



Crowe

# Tax Chat

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# **Latest Update on Withholding Tax Treatment on Payments of Service Fees to Non-Residents**

## Latest Update on Withholding Tax Treatment on Payments of Service Fees to Non-Residents

The Inland Revenue Board of Malaysia (IRBM) issued [Public Ruling 11/2018 - Withholding Tax on Special Classes of Income \(PR 11/2018\)](#) on 5 December 2018 which supersedes the earlier PR 1/2014.

The salient changes in PR 11/2018 are as follows:



The exclusion of “allocation of head office expenses for ordinary day-to-day or routine administration expenses” from the scope of withholding tax has now been removed.



The following payments which were previously exempted from withholding tax, are now subject to withholding tax with effect from 5 December 2018:

- Commission paid to general commission agents for deals transacted overseas;
- Guarantee fees connected with any loan or indebtedness or commission for letters of credit;
- Testing services for the provision of test results on finished products to meet required standards. In addition, the provisions of testing, measurement and calibration services are expressly mentioned as examples of technical services which are subject to withholding tax.



With effect from 5 December 2018, withholding tax is calculated on the gross fees and regrossing is no longer required where withholding tax on special classes of income is borne by the payer. An example of the difference is as follows:

<b>Prior to 5 December 2018 (Regrossing method)</b>	<b>From 5 December 2018 (Direct method)</b>
<b>Technical fee payment (gross): RM150,000</b>	<b>Technical fee payment (gross): RM150,000</b>
<b>Withholding tax: <math>RM150,000 \times 10/90 = RM16,667</math></b>	<b>Withholding tax: <math>RM150,000 \times 10\% = RM15,000</math></b>

## Latest Update on Withholding Tax Treatment on Payments of Service Fees to Non-Residents



The application of foreign exchange rates on conversion of service fees from foreign currency to Malaysian Ringgit is now clarified. Either one of the following references can be used at the time of payment in calculating the withholding tax:

- i. prevailing foreign exchange rate on the date the payment is made (the rate would be reflected in the telegraphic transfer);
- ii. rate published in the official portal of IRBM; or
- iii. rate published by Bank Negara Malaysia.



The IRBM reiterated its position that where a Double Taxation Agreement (DTA) does not have an article on Technical Fee or Service Fee and the same is not covered in the definition of “royalty” in the DTA, the “Other Income” or “Income Not Expressly Mentioned” article of such DTA would apply.

In light of these changes, you are advised to review your withholding tax practices when making payments to a non-resident service provider.



# **Furnishing of Returns of Imported Taxable Services by Non-Taxable Persons**

## Furnishing of Returns of Imported Taxable Services by Non-Taxable Persons

With effect from 1 January 2019, all businesses (i.e. irrespective of whether registered with service tax or not) would be required to account for service tax when imported taxable services are acquired by the businesses. The differences on the service tax compliance for a taxable person and a non-taxable person are as follows:

	Taxable Person	Non-Taxable Person
Prescribed form	SST-02 return	SST-02A declaration
Submission deadline for furnishing of the declaration and payment of service tax due	In the respective taxable period	By the last day of the month following the month in which the tax is due on the imported taxable services (i.e. the earlier of payment made or invoice received date)

Please take note that the deadline to furnish the SST-02A declaration and pay the service tax for a non-taxable person who has imported taxable services in the month of January 2019 is on **28 February 2019**.

# **Introduction of the New Section 140C - Restriction on Deductibility of Interest Expenses**



## Introduction of the New Section 140C - Restriction on Deductibility of Interest Expenses

Following the 2019 Budget Announcement to implement the Earning Stripping Rules (ESR) with effective from 1 January 2019, a new Section 140C of the Income Tax Act, 1967 (ITA) was introduced to restrict the deduction of interest expenses on the financial assistance provided between associated persons.

The calculation of the interest deductions will be subject to further rules to be gazetted.

This new section has defined the following words:-

**“control”** means 20% or more shareholding and dependent on proprietary rights (e.g. patents, know-how, trademarks), influence on business activities or a person has been appointed as a director to the board [Section 140A(5A) of the ITA]

**“controlled transaction”** shall be construed as a financial assistance—

- a) between persons one of whom has control over the other; or
- b) between persons both of whom are controlled by some other person (in this section referred to as “third person”);

**“financial assistance”** includes loan, interest bearing trade credit, advances, debt or the provision of any security or guarantee;

**“interest expense”** means—

- a) interest on all forms of debt; or
- b) payments economically equivalent to interest (excluding expenses incurred in connection with the raising of finance).”

With the implementation of ESR, companies should review the interest charged on financial assistance between related parties to reduce the disallowance of interest as well as meeting the arm's length principle from the transfer pricing perspective.

# **Fit For Future: A Refined Approach On Transfer Pricing In South East Asia**

## Fit For Future: A Refined Approach On Transfer Pricing In South East Asia

### **ASEAN business network**

The Association of Southeast Asian Nations or ASEAN with ten (10) member states celebrated its 51<sup>st</sup> anniversary in 2018. The economic growth in this region has been encouraging over the years. In the short and medium term, the region's growth is expected to remain vigorous, driven by new economies such as Cambodia, Lao PDR and Myanmar. One observation is that such growth is largely contributed by the increasing cross-border trades and investments among the business communities from the ten (10) member states.











### **Recent developments in transfer pricing regimes across the region**

From a tax perspective, it is a balancing act for the respective governments between creating ambiances that attract foreign investment whilst at the same time protecting their tax bases. In particular, there has been an increasing focus in the area of transfer pricing with countries legislating transfer pricing law to regulate inter-company transactions between business units of multinational enterprises (MNEs).

To date, eight (8) countries (i.e. Indonesia, Singapore, Malaysia, Thailand, Vietnam, Brunei, Philippines and Cambodia) had already set their transfer pricing regulatory in place, whilst it remains to be seen as to whether Lao PDR and Myanmar will come onboard.

## Fit For Future: A Refined Approach On Transfer Pricing In South East Asia

The table below depicts the transfer pricing rules in the ASEAN countries.

		TP Rules	Year of Introduction
	Malaysia	✓	2003
	Indonesia	✓	2010
	Vietnam	✓	2010
	Singapore	✓	2009
	Philippines	✓	2013
	Cambodia	✓	2017
	Thailand	✓	2002
	Myanmar	✗	-
	Laos	✗	-
	Brunei	✓(*)	-

(\*): Transactions involving related resident and non-resident entities must be conducted on an arm's length basis.

Out of the eight (8), six (6) nations, i.e. Indonesia, Singapore, Malaysia, Thailand, Vietnam, and Brunei are members of Base Erosion and Profit Shifting (BEPS) Inclusive Framework. BEPS is an initiative by the OECD and G20 in combating global tax issues on non-taxation of income earned by MNEs. The measures introduced in BEPS include *Action 5: Countering Harmful Tax Practices*, *Action 6: Preventing Treaty Abuse*, *Action 13: Transfer Pricing Documentation* and *Action 14: Enhancing Dispute Resolution*.

The recent developments in some of the transfer pricing regimes in the region are exemplified as below:



**Thailand:** The Transfer Pricing Act was announced in September 2018 and came into force with effect from 1 January 2019. It is the exceptional country in the region to require taxpayers to submit transfer pricing documentation within a specified timeframe as opposed to being made available upon request by the tax authorities. The documentation is to be prepared in a specified format and submitted to the tax authorities within one hundred fifty (150) days from the financial year end.

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**Cambodia:** In addition to the current transfer pricing rules, i.e. the Prakas No. 986/MEF being effective from October 2017 governing transfer pricing compliance requirements, the Instruction No. 11946 released in August 2018 specifically requires taxpayers to apply the arm's length principle in setting interest rates on related party loans. Intra-group interest-free loans will likely be challenged under the new regime.



**Singapore:** The country remains one of the most active countries in ASEAN in adopting the latest global transfer pricing measures and has historically provided updates to the local transfer pricing guidelines in the first quarter of each year since 2015. Under the Income Tax (Transfer Pricing Documentation) Rules 2018 and Transfer Pricing Guidelines published in February 2018, a general fine of SGD 10,000 for non-compliance and an additional 5% surcharge on any transfer pricing adjustments made during an audit or review have been introduced.



**Malaysia:** Through the 2018 Finance Bill, the definition of control under Section 140A of the ITA has been amended to include a clearer definition for transfer pricing purposes (i.e. the word "control" is defined as 20% shareholding and above in general) along with the introduction of ESR under the new Section 140C of the ITA. It is also widely anticipated that a new Transfer Pricing Audit Framework would be issued by the Malaysian tax authorities at some point this year.



**Vietnam:** It follows a three-tier documentation approach and stipulated declaration forms which are required to be submitted in ninety (90) days from the financial year end as regulated in the Decree 20/2017/ND-CP and Circular 41/2017/ND-CP. The year 2018 saw Vietnam's tax authority stepping up its efforts in transfer pricing audit programs that target enterprises specifically with significant related party transactions, persistent losses or low-margins compared to other industry players.



**Indonesia:** The country has adopted a more stringent application of the BEPS Action 13 through Regulation No. 213/PMK.03/2016. Both Master File and Local Files are required to be made available no later than four (4) months after the fiscal year and are to be submitted upon request within a very short time frame of seven (7) days.

## Fit For Future: A Refined Approach On Transfer Pricing In South East Asia

### Transfer pricing disputes

There are various practical challenges in complying with transfer pricing rules, for instance, lack of communication between tax authorities resulting in misalignments in the enforcement of transfer pricing law, limited opportunities for taxpayers to voice their practical issues in open dialogues with the tax authorities, lack of clarity in the interpretation of grey areas in transfer pricing rules, and tax authorities still habitually developing policies around what is acceptable. Not surprisingly, as a result, MNEs throughout the region are exposed to disputes with the tax authorities during transfer pricing audits.

This is further driven by the speedy adoption of BEPS programs by the governments, increased sharing of taxpayers' information by tax authorities across jurisdictions, and growing tax authorities' anti-avoidance focus. Consequently, making transfer pricing adjustments of even small magnitudes can have a significant impact on tax revenue collection. For taxpayers, the materiality of adjustments and potential penalties may raise cash flow issues that need to be addressed.

### A refined approach over the transfer pricing lifespan

Given the complexity of transfer pricing policies and the unpredictability of transfer pricing landscape affecting the transactions between subsidiaries of MNEs operating in multiple jurisdictions, the following four (4) key elements of the transfer pricing lifespan should be considered by the MNEs in reassessing their approaches for business model optimization purposes:



**Planning:** setting sound transfer pricing strategies by defining the policies, supply chain and business model;



**Execution:** communicating the transfer pricing strategies to the entire MNE group, forming a dedicated working team assigned with specific responsibilities to oversee transfer pricing matters, setting clear direction and guidance on inter-company transactions, aligning the accounting systems with the transfer pricing policies, and reviewing the transfer pricing policies on a regular basis to ensure the policies stay robust and relevant;



## Fit For Future: A Refined Approach On Transfer Pricing In South East Asia



**Managing:** documenting the details and processes in a set of documentation that complies with local transfer pricing laws for review by tax authorities;



**Resolution:** dealing with tax authorities through Advance Pricing Agreement (APA) where necessary, to mitigate future tax risks and interact with tax authorities during transfer pricing audits in resolving disputes.

When it comes to compliance with transfer pricing rules in the ASEAN jurisdictions, it is imperative for MNEs to understand the domestic requirements in order to formulate transfer pricing strategies that are defensible in these tax jurisdictions, thus minimizing the unnecessary traps and pitfalls in the tax reporting to the relevant tax authorities.

It is therefore vital for MNEs to align all of the four (4) elements of the transfer pricing lifespan of setting the right transfer pricing strategies, putting in all appropriate procedures that support these strategies, preparing transfer pricing documentation that comply with transfer pricing rules, and interacting with the tax authorities to mitigate potential tax risks. In particular, MNEs are advised to establish internal risk monitoring mechanisms, develop a consistent risk mitigation approach, and properly monitor and manage compliance with domestic transfer pricing requirements, including timely and proper preparation of transfer pricing documentation.

***This article was written by the Transfer Pricing team of Crowe KL Tax Sdn Bhd***

To know more about **Transfer Pricing**





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