

Does the New Regulation on Pre-Investigation Tax Audit Improve Certainty for Taxpayers?



In a situation involving a tax crime, the tax authority must carry out a pre-investigation audit before proceeding with an investigation. The purpose of this audit is to gather preliminary evidence to determine if a tax crime has indeed been committed. If the tax authority considers that it has enough preliminary evidence, it may escalate the process into a full investigation. On the other hand, if the tax authority determines that there is insufficient preliminary evidence, it will terminate the process.

In practice, many felt that the procedural rules regarding the pre-investigation audit for tax crimes were inadequate in providing taxpayers with certainty. Therefore, the Minister of Finance recently issued a new regulation on pre-investigation tax audit procedures, i.e., Minister of Finance Regulation No. 177/PMK.03/2022, which became effective on 3 February 2023 ("**Regulation**").

Things to Look out For

The Regulation added several substantial new provisions that were absent from the previous rules. These are as follows:

1. **Shorter timeline**

The Regulation sets out a shorter time frame for the tax auditors to complete an open pre-investigation audit within 24 months, whereby the original audit itself must be completed within 12

months and an extension of 12 months can be granted if necessary. Such 12 months extension is shorter compared to the previous rule, which allowed an extension of 24 months.

2. **Mandatory request for clarification**

Before finalising and issuing a notification on the pre-investigation audit results and their audit report, the tax auditors must now request clarification from the taxpayers on the potential state loss due to the tax crime (which is the underpaid tax amount). Such request must be made at least 2 months before the expiry of the 12-month timeline (or the expiry of the 12-month extension).

This process is equivalent to the closing conference in a normal tax audit process.

3. **Notification of audit results**

The tax auditors must notify the taxpayers of the audit results one month after receiving the clarification on the potential state loss. The audit results may reveal evidence of a tax crime; therefore, the tax auditors may escalate the process into an investigation.

On the other hand, if the audit results show no evidence of a tax crime, the tax auditors will close the case.

It should be noted that the previous rules did not prescribe any notification of the audit results, and consequently, taxpayers were frequently unaware of the status of their pre-investigation audit.

Key Takeaways

We believe that the Regulation will improve the previous procedural rules on the same issue and gives more certainty for taxpayers.

If a pre-investigation audit is initiated, taxpayers should cooperate with the tax authority to complete the audit because if there had been a mistake in the tax payment that could indicate a tax crime, the Regulation allows the taxpayer to admit the mistake and pay the underpaid tax plus 100% penalty. This admission can be made during the pre-investigation audit process and before the investigation process is initiated. After the taxpayer makes the admission and the necessary payment, the tax authority will stop the audit process and not escalate the case to the investigation stage.

On the other hand, if a taxpayer is aware of a mistake and chooses not to admit it and the tax authority escalate the case to the investigation stage, any admission by the taxpayer then will be subject to a penalty up to a maximum of 400% of the underpaid tax.

Furthermore, if the tax authority escalates the case to the investigation stage and the case then proceeds to a hearing in a court, the case will not be heard by the tax court, but rather by the general criminal court, whose majority of the judges are not familiar with tax issues.

Thus, despite the increased legal certainty, taxpayers should always take any pre-investigation audit seriously and, if necessary, seek legal counsel.

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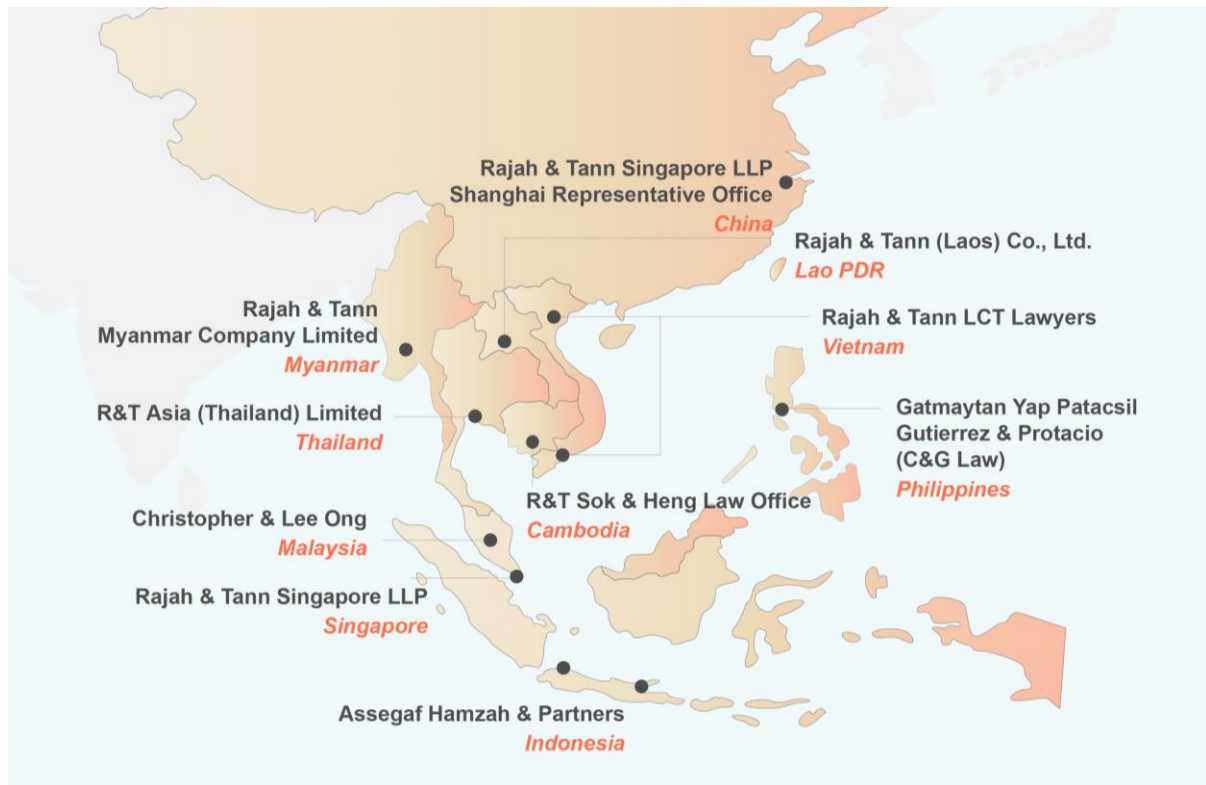
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