companies, sole-proprietorships and partnership businesses (if any).
- extract, review, analyse and reconcile relevant particulars and information from your personal files, bank and credit card records, receipts, invoices, vouchers, etc.

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