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## IRBM TAXPAYER ROADMAP

As a new initiative for 2020, the Inland Revenue Board of Malaysia (IRBM) has issued a guideline known as IRBM Taxpayer Roadmap to provide general guidelines regarding income tax administration.

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The Chartered Tax Institute of Malaysia (CTIM) is a company limited by guarantee incorporated on 1 October 1991 under Section 16(4) of the Companies Act 1965. The Institute's mission is to be the premier body providing effective institutional support to members and promoting convergence of interest with government, using taxation as a tool for the nation's economic advancement and to attain the highest standard of technical and professional competency in revenue law and practice supported by an effective Secretariat.




**INSTITUTE ADDRESS**

The Secretariat, Unit B-13-1,
Block B, 13th Floor, Megan Avenue II,
No. 12 Jalan Yap Kwan Seng,
50450 Kuala Lumpur
Telephone : 603 2162 8989
Facsimile : 603 2162 8990
E-mail : secretariat@ctim.org.my
Website : www.ctim.org.my





**PUBLISHING CONSULTANT**

**Executive Mode Sdn Bhd** (317453-P)
Tel: +603-7118 3200, 3205, 3230
Fax: +603-7118 3220
e-mail: executivemode@executivemode.com.my
web: www.executivemode.com.my

**PRINTER**

**BHS Book Printing Sdn Bhd** (95134-K)
Lot 4, Lorong CJ 1/1B
Kawasan Perindustrian Cheras Jaya
43200 Cheras, Selangor DE
Tel: +603-9076 3399, 9074 7558, 9074 7017
Fax: +603-9074 7573, 9074 5226
e-mail: bhs@bhsbookprint.com


# Tax Guardian

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# Tax Guardian

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**INVITATION TO WRITE**

The Institute welcomes original contributions which are of interest to tax professionals, lawyers, academicians and students. They may cover local or international tax developments. Article contributions should be written in UK English. All articles should be between 2,500 to 3,500 words submitted in a typed single spaced format using font size 10 in Microsoft Word via email.

Contributions intended for publication must include the author's name, contact details and short profile of not more than 60 words, even if a pseudonym is used in the article. The Editorial Committee reserves the right to edit all contributions based on clarity and accuracy of contents and expressions, as may be required.

*Contributions may be sent to:*
The Chairman, Editorial Committee
Chartered Tax Institute of Malaysia
Unit B-13-1 Block B, 13th Floor, Megan Avenue II,
No.12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur.
Email: *publications@ctim.org.my*

FARAH ROSLEY

# DEALING WITH UNPRECEDENTED TIMES AND STAYING POSITIVE

Greetings! The announcements of the Economic Stimulus Packages 2020 on 27 February 2020, 27 March 2020 and 6 April 2020 respectively to address the heightened economic uncertainties due to the COVID-19 outbreak is most welcomed. Businesses have been affected by the declining trend in consumption, uncertain business environment and cash flow issues which may lead to further economic slowdown from the previous quarter. It is hoped that the measures proposed in the Packages will help to turn things around by boosting consumption, supporting affected businesses and encouraging domestic private sector investment to continue to help spur and support economic activity. The measures related to tax will provide an opportunity for members to engage with their clients to comply with their tax obligations. Members should note that the measures would be subject to relevant guidelines issued by the relevant authorities or being legislated where applicable.

In the first quarter of 2020, the Institute actively engaged with the authorities on matters including the following: -

## Dialogue on Post-2020 Budget Issues

The Inland Revenue Board of Malaysia (IRBM) chaired a dialogue on 9 January 2020 with the Institute, other professional bodies and the Ministry of Finance (MoF) on the Institutes' Joint Memorandum on Post-2020 Budget issues and Memorandums on the Labuan Business Activity Tax (Amendment) Bill 2019 issues. The IRBM's minutes of the dialogue and responses to the issues raised in the Memorandums have been circulated to members. The Institute's technical committees are reviewing the IRBM's responses. Members may write to the Institute if they have any comments on the responses.

## Other Engagements on Post-2020 Budget Matters

The Ministry of International Trade and Industry (MITI) engaged with the Institute and the business community to solicit preliminary views on the 2020 Budget proposal to review and revamp the Promotion of Investments Act 1986 by 1 January 2021. The Institute was also engaged by the MoF to provide its preliminary views on the 2020 Budget proposal to merge the Special Commissioners of Income Tax and Customs Appeal Tribunal into the Tax Appeal Tribunal which is to be in operation in 2021. The invitation by MITI and MoF to engage on these Post-2020 Budget matters is very much appreciated.

## Memorandums to the Tax Authorities

The IRBM invited the Instititute to comment on its draft Guidelines on determining the place of business

pursuant to Section 12 of the Income Tax Act 1967. The draft Guidelines are in view of concerns raised by the Institute in the Post-2019 Budget issues. The Institute has submitted a memorandum of its comments to the IRBM for their consideration and the matter is pending their issuance of the Guidelines to the public.

The Institute also submitted a memorandum on members' compliance and operational issues to the IRBM. The issues will be discussed at a dialogue chaired by the IRBM with the Institute and other professional bodies which is expected to take place in the forthcoming quarter.

During the movement control order (MCO) period which commenced on 18 March 2020, CTIM has been actively engaging with the IRBM and the Royal Malaysian Customs Department (RMCD) on the frequently asked questions (FAQs) issued and clarifications being escalated and communicated with the IRBM and the RMCD respectively on tax matters during the MCO period. In this regard, CTIM would like to express our gratitude to the IRBM, RMCD and MoF on the close collaboration.

## CPD Events

CTIM successfully organised a one day Transfer Pricing Seminar 2020 on 21 January 2020 in Kuala Lumpur. Distinguished speakers from the CTIM Transfer Pricing Technical Committee, the tax fraternity and government authorities covered transfer pricing (TP) issues such as Earning Stripping Rules, TP dispute resolution, TP cases and TP documentation and practical issues. CTIM also organised a one day course on Tax Audit and Investigation in February 2020 in Kuala Lumpur and multiple locations throughout Malaysia. The turnout in Kuala Lumpur was so encouraging that a re-run of the course was held the very next day.

**The Institute also submitted a memorandum on members' compliance and operational issues to the IRBM. The issues will be discussed at a dialogue chaired by the IRBM with the Institute and other professional bodies which is expected to take place in the forthcoming quarter.**

CTIM will be organising webinars due to the current COVID-19 situation and the MCO. Further information will be shared in due course.

## CTIM Branch Activities

Following the positive responses from the Networking Events for Tax Practitioners organised by the CTIM East Coast Branch and the CTIM Northern Branch for members in December 2019 and November 2019 respectively, I am pleased to let you know that more of such events are coming your way. Details of the members' events will be conveyed to the members in the respective states via e-CTIM.

I would like to thank the various Branch Chairmen and their committees for their efforts in organising the branch activities for the benefit of members.

## Membership

The CTIM membership currently stands at 3,632 compared to 3,606 in the previous quarter. I am pleased to observe that more and more eligible tax practitioners who were not CTIM members before are applying to the Institute for membership. Do encourage others in the tax practice to apply for membership. The eligibility criteria and application procedure are available in the membership section of the Institute's website at *www.ctim.org.my*.

The CTIM Council and I are grateful for the members' support of the Institute and we will continue to work closely with members in driving the taxation agenda and matters arising. Take care and stay safe everyone.

# Editor'sNote

YEO ENG PING

The changes since February 2020 have been nothing if not eventful, all quite unprecedented and happening at astounding speed. At the time of writing, 4 of May, being the first day of "MCO4", my catalogue of events includes:

- The sweeping political changes, from the resignation of the then Prime Minister Tun Mahathir Mohamad to the ushering in of Tan Sri Muhyiddin Yassin as Prime Minister together with a fresh government;
- The COVID-19 news from China escalating into a global health threat and pandemic with no cure in sight;
- The domino effect thereon, from travel restrictions leading to the Great Lockdown and plunging the world into a global economic crisis that is compared to the recession during the Great Depression, to precipitating loss of jobs and business closures at an unimaginable scale; and
- What the Recovery would look like, with raging debates about the New Normal in our personal lives, the way we work, how businesses operate and how we interact as a community.

The fight is far from over, and it is clear all Malaysians have come together to battle this, from our brave frontline health care workers, the respect and general adherence to the Movement Control Order that first started on 18 March, and corporate Malaysia, academics, trade and professional associations, Ministries and agencies working closely and tirelessly to craft a suitable government policy response to help Malaysians and our businesses continue.

The government announced a bold stimulus package which in aggregate total RM260b (of which RM35b is in direct fiscal injection), designed to cushion the adverse impact of the MCO and global economic slowdown, focusing on a number of groups, including Small and Medium Enterprises and some of the hardest hit sectors. It is said that at 17% of GDP, this is by far the largest stimulus package that Malaysia has introduced, and it is expected to increase the 2020 budget deficit to 4.7%. Bank Negara has also cut the Overnight Policy Rate again to 2% in its May meeting, to help reduce borrowing costs and ease liquidity. This is the third cut in 2020, totalling 100 basis points reduction this year, and bring the OPR to its lowest in 10 years. To date however, it is still unclear how the Malaysian GDP growth for 2020 will be impacted, particularly with the multiple extensions of the MCO.

While the stimulus package has been generally well received, there have also been questions on how all of this will be funded. It was mentioned by the Finance Minister Tengku Zafrul that the earlier strict MCO cost the nation about RM2.4b per day, in terms of loss of production of goods and services. The fluidity and complexity of the situation should not be underestimated, including the sudden fall in crude oil prices (at one stage to "negative") just a couple of weeks ago. The government is performing a fine balancing act to ensure proper governance while supporting the economy and managing the overall health and well-being of the rakyat. At least one rating agency however, has since revised its outlook for Malaysia from "stable" to "negative".

This comment made by our Prime Minister provides an indication of what is to come - "[we] will need to resume fiscal consolidation measures in the medium term to create fiscal space in the long-term." So far, the tax measures announced have been business friendly, geared towards helping businesses preserve/manage their immediate cash outflow with various administrative measures allowing for reduction or deferral of tax payments, coupled with a number of tax incentives to alleviate unique situations faced currently such as, providing landlords with an additional tax deduction for rental reductions granted to certain business tenants, stamp duty relief on certain types of credit / loan refinancing, accelerated capital allowances for purchase of machinery and equipment, and "tax deduction" of up to RM300,000 for costs of renovation and refurbishment of business premises. The IRBM has also been seen to take an accommodating stance for audits during the MCO, and is concentrating its efforts on addressing immediate needs of taxpayers such as providing clarity on tax operations (e.g. filings, payments), and implementation of the Bantuan Prihatin Nasional incentives.

However, in the medium term, it may be necessary to consider changes to our tax policy and system, and further increase compliance and enforcement, in order to raise tax collections. Media reports suggest that such policy discussions are also being had in other countries, and we need to be prepared for this in Malaysia as well. What could be in store for Malaysia?

We should start seeing more being revealed when Parliament reconvenes later in May, and as we head towards Budget 2021. At CTIM we have been active the last many weeks, contributing ideas to the relevant Ministries and agencies, and we take pride in the quality of the interactions we have had with policy-makers, but we need continued regular feedback and input from our broader group to keep the ideas we share fresh and relevant. Please help.

By all accounts, the road to recovery is expected to be long. A V-shaped recovery is now considered an optimistic scenario, with more thinking of a long-bottomed U-shape representing a longer period of slow and bumpy growth, and yet, we are creatures of hope. Through it all, there have been heart warming stories of personal sacrifices and charity, each doing something within their realm of control to contribute back to society; and a powerful ignition of our most innovate and inventive selves to adapt, ideate, create new tools and technology solutions so that we and those we care about may continue to thrive. Together, we will weather this, and I wish everyone well.


# CPD EVENTS

The Institute successfully conducted the following workshops/seminar for the 1st quarter 2020:

- Seminar "Transfer pricing 2020 – managing transfer pricing issues "
- Employer's tax reporting and compliance responsibilities in 2020
- Tax issues and law relating to property developers, JMC/MC and investors
- Employment income tax practicalities and complexities
- Tax audit and investigation
- Group relief under Section 44A – a practical approach and latest updates

A one-day seminar entitled "Transfer Pricing 2020 – managing transfer pricing issues" was conducted on 21 January 2020 at the Sime Darby Convention Centre, Kuala Lumpur. The speakers for this seminar were representatives from the Inland Revenue Board of Malaysia and transfer pricing experts in the private sectors. It was attended by more than 180 participants.

The workshop on "employer's tax reporting and compliance responsibilities in 2020" was conducted by Mr. Sivaram Nagappan at various places such as Ipoh (9 Jan), Kuala Lumpur (21 Feb) and Penang (5 March). The speaker highlighted various tax implications on payroll reporting and the benefits provided to its employees.

The participants were guided step-by-step in preparing capital statements in accordance with the IRBM's requirements by the speaker of the workshop, Ms. Yong Mei Sim. The workshops were conducted in Johor Bahru (10 February), Melaka (18 February), Kuala Lumpur (19 & 20 February), Kota Kinablu (24 February), Kuching (25 February) and Penang (28 February).

Ms. Karen Koh Sai Tian conducted a workshop on "group relief under Section 44A – a practical approach and latest updates" on 5 March 2020 at the Saujana Hotel, Subang. The speaker shared her experiences in dealing with the issues during her tenure in the IRBM as well as provided several case studies for better understanding.

# IRBM TAXPAYER ROADMAP

Dr Rasyidah Che Rosli

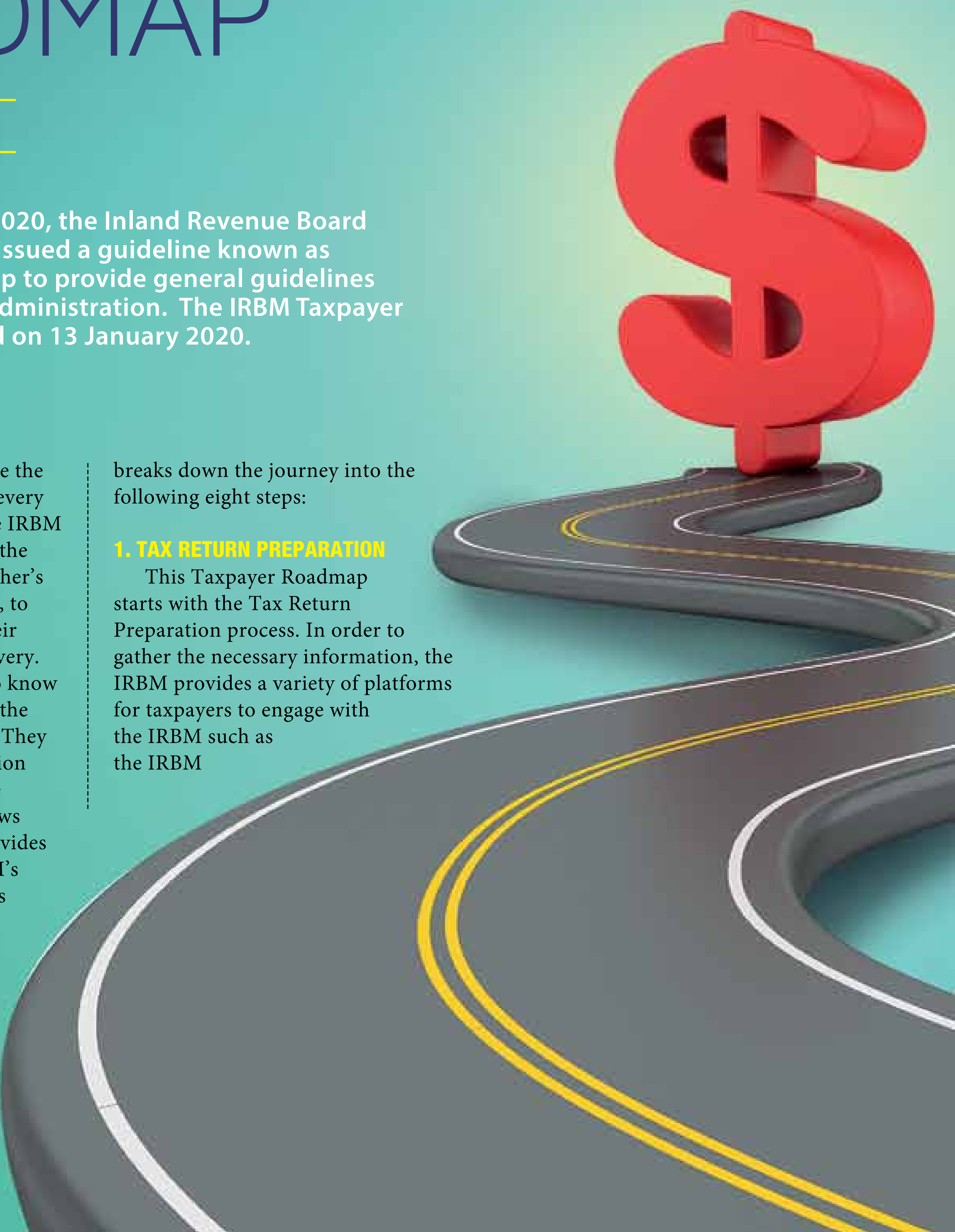
**As a new initiative for 2020, the Inland Revenue Board of Malaysia (IRBM) has issued a guideline known as IRBM Taxpayer Roadmap to provide general guidelines regarding income tax administration. The IRBM Taxpayer Roadmap was launched on 13 January 2020.**

It was developed to reassure the public on the transparency of every action taken by the IRBM. The IRBM Taxpayer Roadmap also helps the IRBM officers to know each other's roles and responsibilities; thus, to facilitate the monitoring of their tasks and improve service delivery.

Taxpayers have the right to know that they need to comply with the laws and regulations in place. They are entitled to a clear explanation of the IRBM's procedures. The IRBM Taxpayer Roadmap shows the taxpayers' journey and provides them with a summary of IRBM's procedures and work processes in terms of tax filing, tax law, audit process, appeal process, collection and litigation procedures. The IRBM is aware that the issue of taxation is complex. Therefore, this roadmap breaks down the journey into the following eight steps:

### 1. TAX RETURN PREPARATION

This Taxpayer Roadmap starts with the Tax Return Preparation process. In order to gather the necessary information, the IRBM provides a variety of platforms for taxpayers to engage with the IRBM such as the IRBM



branches, Hasil Care Line, website and media releases. Taxpayers are given a choice to either employ the services of tax agents and professionals for the purpose of preparing tax forms or to file their tax returns themselves.

## 2. TAX RETURN PROCESSING

Taxpayers have the choice to either submit their tax return form electronically through e-filing or manually filing in the paper form. Nevertheless, the IRBM encourages taxpayers to submit their income tax return forms through e-filing because it is faster, more convenient and secured.

If taxpayers e-file their tax return, there is an online verification where taxpayers can only key-in allowable amounts or reliefs. Therefore, e-filing submission minimises human error as the calculation is done automatically as compared to the conventional method of manually filing in the form. The IRBM's system can also detect whether taxpayers have submitted their return forms on time or manually. All the tax return forms will go through the screening station to determine whether the taxpayer is to receive tax refund, no balance due or has to pay an outstanding balance.


In the last few years, the IRBM has made significant progress in technological innovation. The IRBM has created a big data platform in 2017 known as Hasil Power Data and integrated data from various sources including data from its (i) internal system, (ii) information gathered from compliance activities, (iii) cooperation with government agencies, (iv) international cooperation on exchange of information through automatic exchange of information (AEOI), common reporting standard (CRS) and country by country reporting (CbCR). Therefore, the IRBM has managed to develop a complete profile to identify non-filers or potential taxpayers by linking the data from internal and external sources.

**If taxpayers e-file their tax return, there is an online verification where taxpayers can only key-in allowable amounts or reliefs. Therefore, e-filing submission minimises human error as the calculation is done automatically as compared to the conventional method of manually filing in the form. The IRBM's system can also detect whether taxpayers have submitted their return forms on time or manually.**

## 3. IRBM AUDIT PROCESS

Under the self-assessment system, to ensure taxpayers carry out their responsibilities and to increase voluntary tax compliance, one of the methods employed by the IRBM for tax compliance and enforcement is audit. A taxpayer may be selected for an audit at any time. However, if the taxpayer has been selected to be audited, it does not necessarily mean that the taxpayer has made a mistake.

The main objective of a tax audit is to encourage voluntary compliance with the tax laws and regulations and to ensure tax compliance is achieved under the self-assessment system. Accordingly, audit officers must ensure that the correct income is reported and that the tax is paid in accordance with the tax laws and regulations. Tax audit case selection is made through a computerised system based on risk assessment or based on various sources of information received.

Therefore, this Taxpayer Roadmap details the work process and the information or documents needed during an audit. Taxpayers are also informed of the time period stipulated when the audit activity is carried out. At the beginning of an audit, a letter requesting documents and information is issued to the taxpayer. In cases where taxpayers are required to submit documents and information, they are required

to do so within fourteen (14) days. The IRBM will visit any taxpayer or taxpayer-related premises by notifying them in advance. During the audit activity either on-premise or in the office, the IRBM reviews the taxpayer's documentation. The taxpayer will be notified in writing regarding the audit findings. If the taxpayer agrees with the findings, the case is then settled with an agreement. However, if the taxpayer disagrees with the findings of the audit, the taxpayer may formally file an objection within eighteen (18) days from the date of the finding letter by providing additional information and evidence to support the appeal. After the discussion session, if the taxpayer agrees, the IRBM will raise a tax assessment notice or issue a non-taxable notice.

### 4. IRBM INVESTIGATION PROCESS

In addition to tax audit, the IRBM also conducts tax investigation as one of its enforcement activities. Tax investigation is the examination of books, documents, objects, articles, materials and things related to a taxpayer's business and financial matters including personal documents. This examination is to determine that the correct amount of income is reported, the appropriate tax is charged and payment is made in accordance to the tax laws and regulations. The taxpayer may be prosecuted in court for tax offences.

The investigation process begins with a letter to the taxpayer, tax agent and/or any other third party involved, requesting for documents and information. The taxpayer may be required to give written information and oral explanation at any IRBM office. The IRBM may also visit the taxpayer's business premises with a written notification given prior to the visit. Nevertheless, the investigation can also be carried out by making an inspection visit without any notice at the taxpayer's premises, residences, tax agent's premises, third parties and other premises if deemed necessary.

During the visit, the IRBM officer will gather evidence for tax evasion and may request any party to produce documents in his/her custody or control. The IRBM will evaluate the information on whether to continue with the case under civil or criminal investigation. The decision will be based on the facts of each case. In most instances it will be a civil investigation where examinations will be carried out by the investigation officers. The IRBM will issue a letter to the taxpayer confirming the conclusion of the investigation. After the negotiation process, the taxpayer will have to sign an agreement and make the appropriate tax payment. If the taxpayer does not agree with the investigation findings, the Director General of Inland Revenue (DGIR) may according to the best of his judgement raise an assessment with penalty.

### 5. IRBM TAX COLLECTION

The IRBM will ensure that taxpayers with tax balance due make the appropriate payments through the various means such as mailing out reminder letters, making phone calls or sending out e-mails. The IRBM will also issue a Notification of

Civil Proceedings if the taxpayer fails to settle the outstanding payment. If a taxpayer does not comply with the outstanding payment, the IRBM will take other actions such as caveat, agent appointment, stoppage order or recovery action against taxpayers.

## 6. IRBM CIVIL RECOVERY PROCEDURE

A civil recovery suit in court will be taken against taxpayers who fail to pay their tax arrears. Through the court process, the IRBM will proceed to obtain judgement against the taxpayer for any outstanding amount of tax. In the event the taxpayer refuses to pay the judgement sum, despite issuance of demand letter or a notice of demand, the IRBM will take steps to execute the judgement. There are various modes of execution, namely, by initiating a winding up proceeding, bankruptcy action, garnishment, writ seizure and sale or judgement debtor summon.

In the case of judgement debtor summon, the IRBM may commence a committal proceeding against the taxpayer if there is a failure to comply with the instalment payment that has been ordered by the court. In addition, the garnishment proceeding will be an effective mode of execution if the IRBM has an adequate banking information of the taxpayer. A garnishment order from court will require the financial institution to remit any fund of the taxpayer to the IRBM for the purpose of paying the outstanding tax.

## 7. IRBM CRIMINAL PROSECUTION PROCEDURE

A criminal action may be taken against a taxpayer who fails to submit tax return or for furnishing incorrect tax return or for tax evasion cases. The offences are in most cases determined during an audit or an investigation process. The taxpayer may be charged either under Sections 112 (1A), 113 (1) or 114 (1) of the Income Tax Act 1967. Any taxpayer that has been charged in the criminal court may, upon conviction, be required to pay a fine not exceeding ten or twenty thousand ringgit and ordered to pay a special penalty equal to or three times of the amount of tax under declared. An imprisonment order can also be made by the court in the event of failure to satisfy the amount of fine imposed.

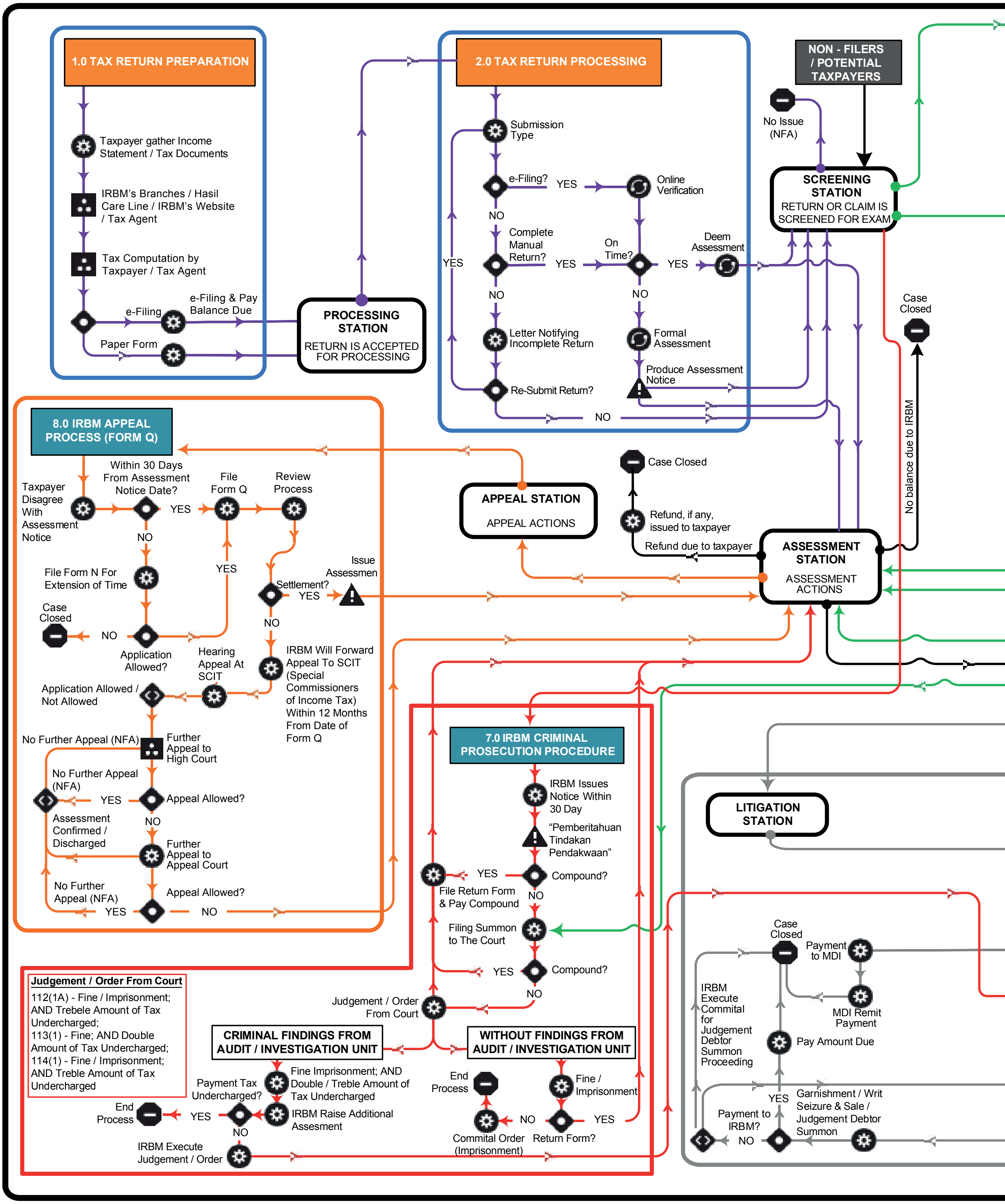
## 8. IRBM APPEAL PROCESS (FORM Q)


The IRBM Taxpayer Roadmap gives taxpayers a clear explanation of their rights to appeal. If the assessment notice is raised without the taxpayer's consent, he or she has the right to file an appeal using Form Q. The appeal must be made by the taxpayer within 30 days of the date when the assessment notice is served. The taxpayer's appeal will first be reviewed by the IRBM and in the absence of a remedial action between the IRBM and the taxpayer, the taxpayer's appeal will be submitted to and heard before the Special Commissioners of Income Tax (SCIT). Any party who is still dissatisfied with the SCIT's decision can appeal to the High Court and the Court of Appeal.

As a conclusion, the IRBM's Taxpayer Roadmap helps taxpayers to understand every step of the tax system beginning with the preparation of tax forms, compliance, tax collection, civil recovery, criminal prosecution and appeals processes. The Taxpayer Roadmap is an effective tool for tax education purposes as it presents the tax system visually, using graphs and charts. As such, the IRBM has displayed this roadmap at its premises nationwide and uploaded it into its official portal at *www.hasil.gov.my* to explain the guidelines of the tax system so that taxpayers have a better understanding of each of the tax processes that are involved.

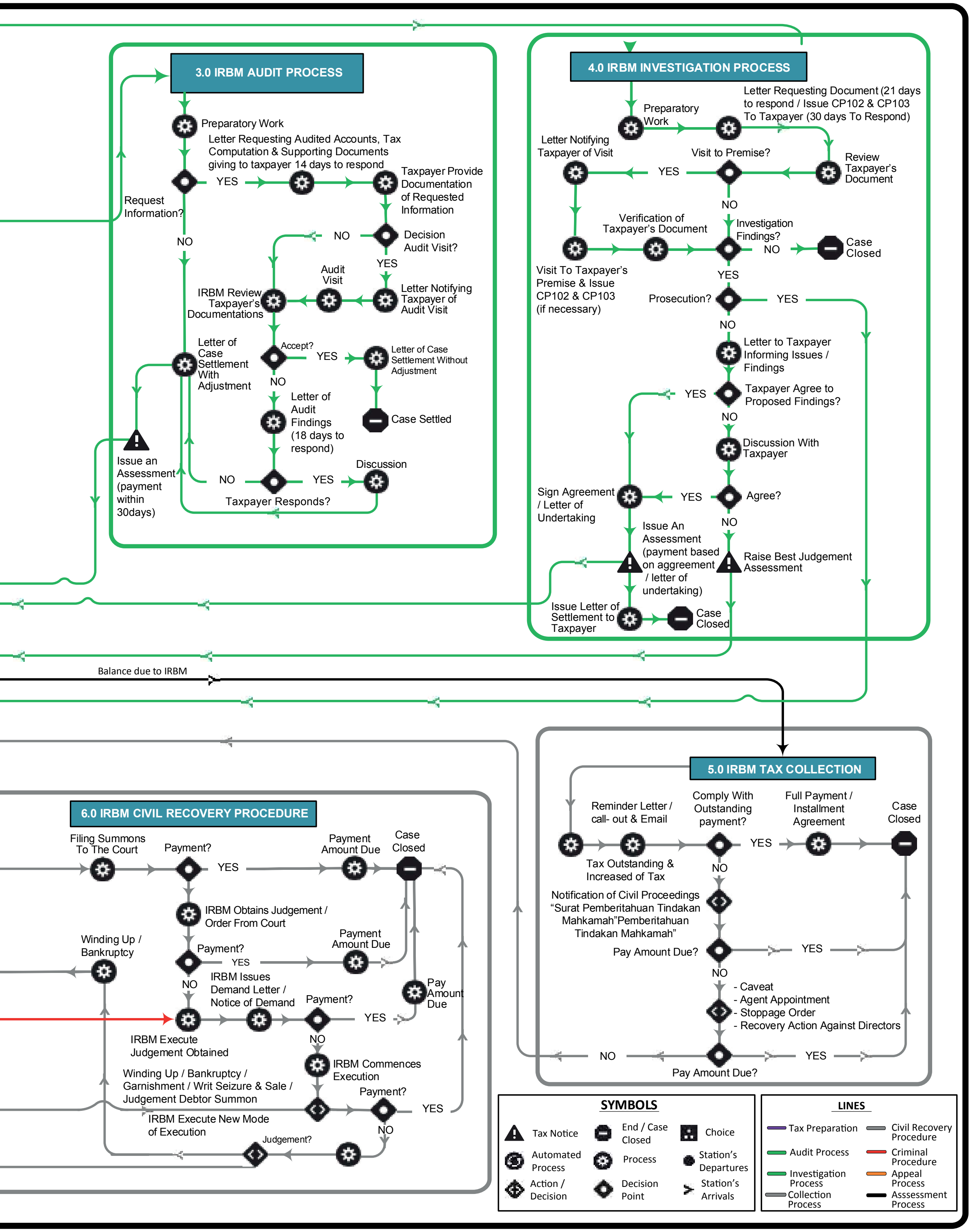
***Dr. Rasyidah Che Rosli*** *is the Principal Assistant Director in the Analytics & Statistics Division, Tax Operations Department, Inland Revenue Board of Malaysia*

# IRBM TAXPAYER ROADMAP



**The roadmap below shows the taxpayer's journey from getting answers regarding tax law, audit process, appeal, collection and litigation procedure. As we know, the road to compliance isn't always, nevertheless easy to navigate, nevertheless IRBM hopes that this map will help taxpayer towards tax compliance.**

**For further information: [www.hasil.gov.my](http://www.hasil.gov.my)**



# REVIEW AND APPEAL AGAINST GST FINDINGS POST 1.9.2018

S. Saravana Kumar & Nur Amira Azhar

It has been nearly two years since the abolishment of the Goods and Services Tax (**GST**) on 1.9.2018. Nevertheless, the issues pertaining to GST are very much still alive as the Royal Malaysian Customs Department (**"Customs"**) is actively conducting GST closure audits on companies to ensure that all GST were properly accounted for during the GST era. The GST closure audits would typically focus on whether the GST registered companies have correctly reported and disclosed all the relevant information in their GST returns (namely, the GST-03 form). The key areas to be considered by Customs would include, among others, the calculation of GST for the supplies provided, the input tax credit claims and the compliance with the provisions under the Goods and Services Tax Act 2014 (**GST Act**).


The GST Act was repealed by Section 3 of the Goods and Services Tax (Repeal) Act 2018 (**GST Repeal Act**), which came into effect on 1.9.2018. Consequently, the GST Appeal Tribunal established under the GST Act has also been abolished and aggrieved taxpayers may no longer appeal to the GST Appeal Tribunal post 1.9.2018. However, despite the abolishment of the GST Appeal Tribunal, Customs is empowered under Section 4(1) of the GST Repeal Act to continue issuing findings on GST matters even after 1.9.2018. This then begs the question: What recourse is available to aggrieved taxpayers who wish to review or appeal against a GST audit finding made after 1.9.2018?

## APPEAL BEFORE THE CUSTOMS APPEAL TRIBUNAL

The GST Repeal Act provides taxpayers with the right of review and appeal to the Customs Appeal Tribunal on GST matters after the repeal of the GST Act on 1.9.2018. Such right is provided under Section 5 of the GST Repeal Act, which can be summarised as follows:

(a) Any application for review under the GST Act pending before the Director General of Customs (**DGC**) for his immediate decision before 1.9.2018 shall be dealt with under the GST Act as if the GST Act had not been repealed;

(b) Any decision made by the DGC pursuant to an application for review under the GST Act which is appealable to the GST Appeal Tribunal may be referred to the Customs Appeal Tribunal, provided that the appeal is made within 30 days from the date the decision was made known to the taxpayer; and

(c) Any appeal before the GST Appeal Tribunal which is pending immediately before 1.9.2018 shall continue to be heard and decided by the Customs Appeal Tribunal.

Based on the wording used in Section 5 of the GST Repeal Act (as summarised above), it appears that the right of review and appeal to the Customs Appeal Tribunal under the GST Repeal Act is available only in instances where the aggrieved taxpayers have filed an application for review by the DGC or an appeal to the GST Appeal Tribunal against any finding relating to GST matters prior to 1.9.2018. The wording does not seem to suggest that aggrieved taxpayers have a right to file an application for review to the DGC or an appeal to the Customs Appeal Tribunal against any decision that was made after 1.9.2018. Such position appears to be supported by Customs whose officers had previously informed aggrieved taxpayers that they would no longer have the authority to process any review application filed after the repeal of the GST Act. As a result, aggrieved taxpayers have been left in limbo.

The limited right of review or appeal under Section 5 of the GST Repeal Act has certainly created a significant disadvantage to the taxpayers who are subject to GST closure audits and received a GST audit finding by Customs after 1.9.2018. As mentioned above, Section 4(1) of the GST Repeal Act allows Customs to enforce any GST liability and collect any GST due after

1.9.2018 as if the GST Act was not repealed. The provision also enables Customs to issue any GST finding relating to a purported incorrect disclosure in the GST return or incorrect claim for GST refund post 1.9.2018. It is unfortunate, however, that the GST Repeal Act is silent on the recourse available to aggrieved taxpayers who wish to seek relief against those decisions made after 1.9.2018.

## THE AVAILABILITY OF JUDICIAL REVIEW

In the circumstances, the primary recourse available to taxpayers to appeal against GST findings or decisions made after 1.9.2018 would be to file a judicial review application at the High Court. As held by the High Court in *Malayan United Industries Bhd v Ketua Pengarah Hasil Dalam Negeri & Anor* [2006] 5 CLJ 240, one may resort to judicial review to challenge a decision made by a tax authority in instances where there is no other recourse or alternative remedy available under the legislation.

In the *Malayan United Industries Bhd* case, one of the issues raised was whether judicial review is the most appropriate, convenient and suitable procedure to challenge a decision under Section 108 of the Income Tax Act 1967 (**ITA**). Upon considering the matter, the High Court held that a decision under Section 108 of the ITA is not an assessment and thus cannot be appealed to the Special Commissioners of Income Tax (**SCIT**). Accordingly, the High Court held:

> "… the only revenue to seek judicial resolution of the matter would be to apply for judicial review under O 53 of the Rules of the High Court 1980, which the applicant did in this case. Hence the submission by the respondents that judicial review is a wrong procedure to [be] adopted by the applicant cannot be right."


To date, it remains unclear whether taxpayers who received a GST decision or finding made by Customs after 1.9.2018 may appeal to the Customs Appeal Tribunal under Section 5 of the GST Repeal Act. Nevertheless, the author takes the position that Section 5 of the GST Repeal Act is applicable only to very limited circumstances, i.e. to Customs' decisions or review applications which were made prior to 1.9.2018; the provision does not appear to cover Customs' decisions or findings made after 1.9.2018.

The availability of the judicial review process in respect of decisions pertaining to GST made after 1.9.2018 was disputed in *Asiaspace Sdn Bhd v Ketua Pengarah Kastam dan Eksais* [2019] *1 LNS 325* and *Pengerang Independent Terminals Sdn Bhd v Menteri Kewangan Malaysia & Anor* [2018] *1 LNS 1945*. In both cases, the aggrieved taxpayers filed a judicial review application to challenge the Bills of Demand issued by Customs after 1.9.2018. In its defence, Customs raised a preliminary objection that the aggrieved taxpayers should have exhausted the statutory appeal procedure under the GST Act prior to filing the judicial review applications. The High Court, upon considering the submission by all parties in the respective cases, allowed the preliminary objection raised by Customs and dismissed the taxpayer's judicial review application on the basis that the aggrieved taxpayers have an alternative remedy to appeal against the Bills of Demand at the Customs Appeal Tribunal. According to the learned High Court judge:

(a) Section 4 of the GST Repeal Act, which provides Customs with the right to claim for underpaid GST "as if the repealed Act had not been repealed", must naturally mean that aggrieved taxpayers may appeal against Customs decisions to the GST Appeal Tribunal under Section 124 of the GST Act as if the GST Act had not been repealed;
(b) Section 5(3) of the GST Repeal Act empowers the Customs Appeal Tribunal to hear appeals by aggrieved taxpayers in respect of findings made after the abolishment of the GST Appeal Tribunal on 1.9.2018; and
(c) It is settled law that one may only avail himself to of all alternative recourse or remedy before he has a right to come to the courts.

### *PER INCURIAM* DECISIONS

Based on the reported judgements of the High Court in *Asiaspace*'s case and *Pengerang Independent Terminals's* case as summarised in the aforementioned paragraph, the author is of the view that the High Court decisions are *per incuriam* on the premise that the High Court had misdirected itself on the operation of Sections 4 and 5(3) of the GST Repeal Act, based on the following reasons:

(a) Firstly, it is not expressly stated in Section 4 of the GST Repeal Act that aggrieved taxpayers may continue to appeal to the GST Appeal Tribunal after 1.9.2018 as if the GST Act had not been repealed. In the absence of any express wording in the provision, it is, with respect, incorrect for the learned High Court judge to imply such right under the provision. As held by the (then) Supreme Court in *National Land Finance Co-operative Society Ltd v Director General of Inland Revenue [1993] 4 CLJ 339,* taxing legislation must be interpreted strictly and "nothing is to be read in, nothing is to be implied. One can only look fairly at the language used";

(b) Secondly, Section 4 of the GST Repeal Act merely provides for the continuing liability of the taxpayers to account for underpaid GST after the repeal of the GST Act. It does not relate to the aggrieved taxpayers' right to appeal or the right to claim input tax credits, which are both addressed in different sections under the GST Repeal Act; and

(c) Thirdly, Section 5(3) of the GST Repeal Act merely provides the right to appeal to the Customs Appeal Tribunal in respect of an "appeal before the GST Tribunal which is pending immediately before the appointed date" i.e. 1.9.2018. The learned High Court judge seems to have failed to appreciate that the provision is applicable only to matters which are pending appeal at the GST Tribunal immediately before 1.9.2018. As held by the Federal Court in *Krishnadas a/l Achutan Nair & Ors v Maniyam a/l Samykano [1997] 1 MLJ 94:*

> "The function of a court when construing an Act of Parliament is to interpret the statute in order to ascertain legislative intent primarily by reference to the words appearing in the particular enactment. Prima facie, every word appearing in an Act must bear some meaning. For Parliament does not legislate in vain by the use of meaningless words and phrases. A judicial interpreter is therefore not entitled to disregard words used in a statute or subsidiary legislation or to treat them as superfluous or insignificant."

Further, the *Asiaspace* case and *Pengerang Independent Terminal* case are also per incuriam as the High Court failed to consider the fact that the Customs Appeal Tribunal only has the jurisdiction to hear matters which are stated under Section 141M of the Customs Act 1967 (**CA**) and the aforementioned section does not provide any jurisdiction to the Customs Appeal Tribunal to hear appeals pertaining to GST which were filed after 1.9.2018. Given that the Customs Appeal Tribunal is a creation of statute, its jurisdiction to hear a case shall be strictly confined to the express jurisdictions provided under the statute. The Customs Appeal Tribunal is not allowed to hear matters which are beyond the confines of the jurisdiction conferred by Parliament (see the Federal Court decision in *Indira Gandhi a/p Mutho v Pengarah Jabatan Agama Islam Perak & Ors [2018] 1 MLJ 545).* As held by the House of Lords in *Anisminic* Ltd v Foreign Compensation Commission *[1969] 1 All ER 208:*

> "Such tribunals must, however, confine themselves within the powers specially committed to them on a true construction of the relevant Acts of Parliament. It would lead to an absurd situation if a tribunal, having been given a circumscribed area of inquiry, carved out from the general jurisdiction of the courts, were entitled of its own motion to extend that area by misconstruing the limits of its mandate to inquire and decide as set out in the Act of Parliament."

In any event, it shall be noted that the existence of an alternative appeal process to the Customs Appeal Tribunal under Section 5 of the GST Repeal Act should

not outright prohibit aggrieved taxpayers from seeking relief by way of a judicial review application. As held by the (then) Supreme Court in *Government of Malaysia & Anor v Jagdis Singh [1987] CLJ (Rep) 110,* the remedy of judicial review is still available in exceptional circumstances despite the existence of an alternative appeal under the legislation. One of the exceptional circumstances is where there has been *"a clear lack of jurisdiction or a blatant failure to perform some statutory duty or in appropriate cases a serious breach of the principles of natural justice"*.

Further, it is trite law that existence of an alternative remedy in tax cases is not a complete bar to judicial review. For instance, in Society of *La Salle Brothers v Ketua Pengarah Hasil Dalam Negeri [2017] 8 CLJ 298,* the Court of Appeal dismissed the Inland Revenue Board ("**IRBM**") 's contention that the taxpayer had abused the court process by filing a judicial review application to challenge a decision made by the IRBM instead of filing an appeal to the SCIT under Section 99 of the ITA. The Court of Appeal affirmed the decision in the *Jagdis Singh* case, and held that a taxpayer cannot be precluded from applying for judicial review notwithstanding the fact that it has not resorted to the appeal procedure under Section 99 of the ITA. A similar decision was also arrived at in *Metacorp Development v Ketua Pengarah Hasil Dalam Negeri [2011] 5 MLJ 447* and *Magnum Holdings Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2018) MSTC 30-151,* where the High Court in both cases allowed the taxpayers' judicial review application and held that it would be wrong to insist on the exhaustion of an alternative remedy in instances where the IRBM had acted in excess of its jurisdiction.

It is notable that there are at least three cases where taxpayers had been granted leave by the High Court to commence judicial review proceedings against the Customs in respect of the bills of demand issued by the Customs subsequent to a GST closure audit. However, no grounds of judgement were made available in these three cases as the Attorney General and the Customs did not challenge the taxpayers' applications in these three cases.

## CONCLUSION

Filing a judicial review application appears to be the primary recourse available to taxpayers to appeal against the Customs' decision on GST matters post 1.9.2018. While Section 5 of the GST Repeal Act provides for an alternative recourse to appeal to the Customs Appeal Tribunal, such right of appeal appears to be limited to only decisions or appeals pending at the GST Tribunal prior to the repeal of the GST Act and abolishment of the GST before the DGC or Appeal Tribunal on 1.9.2018. It is unclear whether an aggrieved taxpayer has a right to appeal to the Customs Appeal Tribunal against decisions in respect of GST matters made after 1.9.2018. Nevertheless, in the event that the aggrieved taxpayer is able to satisfy that there has been ***"a lack of jurisdiction or a blatant failure to perform some statutory duty or in appropriate cases a serious breach of the principles of natural justice"***, the aggrieved taxpayer is entitled under the law to commence a judicial review application to challenge the Customs' decisions post 1.9.2018 despite the availability of the right to appeal to the Customs Appeal Tribunal.


***S. Saravana Kumar*** *is a tax lawyer and heads the Tax, SST & Customs Practice of Rosli Dahlan Saravana Partnership (RDS). He read LL.M(Tax) at the London School of Economics. He can be contacted at sara@rdslawpartners.com*
***Nur Amira Azhar*** *is a tax lawyer with RDS and has appeared in many tax and GST disputes with Saravana. She holds a LL.B(Hons) from UITM.*

# DISCORD OR HARMONY

## DIGITAL SERVICE TAX VS SERVICE TAX ON IMPORTED SERVICES?

Chong Mun Yew , Chris Yee & Fam Fui Chien

Beginning 1 January 2019, taxable services that are imported into Malaysia would require the recipient of such services to self-account and pay a 6% Service Tax to the Royal Malaysian Customs Department ("RMCD")[1]. In other words, any person in Malaysia (irrespective of whether he is registered for Service Tax or not) has to pay a 6% Service Tax to the RMCD when the following conditions are met:

- The services acquired are prescribed as taxable services in the Service Tax Regulations 2018;
- The services are imported into Malaysia; and
- The services are used for business purposes.

If by any chance, any of the conditions are not met (e.g. the services were not used for business purposes), the recipient of such service would not be required to account for the 6% Service Tax.

Exactly one (1) year after 1 January 2019, the authorities widened the scope of the Service Tax legislation further to include digital services that are provided in Malaysia. The Service Tax for this new category of taxable services is commonly referred to as the "Digital Service Tax" which took effect from 1 January 2020[2]. As a result of this tax, a foreign company that has no physical presence in Malaysia may now be liable to register for Service Tax[3] in Malaysia under this new system and would have to charge a six per cent (6%) Service Tax on any digital service provided by this foreign company to any consumer in Malaysia.

As of 20 December 2019, an RMCD spokesman said that at least 126 foreign digital service providers including companies like Netflix, Spotify, Google and Airbnb had registered for this Digital Service Tax[3]

## WHAT ARE THE DIFFERENCES BETWEEN THE DIGITAL SERVICE TAX AND SERVICE TAX ON IMPORTED SERVICES?

Before we look into the differences between these two taxes, let us first understand their common features.

Firstly, both the Digital Service Tax and Service Tax on Imported Services relate to taxable services that are acquired from service providers that are not from Malaysia. A company would not need to consider the implications of these two taxes below if the service provider is from Malaysia. Secondly, the taxable services under these two types of taxes are in relation to services that are imported into Malaysia or provided to consumers that reside in Malaysia. An example of a type of taxable service that is not treated as being imported into Malaysia would be a hotel stay in a foreign country.

**Taxable services in Group G of the Service Tax Regulations only**


Having gone through the similarities, we shall now analyse the differences between these two taxes. From a policy perspective, the ex-/ previous Finance Minister, Mr. Lim Guan Eng has clarified that the Service Tax on Imported Services is meant to be imposed on services imported by businesses in Malaysia whilst the Digital Service Tax is meant to be imposed on services imported by consumers[4].

The policy to impose Service Tax on services imported by businesses is expressed in the Service Tax Act which requires a person not registered for Service Tax to account for the Service Tax on Imported Services only if the services are acquired for the purpose of carrying a business[5]. The Digital Service Tax is, however, meant to tax digital services that are provided to consumers in Malaysia, with the definition of what constitutes a "consumer" being provided in the same Act[6].

The types of services to be taxed by the two taxes are vastly different from each other. By definition, the self-accounting of the 6% Service Tax is required to be performed by the recipient on the acquisition and importation of all types of services that are prescribed to be taxable in the Regulations[7]. However, the Digital Service Tax is only imposed on taxable digital services that are provided to consumers in Malaysia (as opposed to businesses), with the definition of "digital services" being also provided in the same Act[8]. In other words, the scope of taxable services to be taxed under the Digital Service Tax only represents a subset of the whole set of taxable

*Table 01*

| TYPE OF SERVICES | EXAMPLES OF DIGITAL SERVICE |
|---|---|
| **Software, application and video games** | Online licensing of software, updates and add-on website filters, firewalls, provision of mobile applications, etc. |
| **Music, e-book and film** | Provision of music, live streaming services, including subscription-based media or membership, etc. |
| **Advertisement and online platform** | Offering of online advertising space on intangible media platforms, offering platforms to trade products or services, etc. |
| **Search engines and social networks** | Customised search-engine services, etc. |
| **Database and hosting** | Website hosting, online data warehousing, file-sharing and cloud storage services, etc. |
| **Internet Based Telecommunication** | Cloud-PABX, VOIP Phone, etc. |
| **Online training** | Online courses, webinars, etc. |
| **Others** | Provision of other digital content like images, text, information and payment processing services, etc. |

services that are prescribed in the Regulations.

The RMCD has further clarified that digital services are a service that is to be delivered through information technology medium with minimal or no human intervention from the service provider. For clarity purposes, the following table presents a non-exhaustive list of services that are viewed to be digital services[9] ***(refer Table 01).***

Another critical difference between the two types of taxes is the manner in which the Service Tax is paid to RMCD upon the acquisition of the taxable services by the consumer or recipient. As mentioned earlier, a foreign service provider of digital services in Malaysia may be liable to register for Service Tax in Malaysia if the registration threshold of RM500,000 is exceeded[10]. Once registered, the foreign service provider is expected to impose and charge a 6% Service Tax to the consumers in Malaysia for the digital services provided. In this regard, the recipient or the consumer of such digital services would only have to pay the 6% Service Tax to the foreign service provider. The liability to account and pay the Service Tax to RMCD lies with the foreign service provider and not with the consumer or recipient.

***Table 02***

| IMPORTED SERVICES | DIGITAL SERVICES TAX |
|---|---|
| **Similarities** | |
| • Relates to services that are provided to consumers in Malaysia by a foreign service provider.<br>• Both are subject to 6% Service Tax. | |
| **Differences** | |
| • For business purposes | • For personal consumption |
| • Covers all taxable services | • Covers only digital services |
| • Recipient is liable to account and pay the 6% Service Tax to the authorities | • Foreign service provider is liable to account and pay the 6% Service Tax to the authorities |

In contrast to the Digital Service Tax, the taxable services that fall within the purview of Service Tax on Imported Services would require the recipient of the taxable service to do a self-accounting of the 6% Service Tax to RMCD. Depending on the registration status, the recipient would have to file a Service Tax return to the RMCD and make the payment for the Service Tax due. Thus in such cases, the liability to account and pay for the Service Tax to RMCD lies with the recipient and not with the foreign service provider ***(refer Table 02).***

As one will note, the above rules can result in an overlap of Service Tax in certain situations. This is because, generally, the recipient of any imported taxable services (including digital services) bears the responsibility to perform the self-accounting of the 6% Service Tax to RMCD if the foreign service provider is not registered for Service Tax in Malaysia. What would happen if the foreign service provider is registered? Would the same digital service be taxed twice and thereby, create a cascading effect?


## EXEMPTIONS PUT IN PLACE TO AVOID DOUBLE TAXATION

*"The government is conscious of the issue of rising prices and the cascading effect from double taxation on the consumers in Malaysia"*, the Finance Ministry said through the *New Straits Times* on 31 December 2019.

To address the double taxation resulting from services provided by foreign companies in Malaysia, the following exemptions have been put in place:

***i. Exemption on digital services - Item 3 of the Exemption Order***[11]

A Foreign Registered Person ("FRP") means a foreign service provider that is registered for Service

Tax in Malaysia for the provision of digital services in Malaysia. Based on Item 3 in the Exemption Order, any person who, in carrying on his business, acquires the digital service from a FRP would be exempted from the payment of Service Tax on the digital service if the exempted person holds a valid invoice or other document issued by the FRP and the digital service is not used for personal consumption.

The RMCD had published a separate Service Tax Policy No. 7/2020 to clarify that this exemption is referring to the requirement of accounting for Service Tax by the recipient. In other words, the recipient of digital services from a FRP would not be required to account for Imported Services separately once the recipient has been charged with 6% Service Tax on the digital services by the FRP.

This exemption appears to be consistent with the government's policy to ensure that the digital services acquired by the recipient for business purposes are not taxed twice i.e., by the FRP and by the self-accounting mechanism of Imported Services. Nevertheless, it would still cost the recipient an additional 6% Service Tax to be paid to the FRP.

***ii. Exemption on digital services - Service Tax Policy No. 3/2020***

Notwithstanding the abovementioned exemption, the RMCD has published a separate Service Tax Policy No. 3/2020 that allows for the claiming of a refund resulting from the acquisition of digital services provided by the FRP. Based on this Service Tax Policy, the following conditions have been imposed by the RMCD:

- The person claiming the refund is a registered person for Service Tax;
- The person who acquires the digital service also provides the same digital service to its customer;
- The payment of Service Tax has been made to the FRP.

Based on the mechanism in this Service Tax Policy, it would mean that the FRP is still required to charge Service Tax on the digital services provided. Subsequently, the person who acquires the digital services would have to make payment in full to the FRP and should then claim the Service Tax charged by and paid to the FRP as a refund from the RCMD. The approved refund would be used to set off against the Service Tax due and payable by the recipient.

Expectedly, to enjoy this refund facility, the recipient of such digital services would have to charge and impose Service Tax when the same digital services are provided to the recipient's customers. The mechanism under this Policy would also be consistent with the government's initiative to avoid double taxation for the same supply of digital services as the services go through the distribution chain.

This refund facility is essentially different from the earlier Item 3 exemption where the recipient is indeed consuming the digital services provided by the FRP itself whilst, the mechanism under Policy 3/2020 is for the case where the recipient is further distributing the digital services provided by the FRP.

***iii. Exemption on other imported services - Item 4 of the Exemption Order***

Effective 1 January 2020, another exemption from Service Tax is available for IT services that are imported by a registered person. Based on Item 4 of the Exemption Order[12], a registered person that provides IT services would be exempted from accounting for Service Tax on Imported Services if the following conditions are met:

- The exempted person is a registered person for Service Tax;
- The acquired IT service is identical to the IT service distributed or sold by the exempted person; and
- The taxable IT service is not for personal consumption.

Based on the conditions prescribed, this Item 4 exemption appears to be made only available to registered IT service providers in Malaysia that would distribute the imported IT services to its customers in Malaysia. Similar to the above exemptions, such exemption would be consistent with the government's efforts to eliminate the cascading effect of having Service Tax being imposed more than once for the same or identical services. However, this particular exemption would not be available to a person that is not registered for Service Tax in Malaysia.

### *iv. Exemption on imported services - Service Tax Policy No 2/2020*

In order to accommodate similar exemptions for other types of taxable services, the Minister of Finance has granted a separate exemption through the publication of the Service Tax Policy No. 2/2020 by the RMCD.

As stated in this Policy 2/2020, a registered person is exempted from accounting and paying the Service Tax on Imported Services if the following conditions are met:

- The exempted person is registered for Service Tax;
- The exempted person provides the same services as the imported services acquired to its customers;
- The imported services are for the furtherance of business and not for personal consumption; and
- The exempted person has made payment to the foreign provider for the imported services.

The exemption granted by the Minister of Finance under this Policy No 2/2020 is only applicable to professional taxable services prescribed under Group G [excluding item (j) and item (k)] and advertising services under Item 8 of Group I of the Regulations[13].

It is worthwhile to note that this particular exemption is not included in the gazetted Exemption Order[14] that we have discussed previously. This would imply that the exemption in Policy 2/2020 was granted by the Minister of Finance through the power conferred on the Minister under subsection 34(3)(a) of the Service Tax Act 2018.

Whilst the Item 4 exemption is granted to imported IT services only, the exemption provided in this Policy 2/2020 covers a wider range of taxable services. The exempted services in this Policy 2/2020 are similar to those exempted services for the business-to-business exemption that have been previously introduced and implemented since the beginning of the Year 2019[15].

### *v. Intra-group exemption for Imported Services*

Another form of exemption that would be available for consideration would be the exemption on selected imported taxable services acquired from a foreign provider that is within the same group of companies[16]. This particular exemption took effect on 1 January 2019 and is only applicable for selected taxable services in Group G in the First Schedule of the Service Tax Regulations 2018.

Similar to the commonly known intra-group exemption, this particular exemption works the same way but is specifically for services that are provided by foreign-related companies of the recipient. In the event a local Malaysian company acquires the selected taxable services from a foreign company that qualifies to be treated as being within the same group of companies as the Malaysian company, the local Malaysian company is not required to account for and pay the Service Tax on the Imported Service.

## CONCLUSION

It may seem a bit confusing to certain companies in understanding the different types of exemptions that are now available from 1 January 2020 onwards. Each of the available exemptions have been designed to fit a specific business model or trade arrangement. Hence, businesses should take note of the different requirements and conditions for each of these exemptions before using any of these exemptions.

From these available exemptions, it is noted that the government is indeed


trying to minimise the occurrence of double taxation or the cascading effect of the Service Tax for the same supply of taxable services as it goes through the distribution chain. What remains clear is that a 6% Service Tax would eventually be imposed and levied for the provision of any taxable service in Malaysia irrespective of whether the taxable service originated from a foreign provider or from a local provider.

Quoting Richard Record, the World Bank leading economist for Malaysia who commented in *The Sun* daily on 14 October 2019, *"The implementation of the Digital Service Tax in Malaysia is the right move towards helping the government increase its revenue base from the Sales and Service Tax".*

Thus, Malaysia can be seen as moving in the right direction with the implementation of this new Digital Service Tax. However, how efficient or successful will this new tax be? How will the RMCD ensure that all FRPs register and comply with Malaysia's new Digital Service Tax?

Google Malaysia was quoted in a report in *The Star* on 2 December 2019 as saying, "We always comply with the tax laws in every country we operate in, and we continue doing so as tax laws evolve." The report also has stated that Google has confirmed that the 6% Service Tax will be applicable on G Suite services. The tax will be charged on user purchases and reflected under Billing & Payments.

*"Facebook also said it would be charging the 6% digital service tax for its advertisements in Malaysia, while PlayStation Store said it would apply the tax on purchasable items and subscriptions on their platform. Other companies, such as Netflix and Spotify, have yet to announce whether they will absorb the tax or charge it to their users,"* as reported on 30 December 2019 in *The Star*.

Taking all these tech giants as an example, it is hoped that companies will come forward and start complying with this new Digital Service Tax because of the possible reputational risk that they may face for not complying.

*[1] Section 7 of the Service Tax Act 2018.*
*[2] This is with reference to the Malaysian Service Tax only and is not to be mistaken with other corporate taxes, VAT or GST globally that may have similar names.*
*[3] The Star on 30 December 2019.*
*[4] In the News Straits Times written by Bernama on 2 November 2018.*
*[5] Subsection 26A(1) of the Service Tax Act 2018*
*[6] Subsection 2(1) of the Service Tax Act 2018 (amended from Service Tax (Amendment) Act 2019)*
*[7] First Schedule of the Service Tax Regulations 2018*
*[8] Subsection 2(1) of the Service Tax Act 2018 (amended from Service Tax (Amendment) Act 2019)*
*[9] Guide on Digital Services (dated 20 August 2019)*
*[10] Section 56B of the Service Tax Act 2019*
*[11] Item 3 in Schedule of Service Tax (Person Exempted From Payment of Service Tax) Order 2018*
*[12] Item 4 in the Schedule of Service Tax (Person Exempted From Payment of Service Tax) Order 2018*
*[13] First Schedule of the Service Tax Regulations 2018*
*[14] Service Tax (Persons Exempted from Payment of Tax) Order 2018*
*[15] Item 1 and Item 2 in the Schedule of Service Tax (Persons Exempted from Payment of Tax) Order 2018*
*[16] Paragraph 3A in the First Schedule of the Service Tax Regulations 2018*

***Chong Mun Yew** is an Executive Director, Crowe KL Tax Sdn Bhd. He can be contacted at munyew.chong@crowe.my.*

***Chris Yee** is an Indirect Tax Director, Crowe KL Tax Sdn Bhd. He can be contacted at chris.yee@crowe.my.*

***Fam Fui Chien,** is an Indirect Tax Manager, Crowe KL Tax Sdn Bhd. She can be contacted at fuichien.fam@crowe.my.*

***Disclaimer:** This article does not seek to address all Service Tax issues associated with the Digital Service Tax and imported services including the relevant exemptions. All views expressed herein are purely the personal opinion of the authors.*

# DIMINISHING DEDUCTIBILITY OF INTEREST EXPENSE

## A RELOOK AT SECTION 140A ON INTER-COMPANY INTEREST

Kenneth Yong Voon Ken

Unlike most other deductible items, interest expense has seen more and more restrictions being slapped onto its deductibility. This is unfortunate, because the widespread reliance on borrowings for business financing means that interest expense – and its tax deductibility – are important considerations for business survival.

This articles explores the deduction rules surrounding interest expense, and pushes the discussion that the taxing of inter-company interest under Section 140A (transfer pricing rules) should be relooked at, because it may stifle business – especially in light of today's business challenges peppered with global trade wars, worldwide virus outbreaks and international business disruptions.

## TAX OBSESSION WITH INTEREST EXPENSE

Arguably one of the hottest "go to" sections in the Income Tax Act 1967 (ITA), Section 33 when read with Section 39 (specific prohibitions from tax deduction) represents the single yet pivotal backbone upon which the deductibility of most expenses rest upon. Section 33(1) confers deduction to:

*"…all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source…"*

While most expenses fall back on Section 33(1) above, interest expense has six different provisions in the ITA devoted to its deduction, and more importantly, to its non-deduction, namely:

1. Section 33(1)(a) - general deduction of interest expense
2. Section 33(2) - interest restriction
3. Section 33(4) - "due to be paid" timing provision
4. Section 39(1)(f) - withholding tax not paid on interest paid/ credited to non-residents
5. Section 140C - earning stripping rules
6. Section 140A - arms' length interest for inter-company loans

The ITA's obsession with interest expense hints that policy setters place special regard towards interest expense. See **Table 1**. Each point will be briefly explored.

## 1. GENERAL DEDUCTION OF INTEREST EXPENSE

Holding a special position in law, interest expense does not ordinarily follow the "wholly and exclusively" test under Section 33(1).

Instead, the deduction rule for interest expense is encapsulated in Section 33(1)(a) which stipulates that interest is deductible provided the "sum of money borrowed" must be:

i. Employed … in the production of gross income from that source; or
ii. Laid out on assets used or held in that period for the production of gross income from that source.

Interestingly, from item (ii) above, interest incurred on borrowings for acquisition of capital assets (plant and machinery) also qualify for deduction – an important consideration given that capex spending is a big part of business initiation and expansion.

This position is faithfully illustrated in the examples under Para 5 of Public Ruling 2/2011 (PR 2/ 2011) dealing with "Interest Expense and Interest Restriction".

As with other deductions, interest expense can only be deductible against a business source provided the business has commenced. This is a pain point that will be revisited later.

## 2. INTEREST RESTRICTION

Very simply speaking, interest restriction under Section 33(2) forces interest expense to be added back from a business source and matched to the investment source producing such income. While sounding logical in theory, interest restriction is, in practice, fraught with mini perils that can potentially trip up the deductibility of interest expense. Three such perils are discussed below.

Firstly, Section 33(2) is activated when there is mixed utilisation of the borrowings to business use and investment use.

In practice, most companies have some investment elements on their balance sheets (e.g. fixed deposits, other receivables or investment in shares etc). Disproving "mixed utilisation of borrowings" (and side-stepping interest restriction under Section 33(2) ) is not always easy, especially when the written purpose of the borrowings is "for working capital" which is generally amenable to mixed usage.

Secondly, interest that is restricted from the business source may, at times, still need to go through the

"income producing versus NON-income producing test" before being deductible at the investment source.

Consider the following two extracts from Para 8.1 of PR 2/2011 which, on surface, appear to self-contradict:

"For purposes of deducting interest expense against dividends, interest or rental income, all investments … should be aggregated regardless of whether they are income producing or non-income producing."

"However, this tax treatment does not apply to investments which produce income that is exempted from tax and interest-free loans to related parties…"

PR 2/2011 clearly requires a sub-allocation of interest expense between:

i. tax exempt dividends and taxable dividends (such as distributions from Real Estate Investment Trusts); or
ii. interest-free loans to related parties and to other loans

Furthermore, deduction of interest expense against non-business rental income is dependent upon uninterrupted rental generation (with the exception of the two-year "temporary vacant" rule under para 8.4.2 of PR 12/2018 "Income from letting of real property").

The above rules pertaining to dividend, interest and rental income loosely mimics the "income producing" vs "non-income producing" treatment and further restrains the deductibility of interest expense.

Thirdly, if there is no investment income or insufficient investment income to fully offset the interest expense (as quite often is the case), then a portion of the interest expense is non-deductible and permanently lost.

### 3. "DUE TO BE PAID" TIMING PROVISION

Apart from outright non-deduction under Section 33(2) or Section 39, the separate but not unconnected Section 33(4) introduced a time-delayed element to the deduction of interest expense. The key phrase is: "where any sum … is not due to be paid in that period, the sum shall when it is due to be paid be deducted …"

Thus, interest that has been incurred for a particular year may NOT necessarily be deductible until a later time when it is due to be paid; where applicable, this rule further hinders the deduction of interest expense by differing it.

Following on, Section 33(5) requires the payer of the interest to notify the Inland Revenue Board of Malaysia (IRBM) not later than 12 months from the end of the basis period when the sum is due to be paid. This notification generally necessitates a revision to the tax computation of past years which carries the risk of triggering a tax review by the IRBM – something many taxpayers remain averse towards.

### 4. WITHHOLDING TAX NOT PAID ON INTEREST PAID/CREDITED TO NON-RESIDENTS

Where the recipient of the interest is a non-resident, then Section 39(1)(f) is applicable. Any non-payment of the withholding tax on such interest would render the interest non-deductible. Taxpayers would need to closely monitor such interest payments to non-residents to prevent unnecessary non-deduction of interest.

### 5. EARNING STRIPPING RULES (ESR)

First mooted in 2009 (as thin capitalisation rules), placed in cold storage for several years, only to re-emerge in 2018/2019 under a new label, ESR is the latest gadget in the IRBM's toolbox targeting interest deductions.

In short, ESR under Section 140C of the Act seeks to restrict interest deductions to a 'maximum amount of interest' being 20% of the tax-EBITDA (a tax-adjusted amount of 'Earnings Before Interest, Tax, Depreciation and Amortisation').

ESR is only applicable to financial assistance:

a. granted in a controlled transaction; and
b. whereby the interest expense exceeds RM500,000 in the basis period.

Fortunately, this quantitative threshold is high enough to exempt SMEs in the micro segment. But unfortunately, it still ensnares mid-sized and large corporate groups, rendering them vulnerable to ESR's version of interest restriction.

### 6. ARMS' LENGTH INTEREST FOR INTER-COMPANY LOANS

2009 saw the introduction of Section 140A which required loans between related companies in a corporate group to carry an arm's length rate of interest – not too high, not too low, and certainly not zero.

And herein lies the problem. Local corporate groups (especially SMEs) usually do NOT charge any interest for inter-company loans – subsidiaries are seen as an extension of the holding company, left-pocket to right-pocket.

While Section 140A is an interest-charging provision, the problem often falls, not on the lender company, but on the related borrower i.e. an asymmetric tax exposure that becomes an interest deduction problem.

## BREAKDOWN OF TAX SYMMETRY

Tax symmetry (a phrase coined by the author) refers to a tax charge on the lender company that is exactly offset by the tax deduction on the borrower company, resulting in zero additional taxes.

Tax asymmetry (the reverse) occurs because the rules imposing tax on income are not aligned to the rules granting deduction on expenses, either in terms of timing or in quantum.

Nonetheless, Para 3.3 of the IRBM's Transfer Pricing Guidelines (2012 and 2018) offers the following escape route from Section 140A:

"…the Guidelines need not apply to transactions between persons who are both assessable and chargeable to tax in Malaysia and where it can be proven that any adjustments made under the Guidelines will not alter the total tax payable or suffered by both persons."

However, there are numerous situations that, on deeper scrutiny, can rip this exemption apart. The situations that can cause asymmetric tax exposures include:

- Interest restriction under Section 33(2) - interest deduction gets diverted to investment sources which may not have sufficient income to offset, resulting in permanent loss of interest expense.
- Non-deduction of interest expense due to pre-commencement date issues, but interest income is taxed immediately as "obtainable on demand" under Section 29(3) and Section 29(4).
- Loss-making operations of related borrower, which push back interest deduction indefinitely in absence of a profit-turnaround.
- "Due to be paid" timing issues under Section 33(4) which defer interest deduction, but interest income is taxed immediately as "obtainable on demand" under Section 29(3) and Section 29(4).
- Earning stripping rules which limit interest deduction to 20% of tax-adjusted EBITDA
- Unutilised tax capital allowances or unutilised tax losses which prevent enjoyment of interest deductions, but interest income is taxed immediately.
- Differential tax rates between lender and borrower companies, leading to net incremental tax exposure from the interest income-expense pair.

**TABLE 1: THE 6 BIG-GUN SECTIONS AIMED AT RESTRAINING DEDUCTION OF INTEREST EXPENSE. ARRANGED ACCORDING TO CHRONOLOGICAL ORDER.**

| YEAR INTRODUCED | ITA SECTION | RESTRICTION ON INTEREST DEDUCTION |
|---|---|---|
| | 33(1)(a) | **General deduction rule for interest expense**<br>• Interest deductible on borrowings for capex, money employed in production of gross income.<br>• Source must have commenced. |
| | 33(2) | **Interest restriction**<br>• Mixed utilisation of the borrowings to business use and investment use.<br>• Forces a reallocation of interest expense to investment sources.<br>• Income producing vs non-income producing investments further inhibit interest deductions.<br>• Kicks-in for interest expense of at least RM10,000 (companies) or RM6,000 (sole-proprietors) |
| 2009 | S140A | **Forced interest charge on inter-company loans**<br>• Tax asymmetry may cause mismatch between interest deduction (on borrower) and interest income (on lender) |
| 2011 | S39(1)(f) | **Withholding tax not paid for interest paid/ credited to non-residents**<br>• Interest expense added back |
| 2014 | S33(4) | **"Due to be paid" timing provisions**<br>• Defers deduction of interest expense in presence of certain repayment terms |
| 2019 | S140C | **Earning Stripping Rules**<br>• Max interest deduction limited to 20% of tax adjusted EBITDA<br>• Applies to "controlled" inter-company loans<br>• Kicks-in if interest expense exceeds RM500,000 |

## OTHER ISSUES WITH INTER-COMPANY INTEREST CHARGE FOR LOCAL COMPANIES

The above unfavourable points, when applied to local corporate groups – SMEs in particular – can hinder, even harm, their businesses. This calls for a rethink on the application of 'inter-company interest' to local companies as the 'inter-company interest' requirement under Section 140A can morph from a mere inconvenience into a direct body-blow to businesses as elaborated above.

Some further considerations surrounding this issue include:

i. SMEs are especially vulnerable to the inter-company interest rule, whether intended or not
ii. Projects with long gestation period will suffer a tax burden through asymmetric tax treatment
iii. Tax policy should not add burden to choice of business structure or allocation of capital
iv. 'Inter-company interest' charge is artificially created

### i. VULNERABILITY OF LOCAL SME GROUPS TO INTER-COMPANY INTEREST RULE

In the context of local SME companies, the application of an arms' length rate of interest (i.e. a forced interest charge) on inter-company loans presents numerous challenges.

Firstly, interest-free loans are commonplace among local SME groups. Why? Because they are a fast and flexible way to mobilise capital throughout the business units. Interest-free loans have been practised long before the introduction of Section 140A in 2009.

Even after a decade since S140A's introduction, some SME owners still frown questioningly at why they need to charge interest on what to them is essentially a "right pocket to left pocket" fund transfer.

Secondly, a forced interest charge is likely to hit almost every local SME group (whether or not this was intended), with two extreme results.

In the most benign scenario, there is perfect tax symmetry – tax charge on the lender company is exactly offset by the tax deduction on the borrower company. The result: no additional tax to the government, but more paperwork and procedure. Inquisitive readers may wonder: why go through all the trouble to achieve the status-quo?

In the more malignant scenario, tax symmetry breaks down – tax deductions on interest expense are denied but tax charge on interest income is payable. Foreseeably, many local SME groups are likely to suffer additional taxes due to asymmetric tax exposures.

Thirdly, the IRBM's Transfer Pricing Guidelines (2012 and 2018 versions) require related lenders/ borrowers to justify their basis of charging interest and document this down.

Ironically, it is the law that compels companies to break the interest-free tradition and charge interest, but the same law now requires companies to justify why they charge the interest rate they did – an unwanted burden for SME owners already struggling with business survival issues. Given a choice, most (if not all) local SME groups would prefer to revert to the simplicity of interest-free loans from pre-Section 140A.

### ii. PROJECTS WITH LONG GESTATION PERIOD

Very often, risk-seeking businesses will deploy funds into projects with long gestation periods. Where a subsidiary-model is the structure of choice, 'interest on inter-co loan' will kick in, making the entire group a victim of tax asymmetry.

Consider an example of constructing a hospital under a new subsidiary. Temporary loans will be provided by the Holding company to the subsidiary. The building work will require two years, during which time, S140A compels inter-company interest to be charged.

The lender (Holding Company) reports interest income which is taxable in the respective year of charge. However, the borrower (subsidiary) is denied interest deduction because the uncompleted hospital has NOT yet commenced operations, pushing interest deductibility permanently out of reach, and artificially raises the cost of

the tax asymmetry problem presses in.

This disadvantageous situation is created entirely by the 'inter-company interest' rule under Section 140A. Such is the case for all projects with long gestation, forcing a rethink on the wisdom of the 'inter-company interest' rule.

### iii. TAX POLICY SHOULD NOT AFFECT ALLOCATION OF CAPITAL OR BUSINESS STRUCTURE

Ideally, tax policies should not affect choice of business structure nor with allocation of capital (unless intervention was Parliament's intent). Unfortunately, 'inter-company interest' does discriminate. Consider the following:

Company H has a very profitable restaurant outlet (Outlet A) and wishes to use the profits from Outlet A to finance a new outlet (Outlet B). This can be done by setting up Outlet B as:

a. a new branch within Company H itself; or
b. a new 100% owned subsidiary of Company H.

It is assumed that the financing is in the form of an inter-company loan. See **Diagram A**.

Under option (a), the funds from Outlet A to Outlet B are NOT caught by 'interest on inter-company loans' under Section 140A. However, under option (b), the loan from Outlet A to Outlet B (loan from Company H to Subsidiary S) will be subjected to 'interest on inter-company loans'. That means Section 140A imposes additional tax consequences when the chosen method of business organisation is a 100% subsidiary structure.

In practice, the deployment of funds (allocation of capital) are identical under scenario (a) and (b). So why should the tax treatment be different when management chooses to use a 100% subsidiary to house Outlet B?

### iv. 'INTER-COMPANY INTEREST' CHARGE IS ARTIFICIAL

At this juncture, it is worth highlighting that the forced interest charge under Section 140A is an artificial construct imputed by law.

To local SME groups, interest-free loans were the default treatment, the way things were done for decades. After all, subsidiaries are viewed as an extension of the holding company, and inter-company loans are merely "right pocket to left pocket" transfers.

It would not be far-fetched to infer that "interest-free" was the "arms' length" way before the arrival of transfer pricing rules.

Although Section 140A is intended to correct a pricing-distortion, from local SME perspective, Section 140A can be seen as the distortion because it creates an 'artificial' interest income / interest expense pair which causes additional tax in the presence of tax asymmetries.

### POSSIBLE PROPOSALS MOVING FORWARD

Applying a 'forced' interest charge on inter-company loans (Section 140A) affects the capital allocation process, stifles business venturing, and carries a host of other implications.

So what can policy-setters

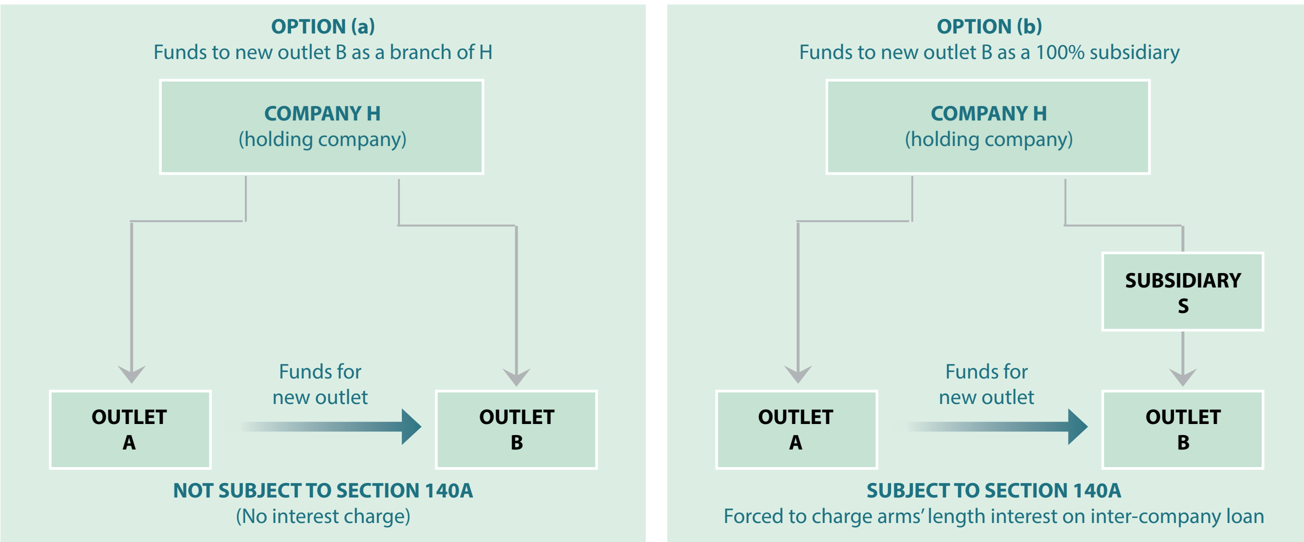
**TABLE 2: SOME FACTORS CONTRIBUTING TO TAX ASYMMETRY IN INTER-CO LOANS**

- Tax Asymmetry refers to the mismatch between tax payable on interest income and tax deduction on interest expense.
- Tax Asymmetry occurs because the rules imposing tax on income are not aligned to the rules granting deduction on expenses, either in terms of timing or in quantum

| ISSUE CAUSING TAX ASYMMETRY | REMARKS |
|---|---|
| **S33(2) Interest restriction problems** | • Insufficient investment income to offset against interest expense |
| **Commencement date issues** | • Interest expense is a permanent loss before commencement date.<br>• Assets / Projects with long gestation period fall here. |
| **Loss-making operations** | • Absence of income to offset interest expense. |
| **"Due to be paid" timing issues** | • Interest expense deferred, but corresponding interest income taxed on demand under s29(3) or s29(4). |
| **Earnings Stripping Rules** | • Interest deduction in excess of 20% of tax-adjusted EBITDA is deferred. |
| **Unutilised tax capital allowance and tax losses c/f** | • Absence of income to offset interest expense. |
| **Differential tax rates between lender and borrower** | • Different tax rates may give rise to net incremental tax exposure from the interest income-expense pair. |

**DIAGRAM A: COMPARISON BETWEEN 'FUNDING AS A BRANCH' [ OPTION (a) ] VS 'FUNDING THROUGH A SUBSIDIARY' [ OPTION (b) ]**

- Company H uses profits from Outlet A (branch) to open new Outlet B.
- In practice, deployment of funds are the same under Option (a) and (b).
- However, companies suffer different tax treatment when they choose a holding co / subsidiary configuration as their business structure.
- Ideally, tax policy should not affect choice of business structure.




consider? Here are some possibilities:

### a. WAIVER OF INTER-COMPANY INTEREST FOR LOCAL COMPANIES

Firstly, the forced interest charge on inter-company loans can perhaps be waived IF the lender and borrower are both local companies. This would relax the compliance burden and allow for better capital allocation without the interference of tax asymmetries.

### b. MATERIALITY THRESHOLD TO APPLY INTER-COMPANY INTEREST

Secondly, if the above is not possible, then perhaps a materiality threshold can be set, below which inter-company interest does not need to be charged. This would spare smaller companies (SME groups) from the tax asymmetry problems and all the other setbacks described in this article.

## CONCLUSION

Having at least six big-gun legislations aimed at restraining one deduction – interest expense – seems like an overkill.

Clearly, the rules on interest deduction are numerous and onerous. They are also becoming complex, thus diminishing the deductibility of interest expense.

Yet, it must be remembered that borrowings (which generate interest expense) are a very important factor for businesses to survive and thrive, more so in view of global disruptions seen in today's highly connected world. So, over-regulating interest deductions can have repercussions on Malaysian business competitiveness.

Furthermore, forced interest on inter-company loans can affect capital allocation and attract other problems. Tax asymmetries are abound in inter-company interest income / interest expense pairs, causing unnecessary net tax positions that are arguably unreal and absolutely unhelpful.

Local SME groups are the likely victims of forced interest on inter-company loans which strikes them the most, because inter-company loans are common but vital among SMEs.

Exempting local companies from forced interest charge on inter-company loans can lend a helping hand to SMEs, as will setting a materiality threshold (below which inter-company loans can go interest-free).

The author is wishful that all these factors can drive a rethink for not imposing forced inter-company interest under Section 140A.

***Kenneth Yong Voon Ken*** *is a practising accountant based in Kuala Lumpur. Email: kennethyong.main@gmail.com*

# GUIDELINES FOR FINANCIAL TRANSACTIONS
# THUS SPAKE THE OECD

Venkataraman Ganesan

*"Borrowing today to pay tomorrow is harrowing; loan sharks will arrow your marrow till sorrow wash over you."*

\- **Vincent Okay Nwachukwu,** *Weighty 'n' Worthy African Proverbs - Volume* [1]

## A. INTRODUCTION

If at all there is one sphere in the domain of Transfer Pricing that has lent itself - albeit unwittingly and involuntarily - to complexity, controversy and change, it arguably has been financial transactions. Pricing inter-company financial transactions is a dynamic and fluid endeavour that has been characterised by a great deal of confusion and subjectivity. A lack of prescriptive and harmonious guidance, both at the national (in-country) as well as international ombudsman levels has only gone on to further exacerbate existing dilemmas faced by both the tax payers and tax administrations across the globe. A classic case in point being the path breaking judgement issued by the Australian Federal Court in the case of Chevron[2]. This verdict, by shattering well entrenched beliefs and received wisdom relating to the arm's length nature of inter-company loans, has not merely altered, but in reality, upended the very landscape of inter-company loans.

Even though not within the remit of this article, it would be apposite to encapsulate in a nutshell, the basic premise coursing through the veins of the Chevron decision. Dealing with a related party loan ("Credit Facility Agreement") entered into between Chevron's US subsidiary, Chevron Texaco Funding Corporation ("CFC") and its Australian parent, Chevron Australia Holdings Pty Ltd ("CAHPL"), the Australian Federal Court ruled that the terms of the loan exceeded the

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[1] *https://www.goodreads.com/book/show/48581616-weighty-n-worthy-african-proverbs---volume-1*

[2] *Chevron Australia Holdings Pty Ltd (CAHPL) v Commissioner of Taxation [2017] FCAFC 62*

arm's length consideration that might reasonably have been expected in an agreement between independent parties acting at arm's length. In arriving at this conclusion, the Federal Court adopted a sweeping mechanism analysing not just the terms and conditions of the actual loan but also the nature of the property involved in order to accurately determine what needs to be priced. Intricate contractual queries and evidentiary matters were also considered by the Court.

With a view to providing guidance on the transfer pricing aspects of financial transactions, which should contribute to consistency in the application of transfer pricing and help avoid transfer pricing disputes and double taxation[3], the Organisation for Economic Cooperation and Development ("OECD"), on 11 of February 2020, issued a final report on the topic. As the OECD itself proceeded to acknowledge in the Guidance, "This guidance is significant because it is the first time the Guidelines will be updated to include guidance on the transfer pricing aspects of financial transactions…"[4] Bearing the non-descript title, "Transfer Pricing Guidance on Financial Transactions", the Guidance (as this report would be termed throughout this article) provides illuminating insights on the Transfer Pricing aspects relating to various financial elements such as Intra-Group loans, Cash Pooling, Hedging, Financial Guarantees and Captive Insurance.

## B. ARRANGEMENT OF THE OECD GUIDANCE

The Guidance is segmented into the following five Sections:

- Section 1 articulates delineation of the actual transactions by making references to section D.1 of the OECD Transfer Pricing Guidelines;[5]
- Section 2 dwells on the arm's length principles underlying a myriad of Treasury functions such as intra-group loans, cash pooling and hedging;
- Section 3 focuses on Financial Guarantees;
- Section 4 has a reference to Captive insurance; and
- Section 5, the concluding section in the Guidance holds forth on the concepts of risk-free and risk-adjusted rates of return

## C. SCOPE OF THE ARTICLE

The succeeding paragraphs attempt to provide a macro level overview of the various elucidations provided in the five sections of the Guidance. The objective, as may be inferred from a reading of the aforementioned lines, is not to dissect each section threadbare and analyse all the attendant Transfer Pricing ramifications, but to equip the reader with a fair sense of perception and awareness regarding the potential Arm's Length implications attached to the financial transactions covered by the Guidance.

## D. ACTUAL DELINEATION OF FINANCIAL TRANSACTIONS

The first section of the Guidance provides recommendations regarding the actual delineation of financial transactions. The mechanisms and observations as set out in the draft guidance have been to a large extent retained in this Guidance.[6]

The guidance alludes to ascertaining the purpose and objective of an intra-group loan from the perspective of both the lender and the borrower in addition to discussing aspects such as evaluating the debt capacity of a borrower from the point of view of the borrower's ability to repay the debt.

A very interesting feature which the Guidance illuminates with regard to the actual delineation of transactions, appears in the form of a discussion regarding the "balance of debt and equity funding of an entity". To paraphrase the Guidance, "It may be the case that the balance of debt and equity funding of a borrowing entity that is part of an MNE group differs from that which would exist if it were an independent entity operating under the same or similar circumstances. This situation may affect the amount of interest payable by the borrowing entity and so may affect the profits accruing in a given jurisdiction."[7] The Guidance provides that whilst accurately delineating the actual financial transaction, the most crucial element would be the conduct of a functional analysis. Such an analysis would include the core functions performed by lenders and borrowers

with respect to intra-group loans. The essence underlying such a functional analysis is a recognition that a related party lender may not perform all these functions with the same intensity as an independent lender. The Guidance also prescribes that when a lender is not in a position to assume or exercise control over the risks associated with a lending of funds, and/or or does not possess the financial capacity to assume the risks, such risks should be allocated to the enterprise that actually exercises such control and possesses the financial capacity to assume the risk. As a natural corollary, the lender in such an instance will be entitled to no more than an appropriate risk-free rate of return.

The Guidance also, as may be expected, lays emphasis on the five comparability factors contained within the OECD Guidelines and their linkages with financial transactions. According to the Guidance, factors such as: the amount of the loan; its maturity; the schedule of repayment; the nature or purpose of the loan (trade credit, merger/acquisition, mortgage, etc.); level of seniority and subordination, geographical location of the borrower; currency; collateral provided; presence and quality of any guarantee; and whether the interest rate is fixed or floating, determine the actual characteristics of the loan instrument.[8]

## E. TREASURY FUNCTIONS – INTRA-GROUP LOANS

The Guidance clearly asserts that when one is embarking upon an exercise of evaluating both the commercial and financial relations in addition to the economically relevant characteristics of intra-group financial transactions, it is not sufficient if the perspective of either the borrower or the lender is considered. It is essential to consider the perspective of both the lender and the borrower. Even though in a related party transaction involving intra-group loans, a stringent process of information gathering as would be the prerogative of an independent lender, might not be strictly adhered to, the underlying commercial considerations should not be materially different between a related party loan transaction *vis-à-vis* a third party lending and borrowing arrangement. These considerations include for example creditworthiness, credit risk and economic circumstances.

The Guidance also devotes considerable space for discussing various aspects relating to credit ratings. The Guidance acknowledges credit ratings to be a useful tool to ascertain the creditworthiness from a lender's perspective. The Guidance also exhorts the need for analysing both quantitative and qualitative factors that influence the process of credit rating. In all those instances where the issue rating of a particular debt issuance is available, the use of this rating over a more generic issuer rating would be more appropriate.

In so far as the impact and influence of Group Membership is concerned, the Guidance holds forth on the relevance of such an impact for two primary reasons. The first reason involves the form as well as the underlying terms and conditions subject to which the borrowing entity would have accessed the loan (for example the group's external funding policies). The second reason being the determination of the so-called implicit guarantee. The existence of an implicit guarantee would have the effect of insulating the borrowing entity from potential financial difficulties since the entity may be backed by the group in

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[3] *Executive Summary of the Transfer Pricing Guidance on Financial Transactions ("Guidance") issued by the Organisation for Economic Co-operation and Development ("OECD") under the Inclusive Framework on BEPS: Actions 4, 8-10*

[4] *Ibid.*

[5] *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017. May be accessed at: https://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-20769717.htm*

[6] *https://www.oecd.org/tax/beps/BEPS-actions-8-10-transfer-pricing-financial-transactions-discussion-draft-2018.pdf*

[7] *Paragraph 10.4 of Section B.1 of the Guidance*

[8] *Paragraph 10.29 of Section B.3.3 of the Guidance*

meeting all its financial obligations.

The Guidance also recommends consideration of implicit group support in the determination of the credit rating of the borrower or any debt issued by the borrower. Such a support, however, would be based on certain key criteria/factors such as the relative importance of the entity to the group as a whole, linkages between the entity and the rest of the group, and the consequences of (non-)support of the entity. The Guidance acknowledges the fact that prominent Multinational conglomerates with stronger links will have a credit rating that is more closely linked to that of the MNE group. The Guidance also postulates that in the case of an entity where there is evidence that no support would be provided by the MNE group, it may be appropriate on the prevailing facts and circumstances to consider the entity on the basis of its own stand-alone credit rating only.[9]

The Guidance while briefly discussing on covenants, states that these are unlikely to be included in an intra-group loan situation because of the fact that lenders are less likely to suffer from information asymmetry and to take the same kind of action in the case of a covenant breach.

In determining the arm's length principle for an intra-group loan, the Guidance relies upon the tried and tested Comparable Uncontrolled Price (CUP) method on account of the extensive availability of information and analysis of loan markets. The Guidance veers towards adopting an interest rate setting approach that has at its core the following cumulative attributes:

- the cost of funds incurred by the lender in raising the funds;
- expenses incurred by the lender with respect to arranging the loan and relevant costs of servicing the loan; and
- risk premium reflecting various economic factors inherent in the proposed loan and a profit margin.

The employ of credit default swaps as a method to calculate risk premiums also finds a mention in the Guidance. The Guidance emphasises that a careful evaluation of factors other than default risk which may be reflected in the credit default spreads is warranted.

## F. TREASURY FUNCTIONS – CASH POOLING

Before proceeding to discuss the various arm's length considerations attached to Cash Pooling arrangements, the guidance distinguishes between two types of Cash Pooling arrangements: physical and notional.

In a typical physical pooling arrangement, the bank account balances of all the pool members are transferred daily to a single central bank account owned by the cash pool leader. Any account in deficit is brought to a target balance (usually zero) by a transfer from the master account to the relevant sub account. Depending on whether there is a surplus or a deficit after the members' accounts have been adjusted to the target balance, the cash pool leader may borrow from the bank to meet the net funding requirement of the pool or deposit any surplus as appropriate[10].

In a notional cash pool, some of the benefits of combining credit and debit balances of several accounts are achieved without any physical transfer of balances between the participating members' accounts although the bank will usually require cross-guarantees from pool participants to enable the right to set off between accounts if necessary. The bank notionally aggregates the various balances of the individual accounts of participating members and pays or charges interest according to the net balance, either to

a designated master account or to all participating accounts under a formula determined in the cash pooling agreement.[11]

The Guidance enumerates upon the arm's length remuneration mechanisms for the cash pool leader with reference to accurately delineated roles of the cash pool leader. The compensation mechanism as per the Guidance may take the form of either a service-based return or a spread-based return, depending upon whether the activities performed bear a lower or a high risk. Thus the allocation of rewards to the cash pool leader would largely be a factor of the functions performed, assets deployed, and the risks assumed in facilitating a cash pooling arrangement. The Guidance also postulates the 'sharing' synergistic benefits amongst the cash pool members.

The Guidance provides for the calculation of the returns due to the cash pool members through the determination of the arm's length interest rates applicable to the debit and credit positions within the pool. The participants are expected to be better off than in the absence of the cash pool. Benefits for cash pool participants include, but are not limited to enhanced interest rates to debit and credit positions, qualitative benefits such as access to a permanent source of financing, reduced exposure to banks, or access to liquidity that may not be available otherwise.

## G. TREASURY FUNCTIONS – HEDGING

The Guidance in so far as hedging transactions are concerned, informs the reader that these instruments are regularly employed as a means of mitigating exposure to risks such as foreign exchange or commodity price movements. The Guidance also considers the fact that within a Multi-National Enterprise setting these risks may be viewed and treated differently courtesy, the MNE's approach to risk management and hedging.

The Guidance considers options that are realistically available to both borrower and lender, while stressing on an imperative need for comprehending the group's overall treasury policy.

## H. FINANCIAL GUARANTEES

The Guidance focuses solely on financial guarantees and there is no reference to performance guarantees. The Guidance provides a crisp overview regarding the nature of financial guarantees. "In general, a


financial guarantee provides for the guarantor to meet specified financial obligations in the event of a failure to do so by the guaranteed party. There are various terms in use for different types of credit support from one member of an MNE group to another. At one end of the spectrum is the formal written guarantee and at the other is the implied support attributable solely to membership in the MNE group. In the context of this section, a guarantee is a legally binding commitment on the part of the guarantor to assume a specified obligation of the guaranteed debtor if the debtor defaults on that obligation."[12]

The Guidance demands the recognition of two kinds of economic benefits that are attached to the issuance of an inter-company guarantee. One, an enhancement of the borrower's conditions, for instance by way of an improved credit rating and, two, reduced borrowing costs. The Guidance also reognises that guarantees have the potential to enable the borrower to increase the borrowing capacity as well.

The Guidance also refers to the impact of Group Membership upon financial guarantees. Paragraph 10.163 of the Guidance reads: "The benefit of any such support attributable to the borrower's MNE group member status would arise from passive association and not from the provision of a services for which a fee would be payable". Similar to intra-group loans, the Guidance banks on the CUP Method as the most reliable method to be employed to determine an arm's length guarantee fee. The Guidance in particular talks about two different approaches, the yield and the cost approach, in determining the arm's length nature of a guarantee fee. The yield approach quantifies the benefit to the guaranteed party by ascertaining the spread between the interest cost to the borrower without the guarantee and the interest cost with the guarantee. The spread that is the outcome of an application of the yield approach is the maximum fee a

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*[9] Paragraph 10.78 of Chapter C.1.1.3 of the Guidance*

*[10] Paragraph 10.112 of Chapter C.2.1.1 of the Guidance.*

*[11] Paragraph 10.113 of Chapter C.2.1.1 of the Guidance.*

*[12] Paragraph 10.154 of Chapter D of the Guidance.*

borrower would be willing to pay for the guarantee, which is then subject to a process of bargaining between the borrower and the guarantor.

The cost approach is an attempt to place a value on the costs that would be expected to be incurred by the guarantor in case the borrower defaults. The expected cost is nothing but the value of the expected loss or, alternatively, the capital required to support the additional risk assumed by the guarantor. The cost approach identifies the minimum fee the guarantor would be willing to accept.

## I. CAPTIVE INSURANCE AND REINSURANCE

For the purposes of this Guidance, the term "captive insurance" is defined to mean, "an insurance undertaking or entity substantially all of whose insurance business is to provide insurance policies for risks of entities of the MNE group to which it belongs."[13] The Guidance emphasises a need to accurately delineate the transactions executed by entities engaged in the businesses of both captive insurance as well as captive reinsurance (fronting).

The Guidance lays down a number of indicators all or substantially all of which would be found if the captive insurance was found to undertake a genuine insurance business. These indicators inter alia, include, diversification and pooling of risk in the captive insurance set up; improvement in the economic capital position of the entities within the MNE group as a result of diversification; insured risk that is otherwise insurable outside the MNE Group; presence of requisite skills, including, investment skills and experience, within the captive insurance set up; possibility of suffering losses etc.

In determining the arm' length price for captive insurance and reinsurance activities, the Guidance places reliance upon the Comparable Uncontrolled Prices ("CUP") method. This is the most direct method especially if the captive insurance has suitably similar business with unrelated customers, or there may be found external comparables. However, the Guidance also acknowledges that there may be inherent constraints in the applicability of the CUP Method on account of practical hurdles such as performing comparability adjustments. Those differences may refer, for instance, to situations where the functional analysis indicates that a captive insurance performs less functions than a commercial insurer (e.g. a captive insurance that only insures internal risks within the MNE group may not need to perform distribution and sales functions). Similarly, differences between the captive insurance and the potential comparables in business volume or in the level of capital between the captive insurance and unrelated parties may require comparability adjustments.


The Guidance also throws light on two relatively new if not novel concepts in the domain of arm's length pricing in the form of group synergy and agency sales. According to the Guidance, any synergy benefits that may arise from the collective purchasing arrangement, and not from value added by the captive insurance should be allocated amongst the insured according to the level of premium they contributed.

In so far as agency sales are concerned, the Guidance opines that in those circumstances where the sales agent and insurer or reinsurer are associated, any comparability analysis as part of the process of determining the arm's length level of reward for the parties would need to consider the circumstances that give rise to the high level of profit. The availability of alternative providers may also influence the ability of each party to negotiate a higher level of profit as part of the overall transaction.

The Guidance goes on to provide the following example for illustrating the compensation mechanism for agency sales:

Company A is a high street retailer of high value new technology consumer goods. At the point of sale, A offers insurance policies to third party customers which provide accidental damage and theft cover for a three year period. The policies are insured by Company B, an insurer which is part of the same MNE group as A. A receives a commission with substantially all of the profit on the insurance contract going to B. A full factual and functional analysis shows that the insurance contracts are very profitable and that there is an active market for insurance and reinsurance of the type of risks covered by the policies. Benchmarking studies show that the commission paid to A is in line with independent agents selling similar cover as a standalone product. The profit B earns is above the level of insurers providing similar cover.[14]

## J. RISK FREE RATE OF RETURN

The Guidance defines a risk free rate of return as to be "the hypothetical return which would be expected on an investment with no risk of loss."[15] The Guidance proposes that in all those circumstances where the funding entity either does not undertake decision making functions or lacks the capability to assume/control the risk tagged to the investment in a financial asset, the return that should accrue to such an entity should be no more than a risk-free return. This would reflect the most appropriate measure of the profits such an entity would be entitled to retain.

A classic example of an instrument bearing a risk free rate of return would be specific securities issued by the government. Since these securities are guaranteed by the government against potential defaults, these can be generally considered to be bereft of material risk.

Determining a risk-adjusted rate of return would involve identification and differentiation of the financial risk is assumed by a funding entity while discharging its business of financing, and the operational risk that is assumed by the funded party and is connected to the use of the funds, e.g. for developing an intangible asset.

The Guidance proceeds to set out the following illustration to aid the reader:

For instance, consider a situation where Company F advances a loan to an associated enterprise, Company D, which undertakes the development of an intangible. Consider further that under the guidance in this chapter it is determined that Company F controls and consequently is allocated the financial risk associated with funding the development of the intangible, including the potential risk of Company D failing to develop the intangible and therefore being unable to repay the loan. However, Company F does not assume the risk of developing the intangible, which is entirely assumed by Company D under the accurate delineation of the actual transaction. Accordingly, in the event that the ex post results derived from the exploitation of the developed intangible were higher (or lower) than the results calculated on an ex ante basis, Company F would not be entitled to that difference but to a risk-adjusted rate of return as described in this section.[16]

## K. CONCLUSION

While the finalised Guidance is a welcome step in so far as eliminating uncertainty as well as the risks of double taxation in the sphere of financial transactions is concerned, the one shortcoming is the lack of illustrations that would further go to embellish the principles and proposals contained within the Guidance. Specific examples to guide the tax-payer in the otherwise complex and intricate subjects such as Hedging, would have gone a long way in bolstering the clarifications. However, having said that this represents the first step in ironing the creases and clearing the air. It is now in the reciprocal hands of both the tax payers and the tax administrations to suffuse meaning to the methods, and vice versa.

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[13] *Paragraph 10.190 of Section E.1 in the Guidance.*

[14] *Paragraph 10.225 of Section E.3.4 in the Guidance.*

[15] *Paragraph 1.109 of Chapter F in the Guidance.*

[16] *Paragraph 1.119 of Section F in the Guidance*

***Venkataraman Ganesan** is a Transfer Pricing advisor at Petroleum National Berhad (Petronas). The views expressed are solely those of the author and do not represent either the views or the opinions of the firm of which he is a part of.*

# International**News**

The column only covers selected developments from countries identified by CTIM and relates to the period 16 November 2019 to 15 February 2020.

## INDONESIA

### Taxation of foreign digital companies – regulation issued

On 4 December 2019, it was reported that the government had issued a new regulation providing that foreign companies with a significant presence in the emerging Internet economy in Indonesia are subject to local taxes in Indonesia.

According to the regulation, foreign companies trading goods and services online in Indonesia will be treated as having a physical presence in Indonesia, and will be required to comply with local taxation rules as a result. Foreign companies are also required to appoint representatives to act on their behalf for tax purposes.

The new regulation will apply to foreign companies that meet certain criteria (with further details still to be provided) such as: a certain number of transactions; a certain transaction value; a certain number of shipping packages; and a certain amount of traffic.

Furthermore, the regulation provides that foreign digital companies that were operating in Indonesia before the regulation came into effect will have a grace period of 2 years from the date of implementation. The regulation came into effect on 25 November 2019.

### Updates on tax incentives for companies – regulation issued

On 12 November 2019, the government issued Regulation No. 78 Year 2019 (the regulation), which provides amendments to the regulations on the tax incentives provided for companies investing in certain business sectors. ***The salient features of the regulation are set out below.***

- In order to enjoy the reduction in the net taxable income of up to 30% from the amount invested in fixed asset, the fixed asset invested is required to comply with the following conditions:
- the asset should be new, unless it originates from a complete relocation from another country;
- the asset should be listed in the new business licence as the basis for obtaining the tax incentives; and
- the asset should be owned directly by the taxpayer and utilized for the main business activity.
- An extension of the carry-forward of tax losses of more than five years but not more than 10 years is available, provided that the following annual qualifications to extend the tax loss carry-forward period are met:
- the company carries out eligible investment provided under the regulation;
- the company carries out eligible investment in the Industrial Zone or Bonded Zone;
- the company carries out investment in new and renewable energy;
- the company carries out development in economic or social infrastructure in the operational area of at least IDR 10 billion; the company uses raw materials and/or components which are at least 70% made in Indonesia;
- the company employs a certain number of Indonesian workers;
- the company carries out research and development in Indonesia for product development or production efficiency of at least 5% of the investment made within five years; or
- exports make up at least 30% of the total sales of the company for the investment conducted outside of a Bonded Zone.
- The Online Single Submission (OSS) system is introduced to process the tax incentives applications.
- Taxpayers who have enjoyed tax incentive under the regulation are not allowed enjoy the following tax incentives provided:
- the tax incentive in the Integrated Economic Development Zones;
- the tax holiday provided under GR No.94 Year 2010 (as amended by GR No.45 Year 2019); and
- the super deduction incentives on the labour-intensive industries provided under GR No.94 Year 2010 (as amended by GR No.45 Year 2019).
- The implementing regulations based on the old regulations remain effective, provided that

they are consistent with the provisions of the regulation.

The regulation came into effect on 13 December 2019, and the previous Government Regulation (i.e. GR No.18 Year 2015 (as amended by GR No.9 Year 2016)) is revoked.

## THAILAND

### Tax implications of investment income – decree issued

On 12 November 2019, the Thai Official Gazette published royal decree No. 689 which provides the details on the tax implications of investment income derived by individuals and companies which entered into force on 13 November 2019.

The salient features of the decree are:

- Investment income derived from debt securities and mutual funds will be subject to withholding tax at a rate of 15%.
- Certain investment income from the transfer of investment units in specified mutual funds under the law governing securities and stock exchange are exempted accordingly.

### WHT implication on interest payment made to mutual fund – regulation issued

On 2 December 2019, the government published Ministerial Regulation No. 353 (the regulation) which provides the withholding tax (WHT) implication on the interest payment made by a Thai corporate entity to a resident mutual fund.

It is provided that when a Thai corporate entity (the payer) makes an interest payment to a resident mutual fund, the payer is required to deduct WHT at a rate of 15% in relation to the interest payment made. The regulation is to be applied retroactively from 20 August 2019.

The WHT should be remitted to the Thailand Revenue Department within seven days after the end of the month in which the payment is made.

### Revised draft VAT bill on foreign e-business – issued for public consultation

Recently, the Inland Revenue Department (IRD) issued a revised draft VAT bill (the draft bill) relating to VAT collection for foreign e-businesses for public consultation from 14 to 29 January 2020.

Under the draft bill, foreign e-businesses are required to comply with the VAT obligation (i.e. to file VAT returns and remit the VAT) in Thailand if:

- the digital services are provided from overseas;
- the services are provided electronically and the services are consumed in Thailand; and
- the acquirer of the services is not a VAT registrant in Thailand.

No input tax deduction will be available for the foreign e-businesses. Furthermore, the following definitions are included in the draft bill accordingly:

- "electronic services" is defined as a service delivered through the Internet network or any other electronic network and such services that cannot be performed without the use of information technology; and
- "electronic platform" is defined as any channels or processes that are used by service providers to provide electronic services to the consumers.

### Tax incentive for investment in machinery – regulation issued

On 20 January 2020, the MoF gazette Royal Decree No. 690 (the Royal Decree) which provides a concessionary corporate tax deduction (the incentive) for investments made in machinery.

The salient features of the Royal Decree are set out below.

- The incentive is applicable to the cost of investment in machinery for the period from 1 September 2019

to 31 May 2020.

- An additional 50% deduction is allowed for the cost of investment in machinery.
- To qualify for the incentive, the following conditions must be met:
  - the machinery has not been used before;
  - the machinery acquired is eligible for depreciation deduction under the prevailing tax law, and the machinery is ready to be used by 31 December 2020;
  - the machinery is located in Thailand;
  - the machinery is not eligible for any other incentive under any other Royal Decree issued; and
  - the machinery is not used in a business which is exempt from income tax.
- Companies are required to comply with the requirements referred to above and must provide the details of the investment project and investment plans to the Inland Revenue Department (IRD). The IRD has the authority to impose an additional tax penalty for companies that fail to comply with the above requirements.

### Tax relief measurements for individuals and tourism sector – approved by Cabinet

On 4 February 2020, the Cabinet approved several tax relief measurements to mitigate the impact of a global economic slowdown on taxpayers and the impact of the coronavirus on the tourism sectors. The salient features of the announcement on tax measurements are set out below:

- The deadline for filing personal income tax returns and the payment of tax will be extended for three months from 31 March 2020 to 30 June 2020.
- An additional 100% deduction will be allowed for companies on payments made between 1 January 2020 and 31 December 2020 in relation to the following items:
  - payments made for seminar rooms, accommodation, transportation and other expenses for domestic seminars/training for employees; and
  - payments made to tour business operators under the law for domestic seminars/training between 1 January 2020 and 31 December 2020.
- An additional 50% deduction for payments made between 1 January 2020 and 31 December 2020 will be allowed for companies undertaking hotel business in relation to expenditures incurred for the alteration, extension or improvement of the properties and such properties must be ready for use by 31 December 2020. However, expenditure incurred for the repair of properties with the intention to return the properties to their original state is not qualified for the additional deduction. The properties mentioned herein include buildings used for the purpose of hotel businesses and the furniture or fixtures permanently attached to the buildings.
- The excise duties rate for jet fuel used for domestic flight will be reduced from THB4.726 per litre to THB0.20 per litre until 30 September 2020.

## VIETNAM

### Tax implications of cancellation of loan by foreign organisation – clarified

On 10 December 2019, the Department of Taxation of Ha Noi City issued Official Letter No. 92132/CT-TTHT (the Letter) clarifying the tax implications of the cancellation of a company's loan by a foreign organisation. The Letter clarifies that where a loan (principal and interest) obtained by a company is cancelled by the foreign organization, the foreign organisation will be exempt from withholding tax on the interest, while the company is not required to account for the withholding tax. However, the company must regard the cancelled loan (principal and interest) as other income and account for enterprise income tax accordingly.

### Tax implications of importation of equipment with software – clarified

On 4 December 2019, the Department of Taxation of Ha Noi City issued Official Letter No. 90747/CT-TTHT (the Letter) providing clarification on the tax implications of the importation of equipment with software.

The Letter clarifies that where the imported equipment system comes with controlling software, VAT and enterprise income tax (EIT) will be applicable upon the importation of the equipment. VAT will be imposed on the value of the machinery and equipment upon importation, whereas the software is exempt from VAT according to Clause 13, article 4 of Circular No. 219/2013/TT-BTC. EIT of 10% will be imposed on the value of the software, and 1% on the value of the machinery.

*__Janice Loke__ and __James Cheang__ of the International Bureau of Fiscal Documentation (IBFD). The International News reports have been sourced from the IBFD's Tax News Service. For further details, kindly contact the IBFD at ibfdasia@ibfd.org.*

*The technical updates published here are summarised from selected government gazette notifications published between 17 November 2019 and 16 February 2020, including Public Rulings (PRs) and guidelines issued by the Inland Revenue Board of Malaysia (IRBM), the Royal Malaysian Customs Department and other regulatory authorities.*

## INCOME TAX

### Labuan Business Activity Tax (Amendment) Bill 2019

The Labuan Business Activity Tax (Amendment) Bill 2019 (LBATA Bill) was passed in Parliament on 2 December 2019 without any amendments and was gazetted on 10 February 2020. Generally, the amendments proposed in the LBATA Bill are to allow the IRBM greater powers to audit Labuan entities, to ensure that the Labuan entities transact under arm's length terms, and to align certain provisions in the Labuan Business Activity Tax Act 1990 (LBATA) with the ITA. However, there is a significant proposal that will impact Labuan entities which are not able to comply with the relevant Labuan substance requirements. Some of the key proposals of the LBATA Bill are highlighted below.

- A Labuan entity carrying on a Labuan business activity that fails to meet the substance requirements will be subject to income tax under the LBATA. Such Labuan entity will be taxed at 24% of its chargeable profits, i.e. 24% of the net profits reflected in the audited accounts in respect of such Labuan trading activity of the Labuan entity (Reference: Section 2B of the LBATA, w.e.f. the year of assessment (YA) 2020).
- Introduction of anti-avoidance and transfer pricing provisions (Reference: Sections 17C and 17D of the LBATA, w.e.f. YA 2020)
- The profit of a Labuan entity carrying on a Labuan business activity which is a Labuan non-trading activity excludes income derived from intellectual property rights. Such income will be subject to tax under the ITA (Reference: Section 9 of the LBATA, w.e.f. 1 January 2019).

### Dewan Rakyat passes Finance Bill 2019

The Finance Bill 2019 was passed on 2 December 2019 with the following key amendment relating to the review of the acquisition price for Real Property Gains Tax (RPGT) purposes. It was proposed that for disposals of real property acquired prior to 1 January 2013 by Malaysian citizens and permanent residents, the deemed acquisition price will be the market value as at 1 January 2013. The IRBM has clarified that the said market value will be determined by the Valuation and Property Services Department (JPPH).

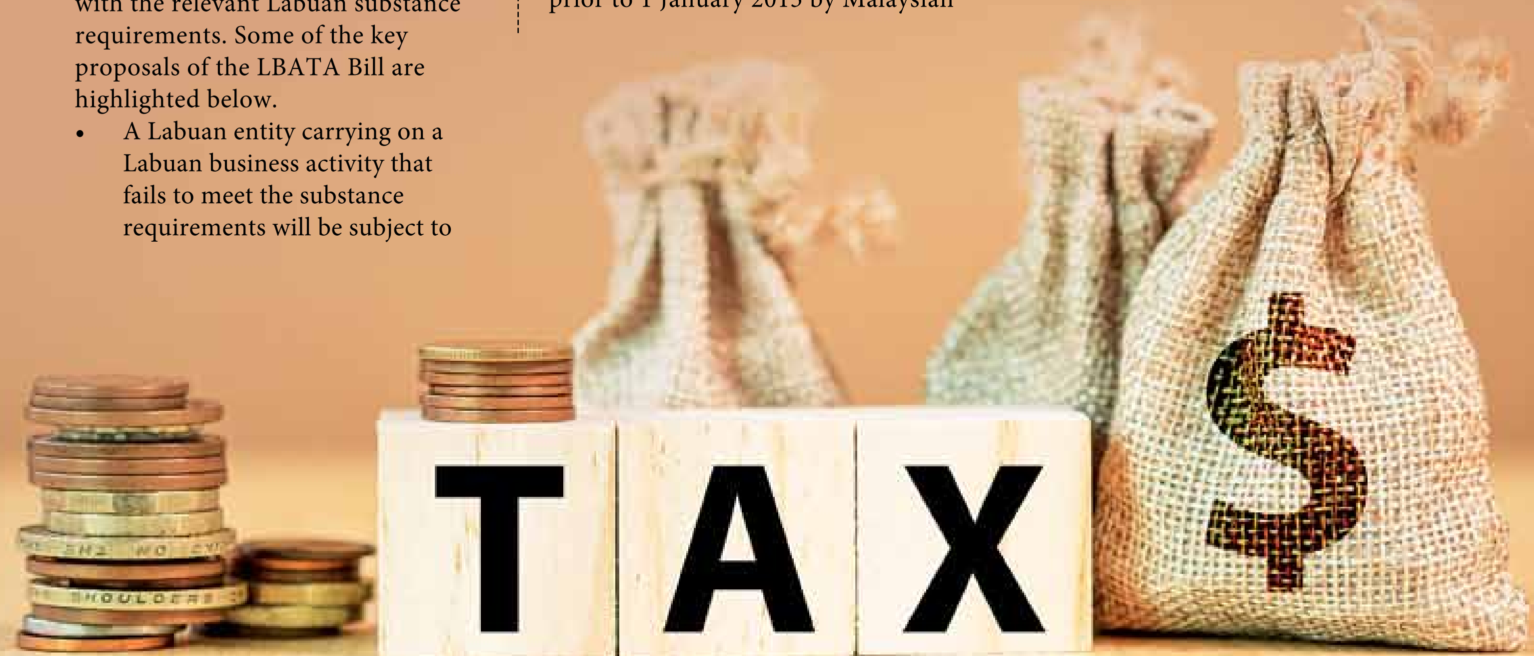
The proposal has now been amended to stipulate that the 1 January 2013 deemed acquisition date will not apply to:

a) Disposal of shares acquired by an individual in exchange for real property transferred to a company controlled by that individual, his wife, jointly with his wife, or with a connected person (Paragraph 34 of the RPGT Act 1976); and
b) Disposal of shares in a real property company (Paragraph 34A of the RPGT Act 1976)

The Bill was subsequently gazetted on 31 December 2019 and adopted all the proposed changes.

### Withdrawal of withholding tax exemptions available to MSC Malaysia status companies

The Income Tax (Exemption) (No. 13) 2005 (Revocation) Order



2019 [P.U.(A) 363], gazetted on 17 December 2019, revokes the Income Tax (Exemption) (No. 13) Order 2005 [P.U.(A) 102]. This is effective from 1 January 2020.

This means that income received by non-resident companies from an approved MSC-status company is no longer exempted from WHT effective 1 January 2020. The types of payments that are included are:

a) Payments for technical advice or technical services;
b) Licensing fees in relation to technology development; and
c) Interest on loans for technology development

### Extension of tax incentive for the repayment of PTPTN loans by employers on behalf of employees

- Income Tax (Exemption) (No. 8) (Amendment) Order 2019 [P.U.(A) 414]
  P.U.(A) 414/2019, gazetted on 31 December 2019, amends the Income Tax (Exemption) (No. 8) Order 2019 [P.U.(A) 205], to extend the income tax exemption on loan repayments made by employers on behalf of their employees, from 1 January 2019 to 31 December 2021. The Amendment Order is effective YA 2019 until YA 2021.
- Income Tax (Deduction for Payment of Educational Loan of Perbadanan Tabung Pendidikan Tinggi Nasional by Employers on behalf of Employees) (Amendment) Rules 2019 [P.U.(A) 415]
  P.U.(A) 415/2019, gazetted on 31 December 2019, amends the Income Tax (Deduction for Payment of Educational Loan of Perbadanan Tabung Pendidikan Tinggi Nasional by Employers on behalf of Employees) Rules 2019 [P.U.(A) 206], to extend the tax deduction period for employers to 31 December 2021 for the repayment of PTPTN loans on behalf of their employees. The Amendment Rules are effective from YA 2019 until YA 2022.

### Tax incentive for Structured Internship Programme

The Income Tax (Deduction for Expenditure Incurred for Provision of Approved Internship Programme) Rules 2019 [P.U.(A) 398], gazetted on 31 December 2019, provides a double deduction for expenses incurred by the qualified person to conduct an approved internship programme. These Rules shall apply to:

a) An approved internship programme in YA 2015 until YA 2016 for a student pursuing a diploma programme in an institute of higher education and a student pursuing a qualified course, i.e. a vocational programme (minimum Malaysian Skills Certificate Level 4); and
b) An approved internship programme for a student in YA 2017 until YA 2021

The double deduction is given for the following expenses:

a) Monthly allowance paid to the students of not less than RM500 per student;
b) Expenditure incurred for the provision of training;
c) Meals, travelling expenses and accommodation for the students during the internship programme

For items (b) and (c), the total deductions allowable for each student shall not exceed RM5,000.

### Extension of tax exemption for angel investors

The Income Tax (Exemption) (No. 3) 2014 (Amendment) Order 2019 [P.U.(A) 399] gazetted on 31 December 2019, extends the income tax exemption for angel investors for another three years, until 31 December 2023.

### Amendment to deduction from remuneration rules

The Income Tax (Deduction from Remuneration) (Amendment) Rules 2019 [P.U.(A) 387], gazetted on 31 December 2019, take effect from 1 January 2020 and amend the Income Tax (Deduction from Remuneration) Rules 1994 [P.U.(A) 507].

The amendments are to take into

account the new tax bracket with effect from YA 2020, where:

a) Individual taxpayers with chargeable income exceeding RM2,000,000 will be subjected to tax at 30%, an increase of two percentage points from 28%; and
b) The non-resident personal income tax rate will also be increased to 30%.

### Extension of tax incentive for women returning to work after a career break

The (Income Tax (Exemption) (No. 9) Order 2019) (Amendment) Order 2020 gazetted on 30 January 2020, extends the income tax exemption on employment income for women returning to work after a career break, by a period of four years. The incentive will now apply to applications received by Talent Corporation Malaysia Berhad (TalentCorp) between 1 January 2019 and 31 December 2023, and the incentive is available from YA 2018 to YA 2024.

### Public Ruling No. 5/2019 – Perquisites from Employment

Public Ruling (PR) No. 5/2019: Perquisites from Employment, dated 19 November 2019, replaces PR No. 2/2013, which was published on 28 February 2013.

### Public Ruling No. 6/2019 – Tax Treatment on Expenditure for Repairs and Renewals of Assets

PR No. 6/2019: Tax Treatment on Expenditure for Repairs and Renewals of Assets, dated 26 November 2019, explains the tax treatment of expenditure for the repair and renewal of an asset.

### Public Ruling No. 7/2019 – Taxation of Foreign Fund Management Company

PR No. 7/2019: Taxation of Foreign Fund Management Company, dated 3 December 2019, replaces PR No. 6/2014, which was published on 4 September 2014. Similar to the earlier PR, the new PR explains the tax treatment of income received by a foreign fund management company that provides fund management services to foreign and local investors. The PR is, however, not applicable to a foreign fund management company that issues, offers or makes an invitation to subscribe or purchase units in conventional unit trust funds.

### Public Ruling No. 8/2019 – Notification of Change of Accounting Period by a Company / Limited Liability Partnership / Trust Body / Co-operative Society

PR No. 8/2019: Notification of Change of Accounting Period by a Company / Limited Liability Partnership / Trust Body / Co-operative Society, dated 6 December 2019, replaces PR No. 7/2011, which was published on 23 August 2011.

### Public Ruling No. 9/2019 – Residence Status of Companies and Bodies of Persons

PR No. 9/2019: Residence Status of Companies and Bodies of Persons, dated 6 December 2019, replaces PR No. 5/2011, which was published on 16 May 2011.

### Public Ruling No. 10/2019 – Withholding Tax (WHT) on Special Classes of Income

PR No. 10/2019: WHT on Special Classes of Income, dated 10 December 2019, replaces PR No. 11/2018, which was published on 5 December 2018.

### Public Ruling No. 11/2019 – Benefits in Kind (BIK)

PR No. 11/2019: BIK, dated 12 December 2019, replaces PR No. 3/2013, which was published on 15 March 2013.

### Public Ruling No. 12/2019 – Tax Treatment of Foreign Exchange Gains and Losses

PR No. 12/2019: Tax Treatment of Foreign Exchange Gains and Losses, dated 13 December 2019, explains the tax treatment of foreign exchange gains and losses recognised by businesses in Malaysia, arising from cross-border transactions denominated in foreign currency.

### 2019 tax audit frameworks (including for Petroleum Income Tax and Transfer Pricing)

The IRBM has issued on its website the following updated audit frameworks in Bahasa Malaysia:

a) Tax Audit Framework, titled "Rangka Kerja Audit Cukai" (replacing the framework dated 1 April 2018)
b) Petroleum Audit Framework,

titled "Rangka Kerja Audit Cukai Petroleum" (replacing the framework dated 1 April 2013)

c) Transfer Pricing Audit Framework Note, titled "Rangka Kerja Audit Harga Pindahan" (replacing the framework dated 1 April 2013)

All the updated tax audit frameworks take effect from 15 December 2019.

### 2020 Tax Investigation Framework

The IRBM has issued an updated Tax Investigation Framework (TIF), dated 1 January 2020. The updated TIF replaces the previous TIF that was effective 15 May 2018.

The contents of the new TIF are broadly similar to those of the earlier framework; it outlines the IRBM's procedures and practices in conducting tax investigations, as well as the rights and responsibilities of the IRBM, the taxpayer and the tax agent in a tax investigation situation.

### Revision to limitation of tax deductions on payments to Labuan companies

Section 39(1)(r) of the ITA provides that a tax deduction will not be allowed on payments by Malaysian residents to any Labuan company, subject to the Income Tax (Deductions Not Allowed for Payment Made to Labuan Company by Resident) Rules 2018 [P.U.(A) 375] gazetted on 31 December 2018.

The Labuan Financial Services Authority (LFSA) has recently issued a circular setting out revisions to the Rules, as approved by the MoF, dated 23 December 2019 (pending the release of gazetted regulations on amendments to P.U.(A) 375/2018). The changes as outlined are effective 1 January 2019.

### 2020 income tax return filing programme issued

The IRBM has made available on its website the 2020 income tax return filing programme (2020 filing programme) titled "Return Form (RF) Filing Programme For The Year 2020". The 2020 filing programme is broadly similar to the position laid out in the 2019 filing programme.

The key change to note is that the 2020 filing programme stipulates that the C.P.8D [i.e. Statement of Remuneration from Employment for the Year ending 31 December 2019 and Particulars of Tax Deduction under the Income Tax Rules (Deduction from Remuneration) 1994] must be submitted via the following methods:

a) Together with the Form e-E (e-Filing) [upload txt file format / C.P.8D e-Filing format]

b) Via e-Data Praisi [upload txt file format on or before 25 February 2020]

c) Compact disc (CD) / USB drive / external hard disk [txt file format or Microsoft Excel]

As such, the submission of C.P.8D by non-company employers together with the paper Form E (as provided under the 2019 Filing Programme) will no longer be accepted.

### Guidelines and procedures for application to the Industry4WRD Readiness Assessment Intervention Programme (Industry4WRD Intervention Fund)

The Malaysian Investment Development Authority (MIDA) has recently issued guidelines and procedures for application to the Industry4WRD Readiness Assessment Intervention Programme (Industry4WRD Intervention Fund). The Fund is a financial support facility for Malaysian Small Medium Enterprises (SMEs) in the manufacturing and related services sectors that have completed the government-funded Industry4WRD Readiness Assessment (RA) programme, to implement intervention projects based on the recommendation of the Industry4WRD RA Report.

The guidelines explain the application procedure, the documents which are to be furnished in support of the application, criteria for evaluation by MIDA, project duration, scope and quantum of funding, notification of

the results, the effective date of the application, as well as the right of the government to withdraw the grant if the applicant fails to execute the intervention project as approved.

## Guidelines on MSC Malaysia Financial Incentives

The Malaysia Digital Economy Corporation Sdn Bhd (MDEC) has recently published on its website the following Guidelines to outline the requirements under the new regime and the grandfathering rules to transition into the new regime:

- Guidelines on MSC Malaysia Financial Incentives (Grandfathering and Transition under Services Incentive)
  The Guidelines explain the:

a) Grandfathering timeline applicable to existing MSC Malaysia Status companies with income tax exemption on non-IP / services income; and

b) Transition of these companies from the existing regime to the new regime in order to enjoy the income tax exemption in respect of non-IP / services income for the remaining exemption period

- Guidelines on MSC Malaysia Financial Incentives (Services Incentive – Income Tax Exemption)
  The new Guidelines outline the eligibility criteria, scope of income tax exemption and relevant conditions, the mechanism of the incentive, the commencement date of the exemption period, the application process for the extension of the exemption period, the application process to add a new promoted activity, and the compliance requirements.

Both Guidelines are effective 1 January 2019.

## LABUAN


## Labuan Investment Committee (LIC) Pronouncement 2-2019

The Labuan Investment Committee (LIC) was established to recommend policies on substantial activity requirements in Labuan and monitor the enforcement of such requirements. The LIC comprises representatives from the Ministry of Finance, Labuan Financial Services Authority and the IRB.

The LIC held meetings recently to further deliberate on various implementation issues arising from the new Labuan tax regime, including proposals that were presented by the Association of Labuan Banks, Labuan Investment Banks Group, Labuan International Insurance Association and Association of Labuan Trust Companies. Some of the important decisions from the Pronouncement 2-2019 (dated 11 December 2019) are as follows:

- Revision to the Labuan substantial activity requirements
  - The substantial activity requirements relating to first-party captives, (re) insurers/ (re)takaful operators, insurance brokers, groups of leasing companies will be moderated.
  - The list of Labuan entities that will be subjected to the substantial activity requirements will be expanded/clarified, for example, entities that undertake pure equity holding.
- Audit requirement for Labuan entities that are dormant, struck-off, winding-up or under liquidation
  Pronouncement 1-2019 indicated that such entities which are not deriving any source of income are not required to comply with the substantial activity requirements. Pronouncement 2-2019 clarifies that such entities will also be exempted from audit requirements for the purpose of fulfilling their obligations under

the LBATA.

- Labuan entities undergoing run-off process (run-off entities)
  Run-off entities are required to comply with substantial activity requirements.
- Non-compliance to substantial activity requirements
- As proposed in the Labuan Business Activity Tax (Amendment) Bill 2019, a Labuan entity carrying on a Labuan business activity and which fails to meet the relevant substance requirements will be subject to tax under the LBATA. Such Labuan entity will be taxed at 24% of its chargeable profits.

On 20 December 2019, further clarification was provided to include an updated list of substantial activity requirements as approved by the Minister of Finance (MoF). The changes to the minimum requirements for full-time employees (FTE) and annual operating expenditure (OPEX) are as outlined in Appendix I and these updated requirements are effective 1 January 2019. These changes will be gazetted in due course.

On 21 January 2020, another further clarification was released to update the minimum requirements for FTE and OPEX for Labuan entities that carry out administrative, accounting and legal services, including backroom processing, payroll services, talent management, agency services, insolvency-related services and management services.

## STAMP DUTY

### Stamp duty exemption on rent-to-own (RTO) scheme

The Stamp Duty (Exemption) (No. 4) Order 2019 [P.U.(A) 394], gazetted on 31 December 2019, provides a stamp duty exemption on qualifying instruments for the transfer of the first residential property which is valued at RM500,000 or less.

This Order will only apply if:

a) The sale and purchase agreement (SPA) between the developer and the financial institution (FI) for the purchase of the residential property is executed between 1 January 2020 and 31 December 2022, and is stamped at any branch of the IRBM;
b) The RTO agreement between the individual and the FI for the rental of the residential property is executed between 1 January 2020 and 31 December 2022;
c) The SPA between the FI and the individual for the purchase of the residential property is stamped at any branch of the IRBM;
d) The value of the residential property shall be based on the purchase price in the SPA between the developer and the FI; and
e) The individual has never

owned any residential property, including a residential property obtained by way of inheritance or gift, which is held either individually or jointly.

For the purpose of point (b) above:

- The period of rental under the RTO agreement must not exceed five years; and
- The tenant may opt to purchase the residential property after a rental period of one year.

The application for the exemption will have to be accompanied by a declaration by the individual confirming point (e) above.

The Order is effective 1 January 2020.

### Stamp duty remission for transfer of property by way of love and affection

The Stamp Duty (Remission) (No. 2) Order 2019 [P.U.(A) 369] gazetted on 26 December 2019, provides for stamp duty remission of 50% on the instrument of real property transferred between parents and children by way of love and affection to be given to Malaysian citizens only (previously Malaysian citizens and non-citizens were eligible). With this, the Stamp Duty (Remission) (No. 7) Order 2002 [P.U.(A) 434] is revoked.

The Order is effective 1 January 2020.

### Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) Order 2020

The Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) Order 2020 [P.U.(A) 24] was gazetted on 21 January 2020. The Order provides that any tax payable under the ITA and any stamp duty payable under the Stamp Act 1949 in relation to the following, shall be remitted in full:

a) Islamic Medium Term Notes issued by Prasarana Malaysia Berhad (formerly known as Syarikat Prasarana Negara Berhad) pursuant to the Islamic Medium Term Notes Programme in nominal values of up to RM3.5 billion; and
b) Guarantee provided or to be provided by the government of Malaysia in relation to the Islamic Medium Term Notes referred to in (a) above

The Order comes into operation on 23 January 2020.

## CUSTOMS DUTIES

### Customs Duties (Exemption) (Amendment) (No. 3) Order 2019

The Customs Duties (Exemption) (Amendment) (No. 3) Order 2019 [P.U.(A) 396] was gazetted on 31 December 2019. This Order provides for amendments in relation to Item 67, paragraphs (viii) and (ix) of column (2) of the Customs Duties (Exemption) Order 2017 [P.U.(A) 445/2017].

### Customs Duties (Exemption) (Amendment) (No. 4) Order 2019

The Customs Duties (Exemption) (Amendment) (No. 4) Order 2019 [P.U.(A) 403] was gazetted on 31 December 2019 and came into operation on 1 January 2020. This Order provides for amendments in relation to Items 10, 11 and 115 in Part I of the Schedule under the Customs Duties (Exemption) Order 2017 [P.U.(A) 445/2017].

### Customs Duties (Pangkor) Order 2019

The Customs Duties (Pangkor) Order 2019 [P.U.(A) 413] was gazetted on 31 December 2019 and came into operation on 1 January 2020. Import duties shall be levied on and paid by the importer in respect of motor vehicles imported into Pangkor at the rates specified in column (5) of the First Schedule of the Customs Duties Order 2017 [P.U.(A) 5/2017].

### Customs Duties (Exemption) 2017 (Amendment) Order 2020

The Customs Duties (Exemption) 2017 (Amendment) Order 2020 [P.U.(A) 2] was gazetted on 6

January 2020 and came into operation on 6 January 2020. This Order provides for amendments in relation to column (3) of Item 76 in Part I of the Schedule under the Customs Duties (Exemption) Order 2017 [P.U.(A) 445/2017].

## EXCISE DUTIES

### Excise Duties (Exemption) (Amendment) (No. 4) Order 2019

The Excise Duties (Exemption) (Amendment) (No. 4) Order 2019 [P.U.(A) 404] was gazetted on 31 December 2019 and came into operation on 1 January 2020. This Order provides for the amendments in relation to Items 36 and 37 in Part I of the Schedule under the Excise Duties (Exemption) Order 2017 [P.U.(A) 444/2017].

### Excise Duties (Pangkor) Order 2019

The Excise Duties (Pangkor) Order 2019 [P.U.(A) 412] was gazetted on 31 December 2019 and came into operation on 1 January 2020. This Order provides that excise duties shall be levied on and paid by the importer in respect of motor vehicles imported, or transported from the principal customs area, into Pangkor at the rates specified in column (5) of the Schedule under the Excise Duties Order 2017 [P.U.(A) 92/2017].

### Sales Tax (Rates of Tax) (Amendment) Order 2019

The Sales Tax (Rates of Tax) (Amendment) Order 2019 [P.U.(A) 370] was gazetted on 26 December 2019 and came into operation on 1 January 2020. This Order provides for amendments in the First Schedule of the Sales Tax (Rates of Tax) Order 2018 [P.U.(A) 221/2018].

### Sales Tax (Person Exempted from Payment of Tax) (Amendment) (No. 2) Order 2019

The Sales Tax (Person Exempted from Payment of Tax) (Amendment) (No. 2) Order 2019 [P.U.(A) 371] was gazetted on 26 December 2019 and came into operation on 1 January 2020. This Order provides for amendments to Schedule A in relation to Items 38 and 54 of the Sales Tax (Persons Exempted from Payment of Tax) 2018 [P.U.(A) 210/2018].

### Sales Tax (Amendment) Regulations 2019

The Sales Tax (Amendment) Regulations 2019 [P.U.(A) 390] were gazetted on 31 December 2019 and came into operation on 1 January 2020. These Regulations provide for amendments to Regulations 2, 4, 10, 12, 16A, 16B, 16D, 16E, 17 and the Second Schedule of the Sales Tax Regulations 2018 [P.U. (A) 203/2018].

### Sales Tax (Imposition of Sales Tax in respect of Designated Areas) (Amendment) (No. 2) Order 2019

The Sales Tax (Imposition of Sales Tax in respect of Designated Areas) (Amendment) (No. 2) Order 2019 [P.U.(A) 391] was gazetted on 31 December 2019 and came into operation on 1 January 2020. This Order provides for amendments to Paragraph 2 of the Sales Tax (Imposition of Sales Tax in respect of Designated Areas)

2018 [P.U.(A) 206/2018].

### Sales Tax (Compounding of Offences) (Amendment) Regulations 2019

The Sales Tax (Compounding of Offences) (Amendment) Regulations 2019 [P.U.(A) 392] were gazetted on 31 December 2019 and came into operation on 1 January 2020. These Regulations provide for amendments to Regulations 4, 5, the First Schedule and Second Schedule of the Sales Tax (Compounding of Offences) Regulations 2018 [P.U.(A) 220/2018].

### Sales Tax (Customs Ruling) (Amendment) Regulations 2019

The Sales Tax (Customs Ruling) (Amendment) Regulations 2019 [P.U.(A) 400] were gazetted on 31 December 2019 and came into operation on 1 January 2020. These Regulations provide for amendments to the First, Second and Third Schedules of the Sales Tax (Customs Ruling) Regulations 2018 [P.U. (A) 204/2018].

### Service Tax (Amendment) (No. 2) Regulations 2019

The Service Tax (Amendment) (No. 2) Regulations 2019 [P.U.(A) 357] were gazetted on 23 December 2019 and came into operation on 1 January 2020. These Regulations provide for amendments to paragraph 8, Group G and Group I, First Schedule of Service Tax Regulations 2018 [P.U.(A) 214/2018].

### Service Tax (Persons Exempted from Payment of Tax) (Amendment) Order 2019


The Service Tax (Persons Exempted from Payment of Tax) (Amendment) Order 2019 [P.U.(A) 388] was gazetted on 31 December 2019 and came into operation on 1 January 2020. This Order provides for amendments to Items 1 and 2 in column (4) of the Schedule and the insertion of Items No. 3 and 4 under the Service Tax (Persons Exempted from Payment of Tax) Order 2018 [P.U.(A) 380/2018].

### Service Tax (Digital Services) (Amendment) Regulations 2019

The Service Tax (Digital Services) (Amendment) Regulations 2019 [P.U.(A) 389] were gazetted on 31 December 2019 and came into operation on 1 January 2020. The Regulations provide for amendments to Regulation 7 and the Schedule by substituting the revised DST-01 and DST-02 Forms under the Service Tax (Digital Services) Regulations 2019 [P.U.(A) 269/2019].

### Service Tax (Imposition of Tax for Taxable Service in respect of Designated Areas and Special Areas) (Amendment) (No. 2) Order 2019

The Service Tax (Imposition of Tax for Taxable Service in respect of Designated Areas and Special Areas) (Amendment) (No. 2) Order 2019 [P.U.(A) 393] was gazetted on 31 December 2019 and came into operation on 1 January 2020. This Order provides for amendments to Items 3 and 5 of the Schedule under the Service Tax (Imposition of Tax for Taxable Service in respect of Designated and Special Areas) Order 2018 [P.U.(A) 212/2018].

### Service Tax (Customs Ruling) (Amendment) Regulations 2019

The Service Tax (Customs Ruling) (Amendment) Regulations 2019 [P.U.(A) 406] were gazetted on 31 December 2019 and came into operation on 1 January 2020. These Regulations provide for amendments to the First Schedule under the Service Tax (Customs Ruling) Regulations 2018 [P.U.(A) 211/2018].

*Contributed by **Ernst & Young Tax Consultants Sdn. Bhd**. The information contained in this article is intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgement. On any specific matter, reference should be made to the appropriate advisor.*

## CASE 1

### HS INFORMATION SYSTEMS SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI (SPECIAL COMMISSIONERS OF INCOME TAX, 2020)

*Counsel for the Appellant*
S. SARAVANA KUMAR (TOGETHER WITH HIM, CHEW YING)

*Counsel for the Respondent:*
ABDUL AZIZ HARUN (TOGETHER WITH HIM, FARAH NORDIN)

*prepared by*
NUR AMIRA AZHAR & NURUL IMANI HAMZAH

## INTRODUCTION

1. On 13.3.2020, the Special Commissioners of Income Tax ("SCIT") allowed the taxpayer's appeal against withholding tax amounting to RM279,290.46 imposed by the Director General of Inland Revenue ("Respondent") for years of assessment ("YA") 2011 to 2013.
2. The issue was whether the payment of RM2,539,004.15 made by the Appellant to S Industry Software Pte Ltd ("SIS") in YA 2011 to 2013 is "royalty" under Article 12 of the Malaysia-Singapore Double Taxation Agreement (PU(A) 200/2015) ("DTA").

## BACKGROUND FACTS

3. (a) The Appellant is a company incorporated in Malaysia with a business address in Selangor, Malaysia. The principal activities of the Appellant are that of sales of computer hardware and related products, and provision of information technology consulting services.
   (b) SIS is a company incorporated in Singapore with a registered office in Singapore. SIS was previously known as S Product Lifestyle Management Software (SG) Pte Ltd.
   (c) On 3.3.2011, the Appellant entered into a reseller agreement with SIS for the right to distribute SIS' software ("Software") to customers in Malaysia. Similar reseller agreements were subsequently executed by both parties on 28.11.2011, 1.10.2012 and 1.11.2013 respectively (the reseller agreements will be collectively referred to as "Reseller Agreements").
   (d) Pursuant to the Reseller Agreements:
      (i) The Appellant is appointed as a non-exclusive reseller and distributor of the Software in Malaysia;
      (ii) The Appellant is authorised to resell and distribute the Software to customers in Malaysia;
      (iii) The Appellant shall have no right to use, copy, develop, modify, prepare derivative works or sublicense the Software;
      (iv) The Appellant is expressly prohibited from utilising the software licenses to reverse engineer, decompile, translate, disassemble or otherwise attempt to discover the source code of the Software; and
      (v) The Appellant is required to make payment to SIS for each copy of the Software purchased ("Distribution Fee"). The sum of payment would depend on the volume of sales concluded by the Appellant and the customers in Malaysia.
   (e) By a letter dated 29.7.2015, the Respondent informed the Appellant that the Distribution Fee paid to SIS under the Reseller Agreements falls under the definition of "royalty" and thus, is subject to withholding tax under the ITA. The Respondent raised notices of additional assessment against the Appellant.

## LEGAL POSITION

***DTA prevails over the ITA***

4. It is settled law that in the event of conflict, the definition under Article 12 of the DTA would prevail over the definition under Section 2 of the ITA. Such proposition was reflected in the High Court's decision in *Damco Logistics Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2011] MSTC 30-033*. The facts in the Damco Logistics case (supra) are similar to the facts and issues in the present appeal.
5. The decision in the Damco Logistic case (supra) was applied with approval by the SCIT in *Maersk Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (Rayuan No. PKCP(R) 55/2009)*, *Thomson Reuters Global Resources v Ketua Pengarah Hasil Dalam Negeri (Rayuan No. PKCP(R) 44/2012)* and *TRGM v Ketua Pengarah Hasil Dalam Negeri (2015) MSTC 10-048*. It shall be noted that the decision in the Thomson Reuters case (supra) was affirmed by the High Court and the Court of Appeal.
6. In addition, reference shall also be made to Section 132(1) of the ITA which clearly provides that in the event there is a conflict between the ITA and DTA, the provisions in the DTA shall prevail (see the Federal Court decision in *Director General of Inland Revenue v Euromedical Industries Ltd [1983] CLJ (Rep) 128)*.

***Meaning of royalty under the DTA***

7. Reference was made to the OECD Commentary to determine the construction of the provisions in the DTA as held in *OA Pte Ltd v Ketua Pengarah Hasil Dalam Negeri (1996) MSTC 2,752*.

***No Transfer of Know-How Information or Copyright***

8. The Reseller Agreements established that the Appellant did not obtain the right to freely use, copy, modify or dismantle the Software.

## DECISION

9. The SCIT held that the Distribution Fee in the present appeal should not be subjected to withholding tax as it does not amount to "royalty" under Article 12(4) of the DTA. It is clear from the express wordings in the Reseller Agreements and undisputed that the Distribution Fee is not intended for any know-how information or copyright of the Software from the Respondent. The Respondent had erroneously subjected the Distribution Fee to withholding tax.

***Nur Amira Azhar*** *and* ***Nurul Imani Hamzah*** *are associates with Rosli Dahlan Saravana Partnership*

## CASE 2

### GL V PEMUNGUT DUTI SETEM, MALAYSIA (2019)

*Counsel for the taxpayer:*
JASON LIANG AND KELLIE ALLISON YAP

*Counsel for the IRBM:*
RIDZUAN OTHMAN DAN ZUL-HASYMI MUHAMAD

## INTRODUCTION

In this case, the taxpayer challenged the decision of the Collector of Stamp Duties, Malaysia (Collector) to deny the taxpayer's application for stamp duty exemption under the Exemption Order and issuing notices of assessment for RM6,260,520 in total. The issue litigated in this case concerned the application and interpretation of the Stamp Duty (Exemption) (No. 3) Order 2012 (Exemption Order).

On 22.10.2019, the High Court decided in favour of the taxpayer where the High Court stated that a taxpayer is only required to fulfil one of the conditions under Paragraph 3 of the Exemption Order to qualify for stamp duty exemption, as per the wording of the Exemption Order. This decision corrected the long-standing practice of the Collector in insisting that each and every requirement under the Exemption Order must be met before the Exemption Order is applicable.

This decision is welcomed as it clarifies that taxpayers are entitled to stamp duty exemption as long as a taxpayer can prove that at least one of the requirements under the Exemption Order is satisfied.

## BACKGROUND FACTS

The taxpayer is a company incorporated under the Labuan Companies Act 1990 to carry on a business of holding shares in a trust structure. The taxpayer executed share transfer forms for the transfer of shares in a company incorporated under the Malaysian Companies Act 2016, and submitted them to the Collector for adjudication.

After adjudication, the Collector issued assessments amounting to approximately RM6.2 million. The taxpayer then submitted notices of objection to the Collector pursuant to Section 38A(1) of the Stamp Act 1949, setting out the taxpayer's position that the share transfer forms are exempted from stamp duty by virtue of Paragraph 3(a) of the Exemption Order. Paragraph 3(a) of the Exemption Order provides for stamp duty exemption on instruments executed by a Labuan entity in connection with a Labuan business activity.

The Collector, however, denied the stamp duty exemption on the grounds that the share transfer forms did not satisfy the requirements of Paragraph 3(c) of the Exemption Order. Being aggrieved by the decision of the Collector, the taxpayer appealed to the High Court.

## COLLECTOR'S ARGUMENTS

The Collector argued that all instruments of transfer of shares by a Labuan entity in relation to a Labuan business activity must satisfy Paragraph 3(c) of the Exemption Order, which exempts from stamp duty instruments of transfer of shares in a Labuan entity. Given that the share transfer forms were executed for the transfer of shares in a Malaysian company, they did not qualify for stamp duty exemption under Paragraph 3(c).

## TAXPAYER'S ARGUMENTS

The taxpayer argued that it satisfied all the requirements of paragraph 3(a) of the Exemption Order as:

- it was undisputed that the share transfer forms are instruments executed by a Labuan entity;
- its business activity of holding shares in a Malaysian company on trust falls within the definition of "Labuan trading activity" under the Labuan Business Activity Tax Act 2010; and
- the execution of the share transfer forms was done in connection with its business activity and was necessary for it to carry out its business activity.

## COURT'S DECISION

The High Court held that a taxpayer

has the right to rely on any specific provision within the Exemption Order as long as the requirements for that provision are satisfied. There is nothing in the Exemption Order that requires Paragraph 3(c) to be applied over Paragraph 3(a) to the facts of this case. As such, the High Court allowed the taxpayer's appeal, and ordered the Collector to return the stamp duty paid to the taxpayer.

## CASE 3

### UNIQLO (MALAYSIA) SDN BHD V KETUA PENGARAH KASTAM DAN EKSAIS (2019)

*Counsel for the taxpayer:*

**DATO MOHD ARIEF EMRAN ARIFIN AND KELLIE ALLISON YAP**

*Counsel for the DGCE:*

**FARAH EZLIN YUSOP KHAN AND SYAMIMI FARHANA MUHAMMAD A. AZIZ**

## INTRODUCTION

In this case, the taxpayer sought to challenge the decision of the Director General of Customs and Excise (DGCE) in rejecting its application for a special refund of sales tax totalling RM6,076,369.33 under Section 190 of the Goods and Services Tax Act (GST Act) (which has been repealed) without providing any justification in its decision letter. The High Court however dismissed the taxpayer's judicial review application. On appeal, the main issue before the Court of Appeal was whether the DGCE has the duty to provide reasons for his decision.

On 7.11.2019, the Court of Appeal allowed the taxpayer's appeal against the High Court's decision and ruled that it is an established principle that public decision-makers owe a general duty to provide reasons for their decisions, unless the specific relevant statute expressly provides otherwise.

This decision is crucial as it helps to increase transparency and fairness in public decision-making. Accordingly, taxpayers are protected from arbitrary decision making by tax authorities. Taxpayers should be informed of the reasons behind the adverse decisions against them so that they have the opportunity to correct and clarify issues.

## BACKGROUND FACTS

The DGCE rejected the taxpayer's application for a special refund of sales tax for goods held on hand pursuant to Section 190 of the GST Act (which has been repealed), without providing any reason for his decision in the rejection letter. The taxpayer subsequently filed a judicial review application against the DGCE's decision, which was dismissed by the High Court on the grounds that (i) there is no statutory duty imposed under the GST Act on the DGCE to give reasons for his decision; and (ii) the information given by the taxpayer in relation to the goods it held is inaccurate. The High Court was also influenced by the fact that the DGCE had issued another letter to the taxpayer explaining the reasons for his decision, notwithstanding that the letter was issued only after the filing of the judicial review application. Being aggrieved by the High Court's decision, the taxpayer appealed to the Court of Appeal.

## TAXPAYER'S ARGUMENT

The taxpayer argued that the DGCE has a general duty to provide reasons for his decision at the time of the decision. The taxpayer relied on the Federal Court's decision in *Kesatuan Pekerja-Pekerja Bukan Eksekutif Maybank Bhd v Kesatuan Kebangsaan Pekerja-Pekerja Bank & Anor [2018] 2 MLJ 590,* which affirmed the principle that in the absence of any statutory provision requiring a public decision-maker to give reasons, the decision-maker still owes a duty to provide reasons for its decision unless the statute expressly provides that no reason needs to be given. The DGCE could not discharge his duty to give reasons by issuing the second letter after the filing of the judicial review application.

As subsequently explained by the DGCE, the taxpayer's application for special refund was rejected primarily because the audit showed an alleged discrepancy in the number of the goods held on hand by the taxpayer. In this regard, the taxpayer explained that the audit was conducted by the DGCE more than six (6) months after the effective date. Further, the audit was undertaken by the DGCE when the taxpayer's stores were open. Therefore, the audit did not take into account goods sold, stolen, or transferred after the effective date.

## COURT'S DECISION

The Court of Appeal unanimously allowed the taxpayer's appeal, holding that the DGCE had acted unfairly and unreasonably in not giving reasons for rejecting the taxpayer's application for special refund.

## CASE 4

### LAYAR BAIDURI SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI (2019)

***Counsel for the taxpayer:***
**DP NABAN AND CHRIS TOH**

***Counsel for the DGIR:***
**NORHISHAM AHMAD, ALTUNNIDOLLAH IDRUS AND AINA ABDULLAH**

## INTRODUCTION

In this case, the taxpayer applied to the court for an order to stay the impugned decision of the Director General of Inland Revenue (DGIR) and the enforcement of recovery of tax, pending the final determination of its appeal to the Special Commissioners of Income Tax (SCIT). The DGIR's impugned decision consists of (i) a notification of non-chargeability for the year of assessment 2014; (ii) the notice of assessment for the year of assessment 2015; and (iii) the notice of additional assessment for the year of assessment 2016. The issue before the High Court concerned whether or not the Court should exercise its inherent power to grant the stay sought by the taxpayer.

On 4.7.2019, the High Court rejected the taxpayer's claim, holding that the High Court cannot exercise its inherent power under Order 92 rule 4 of the Rules of Court 2012 (ROC) to override substantive law, particularly the substantive provisions of the Income Tax Act 1967 (ITA).

What this means is that the High Court will not exercise its inherent power under Order 92 Rule 4, to stay the payment of taxes pending a taxpayer's appeal before the SCIT. Thus, if a taxpayer has failed to make the payment for outstanding taxes within the stipulated time frame, the DGIR may take actions to recover such taxes, notwithstanding whether an appeal is filed with the SCIT or not.

## BACKGROUND FACTS

Being aggrieved by the DGIR's impugned decision, the taxpayer had filed an appeal to the SCIT against the decision. The taxpayer thereafter moved the High Court to invoke its inherent power under Order 92 rule 4 of the Rules of Court 2012 to grant, amongst others, orders to (i) stay the DGIR's decision,

and (ii) stay the enforcement of recovery of tax, pending the final determination of its appeal to the SCIT.

## TAXPAYER'S ARGUMENTS

The taxpayer argued that the court has inherent power under Order 92 rule 4 of the ROC to grant the stay and that it has shown special circumstances justifying the grant of the stay. The taxpayer contended that it will suffer irreparable damage and be irremediably injured as the large amount of tax imposed on it would result in financial crisis and operational disruptions to its business and consequently damage to its reputation.

## DGIR'S ARGUMENTS

The DGIR argued that (i) an order of stay would be contrary to the provisions of the ITA which expressly provide for the recovery of tax in the event of non-payment by a taxpayer, and (ii) the court cannot invoke its inherent power to defeat substantive provisions enacted by the Parliament. Order 92 rule 4 being part of procedural law cannot be read to override substantive law; the stay sought would override substantive provisions of the ITA triggered by the non-payment of tax by the taxpayer.

## COURT'S DECISION

The High Court agreed with the DGIR's arguments. Given that there was an appeal by the taxpayer to the SCIT against the DGIR's decision, the High Court was not deciding on the validity of the DGIR's decision and the question of invoking its inherent power to order a stay of the decision did not arise.

Further, the government through its agent, the DGIR, cannot be restrained from exercising its power to recover tax by an injunction interim by virtue of the Government Proceedings Act 1956. The High Court observed that tax is collected and used for public benefit. Given that an injunction would cause a disruption in the recovery of taxes, it would not be in the public interest.

The High Court also held that the hardship arising from the inability to pay as advanced by the taxpayer does not amount to special circumstances justifying the grant of a stay as the hardship is nothing unusual. Special circumstances must be special and go to the execution of an order.

***Adeline Wong, Jason Liang*** *and* ***Kellie Allison Yap*** *are associates with Wong & Partners.*

# QUALIFYING EXPENDITURE (PART II)

Siva Subramanian Nair

This article continues and completes the discussion on what is qualifying expenditure (QE).

## VEHICLES

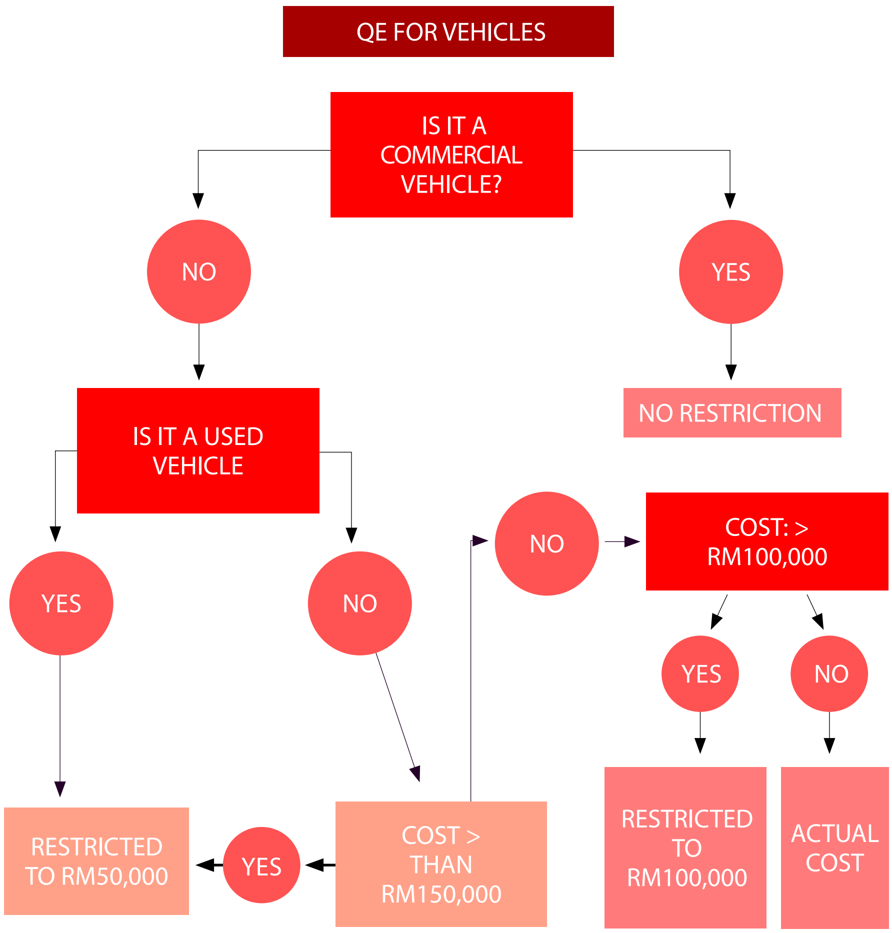
The rules relating to QE for vehicles is contained in paragraph 2(2) Schedule 3

Firstly we need to differentiate as to whether the vehicle is a commercial vehicle i.e. licensed for commercial transportation of goods or passengers or a non-commercial vehicle. This is because the former has no restrictions in determining its QE but latter has certain specific restrictions quite similar to the ones we saw when discussing the deduction for lease rentals in *Tax Guardian Vol.12/No.1/2019/Q1*.

Basically for used non-commercial vehicles, the cumulative maximum claim for QE is RM50,000. However for new vehicles, the restriction is tabulated below:

| Cost of the vehicle (RM) | ≤ 100,000 | > 100,000 to ≤ 150.000 | > 150,000 |
|---|---|---|---|
| QE | Actual cost | RM100,000 | RM50,000 |

**Diagrammatically this can be represented as:**




Public Ruling 6/2015 clearly defines QE for a vehicle to include

- the cash price of the vehicle
- basic accessories i.e. accessories offered by all motor vehicle dealers
- registration fee which is required by the Road Transport Department.

It specifically excludes:

- road tax, insurance and hire purchase interest which are allowable expenditures in ascertaining the adjusted income from that business source
- reserve price for vehicle registration number including number tendered and service fee as they are private expenses
- Optional accessories i.e. those offered only by some dealers

Paragraph 2D of Schedule 3 provides that "…the capital expenditure incurred by a person on the provision of machinery or plant shall not include any amount paid to a non-resident person in consideration of services rendered in connection with the installation or operation of that machinery or plant, if tax has not been deducted therefrom and paid to the Director General under paragraph 109B(1)(a) of the Act … [BUT can be claimed once]… the person has paid the amount referred to in subsection 109B(2).

Basically, if the payment for the installation or operation of the plant or machinery entails the necessity to withhold tax i.e. it is paid to a non-resident, then this payment will only be included as QE once the withholding tax and penalties (if any) are settled. This is similar to the disallowance of revenue expenditure which entails a withholding of tax under Section 39(1).

Another rule for candidates to remember is Paragraph 55 of Schedule 3 which states that "*…any expenditure incurred on the provision of machinery or plant for the purposes of a business the day on which that expenditure is incurred is the day on which the machinery or plant is capable of being used for the purposes of the business*".

**Example 1: ABC S/B (year-end 30 September) wanted to buy a machine and the series of events culminating in the acquisition of the machine was as follows:**

ABC S/B is deemed to have incurred

| Ordered and paid RM 100,000 for the machine | 29 September 2018 |
|---|---|
| Machine arrived at Port Klang | 24 August 2019 |
| Machine was installed at the factory of ABC S/B | 10 October 2019 |

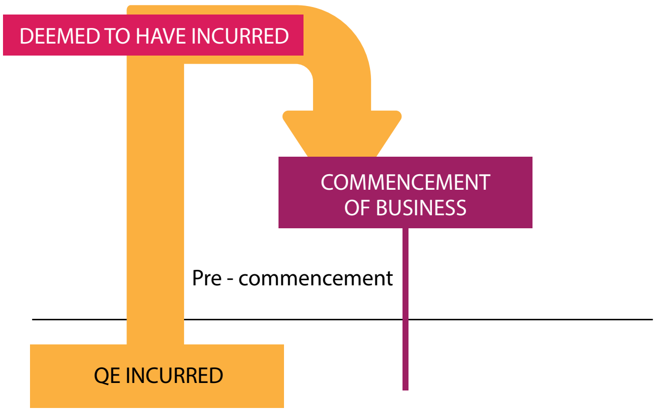
the QE on the machine on 10 October 2020 i.e. in year of assessment 2021

The Paragraph continues to state that "*…where a person incurs expenditure for the purposes of a business of his which he is about to carry on, that expenditure shall be deemed to be incurred when he commences to carry on the business.*".

Although the full QE will ultimately be claimed (assuming the asset is not disposal before that), but there is a loss sustained by the owner in terms of time value of money. For example when a heavy machinery is purchased in 2020 the cost of the asset (QE) will be recovered over four years i.e. by 2023 but if the company only commences business in 2022, then the full claim of the QE will only be achieved in 2025.

The Income Tax Act 1967 also provides for the determination of QE in specific circumstances in Schedule 3 Paragraph 2A

**This is illustrated below**




"… where any person had in use machinery or plant for a non-business purpose, and that machinery or plant is subsequently brought into use for the purposes of a business of his, he is deemed to have incurred qualifying plant expenditure in relation to that machinery or plant and the amount of the qualifying plant expenditure shall be taken to be the market value of the machinery or plant on the day the machinery or plant was so brought into use."

and again in Schedule 3 Paragraph 2C

"… where machinery or plant is brought into use for the purposes of a business in Malaysia by any person and prior thereto the machinery or plant had been used for the purposes of a business outside Malaysia, the person shall be deemed to have incurred qualifying plant expenditure and the amount of the qualifying plant expenditure in respect thereof shall be taken to be the market value or the net book value of the machinery or plant, whichever is the lower, on the day the machinery or plant was so brought into use in Malaysia."

**These rules are summarised in the following table.**

| Circumstance | QE of the asset |
|---|---|
| Asset previously used for non-business purposes is now brought into business | Market value when brought into business |
| Asset brought into Malaysia from outside Malaysia | Lower of market value or net book value |

**Example 2**. Jeffery is employed as a lecturer in a college. He uses a laptop to facilitate his lecturing. He terminated his employment with the college in 2019 and on 1 January 2020 he decided to take up freelance lecturing at various colleges. Since his source of income has now changed from employment to business, he can claim capital allowances on his laptop. The QE on which he can claim the capital allowances is the market value of the laptop on 1 January 2020.

**Example 3**. DEF S/B transferred a computer from its branch office in Singapore to its head office in Kuala Lumpur on 1 January 2020. The market value and the net book value of the computer on that date were RM3,500 and RM3,200 respectively. The QE of the computer for the purposes of claiming capital allowances in Malaysia is RM3,200

Aside from the above QE also includes capital expenditure incurred on fish ponds, animal pens, chicken houses, cages, buildings (other than those used wholly or partly for the living accommodation of a director, an individual having control of that business or an individual who is a member of the management, administrative or clerical staff engaged in the business), and other structural improvements on land which are used for the purposes of poultry farms, animal farms, inland fishing industry or other agricultural or pastoral pursuits.

This concludes our discussion of the various facets of qualifying expenditure.

All the best to the candidates attempting the June 2020 examinations & God bless!

***Siva Subramanian Nair** is a freelance lecturer. He can be contacted at sivasubramaniannair@gmail.com*

***FURTHER READING***

*Choong, K.F. Malaysian Taxation - Principles and Practice, Infoworld,*
*Kasipillai, J. A Guide to Malaysian Taxation, McGraw Hill.*
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# COVID-19

The Institute encourages members to follow all the guidelines issued by the Ministry of Health pertaining to COVID-19.

Stay healthy and safe.

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