Tax Chat

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Audit / Tax / Advisory

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Withdrawal of Withholding Tax Exemption on Income from MSC Status Companies

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Presently, a non-resident company is exempted from payment of income tax in Malaysia on the following types of income received from an approved MSC status company:

- fee for technical advice or technical services;
- licensing fee in relation to technology development; and
- interest on loans for technology development.

This exemption was given under Income Tax (Exemption) (No.13) Order 2005.

The Malaysian Digital Economy Corporation Sdn Bhd (MDEC) has placed an announcement on their website stating that the above income tax exemption order will be revoked effective from 1 January 2020.

What is the tax implication upon revocation of the exemption order?

From 1 January 2020 onwards, withholding tax will be applicable on income received by non-resident companies from approved MSC status companies.

- Before the above income tax exemption order is revoked, affected multinationals engaged in transactions with approved MSC status companies in Malaysia should review their current business arrangements.

- Affected multinational companies should assess their exposure to Malaysian tax by considering:

  - Whether the burden of withholding tax has been shifted to the approved MSC status company; or
  - Availability of relief under Malaysia income tax treaties.

Tax Incentive for Women Returning to Work after a Career Break

Tax Incentive for Women Returning to Work after a Career Break

It was proposed in Budget 2018 that a tax exemption would be given on employment income received by women returning to the workforce after being on a career break for at least two (2) years as at 27 October 2017.

Income Tax (Exemption) (No. 9) Order 2019 was gazetted on 23 August 2019 to legislate the above proposal. The Order shall have effect from the Year of Assessment (YA) 2018 to YA 2020 and is applicable to applications made through Talent Corporation Malaysia Berhad (TCMB) on or after 1 January 2018 but not later than 31 December 2019.

Who is eligible?

A woman:

- Who is a citizen of Malaysia and is residing in Malaysia;
- Who has ceased employment and has not derived any employment income for a continuous period of at least 24 months prior to or as at 27 October 2017;
- Who had at least three (3) years full-time employment experience prior to the cessation of employment ;
- Who does not exceed the age of 58 years on the date of application;
- Who has signed a full-time employment contract in Malaysia with a qualifying employer for a period of at least 24 months;
- Who has worked for at least 12 consecutive months from the employment contract period with the same qualifying employer, and the period of that employment is between 27 October 2017 until 31 December 2020;
- Whose gross income from an employment is at least RM5,000 a month; and
- Whose application has been approved by TCMB.

What is the exemption?

Exempted from the payment of income tax in respect of her gross income from an employment, for a period not exceeding 12 consecutive months. The exemption period will commence either in the YA or in the following YA.

Who is a "qualifying employer"?

Any person excluding:

(i) A company which is controlled, either directly or indirectly, by the approved individual;

(ii) A sole proprietorship; or

(iii) A relative of the approved individual who is a parent (including a parent-in-law), a child (including a stepchild or child adopted in accordance with any law), a brother or sister, a grandparent or grandchild, or a spouse.

"Ceased employment" in the context of this Order **excludes** no-pay leave, half-pay leave or full-pay leave.

Transfer Pricing Focus: Increased Challenges in Characterization of Controlled Transactions

An article by the Transfer Pricing team of Crowe KL Tax Sdn Bhd

Transfer Pricing Focus: Increased Challenges in Characterization of Controlled Transactions

Transfer Pricing Compliance – Inland Revenue Board of Malaysia (IRBM)'s New Focus?

- The Special Voluntary Disclosure Programme (SVDP) was launched by the Government since 2 November 2018 to increase tax revenue. With the 30 September 2019 deadline having passed, questions have been raised by the business community on the future plans of the IRBM: Would the IRBM step up the enforcement through increased tax audits or tax investigations? The answer could be found from the following statement:

> *After 30 September 2019, the team of investigators would start "risk analyses" and* ***would begin to hunt those who had owed the government in income taxes.***
>
> *Dato' Sri Sabin bin Samitah, CEO of Inland Revenue Board*
> *13 August 2019, Free Malaysia Today*

- One can tell from the above that it is almost certain that tax enforcement activities will be intensified, especially on taxpayers who have not participated in the SVDP. In a tax audit or tax investigation, many tax issues can be targeted by the IRBM that eventually may lead to additional tax payable by the taxpayers.

- For domestic and multinational group of companies, transfer pricing issues will be the attention of the IRBM. The challenges of these companies evolve around justifying their transfer prices on related party transactions and meeting the **arm's length standard**.

Transfer Pricing Focus: Increased Challenges in Characterization of Controlled Transactions

Why Characterization is Important in Transfer Pricing?

- A transfer pricing documentation (TP Doc) is required to be prepared to support the transfer pricing position in a related party transaction and it entails detailed analysis regarding the nature of the controlled transactions, taking into consideration the functions performed, assets employed and risks assumed by the respective parties in a controlled transaction.

- This characterization analysis of the controlled transaction entered into by the parties who are related to each other, known as associated persons, shall lend support to the arm's length returns earned by the respective entities.

- The IRBM may not always agree with the characterization concluded by the taxpayers. According to Rule 8 of the Income Tax (Transfer Pricing) Rules 2012, the IRBM has the power to re-characterize a transaction where the economic substance differs from its form; or where the arrangement differs from those that would have been adopted by independent persons behaving in a commercially rationale manner.

- **Common pitfalls:** The failure to characterize transactions appropriately may lead to disagreement by the IRBM resulting in **re-characterization of** the transaction.

- To understand the issues on proper characterization of transactions, we set out below the different levels of characterization in the context of (a) manufacturing model, (b) distribution model and (c) services provision model.

Transfer Pricing Focus: Increased Challenges in Characterization of Controlled Transactions

Challenges in characterization in a post-BEPS (Base Erosion Profit Shifting) world

In the post-BEPS era, i.e. Base Erosion and Profit Shifting Action Plan, with BEPS Actions 8 to 10 seeking to strengthen TP rules, taxpayers need to act mindfully so that their transfer pricing position could withstand the close scrutiny by tax authorities. This includes addressing the issue of characterization of transactions more diligently by identifying the economical significant functions performed, assets employed and risks assumed by each party in a controlled transaction.

The list is not exhaustive but, potential challenges would include but are not limited to “contractual allocation of risk” and “cash box entity” insofar as transfer pricing characterization is concerned.

❖ **Contractual allocation of risk:**

- Contractual agreements between related parties provide the starting point for allocating risks amongst parties.
- It is no longer enough to defend the characterization purely from the contractual arrangements between the parties.
- Essentially, entity characterization would very much depend on whether the contractual arrangements are supported by **actual** functions, value creation as well as the parties making the important business decisions.

❖ **Cash box entity:**

- Cash box entity is a capital rich entity with no or very low functionality.
- Cash box entity will likely be characterized as a fund provider and will generate no more than a risk-free return, assuring that no premium returns will be allocated to cash boxes without relevant substance.

Transfer Pricing Focus: Increased Challenges in Characterization of Controlled Transactions

What can the taxpayer do to reduce TP risks?

Check Point: To avoid unwanted shocks to the day-to-day business operations, the taxpayers may wish to assess their readiness on their TP issues through ensuring the following are put in place:

Transfer Pricing documentation: Maintain an updated transfer pricing documentation before the submission of the corporate income tax return.

Entity characterization: Ensure the entity is characterized appropriately from the transfer pricing perspective by making reference to the analysis of the functions performed, assets employed and risks assumed by the entity.

Consistency: Ensure there is consistency between contractual risk allocation, actual risk allocation and entity characterization.

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