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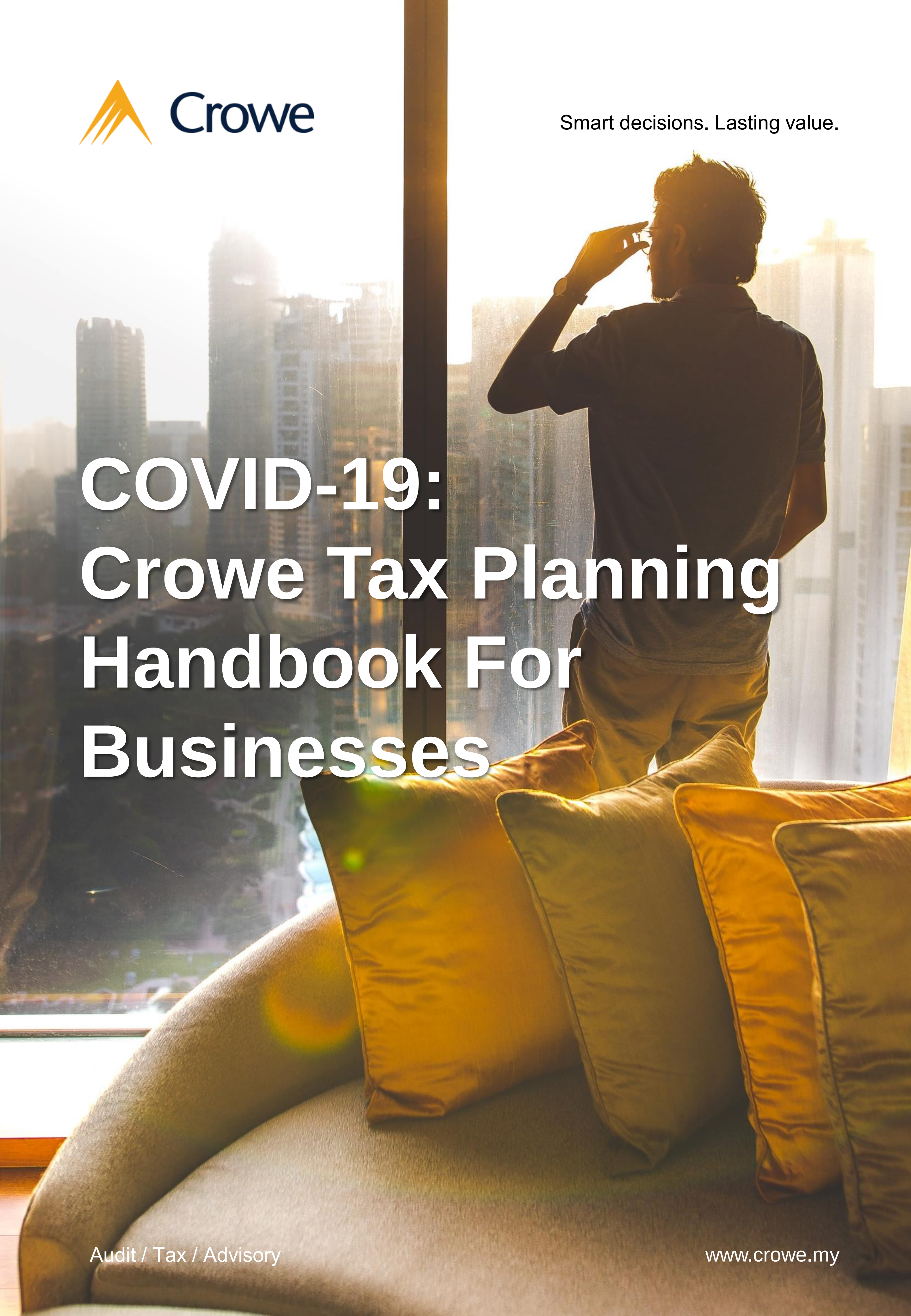

COVID-19: Crowe Tax Planning Handbook For Businesses

Audit / Tax / Advisory

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Section A: Message from the Managing Partner

Message from the Managing Partner

It is often said that resilience is the hallmark of any successful endeavor. Every business journey is filled with challenges that require businesses to be resilient and prepare for any possible outcome. Whilst this is easy to state in principle, we find ourselves operating in a world today in conditions many have not seen since the Spanish Flu of 1918. At the onset of the Covid-19 Movement Control Order (MCO) on 18 March 2020 in Malaysia, many businesses took the temporary business stoppage in their stride. Ten days later after the announcement of a 14-day extension to the MCO, the apathy is turning to concern. The repercussions of this pandemic are being felt everywhere, with Malaysia being no exception.

If this MCO is extended further, it is doubtless that panic may set in. In order not to be caught in a dire situation, businesses need to start looking at managing their operational issues in a more effective manner. These include issues such as cash flow management, inter-company transactions, financing and more. In the ensuing pages of this handbook, our team of experts at Crowe have analysed the various initiatives implemented by the government to help businesses face this crisis from a tax perspective.

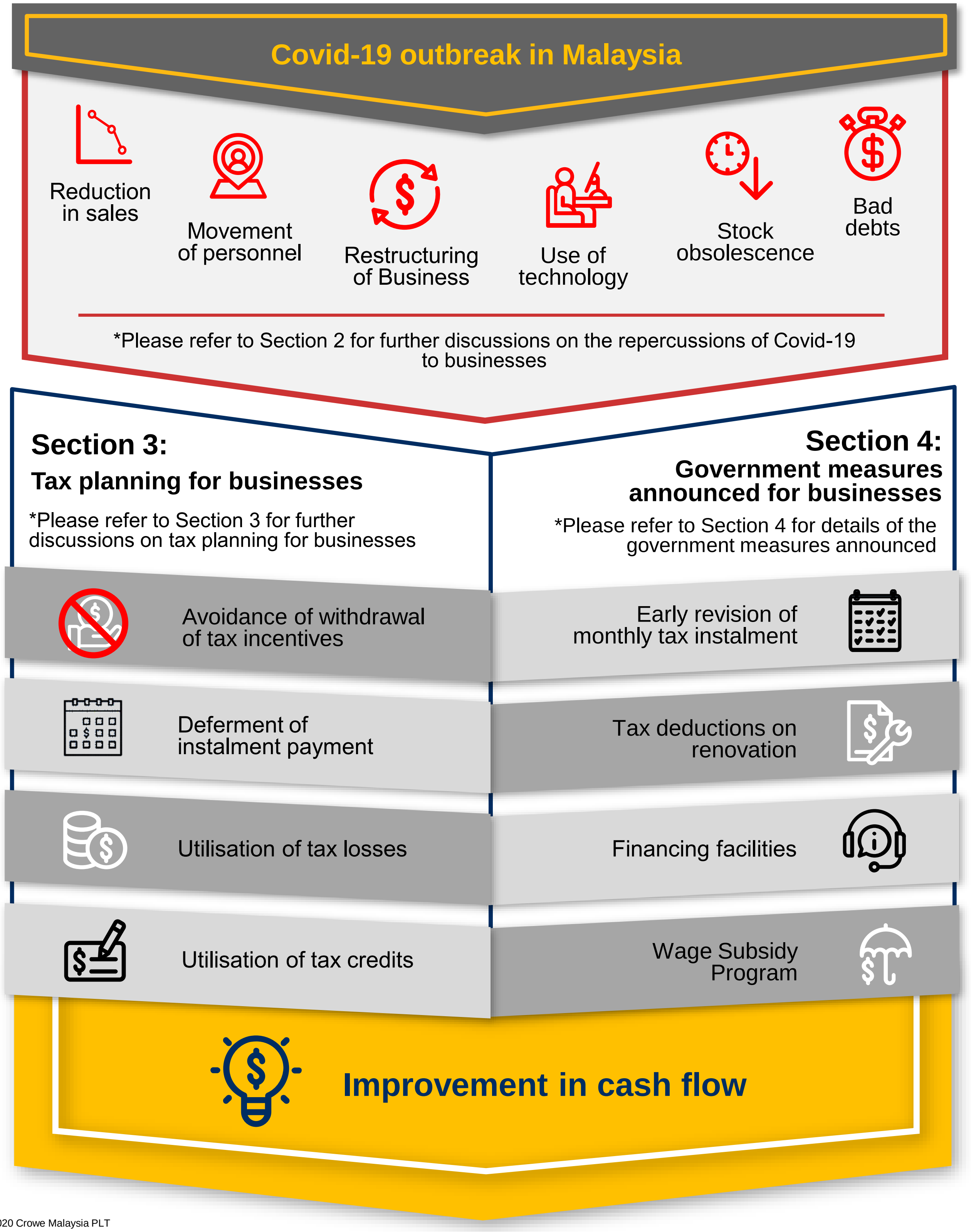
I do hope that this handbook serves as a guiding light for your business in these uncertain times. We would also like to express our gratitude to any of our clients who are helping the community at large to face this crisis. From front-liners to those supporting them, you have our heartfelt thanks and appreciation. May we come out of this situation stronger than ever and look to the future with eager anticipation.

Poon Yew Hoe
Managing Partner
Crowe Malaysia

Section 1: Overview of handbook

Overview of Handbook

We have produced this handbook with the aim of evaluating the possible impact of Covid-19 to businesses in Malaysia and the tax effect therefrom. Further, we have also discussed on the possible tax planning and Government measures that businesses could leverage on to improve the business cash flow during this period. A broad overview of this handbook is as follows:



Section 2: Repercussions arising from Covid-19

1) Overview

Introduction

The Covid-19 virus was first detected in China in late 2019. Since then, the lethal virus has spread throughout the world. As at 1 April 2020, there were over 850,000 positive cases and 40,000 deaths, with countries such as the United States, Italy and Spain being the new epicenters for the disease. What is clear to economists, industry observers and business practitioners alike is that this pandemic is here to stay for the time being, and businesses must rise to the occasion to adjust to the new normal.

Back home, the Covid-19 virus was first detected in Malaysia in January 2020 and has claimed dozens of lives and infected more than 3,000 people to-date. Many lives and businesses have been directly and indirectly affected by the Covid-19 outbreak. The worst affected sectors are those in the tourism industry as most businesses in this industry suffer a severe drop in revenue due to lesser tourists coming into Malaysia.

On 1 April 2020, the Malaysian government imposed further restrictions on its population to curb the spread of the disease, enhancing the existing Movement Control Order (MCO) that was first implemented on 18 March 2020. From an economic standpoint, the government has taken both proactive and reactive measures to contain the economic fallout arising from the Covid-19 pandemic.

Malaysia announced the first Economic Stimulus Package (ESP 1) valued at RM20 billion on 27 February 2020 to ease the financial burden of the people and certain categories of businesses. This was followed by the *Prihatin* Economic Stimulus Package (ESP 2), valued at RM 250 billion on 27 March 2020. An Additional *Prihatin* SME Economic Stimulus Package (ESP 3) valued at RM10 billion and tailored specifically for the micro, small and medium enterprises was announced on 6 April 2020. Whilst the government continues to look at economic policies to help keep the economy afloat, businesses must start taking decisive action in all areas to avoid any other unwanted risks from crystallising.

In this regard, our team of experts have examined the possible repercussions of Covid-19 to businesses on the financial statements (i.e. income, expenses, assets, liabilities) and other issues as well as measures implemented by the government and possible tax planning points that businesses can adopt to ameliorate these difficulties. The guidance provided in this handbook would help to alleviate the tax burdens being faced by businesses to date, as they seek to contain the economic damage that this crisis has brought about.

2) Impact on financial statements

1. Reduction in sales

At the start of the Covid-19 outbreak, many business, particularly those in the tourism industry experienced a reduction in sales once the first case was reported in the country. Initially, businesses had the mindset that they could absorb the effects of the reduction in sales without significant impact to the bottom-line. However, upon the imposition of the MCO on 18 March 2020 and the subsequent extension, all non-essential businesses have now been forced to completely cease operations for an extended period, thus reducing their ability to generate any revenue during this time.

From a tax perspective, the significant reduction in sales poses certain challenges to businesses, especially those enjoying certain tax incentives or facilities (e.g. Principal Hub, Licensed Manufacturing Warehouse, etc) as some of these incentives or facilities often require taxpayers to maintain a specified revenue threshold. Please refer to our comments below on some of the tax effects of reduction in sales to businesses:

Topic	Section reference
Effects of reduction in sales on tax incentives	3(5)(1)
Effects of reduction in sales on indirect tax exemptions	3(5)(2)
Effect of reduction in sales on interest paid to related companies	5(10)

2. Grants and subsidies received from government

The three (3) ESPs announced a wide range of economic initiatives that are targeted towards various sectors of the economy to alleviate the burden of businesses and strengthen their ability to withstand the Covid-19 crisis. Grants provided to selected sectors (e.g. tourism) by government authorities at the federal and state level would carry specific tax treatment that businesses should take note of.

Similar to grants, the three (3) ESPs announced by the government include various subsidies that are aimed at cushioning the impact that the Covid-19 pandemic is having on businesses in general. Whilst ESP 1 focused on human capital related subsidies, ESPs 2 and 3 look into wage subsidies for the lower income category. These subsidies would affect the deductibility of salary expenses from a tax perspective. Our comments on tax issues surrounding grants and subsidies received from government are found under Grants and Subsidies Received – Section 5(1) whilst details of the wage subsidy program are found under Wage Subsidy Program – Section 4(2).

2) Impact on financial statements (cont'd)

3. Costs associated with restructuring of business

Crisis moments often bring about the need to review existing business structures and can give rise to planning opportunities. Business restructuring may be on the cards for some companies as they weather the effects of the Covid-19 pandemic. With the ESP 1 providing a waiver for listing fees and funding for growth-stage companies, taxpayers may start to explore restructuring their existing businesses to achieve a more sustainable business structure to capitalise on growth opportunities post-pandemic.

The tax implications arising from business restructuring are further outlined under Restructuring of Business – Section 5(2).

4. Costs associated with personnel

Due to the movement restrictions imposed as a result of the Covid-19 pandemic, global companies may find themselves in need of relocating staff to new jurisdictions on a temporary or permanent basis. These relocations may give rise to human capital mobility issues and tax deductibility concerns regarding the expenses incurred for the purposes of relocation.

On the other hand, businesses which are badly affected by the Covid-19 outbreak and MCO are looking for ways to reduce operating costs in order to survive. One of the measures is to limit operating hours or downsize the business and expand when the business picks up in the future. In order to do so, some businesses may reduce salary or compel employees to take annual leave or unpaid leave. If the situation becomes untenable, businesses may look at retrenching part of their workforce as a measure to ensure business continuity.

Please refer to the following sections on the measures announced by government and our comments on the tax implications relating to costs associated with movement of personnel:

Topic	Section reference
Wage Subsidy Program	4(2)
Exemption from Payment of Human Resource Development Fund Levy	4(3)
Employer Consultation Service Program by EPF	4(6)
Costs Associated with Movement of Personnel	5(3)

2) Impact on financial statements (cont'd)

5. Use of technology services

With most governments around the world imposing movement restrictions on the population, an estimated one third of the world population is now facing limited mobility. As such, businesses are turning to using technology tools such as social media, video conferencing tools, cloud-based solutions and the like to ensure internal and external communication channels remain open and operations continue. This would give rise to tax implications as there could be payments made to non-residents that could attract withholding tax implications, especially in cases where software is procured from these non-residents. The tax issue is further explored under Use of Technology Services – Section 5(4).

6. Donations and contribution to fight Covid-19

The Covid-19 pandemic has been a call to action for many stakeholders in the Malaysian economy, including businesses. As we witness a coming together of our nation like never before, businesses are also making contributions in monetary terms to the government or designated organisations. These contributions may also take the form of in-kind contributions, such as medical equipment, medication, protective gear and so on. In doing so, businesses should be mindful of the tax implications arising from these contributions and where allowed, benefit from tax deductions on the contributions made.

Please refer to our comments on Donations and Contributions – Section 5(5).

7. Penalties on late payment of statutory contribution / payments

As you may be aware, late payment of statutory contributions to the relevant authorities carry certain penalties under normal circumstances. Whilst employers do not wish to actively run foul of these regulations, the adverse environment and reduced demand with regard to sales may force certain businesses to delay salary payments. Under such circumstances, statutory contributions could also be delayed and this may give rise to penalties being imposed, as the government has taken a firm position that the MCO should not affect the payment of salaries during this time. See our comments under Penalties on Late Payment of Statutory Contributions – Section 5(6) for discussion on the deductibility of such penalties.

2) Impact on financial statements (cont'd)

8. Bad debts

Cash flow concerns are at the top of most business owners' priority list even under normal operating conditions. The scale of the Covid-19 pandemic has left virtually no market untouched by its effects and customers, both domestic and foreign, may find it hard to settle their debts on a timely basis. In this sense, businesses have to take note of the specific bad debt provisions and requirements in existing tax legislation to manage their tax positions accordingly. Please see our comments on this area under Bad Debts – Section 5(7).

9. Stock obsolescence

As markets slow down, businesses operating in retail, manufacturing, trading and distribution industries are having to make critical decisions regarding stocks on hand. Whilst most distribution supply chains utilise lean systems to keep inventory levels low, many businesses are faced with a sudden drop in demand due to movement restrictions, which has caused widespread stock obsolescence in some industries. Writing off such perishable or slow-moving inventories may be necessary, and this may carry certain tax implications as well (e.g. deductibility issues, sales tax considerations). More on this can be found under Stock Obsolescence – Section 5(8).

10. Interest expenses

Just last year, the Malaysian government had put through legislation to implement restrictions on the deductibility of interest expense or more informally know as Earning Stripping Rules. In light of the Covid-19 crisis, many multinational groups may defer payments of interest expenses to foreign holding companies / intragroup lenders based outside Malaysia, in a hope to ease their cash flow burden. Further, as the Earning Stripping Rules are based on tax-EBITDA, many taxpayers facing losses may not be able to claim any interest expense deductions. In addition, businesses which opted for the six (6) months loan repayment moratorium may face issue on the deductibility of interest expenses. Please refer to our comments under the following sections:

Topic	Section reference
Moratorium on loan repayment	5(9)
Interest Paid to Related Companies	5(10)

2) Impact on financial statements (cont'd)

11. Capital expenditure

External pressures on businesses today are immense and many are evaluating their options given the current levels of demand in the market. Hence, businesses may be forced to defer capital expenditure within the current financial year as they move from a growth mindset to a business preservation mindset to face the challenges this pandemic has brought about. In doing so however, they may risk losing certain tax incentives such as investment tax allowance previously obtained that require taxpayers to commit a specified amount of capital expenditure for each year of assessment.

On the other hand, certain businesses may take the opportunity to carry out renovation and refurbishment of their business premises in the current financial year so as to give a fresh start to their business once the Covid-19 pandemic is over. The tax impact of deferment of capital expenditure and renovation is further discussed under the following sections:

Topic	Section reference
Renovation and Refurbishment Costs	4(7)
Deferment of Capital Expenditure	5(11)

12. Investment in shares for a share trading company

With global markets facing declines and the International Monetary Fund recently declaring a global recession, companies that engage in share trading activities or hold investments in equity are poised to incur significant losses in the months to come. These losses on investment may have an impact on the tax position of the company from a corporate income tax perspective. A further analysis on this issue can be found under Impairment Loss on Investments – Section 5(12).

13. Movement of inventories between companies

In light of the crisis and restriction of movement, businesses may be reallocating inventories between companies to meet growing demand in certain markets affected by the Covid-19 pandemic. The movement of inventories between these companies must be carefully executed, with proper consideration given to the value at which these inventories must be transferred at. This is further explored under Movement of Inventories Between Companies – Section 5(13).

2) Impact on financial statements (cont'd)

14. Increase in capital injection

Existing shareholders of companies may be forced during this Covid-19 pandemic, to utilise excess cash to inject capital into struggling businesses to ensure their survival. As such, businesses benefiting from a lower tax rate (e.g. small and medium enterprises benefiting from the 17% tax rate) may no longer be able to do so if share capital amounts increase beyond the threshold. Further, in the case of real property companies, injection of capital may have an impact on timing issues that may affect real property gains tax liabilities in future years. This issue is further discussed under Capital Injection – Section 5(14).

15. Additional borrowings

Central banks around the world have responded to the Covid-19 pandemic by introducing a slew of monetary and fiscal policies aimed at sustaining the nation's economies and avoiding a total collapse. Part of these measures include cheaper access to funding by implementing near-zero interest rates. Malaysian based companies may benefit from access to cheaper external sources of funds as overseas headquarters obtain financing from financial institutions. These companies may then extend such borrowings within their respective groups of companies. This may give rise to transfer pricing implications in light of the arm's length provisions surrounding intercompany financing activities.

Please see our comments under Cash Flow Management from a Transfer Pricing Perspective – Section 5(15) for further details.

16. Slow payment to creditors

At present, businesses may be facing cash flow constraints that would affect their day-to-day operations. As such, they may take the hard decisions to delay payments to creditors to meet certain working capital requirements (e.g. employee expenses, operational expenses). In doing so, businesses may defer payments to creditors (both independent and related parties). These delays to related parties may carry transfer pricing considerations as long-term delays may not be viewed as trade financing in nature. The complexities surrounding this issue are further explored under Cash Flow Management from a Transfer Pricing Perspective – Section 5(15).

3) Other issues

1. Transfer pricing documentation considerations

As companies in Malaysia brace for the impact of the Covid-19 pandemic, few will know the true impact to companies' financial positions at the year end. It remains uncertain if industries within the country can recuperate later on in this financial year or will see all of their profit potential being wiped out in the coming months. These uncertainties give rise to practical challenges from a transfer pricing perspective, as it is anticipated that many businesses that engage in inter-company transactions may face business losses arising from this hostile environment.

As this is often an area of contention with the tax authorities, companies must take proactive measures to incorporate various analyses and information in their transfer pricing documentation for this year of assessment to mitigate transfer pricing risks. The complexities surrounding transfer pricing documentation and compliance issues are further elaborated under Managing Transfer Pricing Risks – Section 5(16).

2. Permanent Establishment (PE) issue due to restricted movement

Malaysia is not the only country that has entered into some form of restricted movement. Many tax jurisdictions around the world are now faced with restricted movement, with some even barring the entry of foreigners (such as the case of Malaysia). In this situation, it is possible that personnel involved with cross-border business may be required to extend their visit within Malaysia for extended periods. This may give rise to a PE issue as rules surrounding the creation of PEs often involve physical presence of personnel. This may impact multinational organisations and companies involved in certain industries (e.g. construction and service-based industries). This issue is further discussed under Service Permanent Establishment – Section 5(17).

3. Restricted movement impact giving rise to tax residency issues

The control measures put in place to restrict the movement of people within and outside of Malaysia may give rise to practical concerns regarding tax residency. For example, from a corporate tax residency perspective, residency is often determined by exercising management and control (determined through directors' meetings held within Malaysia). In the current climate, the Covid-19 pandemic has resulted in business leaders turning to technology to hold meetings as travel between countries are severely restricted. The impact this may have on the tax residency status of companies is further explored Residence Status – Section 5(18).

4) Measures introduced by the Government

1. Government assistance

The three (3) ESPs announced by the government provide various forms of government assistance. This has come in the form of deferment of tax payments, access to funding in various forms and specified tax deductions. These forms of government assistance are aimed at reducing the impact of the Covid-19 pandemic on business across multiple sectors.

From a tax perspective, some of these deductions, such as those involving renovation of workspace and deferment of tax instalments, will be of particular interest to businesses as it may free up cash flow and encourage spending later on.

In addition, the government has implemented several measures to ease the financial burdens of companies and individual citizens. This includes a moratorium on loan and interest repayments on financing obtained from financial institutions (with certain exceptions). As many businesses utilise debt to grow their business, this reduced expenditure may have an impact on qualifying expenditure amounts that businesses incur every year, which in turn may affect certain tax incentives (e.g. investment tax allowance, reinvestment allowance).

We have segregated the government measures announced into two parts – non-fiscal measures and fiscal measures. Further, we have also analysed some of the potential tax issues arising from these measures announced.

The non-fiscal measures are discussed under following sections:

Topic	Section reference
Financing facilities	4(1)
Wage subsidy program	4(2)
Exemption from payment of HRDF levy	4(3)
Waiver of listing fees	4(4)
Discount on electricity bills	4(5)
Employer Consultation Service program by EPF	4(6)
Reduction of foreign worker levy	4(7)

4) Measures introduced by the Government (cont'd)

The fiscal measures and potential tax issues arising therefrom are discussed under the following sections:

Topic	Section reference
Renovation and refurbishment costs	4(8)
Personal protective equipment given to employees	4(9)
Accelerated capital allowance for certain assets	4(10)
Establishment of Regional Office by International Shipping Companies	4(11)
Rental discount given by landlords	4(12)
Stamp duty on restructuring and rescheduling of loans	4(13)
Service tax exemption for hotels	4(14)
Expansion of approved activities in LMW and FIZ	4(15)
Port operators	4(16)
Import duty and sales tax exemption for face masks	4(17)
Import duty, excise duty and sales tax exemption for ethyl alcohol	4(18)
Import duty and sales tax exemption for personal protective equipment	4(19)
Moratorium on loan repayments	5(9)

5) Planning measures

1. Planning measures to defer tax payments, efficient utilisation of tax credits and business losses.

The Covid-19 pandemic represents the first truly global health crisis in our globalised business world. As such, it has adversely impacted financial markets like never before, with some estimates indicating that the economic impact may be worse than the financial crisis in year 2008. As such, proper planning initiatives would be required to ease the tax burden on taxpayers in Malaysia. Further, business losses may be inevitable as Malaysian businesses are largely restricted from conducting operations on normal terms.

From a tax perspective, planning for these business losses for this year of assessment is an important consideration. In addition, businesses may also look to capitalising on the government's proposal to allow deferment of tax instalments, ensuring estimation of taxes are made appropriately, and utilisation of existing tax credits to ease cash flow concerns. These efforts if carried out within a Group may help to lessen the Covid-19 impact on the overall financial performance of the company. Additional details regarding our comments on this area can be found under the following sections:

Topic	Section reference
Deferment of corporate monthly instalment payments	3(1)
Utilisation of tax credits	3(2)
Utilisation of business losses	3(3)
Reduction of taxes	3(4)
Avoidance of withdrawal of incentives	3(5)

Section 3: Tax planning for businesses

1) Deferment of corporate monthly instalment payment

Cash flow is the lifeblood of a business. Hence, managing cash outflows by deferring payments could be a key to improve the cash flow financial position of a business, especially during this challenging time.

Let us see how a business could optimise the measures announced in the Economic Stimulus Packages to defer its monthly tax payment to the Inland Revenue Board (IRB) to a later date, without triggering the late payment penalty.

a) Corporate monthly instalment payment

The statutory requirements for a company under the current tax legislation, amongst others, are as follows:

- A company is required to furnish to the IRB an estimate of tax payable via a prescribed form for a year of assessment (YA) thirty (30) days before the beginning of the basis period;
- Thereafter, the company shall remit the estimate of tax payable to the IRB in equal monthly instalments (CP204 payment) which are due on 15th of the month. The first CP204 payment will commence from the 2nd month of the basis period. A 10% late payment penalty will be imposed on late or unpaid CP204 instalments;
- A company is allowed to revise its estimate of tax payable for a YA in the sixth (6th) and ninth (9th) months of the basis period for that YA;
- A company is required to file its income tax return within seven (7) months from the end of the accounting period (or an extension of time granted by the IRB). Any shortfall between the actual tax payable and instalment payments made shall be remitted to the IRB then. Likewise, in the event of any tax overpaid (i.e. tax instalments paid that exceeds the actual tax payable), the IRB will process a tax refund to the taxpayer upon receipt of the income tax return for the YA; and
- If the tax payable for a YA exceeds the original or revised estimate of tax payable by an amount exceeding 30% of the tax payable, the difference will be subject to a 10% penalty for under-estimation of tax payable.

1) Deferment of corporate monthly instalment payment (cont'd)

b) Measures announced in the Economic Stimulus Packages

As a response to the Covid-19 outbreak, several tax measures have been introduced to ease cash flows of businesses which include the following:

i. <u>Deferment of CP204 payments for the tourism industry</u>

Businesses in the tourism industry are allowed to defer their CP204 payments for six (6) months from 1 April 2020 to 30 September 2020. The deferment is only applicable to travel agencies, hotel operators and airline companies. Based on the updated Frequently Asked Questions Concerning Tax Matters During Movement Control Order Period (18 March 2020 to 28 April 2020) (IRB MCOFAQ) issued by the IRB on 21 April 2020, an automatic deferment of CP204 payments will be given to all businesses under the tourism industry having a record with the IRB.

Further, these businesses are not required to pay the deferred CP204 payments in the remaining months of the basis period but to pay the balance of tax payable, if any, upon submission of the tax return for that YA. In addition, the IRB will not impose any late payment penalty on the deferred CP204 payments.

ii. <u>Deferment of tax instalment payments for SMEs</u>

Small and Medium Enterprises (SMEs) are allowed to defer their CP204 payments for three (3) months starting from 1 April 2020 to 30 June 2020. Based on the updated IRB MCOFAQ, an automatic deferment of CP204 payments will be given to all SMEs. As such, no application is required from the SMEs. Further, SMEs are not required to pay the deferred CP204 payments in the remaining months of the basis period but to pay the balance of tax payable, if any, upon submission of the tax return. In addition, the IRB will not impose any late payment penalty on the deferred CP204 payments.

Based on the updated IRB MCOFAQ, it is mentioned that the automatic deferment of CP204 payments are only given to SMEs that meet the definition of SME as follows

i. a resident company in Malaysia with a paid up capital of RM2.5 million and below at the beginning of the basis period for a YA;
ii. and having gross income from source(s) consisting of a business of not more than RM50 million for the basis period for a YA.

1) Deferment of corporate monthly instalment payment (cont'd)

iii. Special revision of estimate of tax payable in the 3rd month of instalments

Businesses affected by the Covid-19 outbreak are allowed to revise their estimate of tax payable earlier, i.e. in the 3rd month of instalment, provided the 3rd month of instalment falls in the year 2020. In this regard, companies with the financial year ended from 30 November 2020 to 31 August 2021 could revise their tax estimates in the 3rd month of instalment as shown below:

Company with financial year-ended	YA	Revision in the 3rd month of instalment
30 Nov 2020	2020	Mar 2020
31 Dec 2020	2020	Apr 2020
31 Jan 2021	2021	May 2020
28 Feb 2021	2021	Jun 2020
31 Mar 2021	2021	Jul 2020
30 Apr 2021	2021	Aug 2020
31 May 2021	2021	Sep 2020
30 Jun 2021	2021	Oct 2020
31 Jul 2021	2021	Nov 2020
31 Aug 2021	2021	Dec 2020

An application for the revision in the 3rd month of instalment must be made to the IRB by submitting a duly completed and signed form.

It should be noted that the revision of tax estimates for the 6th month and the 9th month of the basis period for a YA is still applicable to a business which has opted for the special revision of tax estimates in the 3rd month of instalment.

c) How a business could plan its monthly tax payments

Every company is advised to diligently look into how revisions or deferments could be made to alleviate the cash outflow burden of the business as such measures would allow the business to preserve more cash during this financial uncertainty period caused by Covid-19 outbreak.

Here are some examples:

1) Deferment of corporate monthly instalment payment (cont'd)

i. December year-end companies – to optimise the revision in the 3rd month of instalment

As December year-end companies affected by Covid-19 outbreak are given a chance to revise its tax estimate for YA 2020 in the 3rd month of instalment, i.e. in the month of April 2020, these companies are advised to review their tax estimate for YA 2020 which was submitted to the IRB previously and determine whether there is a need to revise its tax estimate in view of the impacts and potential repercussions arising from the Covid-19 pandemic.

Illustration:

- Company X with a financial year ended 31 December 2020 submitted its tax estimate of RM1,200,000 for YA 2020 by 30 November 2019.
- With this, Company X shall pay RM100,000 per month as CP204 payment to the IRB from 15 February 2020 to 15 January 2021.
- Company X has remitted the 1st and 2nd CP204 payments totalling RM200,000 to the IRB before the month of April 2020.
- In view of the Covid-19 outbreak and its subsequent financial impacts to the Company, Company X foresees that it could be in a loss position for YA 2020 as the Company's business is badly affected by the Covid-19 pandemic.
- In this regard, Company X may revise its estimate of tax payable for YA 2020 to RM200,000 by utilising the 3rd month of instalment. Since the tax estimate of RM200,000 has been fully paid by Company X, the Company is not required to pay the CP204 payments from April 2020 onwards provided no objection is raised by the IRB on the revision made by Company X in its 3rd month of instalment.
- Should the economy rebound in the subsequent months, Company X may review its financial position in the months of June 2020 and September 2020 to determine whether a revision of tax estimate for YA 2020 is required.
- The 9th month revision that is due in September 2020 should be examined by the Company X diligently to ensure that the penalty for under-estimation of tax payable is not triggered.
- For illustration purposes, if Company X wishes to restate its tax estimate for YA 2020 to RM1,200,000, Company X can do so by submitting a Form CP204A to the IRB in September 2020.

1) Deferment of corporate monthly instalment payment (cont'd)

In respect of the above illustration, the monthly instalment payment scheme for Company X for YA 2020 could be as follows:

Due date for monthly instalment payment for YA 2020	Monthly instalment payment scheme as per original tax estimate (CP204) (RM)	Monthly instalment scheme after revision in the 3rd month of instalment (Note) (RM)	Monthly instalment scheme after the 9th month revision in Sep 2020 (CP204A) (RM)
15 Feb 2020	100,000	100,000	100,000
15 Mar 2020	100,000	100,000	100,000
15 Apr 2020	100,000	NIL	NIL
15 May 2020	100,000	NIL	NIL
15 Jun 2020	100,000	NIL	NIL
15 Jul 2020	100,000	NIL	NIL
15 Aug 2020	100,000	NIL	NIL
15 Sep 2020	100,000	NIL	NIL
15 Oct 2020	100,000	NIL	250,000
15 Nov 2020	100,000	NIL	250,000
15 Dec 2020	100,000	NIL	250,000
15 Jan 2021	100,000	NIL	250,000
Total	1,200,000	200,000	1,200,000

Note – the revised monthly instalment scheme will take effect from 15 April 2020 provided the revision of tax estimate for the 3rd month of instalment is submitted to the IRB by 31 May 2020.

1) Deferment of corporate monthly instalment payment (cont'd)

ii. September year-end companies – to optimise the 6th month revision

September year-end companies are not entitled for the tax revision in the 3rd month of instalment as their 3rd instalment was due in January 2020. However, September year-end companies could optimise the opportunity under the 6th month revision of tax estimate. Here are some tips for September year-end companies to plan their CP204 payments to the IRB:

- The 6th month revision of tax estimate for YA 2020 falls in the month of March 2020, wherein the due date for submission of the Form CP204A (6th month revision) has been extended by the IRB to 31 May 2020 in view of the implementation of the MCO. Hence, September year-end companies still have a chance to review their financial position and submit a revised tax estimate to the IRB, if need be.

- The September year-end companies should review their 9th month tax estimation revision in June 2020 diligently to avoid triggering the penalty for under-estimation of tax payable.

Please do note that October year-end companies wherein the 6th month tax estimate revision falls in April 2020, may adopt this similar approach.

iii. June year-end companies – to optimise the 9th month revision

For June year-end companies, although its 9th month tax estimate revision falls in March 2020, the due date for submission of Form CP204A (9th month revision) has been extended to 31 May 2020.

Hence, there is still some room available for June-year end companies to plan their tax instalment payments for the months of April, May, June and July 2020.

Please do note that July year-end companies wherein the 9th month tax estimate revision falls in April 2020, may also adopt the similar approach.

The abovementioned 9th month tax estimate revision should be used by the companies diligently to avoid the penalty for under-estimation of tax payable.

1) Deferment of corporate monthly instalment payment (cont'd)

iv. Companies in tourism related business – to optimise the deferment of tax instalments

Based on the updated IRB MCOFAQ, travel agencies, hotel operators or airline companies are given automatic deferment of their CP204 payments for the months of April 2020 to September 2020 and these businesses are not required to pay the deferred CP204 payments in the remaining months of the basis period. Instead, these businesses are required to pay the balance of tax payable, if any, upon submission of the tax return.

<u>Illustration:</u>

Below shows the monthly instalment scheme for a December year end tourism related company for YA 2020 after the automatic deferment of CP204 payments:

Due date for payment	Monthly instalment payment scheme as per original tax estimate (CP204) (RM)	Monthly instalment payment paid / payable after automatic deferment (RM)
15/02/2020	100,000.00	100,000.00
15/03/2020	100,000.00	100,000.00
15/04/2020	100,000.00	NIL
15/05/2020	100,000.00	NIL
15/06/2020	100,000.00	NIL
15/07/2020	100,000.00	NIL
15/08/2020	100,000.00	NIL
15/09/2020	100,000.00	NIL
15/10/2020	100,000.00	100,000.00
15/11/2020	100,000.00	100,000.00
15/12/2020	100,000.00	100,000.00
15/01/2021	100,000.00	100,000.00
Total	**1,200,000.00**	**600,000.00**

1) Deferment of corporate monthly instalment payment (cont'd)

v. Small and Medium Enterprise (SME) – to optimise the deferment of monthly instalment scheme

SMEs, with a February or March financial year end, may not benefit from the revision of tax estimate in the 3rd month of instalment or make a 6th month revision or 9th month revision as these SMEs could have factored in the impact of Covid-19 pandemic in the original tax estimate due in January 2020 and February 2020 respectively. In this regard, these SMEs should make good use of the cash arising from automatic deferment of its CP204 payments for the months of April to June 2020 in their business operations.

d) Conclusion

The above illustrations demonstrate that there is room for planning for deferment of monthly tax instalment payments to the IRB. However, the strategy and method to employ the planning for each business would depend on the year-end, business activity and SME status of the said business.

2) Utilisation of tax credits

In the past, your business may have done well and had made lots of profits. It is not the same for this year as sales could have plummeted and cash is running low. The next thing you started to realise is that your company has tax credits with the Inland Revenue Board (IRB) for overpayment of previous years' taxes.

In a tax credit situation, there are usually three (3) options available to the company:

a) Option 1: To apply for refund of tax credits

The standard operating protocol of the IRB is to refund any excess tax payment to the company after the company has duly filed its income tax return within the stipulated deadline for tax filing. A refund is made automatically and directly to the taxpayer's bank account. However, there have been instances that a refund is taking forever. One of the reasons one may expect from the IRB is that the case is being selected for a tax audit, thus the refund is being held back until the case is closed.

Other than that, the delay could be caused by oversights by the IRB. To move forward, a written application for a refund of tax credit is absolutely necessary to kick-start the refund process. Further follow-up visits may be required to expedite the refund.

b) Option 2: To request for a set-off arrangement

Pending a tax refund, a company can apply in writing to request for a set-off arrangement, i.e. utilisation of tax overpaid in the previous YA against the tax instalments (under CP204) for the current YA. This is a quick resolution to conserve your cash in hand as you can avoid further cash outflow from your bank account to the IRB to meet your company's on-going tax obligations.

The offsetting arrangement can also be made if a company has outstanding tax liabilities with the IRB, including the balance of tax payable upon filing of your company's income tax returns to the IRB.

An approval is required for the request for an offsetting arrangement.

c) Option 3: Keep the tax credits with the IRB for future use

If you are not worried about cash flow in this economic climate, or the tax credits are not worth your time and effort after much evaluation, this option represents the best option of all because you can avoid the hassle of dealing with the authorities. On the other hand, the IRB will be grateful to you for your kind gesture.

3) Utilisation of business losses

Businessmen, entrepreneurs, shareholders, CEOs, CFOs, CMOs, CIOs, alike hate to see their businesses making losses. A loss making position will spark off an array of problems with its stakeholders including low employee morale, withdrawal of credit line from suppliers, mistrust by customers, etc.

You probably already know that if a business is making losses, there is no issue on paying taxes in the loss making year because there is no tax to be paid. Those who are a little more tax savvy will give further thought to further planning in realising the tax benefits from the tax losses in the future.

a) Tax Rules on Losses

First things first, a tax loss or in technical terms, "adjusted loss from a business source" is computed by making the required tax adjustments on the accounting "loss before taxation" for any non-tax deductible expenses (such as depreciation, private or domestic expenses, provisional expenses, capital expenses, etc.) and non-taxable income (such as unrealised foreign exchange gains, exempt interest income, capital gains, etc.). In a nutshell, the eventual amount of tax losses will not likely be the same as the accounting losses.

Next, there are prescriptions in the tax legislation on the manner of utilisation of the tax losses arising from a business source, either in the current year of assessment (YA) or future YAs:

- ***Current year tax losses from a business source*** – May be utilised for set off against income from other sources within the current year, including income sources from non-business sources such as rental and interest.
- ***Future year utilisation*** - Any unutilised portion of the tax losses in a YA can be carried forward to future YAs, for set off against that business source only.
- ***Forfeiture of tax losses*** –The life span of the tax losses is capped at seven (7) YAs. For example, tax losses from YA 2020 will only be beneficial to the taxpayers any time between YA 2021 and YA 2027. If the tax losses are not utilised by YA 2027, the remaining tax losses in YA 2020 will be disregarded in YA 2028.

b) Reaping Benefits from Tax Losses

The tax losses in your company are waiting for you to put it into action. But it cannot afford to wait for too long. You have only seven (7) years to reap the benefits by being profitable in your business. The motivation for you to do so is that if your business is profitable, you can expect lower taxes as a result of the previous year's tax losses, thus resulting in a lower effective tax rate.

4) Reduction of taxes

The government announced several measures to help businesses cushion the economic impact of the Covid-19 outbreak during the First, Second and Additional Economic Stimulus Packages. If a business could benefit from the tax deductions, tax incentives and tax reliefs given by the government, it would help to reduce the business's chargeable income which would result in a lower tax payable by the business. The question here is how a business could optimise the deductions and incentives given by the government?

The table below summarises some of the tax measures that a business should take note during this period in order to obtain full benefit from these measures:

	Tax measures
1.	Tax deduction is given for donations and contributions made to Covid-19 Funds.
2.	Tax deduction is given for the provision of disposable personal protection equipment to employees.
3.	Accelerated Capital Allowance (ACA) for machinery, equipment including Information and Communication Technology (ICT) equipment in respect of the expenditure incurred from1 Mar 2020 to 31 Dec 2020.
4.	Tax deduction for the costs of renovation and refurbishment of business premise incurred from 1 Mar 2020 to 31 Dec 2020 up to RM300,000.
5.	Double deduction given to the pre-commencement expenses incurred for establishment of regional office by International Shipping Companies.
6.	Further deduction is given to the training expenses incurred by hotel and tour operators.
7	Additional tax deduction equal to the rental discount is given to landlords of private business premises who give rental discounts to small and medium enterprises.
8.	Import duty and sales tax exemption on the importation or purchase of equipment and machinery (excluding spare parts and consumable items) that would be used directly for the port operations.

4) Reduction of taxes (cont'd)

The table below summarises some of the non-tax measures which a business could potentially benefit from:

	Non-tax measures
1.	Six (6) months moratorium on repayment of bank loans.
2.	Wage subsidy of up to RM1,200 per month per employee given to employer.
3.	Electricity discount by Tenaga Nasional Berhad.
4.	Exemption from HRDF levy for six (6) months from 1 Apr 2020 to 30 Sep 2020.
5.	Employer Consultation Services by the EPF for services on restructuring of employer's EPF contributions.
6.	Loans or facilities offered with lower interest rate and repayment may commence six (6) months after disbursement.

Actions required to reap the benefits from the above measures

Below are the recommended actions by a business to optimise the above measures which would in turn help to improve the financial position of a business:

Step 1: Work together with your tax consultant to spot opportunities

In order to lighten the tax burden of a business, the key strategy lies in planning towards the potential tax upsides as well as avoiding pitfalls from the adverse tax implications. Hence, a taxpayer can work together with a tax consultant on the following:

- to have an in-depth understanding of the measures, including eligible criteria and conditions attached thereto;
- to examine the relevancy of each measure to your business;
- to analyse both the potential tax upsides and pitfalls of each measure;
- the costs and benefits from the identified measures; and
- to work out the execution plan.

Step 2: Ensure the appropriate tax treatment is adopted in the tax computation

Upon execution of the planned action, taxpayers should provide the relevant information and documents to their tax agent to ensure the tax deductions or reliefs are made appropriately in the tax computation.

5) Avoidance of withdrawal of incentives

1. Effects of reduction in annual sales on tax incentives

One tax incentive which prescribes a minimum annual sales to be met by the recipient is the Principal Hub incentive. Briefly, the Principal Hub incentive is given to a locally incorporated company that uses Malaysia as a base for conducting its regional or global businesses and operations such as to manage, control, and support its key functions including management of risks, decision making, strategic business activities, trading, finance, management and human resource.

The Principal Hub incentive is a tax exemption given on statutory income based on the level of commitment of the company. An additional condition is imposed for tax exemption on trading income whereby the Principal Hub is required to meet minimum annual sales turnover of RM500 million.

As the Covid-19 pandemic and MCO have caused a devastating impact to businesses, it could be challenging for some Principal Hubs to meet the annual sales turnover of RM500 million requirement. For a Principal Hub that fails to meet the specified conditions in any particular year of assessment during the exemption period, such Principal Hub would not be able to enjoy the tax incentive given to the Principal Hub. Consequently, this could result in a substantial tax payable by the Principal Hub.

In view of this, a Principal Hub should proactively perform a review on the projection of the annual sales turnover post-MCO period and assess on the likelihood of compliance with the relevant conditions, particularly the annual sales turnover requirement, taking into consideration of the adverse impact due to Covid-19 pandemic.

In the event that the Principal Hub is unable to comply with the condition (i.e. annual sales turnover) due to Covid-19 pandemic and MCO, the Principal Hub should appeal to MIDA immediately to request for exemption from complying with the conditions previously given. Principal Hubs should have good grounds for appeal as the decrease of the annual sales turnover was caused by extenuating circumstances as the Principal Hubs are forced to shut down during the MCO period. However, such approval will be based on the sole discretion of MIDA and the National Committee of Investments.

In conclusion, businesses that are currently enjoying tax incentives should revisit the approval conditions imposed to ensure that all pertinent conditions imposed on the tax incentives will be met.

5) Avoidance of withdrawal of incentives

2. Effects of reduction in sales on indirect tax exemptions

During the MCO period in Malaysia, businesses can still import or export goods if such goods are not prohibited under Customs (Prohibition on Exports) Order 2017 or Customs (Prohibition on Imports) Order 2017 and subject to MCO. For exportation of goods, an approval letter is required to be obtained from the Ministry of International Trade and Industry in advance.

However, businesses may still face some slow down or delay in the exportation or importation of goods during this MCO period.

In this regard, businesses should take note of all the indirect tax drawbacks or exemptions granted and to ensure that the conditions stipulated in the particular drawbacks or exemptions are met, especially when the conditions stated include deadlines for the business to re-export or re-import goods. Otherwise, it may lead to an additional cost to the business as the existing indirect tax exemptions or drawbacks would no longer be applicable to the businesses.

For example, goods imported temporarily and subsequently re-exported are exempted from the payment of Sales Tax under item 33 in Schedule A of the Sales Tax (Person Exempted from Payment of Tax) Order 2018. One of the conditions stated in this Order is that the goods are required to be exported within three (3) months. Therefore, if the importer is unable to export the goods within three (3) months, the importer is required to account for and pay Sales Tax to the Customs.

In addition, a Licensed Manufacturer Warehouse (LMW) may need to take note on the LMW requirements (i.e. to maintain 80% of export sales) in order to maintain the LMW license. Otherwise, once the LMW status is revoked, all the exemptions given to LMW would also be removed (such as, exemption from payment of Import Duty, Excise Duty and Sales Tax on acquisition of raw materials or components that are used directly in manufacturing of finished goods, exemption from registration of Sales Tax, etc.) and the manufacturer may incur additional costs from paying all the indirect taxes.

Section 4: Measures announced by Government

(Stimulus Packages and others)

1) Financing facilities

To support the cash flow of small and medium enterprises (SME) impacted by the Covid-19 outbreak, Bank Negara Malaysia (BNM) is allocating RM13.1 billion of financing facilities under BNM Fund for SMEs to provide support for SMEs in sustaining business operations, safeguard jobs and encourage domestic investments.

A. Types of Facilities Available

There are at least six (6) types of facilities available as shown below:

a) Special Relief Facility (CRF) Covid-19.
b) All Economic Sectors (AES) Facility.
c) Automation and Digitalisation Facility (ADF).
d) Agrofood Facility (AF).
e) Micro Enterprises Facility (MEF).
f) Micro Credit Scheme (MCS)

The financing facilities under (a) to (e) above are operated through BNM whilst the MCS is operated through Bank Simpanan Nasional.

Each of these financial facilities has specific focus on its target sector of the economy. For instance, Special Relief Facility (SRF), with an allocation of RM5 billion, is targeting to help alleviate the short-term cash flow problems faced by SMEs adversely affected by the Covid-19 outbreak. On the other hand, Agrofood Facility (AF), with an allocation of RM1 billion, is aimed to increase food production for export purposes.

Please refer to the table in Section D for the summary of the features of the six (6) financing facilities.

B. Mechanism of Disbursement

It is learned that the financial facilities shall be disbursed through participation from the various financial institutions. Through this, it is anticipated that a broader access to financing continues to be readily available to businesses as financial institutions are expected to approve about RM200 billion of business and home financing to eligible SMEs and households in year 2020.

The Government has undertaken that participating financial institutions can obtain guarantee coverage from the Credit Guarantee Corporation Malaysia (CGC) or Syarikat Jaminan Pembiayaan Perniagaan (SJPP) for these facilities.

1) Financing facilities (cont'd)

CGC was established on 5 July 1972. It is 78.65% owned by Bank Negara Malaysia and 21.35% by the commercial banks in Malaysia. CGC aims to assist Micro, Small and Medium-Sized Enterprises (MSMEs) with inadequate or without collateral and track record to obtain credit facilities from financial institutions by providing guarantee cover on such facilities.

SJPP is a wholly-owned company of Minister of Finance Incorporated and was formed in 2009 to administer and manage government guarantee schemes under the Second Stimulus Package announced in Budget 2009 that enable SMEs to gain access to financing facilities from financial institutions. Backed by the Government, these guarantee schemes benefit many SMEs to obtain access to financing facilities, by allowing financial institutions in Malaysia to provide more financing facilities, and to encourage these financial institutions to offer better rates, terms and conditions to the SMEs.

C. Definition of SMEs

The definition of SME as approved by the National Entrepreneur and SME Development Council (NESDC) is reproduced below:

- For manufacturing sector: Sales turnover not exceeding RM50 million OR full-time employees not exceeding 200 workers; and
- For the services and other sectors: Sales turnover not exceeding RM20 million OR full-time employees not exceeding 75 workers.

All SMEs must be entities registered with SSM or other equivalent bodies. It, however, excludes:

- Entities that are public-listed on the main board; and
- Subsidiaries of:
    - Publicly-listed companies on the main board;
    - Multinational corporations (MNCs);
    - Government-linked companies (GLCs);
    - Syarikat Menteri Kewangan Diperbadankan (MKDs); and
    - State-owned enterprises.

1) Financing facilities (cont'd)

D. Summary of Financing Facilities

A helicopter view of the key features of the financing facilities as announced by the Government to help businesses in combating the adverse economic conditions brought about by the Covid-19 outbreak is reproduced below:

	Special Relief Facility (SRF) Covid-19	All Economic Sectors (AES) Facility	Automation and Digitalisation Facility (ADF)	Agrofood Facility (AF)	Micro Enterprises Facility (MEF)	Micro Credit Scheme (MCS)
Allocation size by Government	RM5 billion	RM6.8 billion	RM300 million (as part of AES)	RM1 billion	RM300 million	RM500 million
Objective	Alleviate short-term cash flow problems faced by SMEs affected by the Covid-19 outbreak	Enhance access to financing for SMEs in all economic sectors, in particular underserved SMEs, and to support growth	Incentivise SMEs to automate processes and digitalise operations to increase productivity and efficiency	Increase agrofood production for Malaysia and for exports purposes	Increase access to collateral-free financing for micro enterprises	Alleviate short-term cash flow problems faced by micro enterprises affected by the Covid-19 outbreak
Eligibility	Malaysian SMEs* affected by Covid-19	Malaysian SMEs*	Malaysian SMEs*	Malaysian SMEs*	Malaysian micro enterprises	Malaysian micro enterprises
Purpose of utilisation of the borrowed funds	Working capital	• Capital expenditure; or / and • Working capital	Purchase of equipment, machinery, computer hardware and software, IT solutions and services, technology support services and other intangible assets to enhance productivity and efficiency	• Capital expenditure; or / and • Working capital; and • Development of agrofood projects	• Capital expenditure; or / and • Working capital	• Capital expenditure; or / and • Working capital
Financing rate	Up to 3.50% p.a. (inclusive of any guarantee fee)	Up to 7% p.a. (inclusive of any guarantee fee)	Up to 4% p.a. (inclusive of any guarantee fee)	Up to 3.75% p.a. (inclusive of any guarantee fee)	To be determined by participating financial institution	0%
Maximum financing amount	RM1 million per SME	RM5 million per SME	RM3 million per SME	RM5 million per SME	RM50,000 per micro enterprise	RM75,000 per micro enterprise
Maximum tenure	5.5 years, including 6 months moratorium on repayments	5 years	10 years	8 years	5 years	5.5 years, including 6 months moratorium on repayments
Availability	Until 31 Dec 2020	Open	Until 31 Dec 2020	Open	Open	Until 31 Dec 2020

** Based on the definition of SME as approved by the National Entrepreneur and SME Development Council (NESDC) with at least 51% shares held by Malaysians.*

1) Financing facilities (cont'd)

E. Where to apply?

Businesses which are interested can apply directly to participating financial institutions which comprise commercial banks, Islamic banks and development financial institutions regulated by BNM. In addition, businesses may also apply online through the business financing referral platform at imsme.com.my.

2) Wage subsidy program

Introduction of Wage Subsidy Program to subsidise affected employers

During this tough economic climate, in particular during the MCO period, businesses are facing financial pressure as they are required to continue paying for fixed costs without generating any income. One of the significant costs incurred by businesses would be salaries and wages paid to their employees. In order to reduce costs and ease tight cash flows faced by businesses, some employees are dismissed or even forced to take unpaid leave during the MCO period.

As part of the *Prihatin* Economic Stimulus Package and Additional *Prihatin* SME Economic Stimulus Package, the government has introduced and enhanced the Wage Subsidy Program to assist businesses to retain existing employees during this tough economic period.

The eligibility criteria of the Wage Subsidy Program are as follows:

- Employers and employees must be registered with and contributing to PERKESO i.e. the Employment Insurance Scheme (EIS) or SOCSO before 1 April 2020.
- Employers must be registered with the Companies Commission of Malaysia or a local authority before 1 January 2020;
- Employers must have commenced business operations before 1 January 2020;
- This subsidy is only given to local employees earning RM4,000 and below.
- Employers who experienced revenue or income loss of more than 50% since 1 January 2020 (only applicable to companies with more than seventy five (75) employees.)
- There are three (3) categories under the program, which are as follows:

No	Size of company based on number of employees	Amount of monthly subsidy per employee	Limit on number of employees eligible
1.	201 and above	RM600	200
2.	Between 76 and 200	RM800	200
3.	75 or less	RM1,200	75

- The subsidy is given for a period of three (3) months commencing April 2020.
- Employers are not allowed to dismiss or retrench employees or force employees to take unpaid leave or salary cuts during the program and three (3) months after the program, e.g. from April 2020 to September 2020.

Applications can be made at prihatin.perkeso.gov.my starting from 1 April 2020.

3) Exemption from payment of Human Resource Development Fund levy

Exemption from payment of Human Resource Development Fund (HRDF) levy

Pursuant to the *Prihatin* Economic Stimulus Package, an automatic exemption from HRDF levies will be given to all sectors of businesses for a period of six (6) months effective from 15 April 2020 to 15 September 2020 (i.e. levy contribution for the months of March 2020 to August 2020.

The levy exemption does not apply to any levy contribution prior to March 2020 i.e. all employers are required to pay the February 2020 levy contribution by 15 March 2020. Hence, employers with outstanding levy arrears should proceed to pay the levy arrears in order to avoid further imposition of interest.

Further, all employers are required to commence payment of the September 2020 levy contribution by 15 October 2020.

There is a minimal saving of 0.5% to 1% of the monthly salary of employees depending on the number of employees employed by the companies which is summarised as tabulated below.

Number of employees	Saving on Contribution
5 to 9 Malaysian employees	0.5% of the monthly salary of employees
10 or more Malaysian employees	1% of the monthly salary of employees

This exemption would only benefit businesses which have registered an HRDF account with Pembangunan Sumber Manusia Berhad.

4) Waiver of listing fees

Waiver of listing fees by Securities Commission and Bursa Malaysia

The Securities Commission and Bursa Malaysia will waive the listing fees for a period of twelve (12) months for companies seeking to list on LEAP, ACE or Main Market. For companies seeking to list on Main Market, the waiver is only applicable to companies with a market capitalisation of less than RM500 million.

This would only benefit companies which are planning to go for an initial public offering within this period of time. The saving of listing fees ranges between RM20,000 and RM200,000. However, no other waivers are granted for professional services (e.g. legal and financial consultancy).

5) Discount on electricity bills

Discount of 2% and 15% on electricity bills

A special discount of 15% on electricity bill is given to companies under tourism sector for a period of six (6) months from April 2020 to September 2020.

Further, a discount of 2% is also given to the commercial, industrial and agricultural sector from April 2020.

Businesses in the following sectors would enjoy the reduction of its overhead costs by 2% or 15% up to September 2020:

- Tourism
- Commercial
- Industrial
- Agricultural

For the month of April 2020, the saving may be minimal as the MCO has been extended to 14 April 2020 where most businesses are unable to operate during this period.

6) Employer consultation service program

Introduction of Employer Consultation Service by the Employees Provident Fund (EPF)

Employer’s EPF contributions is one of the expenses that businesses are obliged to pay regardless of performance of business. Hence, any slowdown of business during Covid-19 pandemic or temporary closure of business during the MCO period would not relieve the employers from fulfilling this obligation.

As part of the initiative under the *Prihatin* Economic Stimulus Package to assist businesses, the EPF will introduce the Employer Consultation Service program on 15 April 2020. This program will allow employers to attend a consultation service with the EPF to discuss on options for deferral of payments, and restructuring and rescheduling of employers’ EPF contributions during this trying time.

This measure is expected to alleviate the cash flow of businesses to the tune of RM10 billion and will benefit more than 480,000 businesses while saving over 8 million jobs.

Further details of this program will only be made available on 24 April 2020.

From a tax perspective, expense on EPF contributions by employers is tax deductible as such expense is wholly and exclusively incurred in the production of gross income. Similar tax treatment should apply to deferment of payments of EPF contributions by employers as long as the exact amount of EPF contributions is accrued in the accounts for the relevant financial year.

7) Reduction of foreign worker levy

Reduction of foreign worker levy by 25%

Pursuant to the Additional *Prihatin* SME Economic Stimulus Package, a 25% reduction of foreign worker's levy will be given to all Small and Medium Enterprises (SME) whose foreign workers' permits are expiring between 1 April 2020 and 31 December 2020. However, this levy reduction does not apply to domestic helpers.

There is a minimal saving of between RM102.50 and RM462.50 per renewal of the foreign worker's permit depending on the business sector that the SME is involved in.

8) Renovation and refurbishment costs

Tax deduction on renovation and refurbishment costs

Currently, any capital expenditure incurred on renovation and refurbishment of business premises is not allowed for tax deduction. In view that businesses may carry out renovation and refurbishment of their business premises in this economic climate, the government has allowed these businesses to claim tax deduction of up to RM300,000 for capital expenditure incurred between 1 March 2020 and 31 December 2020 on renovation and refurbishment of premises used for business purposes.

However, this tax deduction will not apply to capital expenditure which is entitled for capital allowance or industrial building allowance under Schedule 2 or Schedule 3 of the Income Tax Act 1967.

As such, business owners who plan to carry out renovation and refurbishment of their business premises in the near future should consider to bring that plan forward to year 2020 to take advantage of the tax deduction given by the government.

9) Personal protective equipment given to employees

Tax deduction on personal protective equipment (PPE) given to employees

In order to protect individuals from the Covid-19 pandemic, the government has announced that expenditure incurred by companies in providing employees with disposable personal protective equipment (PPE) such as face masks is tax deductible under Section 33(1) of the Income Tax Act 1967, while expenditure incurred in providing non-disposable PPE to employees is entitled for capital allowances.

The above tax treatment is aligned with the present tax treatment given for other PPE provided by employer to employees, such as safety helmets, gloves, eye protection, high-visibility clothing, safety footwear and safety harnesses and respiratory protective equipment. Under the Occupational Safety and Health Act 1994, it is the employers' duty to provide PPE at the workplace so that employees can work in a safe and secure manner.

10) Accelerated capital allowance for certain assets

Accelerated capital allowance for machinery, information communication technology (ICT) equipment

To encourage businesses to undertake investments, Accelerated Capital Allowance (ACA) will be given on qualifying capital expenditure incurred for the purchase of machinery and equipment including Information and Communication Technology (ICT) equipment from 1 March 2020 to 31 December 2020. Such ACA can be claimed within a two (2) year period at initial and annual allowance rates at 20% and 40% respectively.

Type of asset	Current position		Proposed position	
	Initial allowance	Annual allowance	Initial allowance	Annual allowance
Heavy machinery and motor vehicles	20%	20%	20%	40%
ICT equipment	20%	20%	20%	40%
Plant and machinery	20%	14%	20%	40%
Others (furniture & fittings, office equipment, etc.)	20%	10%	20%	40%

The above measure allows businesses who incur qualifying capital expenditure to accelerate the claim of capital allowance in two (2) years as compared to the current option of claiming the capital expenditure incurred over four (4) to eight (8) years. This will result in more capital allowance claim to be set off against the adjusted income of a business and hence reduces taxes. However, this will only have a cash flow impact as there is no change to the amount that qualifies for capital allowances.

The ACA is available for machinery and equipment acquired during 1 March 2020 to 31 December 2020. Businesses with financial resources may consider investments in new machine and equipment during this period to tap into opportunities when the economy rebounds.

11) Establishment of regional office by international shipping companies

Double deduction for establishment of regional office by International Shipping Companies

In order to stimulate the establishment of more regional offices in Malaysia in years 2020 and 2021 and to promote the growth of the economy, the government has announced that a double deduction will be given on pre-commencement expenses incurred by international shipping companies for setting up regional offices in Malaysia.

This tax incentive would be available in relation to applications received by the Malaysian Investment Development Authority not later than 31 December 2021.

Under the current tax legislation, genuine business expenses incurred prior to the date of a business commencing its operations are not tax deductible as these expenses are regarded as preparatory to the carrying on of a business and are not wholly and exclusively incurred in the production of income (i.e. outgoings of a capital nature). These expenses may amount to millions in the case of a large business and may cause a huge tax loss to a company.

This tax incentive would reduce the tax burden of investors and encourage companies in international shipping industry to invest in Malaysia.

12) Rental discount given by landlords

Additional tax deduction for rental discount given by landlords of private business premises

In order to encourage landlords of private business premises to assist Small and Medium Enterprises (SMEs) to cope with the effects of Covid-19 outbreak and the MCO, the government has announced that an additional tax deduction equal to the rental discount will be given to landlords of private business premises who give a rental discount of at least 30% for the tenancy period between April 2020 and June 2020 to the SMEs.

However, the technical details of this additional tax deduction have not been made available at this juncture. Pending the availability of the technical details from the authorities, landlords of private business premises should start to gather the stamped tenancy agreement or documentary evidence of the tenancy showing the tenancy period and rental rate, and calculate the potential rental discount that can be given to tenants.

Further, the landlords of private business premises must also note that the tax treatment for this additional tax deduction may be different if the rental income earned by the landlord is treated as a business source as compared to a non-business source.

Notwithstanding the limited information available, this additional tax deduction on rental discount given would incentivise landlords of private business premises to lend a helping hand to the SMEs during this difficult time.

13) Stamp duty on restructuring and rescheduling of loans

Stamp duty exemption on instrument related to restructuring and rescheduling of loans

The Bank Negara Malaysia has requested all banks operating in Malaysia to provide financial relief in the form of payment moratorium comprising restructuring and rescheduling loans (limited to the existing principal loan amount) for affected businesses and individuals.

Currently, stamp duty of RM10 is imposed on loan restructuring and rescheduling agreements for existing loans where the original loan agreement has been duly stamped. Any additional loan amount obtained for the purpose of restructuring or rescheduling which exceeds the existing principal amount will be subjected to stamp duty as the principal security.

The first Economic Stimulus Package granted a 100% stamp duty exemption on the loan agreement entered into between the borrower and financial institutions for the purpose of restructuring or rescheduling of business loans.

This exemption applies to loan restructuring and rescheduling agreements which are executed between 1 March 2020 to 31 December 2020 on condition that the original loan agreement has been duly stamped.

14) Service tax exemption for hotels

Our government has granted Service Tax exemption on all the taxable services provided by any person who operates accommodation premises (such as hotel operators, etc.) for a period of six (6) months (i.e. from 1 March 2020 to 31 August 2020). With the Service Tax exemption in place, this would mean that the price charged by the accommodation premises operator would be reduced by 6%.

This Service Tax exemption is only given to a registered person who registers under the categories of Group A in the First Schedule of the Service Tax Regulations 2018 (i.e. accommodation premises operator).

In other words, companies that are NOT registered under this category are still required to charge Service Tax on all the taxable services provided to the customer.

> *For example, Restaurant ABC operates a restaurant at Hotel XYZ. The provision of food and beverage provided by Restaurant ABC is still subject to Service Tax.*
>
> *However, if the restaurant is operated by Hotel XYZ itself, the provision of food and beverage by Hotel XYZ to the customer is not subject to Service Tax.*

During this exemption period, the accommodation premises operator is still required to comply with all the Service Tax legislation (e.g. submit the Service Tax return on time, issue the valid invoice and state the Service Tax rate at “0%” or “tax exempted”, declare the exempted amount in the Service Tax return, etc.) and charge Tourism Tax to the customer (if any).

Since these companies operate on payment basis, this exemption does not help in managing or easing the operators’ cash flow. Instead, this exemption is aimed at helping to create the market demand for our local hotels by offering lower prices.

15) Expansion of approved activities in licensed manufacturing warehouse and free industrial zone

Manufacturers with licensed manufacturing warehouse (LMW) status or operating in the free industrial zone (FIZ) are allowed to carry out more value-added services as follows:

i. Supply chain management
ii. Total support solutions
iii. Strategic procurement operations

The expansion of approved activities are likely to increase the revenue of the manufacturers or the operators in LMW or FIZ since they are allowed to provide additional value-added services.

In addition, the manufacturers or the operators can apply and obtain the approval for the above approved activities from the nearest State of Zone of the Royal Malaysian Customs Department (RMCD) instead of the Headquarters of the RMCD or Ministry of Finance at Putrajaya. This is likely to ease the application procedure or administrative work due to these changes.

16) Port operators

Sales Tax and Import Duty exemption on equipment and machinery for port operations

Malaysia has seven (7) major Federal ports namely Port Klang, Johor Port, Port of Tanjung Pelepas, Kuantan Port, Penang Port, Bintulu Port and Kemaman Port. The port in Sabah and Sarawak are under the jurisdiction of the respective State Governments.

In order to reduce the costs and burden of the port operators affected by the Covid-19 pandemic, the government has announced that port operators are exempted from the payment of Import Duty and Sales Tax for the importation or purchase of equipment and machinery provided that they are used directly for port operations as announced in the first Economic Stimulus Package in February 2020.

However, this exemption does not apply to the importation of spare parts and consumable items.

The Sales Tax exemption is also applicable if the equipment and machinery are purchased from a local supplier as long as they are used directly for the port operations by the port operator. The port operator can apply for the above-mentioned exemption from the Ministry of Finance from 1 April 2020 to 31 March 2023.

This stimulus would effectively help lower the operating costs for port operators and would also ease the port operators' cash flow by not having to pay for the Import Duty and Sales Tax upon the importation and purchase of the said equipment.

17) Import duty and sales tax exemption for face masks

The Domestic Trade and Consumer Affairs Minister has announced to increase the ceiling price of face mask due to the increase in production costs.

In addition, to ensure that there is sufficient supply of face masks in Malaysia, all exportation of face masks is prohibited under the Customs (Prohibition of Export) (No. 2) Order 2020 on and after 20 March 2020.

With the high demand of the face masks and shortage of face masks in the Malaysian market, the suppliers or the general public may have to import the face masks from other countries.

In order to reduce the cost of the face masks, the Ministry of Finance has granted exemptions from the payment of Sales Tax and Import Duty on the importation of surgical or medical face mask from 23 March 2020 onwards.

With this exemption, there is an approximately 30% cost saving of (i.e. 20% import duty and 10% Sales Tax) on the importation of face masks by the importers.

In addition, locally registered manufacturers are given exemption from charging Sales Tax for the sales of face masks. It would definitely benefit the local buyer with additional cost savings of 10% on the purchase of face masks from the local manufacturers.

The following are the categories of face masks exempted from the payment of Import Duty and Sales Tax:

1. **Face mask (surgical / medical) 1 ply (ear loop) – 6307.90.40 00**
2. **Face mask (surgical / medical) 2 ply (ear loop) – 6307.90.40 00**
3. **Face mask (surgical / medical) 3 ply (ear loop/head loop/head tie-on) – 6307.90.40 00**
4. **Face mask (surgical / medical) N95 – 6307.90.90 00**

18) Import duty, excise duty and sales tax exemption for ethyl alcohol

In line with the exemption given for face masks, the Director General of the Royal Malaysian Customs Department (RMCD) has announced the Import Duty, Excise Duty and Sales Tax exemptions for ethyl alcohol (i.e. undenatured and denatured ethyl alcohol), which is the material for the production of hand sanitisers.

These exemptions are only given to the manufacturers which produce hand sanitisers (i.e. HS code 3808.94.9000) and shall take effect from 30 March 2020 until further notice to be announced by the RMCD.

In order to enjoy this exemption, the manufacturer is required to apply for the exemption from the Ministry of Finance by submitting the required supporting documents.

Currently, the importer is required to pay for the Import Duty, Excise Duty and Sales Tax of 10% for the importation of ethyl alcohol as per the table below:

Indirect Tax	Undenatured ethyl alcohol	Denatured ethyl alcohol
Import Duty	RM60/VPL	RM1.00 per LTR
Excise Duty	15% and RM22.50 per 100% volume per litre	15% and RM1.10 per litre
Sales Tax	10%	10%

The inclusion of the exemptions for ethyl alcohol would reduce the costs of the production of hand sanitisers. With the saving on the cost of materials, it is hoped that the manufacturers will also reduce the selling price of hand sanitisers.

19) Import duty and sales tax exemption for personal protective equipment

In order to encourage the public to donate the medical equipment and other necessary items to the Ministry of Health, the Minister of Finance has exempted the Import Duty and Sales Tax for the importation or purchase of the following items:

- Medical equipment
- Lab equipment
- Personal Protective Equipment
- Consumable item

The above-mentioned exemptions are only applicable for the person who donates (i.e. the contributor) the above-mentioned items to the Ministry of Health and is effective from 25 March 2020 until a further notice is announced by the Minister of Finance.

In addition, the person must submit an endorsement letter from the Minister of Health to the Royal Malaysian Customs Department.

The contributor is required to apply for the import permit (if any) from the following relevant parties:

- Minister of Health
- Sirim Berhad
- Atomic Energy Licensing Board

The importer may also use the existing Import Duty exemption under Item 77 in the Schedule of Customs Duties (Exemption) Order 2017 for the importation of the gifts and donate it to the Federal or State Government or a statutory body.

Section 5: Details of tax implications

1) Grants and subsidies received

Taxability of grants / subsidies received from the Government

As part of the government strategy to help businesses deal with the impact of Covid-19 pandemic, the government has introduced various grants such as matching grants for tourism promotion, grants of RM1,000 for 10,000 local entrepreneurs to promote sale of their products on e-commerce platforms, matching grant to encourage human capital development, etc. to assist the affected parties during this economic slowdown period.

In addition, the government has introduced a Wage Subsidy Program to help employers to retain their employees so as to prevent loss of jobs. The salient features of the Wage Subsidy Program are summarised as shown below:

- Employers and employees must be registered with and contributing to PERKESO i.e. the Employment Insurance Scheme (EIS) or SOCSO before 1 April 2020;
- Employers must be registered with the Companies Commission of Malaysia or a local authority before 1 January 2020;
- Employers must have commenced business operations before 1 January 2020;
- This subsidy is only given to local employees earning RM4,000 and below.
- Employers who experienced revenue loss of more than 50% since 1 January 2020 (only applicable to companies with more than seventy five employees).
- There are three (3) categories under the program, which are as follows:

No	Size of company based on number of employee	Amount of monthly subsidy per employee	Limit on number of employee eligible
1.	201 and above	RM600	200
2.	Between 76 and 200	RM800	200
3.	75 or less	RM1,200	75

- The subsidy is given for a period of three (3) months commencing April 2020.
- Employers are not allowed to dismiss or retrench employees or force employees to take unpaid leave or salary cuts during the program and three (3) months after the program, e.g. from April 2020 to September 2020.

What the law says?

Businesses may have a concern on whether the grant or subsidy received from government would constitute a gross income to the business and whether it is subject to income tax.

1) Grants and subsidies received (cont'd)

According to the Income Tax (Exemption) (No. 22) Order 2006 and a Technical Guideline issued by the Inland Revenue Board (IRB) on 26 January 2010, the tax treatment on a grant or a subsidy received from the Federal Government or the State Government is summarised as follows

- The amount of a grant or a subsidy received is exempted from tax; and
- The expenditure incurred out of the grant or subsidy is neither tax deductible nor qualify for capital allowances or any allowance under the Income Tax Act 1967 and the Promotion of Investments Act 1986.

Example:

A Hotel Sdn Bhd (year end 31 December) receives the following grant and subsidy from the Federal Government in year 2020:

No	Grant / subsidy	Tax treatment
1.	A wage subsidy of RM18,000	a) The subsidy received of RM18,000 is exempted from tax in the YA 2020. b) The portion of salary incurred out of the subsidy amounting to RM18,000 is not tax deductible. c) A Sdn Bhd is eligible to claim deduction on the net salary incurred.
2.	A grant of RM100,000 to help finance the extension of hotel building which will cost RM500,000	a) The grant received of RM100,000 is exempted from tax. b) The expenditure incurred out of the grant amounting to RM100,000 does not qualify for industrial building allowance. c) A Hotel Sdn Bhd is eligible to claim industrial building allowance for the extension of hotel based on the net expenditure incurred of RM400,000 (RM500,000 – RM100,000).
3.	A grant of RM25,000 being a reimbursement of costs incurred for sending staff to attend training	a) The subsidy received of RM25,000 is tax exempted. b) Similarly, the training costs incurred of RM25,000 is not eligible for tax deduction.

2) Restructuring of business

Tax implications on restructuring of business

In light of the Covid-19 pandemic, many businesses are facing difficulty to keep their business running at a sustainable level and some are even facing the prospect of being forced to close down their business before it causes them to go into insurmountable liabilities.

Even large corporations that form a group of companies are not spared from feeling the adverse effects from the Covid-19 pandemic. Some groups may have to make a decision on whether to consolidate their businesses or properties into fewer number of companies to reduce operating costs for the group as a whole. In more extreme cases, some may even be facing the possibility of having to close down their subsidiary companies which have businesses that are no longer sustainable or may not be expected to make a recovery after this pandemic.

Therefore, let us look at some of the methods to restructure the group as well as its tax implications.

1. Consolidation of Business

Consolidation of businesses can be done by transferring the business of one company into another company. This would include the transfer of assets, liabilities and employees of the company.

This would help to reduce the group's overall expenditure as overhead costs would be consolidated into fewer entities.

The potential tax implications would be as follows:

<u>Income Tax</u>

Generally, any profits gained from the sales of a business would be a capital gain and would not be subject to income tax.

Conversely, any expenses incurred to transfer the business would not be allowed a tax deduction as they would not satisfy Section 33(1) of the Income Tax Act 1967 (ITA) as expenses that are wholly and exclusively incurred in the production of income.

<u>Real Property Gains Tax (RPGT)</u>

There should be no RPGT implications for the transfer of business from one company to another without the transfer of any real properties or shares in a real property company (RPC).

2) Restructuring of business (cont'd)

Stamp Duty

Pursuant to Item 32(a) of the First Schedule of the Stamp Act 1949 (SA), any instrument to enact the transfer of business would be subject to *ad valorem* stamp duty as follows:

- On the first RM100,000 at 1%;
- On the next RM400,000 at 2%;
- On the next RM500,000 at 3%; and
- On any amount exceeding RM1,000,000 at 4%.

2. Consolidation of Properties or Sale of Properties

Consolidation of properties can be done by transferring the property from one company to another company. This can help the group to consolidate assets into operational companies to improve its balance sheet outlook potentially for future financing purposes and to accrue funds for medium term operational needs during this pandemic.

Alternatively, the group could consider selling any properties it owns to generate cash flow.

The potential tax implications from transfer or sales of properties would be as follows:

Income Tax

Generally, any profits gained from the sale / transfer of property would be a capital gain and would not be subject to income tax unless the company is in the business of selling properties.

Conversely, any expenses incurred to sell / transfer the property would not be allowed a tax deduction as they would not satisfy Section 33(1) of the ITA as expenses that are wholly and exclusively incurred in the production of income.

However, if the company is in the business of selling properties, then any income gained from the sale of property would be subject to tax under Section 4(a) of the ITA as business income and any related expenses would be allowed a tax deduction subject to Sections 33 and 39 of the ITA.

2) Restructuring of business (cont'd)

RPGT

RPGT would be applicable on the gains from the transfer or sale of any properties in Malaysia. The applicable RPGT rate for companies would be 10% to 30% depending on the holding period of the transferred / sold property.

Stamp Duty

Pursuant to Item 32(a) of the First Schedule of the SA, any instrument to enact the transfer of property would be subject to *ad valorem* stamp duty as follows:

- On the first RM100,000 at 1%;
- On the next RM400,000 at 2%;
- On the next RM500,000 at 3%; and
- On any amount exceeding RM1,000,000 at 4%.

3. Flattening of the Group Structure

A group may want to flatten its group structure by transferring the shares of any company to be held under a single holding company. This could help to ease the movement of cash flow within the group as profitable companies with excess cash can declare a dividend to the holding company which in turn can flow the cash to companies that need it by way of intercompany loan or direct capital injection.

The potential tax implications from transfer of shares would be as follows:

Income Tax

Generally, any profits gained from the sale of shares would be a capital gain and would not be subject to income tax.

Conversely, any expenses incurred to sell the shares would not be allowed a tax deduction as they would not satisfy Section 33(1) of the ITA as expenses that are wholly and exclusively incurred in the production of income.

2) Restructuring of business (cont'd)

RPGT

Generally, there should be no RPGT implications for the transfer of shares from one company to the holding company.

However, if it is a transfer of shares of an RPC, then RPGT would be applicable at the RPGT rate for companies of 10% to 30% depending on the holding period of the shares being sold.

Stamp Duty

Pursuant to Item 32(b) of the First Schedule of the SA, any instrument to enact the transfer of shares would be subject to stamp duty at the rate of 0.3% of the consideration or market value of the shares, whichever is greater.

4. Liquidation of Company

In a worst case scenario, a company may be forced to be liquidated in order to stop incurring continuous losses or the company may be deemed to be unable to be self sustainable.

The potential tax implications from a liquidation exercise would be as follows:

Income Tax

Generally, when a company is liquidated, all of its assets would be sold to settle its liabilities. Any excess in cash would then be distributed to its shareholder(s).

The sale of assets should be a capital gain and not subject to income tax. Some exceptions would be e.g. the clearing of inventories, or the sales of properties by a company in the business of trading properties. The gains from the sale of those types of assets would be a business income which should be taxed under Section 4(a) of the ITA.

The expenses incurred on services for the liquidation exercise would be capital expenditure and not allowed a tax deduction because it would not satisfy Section 33(1) of the ITA as expenses that are wholly and exclusively incurred in the production of income.

Finally, any capital distribution paid out to the shareholder(s) would be capital gain in the shareholder(s) hands and should not be subject to income tax.

2) Restructuring of business (cont'd)

RPGT

Generally, there should be no RPGT implications for the shareholders of a company being liquidated.

However, if the liquidated company sells of its properties, then the gain from the sales of such properties would be subject to RPGT at the RPGT rate for companies of 10% to 30% depending on the holding period of the property being sold.

Stamp Duty

Generally, there should be no stamp duty implications for the liquidation of a company.

Nevertheless, stamp duty relief and/or RPGT exemption may be available for the above restructuring if the relevant pertinent conditions are satisfied.

3) Costs associated with movement of personnel

Deductibility of staff relocation or retrenchment costs

Many businesses are impacted by the Covid-19 pandemic. Businesses will likely need to make some adjustments to their current operations as there is no indication on how long this crisis will last. As a result, businesses may choose to relocate their staff to other companies within the Group temporarily for better profit and cash flow management.

Generally, expenses related to this relocation such as fees incurred for planning and execution or supervision of the relocation process, packing and unpacking (material and labour charges), transportation cost, insurance premium (coverage for lost or damaged items during the moving process) will qualify for tax deduction if such relocation results in enhanced business efficiency.

However, in the event that the relocation arises from transfer of business from one company to another company which results in the closing down of a company's operations, then such relocation expenses may not qualify for tax deduction.

Businesses which are badly affected by the Covid-19 pandemic may even need to downsize their operations. Some employers may choose to reduce costs by way of staff retrenchment. Generally, compensation paid to employees for loss of office is tax deductible if such payment results in the company's business operations being more efficient. However, in the following circumstances, the said compensation may not be tax deductible:-

1. Payments made by the successor company in respect of services rendered by an employee to the previous company in a reorganisation of a company where the activities of the company are taken over by another.
2. Payments to an employee in lieu of notice for a period after the business has ceased.

In view of the above, any relocation or retrenchment plan by businesses should be given due consideration in order to minimise any negative tax implications.

4) Use of technology services

Tax Implications on Digital Services – Direct tax perspective

It is amazing to see how quickly people turned to technology in order to continue with what they do during the MCO in Malaysia or lockdown in other countries. When you are under a lockdown or quarantine or MCO, you need to continue to reach out to your customers and support them. This is fortunately possible in our high tech age.

a) Wider Adoption of Digital Services in Business

For example, those in the education and training industry have quickly switched to providing their sessions online using video chat applications like Skype or Zoom. Emails, virtual private networks (VPNs), WhatsApp and video chat applications have enabled many white collar staff to work from home.

Some of these digital services are free but for some, a payment is required. Let us take Zoom as an example. A user can subscribe to the Basic Plan for free. If more features are required, one can subscribe for the Pro version which will cost USD14.99 per month.

b) Withholding Tax on Payment of Software Charges to Non-Residents

Generally, there are no withholding tax implications for individuals who make use of these applications for private consumption.

However, businesses are required to account for the withholding tax in order to avoid being penalised by the Inland Revenue Board (IRB) for not complying with the relevant withholding tax provisions. Although withholding tax is supposed to be the costs for the non-residents, often, the Malaysian businesses are made to pay in situations where the non-resident refuses to bear the tax costs. To add to this, a business will not be allowed to claim tax deduction on the expenses incurred for failure to observe the withholding tax provisions.

When it comes to payments for digital services, it is important to distinguish between payments for services vis-à-vis payments for royalties. The reason for this is that payments for services and payments for royalties have different withholding tax implications. Payments for services are subject to withholding tax only if the services were rendered in Malaysia. On the other hand, payments for royalties are subject to withholding tax regardless of where the rights are seated. That is the reason why most taxpayers would argue that digital services are indeed services in nature so as to alleviate them from the withholding tax burden on grounds of absence of physical services in Malaysia.

4) Use of technology services (cont'd)

c) Services vs. Royalties

According to Section 4A of the Income Tax Act 1967 (ITA), the payments for services which attract withholding tax under Section 109B of the ITA are as follows:

- *amounts paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;*
- *amounts paid in consideration of any advice given, or assistance or services rendered in connection with the management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; or*
- *rent or other payments made under any agreement or arrangement for the use of any moveable property.*

The withholding tax provisions under Section 109 of the ITA are applicable on royalty payments. The definition of "royalty" in Section 2 of the ITA is quite lengthy. Hence, an excerpt of the definition that is relevant to this article is reproduced below:

"Royalty" includes any sums paid as consideration for, or derived from—

- *the use of, or the right to use in respect of, any copyrights, software, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks or other like property or rights;….."*

d) IRB's Withholding Tax Position on Digital or Online Services

One will note that the word "software" in the definition of royalty is wide enough to potentially cover digital services and applications like Zoom even though one may see it as a "service" of providing video chat.

In practice, the IRB is inclined to take the view that payments made to non-residents for digital services can be somehow associated with the right to use software, hence are royalties in nature. One clear example is the IRB's view adopted on digital advertisements e.g. payment to Google, Facebook, etc. where such payments have been construed as royalty payments because the Malaysian payer is granted the right to use the non-resident's software to design and develop its own advertisement campaign.

4) Use of technology services (cont'd)

e) Withholding tax rate

The withholding tax rate for both services and royalties is 10% but depending on the tax treaty between Malaysia and the respective countries, the rate may be further reduced. Malaysia has signed tax treaties with over 75 countries, including most countries in the European Union, the United Kingdom, China, Japan, Hong Kong, Singapore, Australia, etc. to name a few. Certain tax treaties provide for the withholding tax rate on services and royalties to as low as 5%.

On this note, the double taxation agreement between Malaysia and the United States of America is of limited scope and does not address double tax issues relating specifically to services and royalties. Thus, the 10% rate shall be applicable for both service and royalty payments to a US resident.

Withholding tax is usually payable to the IRB within one (1) month of crediting or paying the non-resident.

f) Seek professional advice when in doubt

As mentioned earlier, services performed outside Malaysia is not subject to withholding tax. In contrast, royalty payments are subject to Malaysian withholding tax regardless of where the rights are seated. Therefore, whether to comply or not to comply with withholding tax on payments made on digital services would require a careful study of the nature of the payment via understanding of the contractual terms between the non-resident service provider and the user, i.e. the Malaysian company. What may seem to be a "service" to the company, can turn out to be a "royalty" in the keen eyes of the IRB. The repercussions can be huge on the pocket of your business, especially over a long term if this is not clarified at the initial stage.

Hence, it is always best to seek professional tax advice if one is unsure of the nature of the payment for digital services.

4) Use of technology services (cont'd)

Tax implication on Digital Services – Indirect tax perspective

The acquisition of online technology services (e.g. online video conferencing, etc.) from the local or foreign service provider would be subject to 6% Service Tax because this is a form of taxable service (i.e. digital service or information technology service).

If the service were to be acquired from a local service provider, 6% Service Tax would be charged by the local service provider if the local service provider is registered for Service Tax. Businesses would not be charged with the said Service Tax if the local service provider is not registered for Service Tax.

However, if the service were to be acquired from a foreign service provider, businesses need to be aware whether this foreign service provider is registered for Service Tax in Malaysia.

If the foreign service provider is a registered person in Malaysia, a 6% Service Tax would also be charged by the foreign registered person. If the foreign service provider is not registered for Service Tax in Malaysia, the businesses are required to self-account and pay Service Tax to the Royal Malaysian Customs Department on this imported taxable service.

5) Donations and contributions

Deductibility of donations and contributions made to fight Covid-19

In order to appreciate and to encourage individuals and businesses to make contributions and donations to combat the spread of Covid-19 virus and to help the people affected by the outbreak, the government has announced that certain donations and contributions would be given tax deduction.

In this regard, the Inland Revenue Board (IRB) issued a Media Release and updated the Frequently Asked Questions Concerning Tax Matters During Movement Control Order Period (18 March 2020 to 28 April 2020) (IRB MCOFAQ) on 26 March 2020 and 21 April 2020 respectively to shed light on the deductibility of the contributions made to the Covid-19 Fund. Further, the Ministry of Finance (MOF) also issued a Special Guideline on Application for Tax Deduction on Contributions to a Charity or Community Project to handle Covid-19 Outbreak.

a) Types of contributions

Based on the IRB Media Release and IRB MCOFAQ, tax deduction is allowed for contributions and donations made to the following:

Types of fund	Types of contribution
Tabung Covid-19 (Kementerian Kesihatan Malaysia)	Cash and in kind
Tabung Covid-19 (Pengurusan Bencana Negara, Jabatan Perdana Menteri)	Cash only
Donations to institutions and organisations approved under Section 44(6) of the Income Tax Act 1967 (ITA)	Cash only

Meanwhile, based on the MOF Special Guideline, tax deduction is allowed for contributions and donations made under any community or charity project that assists the government or non-governmental organisation registered under any written law to handle the Covid-19 outbreak.

b) Supporting documents required

Taxpayers are advised to keep the transaction records as well as receipts or documents so that they can be used as a reference when filing of their income tax return for YA 2020 and for inspection by the IRB in the event of a tax audit in the future.

For donations in kind e.g. medical equipment, personal protective equipment, etc., taxpayers are required to obtain a letter of acceptance of contribution from the recipient of the contribution together with the official stamp from the recipient according to the prescribed format in the MOF Special Guideline.

5) Donations and contributions (cont'd)

Taxpayers are required to submit their application for tax deduction for donation in kind to the Tax Division of the MOF. Examples of the supporting documents required to substantiate the donation are as follows:

Supporting documents	
Donation in cash	**Donation in kind**
Government official receipt (Kew. 38) Money transfer Slip via ATM	Original approval letter by the Minister of Finance
Cheque Deposit Slip A deposit Slip via bank counter	Official receipt or acknowledgement of contribution from the recipient body
Online Payment Slip Mercurial Giro (IBG Transfer) Slip Real Time Electronic Transfer Fund and Securities Systems (TRANS)	Letter of acknowledgement of service value or project cost value from the relevant government agencies
Telegraphic Receipt (TT) with advice of credit	
Real Time Electronic Transfer Fund and Securities Systems (TRANS)	
Telegraphic Receipt (TT) with advice of credit	

c) What does the current law says?

Presently, deduction is allowed for cash donations made to the Government, State Government, Local Authority and the institutions / organisations approved under Section 44(6) of the ITA. The donation is deductible against the Aggregate Income (AI) of a taxpayer but subject to limits as follows:

Categories	Maximum Limit Of Tax Deduction against Aggregate Income	
	Individual	**Company**
Gift of money to the Government / State Government / Local Authority	No limit	No limit
Gift of money to approved institutions / organisations / funds	Restricted to 10% of Aggregate Income	Restricted to 10% of Aggregate Income
Gift of money or cost of contribution in kind for any project of national interest approved by the MOF		
Gift of money or medical equipment to any healthcare facility approved by the Ministry of Health	RM20,000	Not applicable for business

5) Donations and contributions (cont'd)

It should be noted that donations made to organisations or charitable bodies that are not recognised by the IRB will not be allowed for tax deduction. Taxpayers are advised to visit the IRB website for the list of approved institutions / organisations which are recognised by the IRB before making any donation / contribution so as to ensure it qualifies for a tax deduction.

Notwithstanding the above, pursuant to Section 34(6)(h) of the ITA, contributions to a charity or community project pertaining to health approved by the Minister of Finance is allowed full deduction against gross business income of the individual or company.

d) How tax deduction works for donations / contribution for Covid-19 Fund?

Based on the IRB MCOFAQ, deduction under Section 34(6)(h) of the ITA i.e. deduction against gross business income of the individual or company, will be given for cash or in-kind donations or contributions made to the Covid-19 Fund (Kementerian Kesihatan Malaysia). Further, any businesses that are in an adjusted business loss position as a result of the donation would be allowed to carry forward the loss to offset against its future business income.

In order to claim the tax deduction under Section 34(6)(h) of the ITA, all relevant supporting documents as mentioned earlier must be kept and made available for inspection upon request by the IRB.

On the other hand, tax deduction under Section 44(6) of the ITA will be given for cash donations or contributions made to the Covid-19 Fund (Pengurusan Bencana Negara, Jabatan Perdana Menteri) or any institutions and organisations approved under Section 44(6) of the ITA. However, the tax deduction on the said donation will be limited to 10% of the Aggregate Income of the individual and company.

Similarly, for the tax deduction to apply, all relevant supporting documents as mentioned earlier must be kept and made available for inspection upon request by the IRB.

5) Donations and contributions (cont'd)

e) How tax deduction works for donations / contribution for other Covid-19 initiatives?

Donations or contributions made for other Covid-19 initiatives may not qualify for tax deduction if such donations or contributions do not fall under any one of the categories mentioned under Section 44(6) of the ITA or Section 34(6)(h) of the ITA.

In this regard, individuals and companies should enquire with the donation or contribution recipient on whether the donation or contribution qualifies for tax deduction if tax deduction is one of the individual's or company's concern when making such donation or contribution.

6) Penalties on late payment of statutory contributions

Deductibility of penalties on late payment of statutory contributions

Based on the latest announcements available as at 21 April 2020, extension of deadlines has been given for payments of statutory contributions to Employees Provident Fund (EPF), Social Security Organisation (SOCSO) and Employment Insurance System (EIS) following the implementation of the MCO.

Nevertheless, businesses may take a longer period of time to process their payroll due to the implementation of MCO or could be facing liquidity issues during this economic climate. As a consequence, businesses may delay, either intentionally or unintentionally, on the payments of these statutory contributions to the relevant authorities and such late payment would likely result in late payment penalties being imposed by the relevant authorities on the businesses.

For income tax purposes, fines or penalties imposed on a taxpayer for an infraction of the law would not qualify for tax deduction as these fines or penalties are meant to be a punishment for breaching the law and not a commercial loss connected to the business. In this regard, businesses should not intentionally delay the payment of statutory contributions as such delay in payment would result in additional tax cost to the business.

7) Bad debts

Tax implications on bad debts – Direct tax perspective

One of the unwelcome Covid-19 pandemic consequences that businesses may face is the difficulty in recovering trade debts since many businesses are either in distress or at the brink of bankruptcy. It would be a double whammy if a taxpayer is unable to claim tax deduction on his bad debts because he would have already paid taxes on the income previously. All is not lost as a bad debt can be tax deductible. It just takes proper management of trade debts and the collation of sufficient supporting evidence to obtain tax deduction.

Section 34(2) of the Income Tax Act 1967 (ITA) provides deduction for a debt which is reasonably estimated in all the circumstances of the case to be irrecoverable. The words "reasonably estimated" connote that a debt does not have to turn completely bad before a deduction can be taken, for as long as the irrecoverability can be estimated justifiably.

First of all, the debt mentioned in the above legislation is of the kind where the amount of such debt has been included in the gross business income of the person for a year of assessment prior to the year of assessment in which a deduction is taken. In other words, the debt must be a trade debt. No deduction can be given to non-trade debts, such as inter-company advances.

A. Bad debts written off

In the Public Ruling 4/2019 Tax Treatment of Wholly & Partly Irrecoverable Debts and Debt Recoveries (PR 4/2019), it is stated that a debt can be considered bad on the occurrence of any one of the following:

(a) The debtor has died without leaving any assets from which the debt can be recovered;
(b) The debtor is a bankrupt or in liquidation and there are no assets from which the debt can be recovered;
(c) The debt is statute-barred;
(d) The debtor cannot be traced despite various attempts and there are no known assets from which the debt can be recovered;
(e) Attempts at negotiation or arbitration of a disputed debt have failed and the anticipated cost of litigation is prohibitive; and
(f) Any other circumstances where there is no likelihood of cost effective recovery.

Generally, there should not be any difficulties in claiming bad debts written off in the above circumstances provided that there are adequate and proper supporting evidence.

7) Bad debts (cont'd)

B. Provision for doubtful debts

A general provision is not tax deductible because it is, more than often, just an amount based on a certain percentage of the total outstanding debts. It is unlike a specific provision whereby each debt is evaluated separately. Even if there is a legal requirement or accounting convention for a particular trade or industry to make such a provision, a general provision is not deductible.

A specific provision, on the other hand, may be deductible. The making of a specific provision for doubtful debts requires determining the likelihood of the recovery of each debt. When evaluating a debt as doubtful, one should look at the period over which the debt has been outstanding, the current financial status of the debtor and the credit record of the debtor.

In the tax case of *Sasteps Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2017) MSTC*, the High Court decided against the appellant on the grounds that the reason to write off the debt was not *bona fide* because the appellant was able to recover the debt which was owed by a related party but did not do so. The decision to write off the debt was not done based on prudent commercial consideration. As for the legal action taken against the debtor, it was only filed after the debt was already time barred and only for the purpose of the tax appeal. Prior to that, the only action taken to recover the debt was sending a series of notices of demand to the debtor and there were prolonged periods between the demands.

C. Ensuring tax deductions

As you can see, it is not difficult to claim tax deduction on bad debts written off and specific provision for doubtful debts, provided that, of course, the debts are *bona fide*, the reasons are valid, reasonable steps have been taken to recover the debts, and all the relevant supporting evidence are available. Things only get difficult when any one of these is not fulfilled. In practice, taxpayers usually fail to get tax deduction because they did not take sufficient steps to recover the debts and/or there is insufficient documentary evidence.

However, these failures can be easily overcome. One just needs to have a healthy debt monitoring system to ensure that reasonable steps are taken to recover the debts and good practices are kept in place to archive the documentary evidence along the way.

One should bear in mind that tax deduction on bad and doubtful debts is rightfully yours since you have already paid tax on your revenue.

7) Bad debts (cont'd)

Tax implications on bad debts – Indirect tax perspective

For bad debts written off, the registered person can claim back the refund from the Royal Malaysian Customs Department (RMCD) within six (6) years from the date of Sales Tax or Service Tax paid to the RMCD provided that sufficient effort has been made by the registered person to recover the debt pursuant to Section 36 of the Sales Tax Act 2018 and Section 35 of the Service Tax Act 2018 respectively.

As such, if sufficient efforts (e.g. letter of demand, etc.) have been made by the registered person, the registered person is entitled to claim back the Sales Tax or Service Tax from the RMCD on the unrecovered debts.

It should be noted that such a refund is only applicable for bad debts written off. Currently, the registered person is not entitled to obtain any refund from the Customs for the provision of bad debts or allowance made for impairment losses (i.e. doubtful debts).

Should there be any subsequent payment received from the customer in future, the registered person is required to pay back the recovered Sales Tax or Service Tax to the RMCD if a claim of refund has been made from the RMCD previously.

8) Stock obsolescence

Deductibility of stock obsolescence – Direct tax perspective

The implementation of the MCO on 18 March 2020 caught businesses by surprise. Other than essential services, the rest of the economy has to come to a halt to give way to contain the spread of the infectious deadly Covid-19 virus. Businesses are swamped with many core business issues within short notice because it is a real concern to them as the duration for the month-long MCO period is considered extremely lengthy for most businesses. It is certain that rock bottom sales become the fact, and maintaining steady sales volume becomes a dream during this lockdown period. One may also need to forget about business growth as other key burning issues affecting business survival have to be dealt with immediately.

a) Businesses with stock obsolescence issue

The MCO has derailed the normal flow of supply chain completely because:

i. Port operations for goods clearance ceased, except for essential goods.
ii. Logistics became inconvenient causing long delay and slowdown in getting goods from one place to another.
iii. Closure of retail shops translating to closure of distribution channels at the last mile.
iv. Cessation of factory production leading to build up of raw materials, work-in-progress and also finished goods, all of which are being locked down in factories and warehouse premises.

For many, the stock obsolescence issue becomes the number one cruel reality confronting these businesses right from the first day of MCO. It is only a matter of time that the unsold stocks become perished, damaged, expired, destroyed, out of trend, obsolete, etc. Probably, these stocks will not even reach the market, or even if they do, unable to fetch their usual market price any more.

After the end of MCO, it is also questionable whether the economy is able to recover fast enough to absorb the unsold stocks piled up during the MCO. For businesses dealing with goods at large, stock obsolescence issue is a business threat when the stocks on hand cannot be sold or the selling prices are below the costs. For instance, businesses dealing in perishable goods, such as farmers, restaurants, hawkers, flower shops, etc. had to give away or throw away their vegetables and flowers, without any income being generated from such stocks. Retail businesses are not spared as such businesses are facing muted sales during MCO and the subsequent business recovery may take time. It may then be necessary to write down their slow moving inventories and inventories sold at below cost to net realisable value.

8) Stock obsolescence (cont'd)

When this happens, for accounting purposes, these costs are to be treated as expenses that will be recorded in the income statement, and giving the effect of lowering profitability for the year. For some, this expense drives businesses to make losses. Whichever it is, it is imperative to understand the tax impact relating to stocks.

b) Will the write-off of inventories and write down of inventories be tax deductible?

i. Write off – Stocks cannot be sold at all and discarded

In instances whereby the inventories are discarded, the write-off of the inventories is fully tax deductible, to the extent that the taxpayer is able to prove that the inventories have been discarded.

ii. Write down – Stocks can be sold but expected to be sold at below their cost

The provisions under Section 35(3) of the Income Tax Act 1967 allow companies to value their stocks at market value when the market value is below the cost. Having said this, the practicality involved to satisfy the deductibility of stocks that are valued at below cost could become a hurdle for tax deduction under Section 35(3).

First, for accounting purposes, a write-down of inventories is generally treated as a provision unless the net realisable value can be substantiated. There is an obvious disagreement between the net realisable value concept and market value concept. With the exception for those stocks that have readily available market value information, such as quoted shares, commodities and price-controlled items, it would be difficult to substantiate the net realisable value of most other types of goods to be equivalent to the market value of the inventories.

To explain further, a write-down of quoted shares which were traded on the stock exchange would be deductible for a share trader (whose income are in the nature of ordinary business income) because the net realisable value of the shares can be substantiated by the prices of those shares on the stock exchange. The write-down can be tax deductible under Section 35(3).

For other goods without a clear market value indication, it would appear that claiming a tax deduction based on accounting write-down could be challenged by the tax authorities during a tax audit.

8) Stock obsolescence (cont'd)

iii. Provision for slow moving inventories – Stocks may not be sold

For accounting purposes, costs which are established using the estimation approach can be accepted as expenses in the income statement, such as provisional expenses.

The tax legislation has an opposite view as expenses which are provisional in nature cannot rank for tax deduction under Section 33(1) of the ITA, unless it could meet the test under Section 35(3) as discussed in the foregoing section. Hence, where a company is making provisions for slow-moving inventories, these provisions are not tax deductible. The deductibility event shall only take place during an actual stock write off. Therefore, the subsequent write-off against the provision may be tax deductible if the inventories are discarded or sold, i.e. realisation of the provisional expenses.

c) Conclusion

Your business is confronted with stock obsolescence issues during this Covid-19 outbreak. It is only tax efficient that the costs associated with stock obsolescence are fully tax deductible in arriving at the chargeable income. As pointed out, the tax treatments on this particular business cost may not align with the accounting treatments. To warrant for tax deduction, companies are required to demonstrate to the tax authorities that such costs have to be actual by providing evidence to the authorities that the stocks written off have been destroyed or discarded.

8) Stock obsolescence (cont'd)

Accounting for Sales Tax on stock obsolescence – Indirect tax perspective

Due to the Covid-19 pandemic dilemma, some manufacturers may have to write-off or dispose of some stocks or inventories due to obsolescence or other reasons. Stocks and inventories can be generally categorized as:

- Finished goods ready for sale; or
- Materials used for manufacturing purposes.

The disposal or writing-off of taxable goods (i.e. finished goods or semi-finished goods) by a manufacturer registered for Sales Tax would require the manufacturer to account for Sales Tax. The value used to account for the Sales Tax should be determined in accordance with the Sales Tax (Determination of Sale Value of Taxable Goods) Regulations 2018.

For trading goods not manufactured by the registered manufacturer, the disposal or writing-off of such goods would not be subject to Sales Tax since the businesses did not manufacture the trading goods except if the trading goods were purchased using exemptions available in the Sales Tax (Persons Exempted from Payment of Tax) Order 2018. However, the registered manufacturer or any other businesses would be required to account for Sales Tax on the disposal or writing-off of these trading goods if any of the conditions in the said Order are not met.

For example, the business had purchased the trading goods to be sold to another registered manufacturer and the exemption under Item 3 of Schedule C in the said Order is used. In this case, the business would have to account for Sales Tax for breaching the conditions of the exemption if the trading goods were not sold to the intended registered manufacturer.

Similarly, if the registered manufacturer had to dispose of or write-off materials that were purchased using the available exemptions in the said Order (e.g. Item 1 of Schedule C), the disposal or writing-off of these materials would also require the registered manufacturer to account for Sales Tax for breaching the conditions of the exemption.

9) Moratorium on loan repayments

Bank Negara Malaysia has on 25 March 2020 announced certain measures in support of efforts by banking institutions to assist individuals, small and medium enterprises (SMEs) and corporations to manage the impact of the Covid-19 outbreak.

One of the measures to help individuals and SMEs who are facing financial difficulties to cope with challenges during this period is deferment of loan or financing facility repayments.

a) What is deferment of loan or financing facility repayment?

It is a temporary deferment or suspension of loan or financing facility repayment obligation (principal and interest) for a period of six (6) months beginning from 1 April 2020 to 30 September 2020. During this period, borrowers with loan or financing facility do not need to make any monthly repayment, and no late payment charges or penalties will be imposed by the banking institutions.

b) Important things to know about this initiative:

i. It is available for all individuals and SMEs.
ii. It will be granted automatically.
iii. It is applicable for all ringgit-denominated performing loans offered by the financial institutions regulated by Bank Negara Malaysia such as term loans, overdrafts, housing loans, hire purchase, bank guarantees and any other financing facility that has been made available.
iv. It does not apply to loans or financing facilities that are more than ninety (90) days in arrears as at 1 April 2020.
v. Normal interest charges will apply on the deferred payments during these six (6) months.
vi. It does not apply to credit card facilities.
vii. Borrowers will not be classified under CCRIS for deferment of loan payments.

As for credit card facilities, financial institutions will offer to convert the outstanding balances into a three (3)-year term loan with reduced interest rates of not more than 13% per annum to help the borrowers better manage their debts.

For individuals and SMEs who do not wish to defer repayment may notify the respective financial institutions and continue with their current repayment structures.

9) Moratorium on loan repayments (cont'd)

c) Interest will continue to accrue

It is important to note that interest will continue to be accrued during the six (6)-month loan moratorium and borrowers will need to honour the deferred interest and loan principal in the future either through higher subsequent instalment amounts or an extension of the loan tenure. Hence, borrowers should ensure that they understand and discuss with their financial institutions on the options available to resume their scheduled repayments after the deferment period, i.e. lower payment and longer period if necessary.

However, it is good to note that the majority of the banks are doing their bit by announcing that although interest and profits will continue to accrue on the loans, such accrued interest and profits will not be compounded to be in line with the Bank Negara Malaysia's decision to grant an automatic moratorium on loan repayments. This initiative will further alleviate the financial burden of the individuals and SMEs.

d) Expansion of coverage

It was announced under the *Prihatin* Economic Stimulus Package that the deferment of loan repayment by SMEs will be extended to include loans taken from TEKUN, MARA and co-operatives, and government agencies from 1 April 2020.

e) Loans or financing facilities given to corporations

Financial institutions will also facilitate requests by corporations to defer or restructure repayments of their loans or financing facilities in a way that will enable viable corporations to preserve jobs and swiftly resume economic activities when conditions stabilise. Corporate borrowers may discuss with their respective financial institutions on the following options:

i. to request for a moratorium on loan or financing facility repayments or payment;
ii. to agree on a suitable repayment plan; or
iii. to restructure the existing credit facilities.

9) Moratorium on loan repayments (cont'd)

Moratorium on loan repayments – effects on deductibility of interest expenses

The moratorium on loan or financing facility repayment is a deferment and not a waiver. In this regard, banking institutions will continue to charge and accrue interest on the principal loan or financing facility amount outstanding during the six (6)-month loan moratorium period.

For income tax purposes, the interest expense accrued during the moratorium period may not be eligible for tax deduction. Section 33(4) of the Income Tax Act 1967 (ITA) provides that interest expense incurred and payable on monies borrowed will only qualify for tax deduction when the said interest is due to be paid.

In view of this, taxpayers may need to identify and segregate their accrued interest expense which is not due to be paid in that year of assessment (YA) (especially during the loan moratorium period) and ensure no deduction is claimed thereon in their income tax returns. Taxpayers are required to submit a revised income tax return in order to claim the interest expense incurred once the "due to be paid" provision is satisfied.

Example:

A company with a financial year ended 31 August opted for the six (6) months moratorium on one of its loans from a banking institution. The monthly interest charged by the banking institution for the loan is RM10,000. The tax implications on the interest expenses accrued prior to and during the moratorium is shown below:

	YA 2020	
Period	01.09.2019 - 31.03.2020	01.04.2020 - 31.08.2020
Interest accrued by bank	RM70,000	RM50,000
Deductibility pursuant to Section 33(4) of the ITA	Deductible as the interest charged by the banking institution during this period is due to be paid in YA 2020.	Not deductible in YA 2020 as the interest is solely accrued by the banking institution and is only due to be paid by 30.09.2020 (i.e. in YA 2021).

9) Moratorium on loan repayments (cont'd)

Moratorium on loan repayments – effects on tax incentives

Businesses that are enjoying tax incentives should think twice whether the six (6) months' moratorium on loan / financing facilities may have severe repercussions from the tax perspective.

For instance, if cash flow positions allow, businesses that are claiming tax incentives i.e. reinvestment allowance (RA) or investment tax allowance (ITA) on assets being acquired under hire purchase assets may be better off in continuing with the repayment of hire purchase instalments for the six (6) months' moratorium so as to maximise the tax benefits from RA or ITA before the tax incentive period lapses.

The RA incentive has a finite tax relief period of fifteen (15) years, whilst the ITA incentive's tax relief window ranges from five (5) years to fifteen (15) years. The principal portion of a hire purchase repayment paid during the tax relief period qualifies for additional 60% / 100% of RA or ITA claims.

How will your business miss out the tax benefits under RA or ITA? To find out more, an illustration of the potential tax benefits a company may have to forego should it defer its HP instalments during the six (6) months' moratorium period is explained below.

<u>Illustration</u>
Company A is a manufacturing company which has been claiming RA on the additions of qualifying capital expenditure for the past fourteen (14) years of assessment (YA). As a company is only allowed to enjoy this incentive for a consecutive period of fifteen (15) YAs, the RA period for Company A will be expiring in year of assessment (YA) 2020 assuming the financial year ends on 31 December 2020.

In YA 2017, Company A purchased a production line under a hire purchase arrangement and the details of the hire purchase are as follows:

Cost of Production Line: RM2 million
Deposit paid: RM200,000
Amount financed under HP: RM1,800,000
HP Tenure: 4 years commencing from January 2017

The detailed calculations of the RA enjoyed by Company A from YA2017 to YA2020 and the loss in tax benefits of RM32,400 should Company A defer its HP instalments from April to September (six (6) months moratorium period), are shown in the following table:

9) Moratorium on loan repayments (cont'd)

The detailed calculations of the RA enjoyed by Company A from YA2017 to YA 2020 and the loss in tax benefits of RM32,400 should Company A defer its HP instalments from April to September (six (6) months moratorium period), are shown in the following table:

	Scenario 1: No Deferment of HP Repayments (RM)	**Scenario 2: Deferment of HP Repayments (RM)**
YA 2017 Deposit paid: RM200,000 HP Principal repayment from Jan 2017 to Dec 2017 RM37,500 x 12 months	 200,000 450,000	 200,000 450,000
YA 2018 HP Principal repayment from Jan 2018 to Dec 2018 RM37,500 x 12 months = RM450,000	450,000	450,000
YA 2019 HP Principal repayment from Jan 2019 to Dec 2019 RM37,500 x 12 months = RM450,000	450,000	450,000
YA 2020 HP Principal repayment: - Jan 2020 to Mar 2020 (paid) RM37,500 x 3 = RM112,500 - Apr 2020 to Dec 2020 (payable) RM37,500 x 9 = RM337,500 Apr 2020 to Sept 2020 – no repayment made Oct 2020 to Dec 2020 RM37,500 x 3 = RM112,500	 112,500 337,500	 112,500 0 112,500
Total qualifying expenditure for RA purposes	2,000,000	1,775,000
Difference in QE		225,000
RA not claimed @ 60%		135,000
Loss in tax benefits @ 24%		32,400

10) Interest paid to related companies

Effect of reduction in sales on interest paid to related companies

Section 140C of the Income Tax Act 1967 (ITA) seeks to restrict deductibility of interest expenses in respect of financial assistance in a controlled transaction. Similar tax rules are also legislated in other tax jurisdictions and such rules are commonly referred to as “Earnings Stripping Rules” (ESR) among the international tax community.

a) ESR Rules in Malaysia

The salient features of the ESR rules in Malaysia are as follows:

- Applicable when interest expenses exceed RM500,000 in a year of assessment (YA).
- Interest expense refers to interest on amount payable or paid to:
  - Associate person outside Malaysia (with or without a permanent establishment in Malaysia);
  - Third party lender outside Malaysia, with the loan guaranteed by a related party in the group.
- Restriction is calculated on any interest expenses in excess of 20% of “Tax-EBITDA” (Earnings before interest, taxes, depreciation and amortization).
  - *Where: “Tax-EBITDA” = A + B + C*
  - *And,*
    ***A** = Adjusted income of the person from business source for the year of assessment, before any restriction on the interest expenses under Section 140C.*
    ***B** = Qualifying deductions allowed in ascertaining the adjusted income. This refers to expenditure allowed for double deductions, further deductions and specific deductions allowed by the Minister.*
    ***C** = Total interest expenses incurred on any financial assistance in a controlled transaction from sources consisting of business for the year of assessment (YA). This refers to the same interest amount that are subject to the calculation of the threshold of RM500,000.*

10) Interest paid to related companies (cont'd)

b) Non-deductibility of intra-group interest costs in YA 2020

The reduction in sales revenue will likely lead to narrower profit margins for the year 2020 for many companies, an aftermath of Covid-19 pandemic and the MCO. On the contrary, there is no sign of reduction of interest costs for companies with borrowings. Instead, there could be higher interest costs due to additional borrowings from related companies. In order to conform with the transfer pricing provisions on inter-company loans, lenders will continue with arm's length interest with the borrowers.

With the above setting in, the chances are high for the borrower entity that the ratio of 'intra-group interest costs' to 'tax-EBITDA' will exceed the 20% threshold, thereby opening the door for ESR to reduce tax deduction on such interest costs.

Every dark cloud has a silver lining. In this case, Section 140C of the ITA allows the portion of interest expenses which are restricted in a YA to be carried forward to a subsequent YA indefinitely. It will thus be a question of time for the costs be translated to tax deductions.

11) Deferment of capital expenditure

Effects of deferment of capital expenditure on tax incentives

On 1 April 2020, it was reported in all media in Malaysia that the World Bank revised Malaysia's 2020 Gross Domestic Product (GDP) growth projection to negative 0.1%. This is a sharp downward revision from its previous expectation of GDP growth of 4.5%. Malaysia net exports are expected to decline by 3.9% this year.

The Covid-19 pandemic has disrupted global supply chains, and the implementation of MCO caused production outages during the period. Major economies globally are experiencing sharply lower regional and global growth.

a) Companies with Existing Tax Incentives In Malaysia

Tax incentives such as pioneer status (PS) and investment tax allowances (ITA) are commonly awarded by government agencies e.g. Malaysian Investment Development Authority (MIDA), Ministry of Finance, Malaysia Digital Economy Corporation (MDEC), Iskandar Regional Development Authority (IRDA), etc.

Apart from carrying on the qualifying activities, a company may be required to comply with other conditions. These include meeting minimum knowledge workers threshold, minimum production value add ratio, restriction on location of operations, compliance with health, safety and environment standards, and commitment on minimum spending on capital expenditure investment within a stipulated period of time.

b) Condition: Meeting Minimum Spending On Capital Expenditure

The condition imposed on binding the applicant company to commit on minimum capital expenditure spending is understandable. Through capital investments, the Government is aiming at positive social and economic outcome - increased production capacity, transfer of technology, job creation, highly skilled workers, adoption of IT, economic spin-off, etc. which ultimately help Malaysia to escalate up the economic value chain.

11) Deferment of capital expenditure (cont'd)

c) Breach of conditions

With on-going pessimism in the local and global economic environment, only the fearless entrepreneurs will adopt more aggressive business expansion plans. This leaves behind a vast majority of investors and businesses who are more likely to switch to a wait-and-see mode when it comes to expansion. Not to forget, some will still be under a fire-fighting mode to stay afloat. In this regard, manufacturers are extremely vulnerable as they are already tied down with existing heavy capital commitments.

The dire consequence of the Covid-19 pandemic is the disruption of a company's short term investment plan. The change in plan will result in possible failure on the company's part to commit to the amount of capital expenditure required to be incurred. If your company has somehow fallen short in fulfilling the capital expenditure commitment as required by the authorities, it may run the risk of having the tax incentive being revoked or withdrawn.

d) What options are available?

There is only one option – Renegotiation. By now, your company should have been able to gauge the situation sufficiently to know if it is able to invest the sum as promised, or otherwise. To avoid losing the entire tax benefits as a consequence of the revocation of the tax incentive by the authorities, you should take the initiative now to renegotiate a revised incentive package with the authorities that seeks to lower the threshold set for capital investment, to one that is practical and reasonable to your company.

12) Impairment loss on investments

Deductibility of impairment loss on shares held as trading stock

The share prices in the stock market have fallen drastically as the Covid-19 pandemic shuts down the world's economies. As a consequence, businesses will have to carefully evaluate the impairment of the value of their investment in shares.

For an investment dealing company, any diminution in the value of shares to reflect market value is tax deductible under Section 35(2) of the Income Tax Act 1967 as these shares constitute stock-in-trade of the investment dealing company. Likewise, any accretion in the value of the shares will be taxable for an investment dealing company.

However, the tax treatment for shares held as long-term investments should be distinguished from those shares held as stock in trade as explained above. For shares that are held for investment purposes, any diminution and accretion in the value of shares are not deductible and not taxable as these represent capital loss and capital gain respectively for the business.

13) Movement of inventories between related companies

Tax Implications on movement of inventories between related companies

Many businesses are adversely affected by the current Covid-19 pandemic. To survive, businesses have to constantly engage itself to strategise and re-strategise business plans in navigating themselves through this economic storm.

For groups of companies having multiple entities incorporated to undertake similar business activities, commonly seen in the retail and food & beverage sector, chances are that some of these entities will perform better than others, largely depending on factors such as, geographical location, demographic of consumers, management effectiveness, etc. Provided that the group's cash reserve is strong to provide continuous financial support in terms of the working capital of all its entities during a pro-longed lockdown period and the subsequent recovery stage, business owners have to make tough decisions to scale down operations, or worse still, temporary or permanent closure of certain non-strategic loss making operating entities.

When faced with a decision to scale down or close down a loss making entity, the main consideration includes realising some or all of the business assets for cash to recover whatever is worthy in value it has invested in, including unsold stocks. Some inventories may have to be discarded due to damage and obsolescence. As for the remaining unsold inventories, other operating business entities within the group are likely to be asked to absorb such stocks into their business.

The tax implications on the transfer of unsold inventories from one business entity to other business entities within the group are discussed below.

a) Inventories sold or transferred – must be at market value

The general prescription in tax rules is that inventories are to be sold or transferred at market value. In cases whereby the inventories are sold or transferred at prices lower than the market value, the Inland Revenue Board (IRB) may invoke the provisions under Section 35 of the Income Tax Act 1967 (ITA) to make tax adjustments to restate the sales value to market prices.

13) Movement of inventories between related companies (cont'd)

b) Exception – Sale at value other than market value

However, there is an exception to the market value in Section 35 of the ITA where market value is not prescribed as the sale value, i.e. the sale consideration may be stated at value other than market value for tax purposes. In the words of Section 35(5) of the ITA, inventories may be sold at any consideration when:

- ***Cessation of seller's business*** - the seller or transferor permanently ceases to carry on a business; and
- ***Buyer uses inventories for his trading stocks*** - at or about the time he ceases in the business, he sells or transfers his inventories for valuable consideration to another person who uses the inventories as stock in trade in his business; and
- ***Transacted price accepted as it is*** - the price paid for the inventories or the value of the consideration is to be taken as the value of the inventories at the cessation of the business.

c) Summary

When unsold inventories are sold from one company to another company within the same group of companies, depending on the circumstances surrounding the transfer of such inventories, the tax implications can be summarised as follows:

	Transferor / Seller Ceases Business Operations Permanently	**Transferor / Seller Continues Its Business Operations**
Transferee / Buyer uses the inventories as stock in trade in his business	Actual transacted value	Market value
Transferee / Buyer does not use the inventories as stock in trade in his business	Market value	Market value

14) Capital injection

Effects of increase in capital injection

In line with the MCO measures to curtail the spread of Covid-19 pandemic in Malaysia, businesses which fall under the category of non-essential services are forced to close their premises temporarily. The temporary closure during the MCO period has caused a damaging impact to businesses, especially to small and medium enterprises (SMEs), which are struggling to sustain their businesses with negative cash flows. Some businesses may collapse while some businesses have the option to obtain financing through equity from shareholders to weather the storm caused by the catastrophic Covid-19 pandemic.

What are the key areas of concern, from the tax perspective, if businesses are to consider financing by way of capital injection?

a) Impact on SME status

Pursuant to Paragraph 2A, Part I, Schedule 1 of the Income Tax Act 1967 (ITA), Small and Medium Enterprises (SME) is defined as a resident company in Malaysia with paid up capital / total contribution of capital of RM2.5 million and below at the beginning of the basis period and having gross income from source(s) consisting of a business of not more than RM50 million for the basis period for a year of assessment. SMEs and Limited Liability Partnerships (LLPs) qualify for preferential corporate tax rate of 17% on the first RM600,000 of chargeable income.

For SMEs which currently enjoy the preferential corporate tax rate, such SMEs may potentially breach / exceed the threshold of the paid up capital / total contribution of capital if the SMEs consider increasing their equity to finance their businesses. Consequently, in the event the SMEs or LLPs exceed the paid up capital / total contribution of capital of RM2.5 million at the beginning of the basis period, such SMEs or LLPs would cease to enjoy the preferential corporate tax rate and be hit by a higher corporate tax rate of 24% for the basis period for the relevant year of assessment.

b) RPGT issue on the disposal of Real Property Company (RPC) shares

Pursuant to Paragraph 34(6)(b) of Schedule 2 to the Real Property Gains Tax Act 1976 (RPGTA), RPC refers to *"a controlled company, at any date after 21 October 1988, acquires real property or shares or both whereby the defined value of real property or shares or both owned at that date is not less than seventy-five per cent of the value of its total tangible assets"*. *"Controlled company"* is defined as one having not more than fifty (50) shareholders and which is controlled by not more than five (5) members.

14) Capital injection (cont'd)

In the event that a company is regarded as an RPC from the RPGT perspective, shareholders, i.e. individual shareholders and/or corporate shareholders who acquire new shares following the capital injection will be acquiring more RPC shares in that particular company. The date of acquisition of these new RPC shares by the shareholders would be based on the date of allotment of these new shares.

Subsequent disposal of RPC shares by the shareholders is deemed as a disposal of chargeable asset pursuant to Paragraph 34A(1) of Schedule 2 to the RPGTA. In this regard, the shareholders may be caught with a higher RPGT liability on the disposal of RPC shares as the shareholders would have a shorter holding period for the new RPC shares acquired following the capital injection.

15) Cash flow management from a transfer pricing perspective

The wheels of the global economy have virtually stopped turning in the past weeks as the world struggles to adapt to the realities of living in the age of the Covid-19 pandemic. Against this backdrop, it is projected that Malaysia will suffer a negative GDP growth of 2.9% for the 2020 fiscal year (MIER, 2020). Despite the enforcement of the MCO from 18 March 2020 to 14 April 2020, infections are expected to rise in the short-term (JP Morgan, 2020), and the month long MCO shall further increase the difficulties to be faced by Malaysian businesses in the months ahead.

Unprecedentedly, the Malaysian Government announced two rounds of economic stimulus packages (ESP), with ESP1 and ESP2 announced on 27 February 2020 and 27 March 2020 respectively to ease the financial burdens of the *Rakyat* and to counteract the effects of recession that are expected to set in for the next few months. Amongst others, the ESPs introduce special support packages for SMEs, enhanced access to working capital through credit lines and deferment of tax payments. These measures are in line with the OECD's Secretary General's recommendations (OECD Tax Policy Note, 2020).

Cash flow is the life-blood of any business. With the current lockdown, businesses across the economic spectrum are facing the biggest business sustainability issue – to ensure sufficient working capital requirements to weather through this economic storm! Obtaining loans from banks is one option, and for companies belonging to a group of companies, there is an additional option - getting financial support from their parent company or other related companies who may be in a much stronger financial position. This may lead to incremental intra-group financing and transfer pricing activities as follows:

- Movement of funds across borders will result in higher volume of intercompany financing transactions materialising within the current financial year;
- More trade financing between associated persons due to deferment of payments for extended periods;
- Subsidiaries of Multinational Enterprises (MNEs) / large companies seeking review of their existing arrangements surrounding payments of intercompany charges (e.g. management fees, support fees, information technology service charges) causing delays or reductions in payments.

15) Cash flow management from a transfer pricing perspective (cont'd)

As observed above, there are bound to be potential complications within the existing transfer pricing framework in these companies. Much of the transfer pricing risks may crystallise in areas concerning intercompany financing, as businesses seek to increase liquidity and overcome short-term cash shortages to ensure business continuity. Overcoming these challenges would require significant planning and on-the-go solutions in order to not only address the current business risks facing the organisation but also to make certain that solutions adopted meet the requirements under existing transfer pricing regulations.

As much of the transfer pricing risks may arise in the area of intercompany financing, the taxpayers in Malaysia may consider the following in easing cash flow concerns with respect to transactions with associated persons:

- Taxpayers may extend lines of credit within the same Group for trade transactions to ease cash flow burden

  Crowe's View: As businesses may decide to defer payments for trade transactions (especially within the same group), taxpayers from both trade debtor and trade creditor perspectives, need to be aware that extended periods of deferment of payments may give rise to transfer pricing complications i.e. whether interest should be imposed by the trade creditor during this extended period. It is important that the issues surrounding such business decisions are well documented, highlighting the necessity to take such decisions and determine upfront the revised terms of settlements. It would also be helpful if these terms have some level of consistency with third party arrangements, thus mitigating the risks of tax authorities questioning these arrangements in the years to come.

- MNE Groups may seek to utilise external sources of funds for group funding in view of the availability of cheaper financing arising from central banks reducing interest rates around the world.

  Crowe's View: Originators of such requests within the Group may have the incentive to utilise these cheaper sources of funds and pass on these savings to their respective associated persons. We note that this solution may be necessary given the current economic climate but proper consideration needs to be given by taxpayers to ensure that intercompany financing is not granted free of interest during this period to prevent tax authorities from questioning the arm's length nature of the transaction in future years.

15) Cash flow management from a transfer pricing perspective (cont'd)

Also, in deferring interest payments, these should track closely with economic developments within the country (e.g. Bank Negara Malaysia's moratorium on deferment of payments) and avoiding deviation from the market practice. There should not be any unique arrangements that are extremely favourable to associated persons that extend beyond the affected period.

- Local subsidiary companies of MNE Groups may not be able to cease payment to service providers within the Group

  Crowe's View: Whilst it is natural and necessary for taxpayers to review intercompany payments due to the reduction in utilisation of intercompany services, local taxpayers may be at the mercy of larger organisations that may continue to impose charges despite reduced utilisation. Malaysian taxpayers should be cautious in readily accepting charges for intercompany services in the event that such benefits are no longer accruing to the Malaysian subsidiaries as their operational requirements may have reduced during and post MCO period. These transactions should be reviewed and may also assist taxpayers in easing their cash flow positions.

On an overall basis, taxpayers within Malaysia and around the world are forced to adapt to the new norms in the current hostile business conditions. From a tax perspective, these harsh business conditions should not be used as a blanket-wide justification for avoiding compliance with existing tax legislation. As the pandemic subsided over time, tax authorities will seek to step up their compliance efforts to make up for lost time. In such a scenario, it is worthwhile for taxpayers to be mindful of their commercial arrangements, continuously review their decision making during this difficult time and seek to adopt solutions that are sustainable from a tax perspective as the year progresses.

16) Managing transfer pricing risks

What Do Multinational Enterprises (MNEs) Need to Know About Managing Transfer Pricing Risks?

Amidst the Covid-19 pandemic globally, countries are imposing lockdown measures to contain the rapid spread of the virus. Economies are virtually at a standstill as consumption plummeted, compounded by large scale closure of manufacturing and trade activities. This sudden jerk of global supply chain landscape coupled with an array of dysfunctional events are putting tremendous pressure on multinational enterprises (MNEs).

As a CEO or CFO of the Malaysian subsidiary of MNEs, you are faced with the immediate concerns on keeping up the robustness of the company's transfer pricing process.

We will examine the transfer pricing issues, establish analytical frameworks and suggest for action plans by addressing on the following four (4) areas of contention:

- Limited risk operations;
- Special factor analysis;
- Selection of third party comparable companies; and
- Transfer pricing adjustment for the impacted period.

16) Managing transfer pricing risks (cont'd)

#1 Limited risk operations

Manufacturing, distribution and service operators structured using a limited risk model are common in businesses. In particular, subsidiaries of MNEs operating globally are organised with limited functional profile and conferred with limited decision-making power. Under a limited risk model, as the market risk and/or operational risk are not assumed by the limited risk entities, the general expectation is that limited risk entities should earn a routine profit in line with their peers in the industry based on the returns derived from the periodic updates of their benchmarking studies.

With the Covid-19 pandemic, even in the best case scenario, most Malaysian companies will likely lose one (1) full month of sales. While companies are putting hope of catching-up with the lost sales in the remaining part of the year, global demand may be suppressed putting the hope at great risk. Unfortunately, the overhead costs are not reducing at a speed in tandem with the drop in business revenue. These combined factors could very well erode the entire profits of the Malaysian company for 2020 resulting in losses, or a non-tax paying position. Fast forward to post Covid-19 era, it will not be surprising to see the Inland Revenue Board (IRB) taking the conventional approach to dispute the loss making positions for these limited risk operators. In the eyes of the IRB, limited risk operators should earn routine profits, notwithstanding the ups and downs of the economy. With this hindsight in mind, limited risk companies need to better manage their transfer pricing affairs now rather than later.

Conclusion

The transfer pricing risks in Malaysia may be mitigated through the following measures:

- Companies may choose to continue with the current transfer pricing policy set under the limited risk structure, i.e. earning a targeted routine return. To meet this objective, loss making companies will need to resort to making year end transfer pricing adjustments (upwards) on their operating margins.
- Alternatively, companies may wish to review the current transfer pricing policies by seeking for a reduced target margin for the remaining part of the year. To this end, additional steps are required to provide a robust defense against any accusation of inappropriate transfer pricing practices. This involves comprehensive documentation of the financial impacts of Covid-19 on the final operating results.

16) Managing transfer pricing risks (cont'd)

#2 Special factor analysis

The transfer pricing documentation for 2020 is to be contemporaneous to address the different business landscape in light of the Covid-19 pandemic. Every affected business should carry out a special factor analysis where all legal, commercial rationales and justifications are in place to establish a defensible position. Amongst others, a detailed discussion should be in place relating to the options considered by the business in confronting the issues threatening its survival during the Covid-19 hardship. This is needed bearing in mind that the IRB is less likely in accepting cosmetic explanations that coronaviruses are to be blamed for the business losses or reduced profits.

The special factor analysis of each factor, may include, but not be limited to, the following:

- ***Contractual analysis:*** The starting point of an analysis is to conduct a thorough review of the contracts governing the intercompany transactions - the terms, rights, and obligations. Many contracts contain force majeure clauses. The pertinent question is whether the related parties will be able to rely on the clause to relieve related parties from compensating the Malaysian entities' reduced profitability under the existing transfer pricing framework. The actions warranted to be taken would depend upon the contractual terms.

- ***Loss factor analysis:*** The detailed analysis relating to the commercial rationales contributing to the loss making position seek to help to identify the direct impacts attributed to the Covid-19 virus outbreak, away from those impacts of the transfer pricing systems itself.

- ***Specific period analysis:*** A final piece of a convincing analysis should include the segregation of the results in different stages of the business: (i) fully-virus-impacted, (ii) transition, and (ii) resumption. Such analysis shows the details of the costs incurred and revenue generated during the respective periods, thus justifying the decisions made by taking different measures to counteract the impacts at different levels. Arguably, much of the analysis should focus on the fully-virus impacted period, and to a lesser extent, the transition period. Whereas during resumption periods, existing transfer pricing policies should be observed without the need of adjustments.

Conclusion

A sound transfer pricing position is to be supported by a set of contemporaneous transfer pricing documentation setting out the specific business factors, with the contractual and financial analysis as evidence of the loss making position.

16) Managing transfer pricing risks (cont'd)

#3 Selection of third party comparable companies

An examination into the latest third party comparable companies and the broader business practices would shed light on the approach for MNEs to adopt when faced with the issue of whether and how to compensate the Malaysian entity.

The financial results of comparable companies provide an indicator on the level of profit that should be earned by the Malaysian entity (i.e. tested party) through a benchmarking analysis. It is anticipated that third party companies in similar businesses may tend to suffer losses given the overall unfavorable economic conditions. Even with third party results that may likely to align with the tested party's results, the final hurdle is the IRB, who may decide to reject loss-making comparable companies on grounds of non-comparability. It is therefore imperative for taxpayers to document down the functional analysis and the process involved in selecting third party companies. The functional analysis helps to support comparability of third party companies in terms of functions, risks and assets. The selection of third party companies should strictly adhere to the comparability requirements and meet with the independence criterion.

The reality in a benchmarking analysis is that information on financial results of third party companies earned during the span of the coronavirus in 2020 will not be publicly available until sometime in 2021, making it impossible for any real time analysis. The lack of real-time data is a hindrance to the required comparable analysis, and without such analysis, sound comparability adjustments could not be made.

Conclusion

During a period of crisis, MNEs are faced with numerous challenges affecting their transfer pricing systems, including selection of comparable companies. It is an added burden to the MNEs to be able to carefully assess the comparability of the third party companies for inclusion in their benchmarking analysis. The benefits from these additional exercise could be garnered when its transfer pricing position in Malaysia is being challenged by the IRB post Covid-19 period.

16) Managing transfer pricing risks (cont'd)

#4 Transfer pricing adjustment for the impacted period

Traditionally, to achieve a targeted profit level for the Malaysian subsidiary, MNEs resort to making an accounting adjustment to make up the difference between the actual profit of the Malaysian subsidiary, and the targeted profit level, with the objective of meeting the targeted profit level that is defensible in a transfer pricing audit. This adjustment is known as a transfer pricing adjustment. A transfer pricing adjustment is often made at the year end, and can be either an upward or downward adjustment depending on the actual profit vis-à-vis targeted profit.

In the Malaysia context, a transfer pricing adjustment can be a highly disputable area due to lack of clarity. In the absence of guidance from the IRB, MNEs have to exercise extra caution with regards to making transfer pricing adjustments. When performing an analysis on the quantum of the transfer pricing adjustment, it is important for MNEs to evaluate all aspects of their transfer pricing policy.

Some areas are highlighted below:

- Ascertain the impact on the industry as a whole, which sets the foundation for any profitability analysis for the group companies involved in intercompany transactions.
- Evaluate the impact of the low participation of the consumers in the market and its correlation with the MNE's inventory obsolescence.
- Identify significant issues on the supply chain management in light of the border closure policies adopted by affected tax jurisdictions.
- Assess the type of risks for the members in the group involved in the intercompany transactions and identify the parties bearing the risks.
- Internalise any revised transfer pricing policy devised for the entire MNEs that is aimed to ensure the sustainability of the MNEs.

Conclusion

In making a transfer pricing adjustment, various commercial considerations have to be taken into account such as those highlighted above, to ensure that the transfer pricing adjustments will not end up futile but instead, could withstand any challenges posted by the IRB.

16) Managing transfer pricing risks (cont'd)

What's Next?

While your company navigates itself through this economic turbulence, managing tax and transfer pricing risks is an item on your long to-do list. There are many areas that can possibly give rise to tax and transfer pricing risks for MNEs operating in multiple tax jurisdictions, including Malaysia. The four (4) areas of contention for transfer pricing disputes could well be a tip of the iceberg.

The outcome of the Covid-19 is that MNEs are constrained by limited resources to address all business needs. As a result, the non-essential aspect of the business may need to give way to other areas of top most priorities. Given this, will MNEs seek to maintain the financial budgets for transfer pricing compliance?

The answer is quite negative at this moment. Nevertheless, to strike a balance between meeting compliance requirements and maximising its resources, MNEs may consider a more streamlined, cost-effective solution to manage their transfer pricing risks and compliance across all the tax jurisdictions they are operating in.

17) Service permanent establishment

Effects on creation of service permanent establishment by non-residents

Generally, a non-resident company which has created a Permanent Establishment (PE) in Malaysia would be held taxable in Malaysia on its income accruing in or derived from Malaysia. Pursuant to Section 12(4) of the Income Tax Act 1967 (ITA), a non-resident company could be deemed to have a PE in Malaysia if the non-resident company carries out supervisory activities in connection with a building or worksite, or a construction, an installation or an assembly project in Malaysia (Service PE).

A Double Tax Agreement (DTA) is an agreement signed between two (2) countries to avoid or alleviate territorial double taxation of the same income by two (2) countries. There are certain DTAs signed between Malaysia and other countries that stipulate a time frame (e.g. six (6) months) before a Service PE is triggered. With the MCO and extended MCO period imposed by the Government to curb the spread of Covid-19 virus, employees / personnel of the non-resident companies could have extended their stay unexpectedly in Malaysia immediately after the construction, installation or assembly project is completed.

Will the extended presence of the non-resident companies' employees in Malaysia create a Service PE for these non-resident companies in Malaysia by virtue of having a presence exceeding a period six (6) months after taking into consideration an additional one (1)-month MCO period?

For non-resident companies, like contractors and MNEs which carry out supervisory works in Malaysia and which foresee to have a presence in Malaysia exceeding a period of six (6) months after taking into consideration the additional one (1)-month MCO period, should obtain a further clarification on the applicability of Service PE to these non-resident companies. This is a grey area which requires clarification from the Inland Revenue Board as the non-resident's employees in Malaysia are not allowed to perform any supervisory works in Malaysia during the MCO period and hence, such presence should not be taken into consideration for determination of a Service PE.

Non-resident companies having PE in Malaysia are required to comply with the tax filing requirements to report the income derived in Malaysia and payment of taxes to the IRB. Failure to furnish tax returns would render the non-resident companies to be penalised under Section 112 of the ITA.

18) Residence status

Effects on residence status of companies in Malaysia

Pursuant to Section 8(1)(b) of the Income Tax Act 1967 (ITA), a company or a body of persons is resident in Malaysia for the basis year for a YA if at any time during that basis year the management and control of its business or any one its businesses are exercised in Malaysia. Generally, the management and control is considered to be exercised in Malaysia if important policy decisions are made during the board of directors meeting in Malaysia.

The imposition of MCO by the Government should not have a significant impact on the residence status of companies as long as important and key policy decisions are made at any time for the basis year for a relevant YA. However, residence status could be a concern to non-resident companies which created a PE in Malaysia, through fixed place of business, Service PE or Agency PE. Most of the time, these non-resident companies may not be tax residents in Malaysia as their management and control are exercised either in their home countries or other countries.

In terms of corporate tax rate for companies, corporate tax rate under Paragraph 2, Part I, Schedule 1 of ITA is applicable to the non-resident companies having a PE in Malaysia. Nevertheless, there are several distinct differences in terms of the tax treatment of a resident company and non-resident company. These differences are discussed as follows:

Areas	Resident company	Non-resident company
Incentives under the Promotion of Investment Act 1986 (PIA) and ITA	Certain incentives are only applicable to companies which are tax residents in Malaysia. For example, reinvestment allowance, investment tax allowance and pioneer status.	Non-resident company may not be able to enjoy certain tax incentives available in Malaysia.
Withholding taxes in respect of payments made by a Malaysian resident company to a resident or non-resident company	Withholding tax is not applicable.	Certain receipts by the non-resident companies (e.g. interest, royalty, special classes of income under Section 4A of ITA, etc.) would be subject to withholding tax.

18) Residence status (cont'd)

Areas	Resident company	Non-resident company
Double tax relief	Depending on the DTA between Malaysia and other countries, double tax relief is available (e.g. reduced withholding tax rates). Illustration: Malaysian Co has made a payment of technical fee to a Germany Co (a tax resident in Germany). The reduced withholding tax rate of 7% under Article 12 of the Malaysian-Germany DTA would apply to the payment of technical fee by Malaysian Co to Germany Co.	Double tax relief provided under the DTA may be applicable, depending on situations. Illustration: Singapore Co (a tax resident in Singapore having a PE in Malaysia) (NR Co) has made a payment of technical fee to a Germany Co (a tax resident in Germany). The technical fee paid to Germany Co by NR Co should be deemed derived from Malaysia if the payment is charged as an outgoing / expense in the accounts of the business carried on in Malaysia pursuant to Section 15A of the ITA. In such situation, withholding tax provision under Section 109B of the ITA would be applicable on such payment. However, the reduced withholding tax rate of 7% under Article 12 of the Malaysian-Germany DTA would apply to the payment of technical fee by NR Co to Germany Co.

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