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PREMIER TAX EVENT OF THE YEAR
NATIONAL TAX CONFERENCE
2018

16 & 17 JULY 2018 | MONDAY & TUESDAY
KUALA LUMPUR CONVENTION CENTRE

DAY 2 : 17 JULY 2018

TOPIC : Earnings Stripping Rules

Speaker : Theresa Goh
Executive Director/ National TP Leader
Deloitte

Draft ESR rules in Malaysia*

Effective date

- Financial years starting on or after 1 January 2019

De minimis rule

- RM 500K

Fixed ratio

- 20 percent of tax EBITDA

Interest expense


- Interest on all forms of debts
- Payment economically equivalent to interest
- Exclude expenses incurred in connection with raising of finance

Exemption


- Licensed / Islamic bank

*Source – Malaysian Tax Conference 2018


De minimis threshold

- Main policy goal is to address BEPS using interest. Purpose of de minimis threshold is to exclude entities which pose low BEPS risk
 - Proposed threshold: RM500,000
 - Suggestion: increase proposed threshold to RM1m
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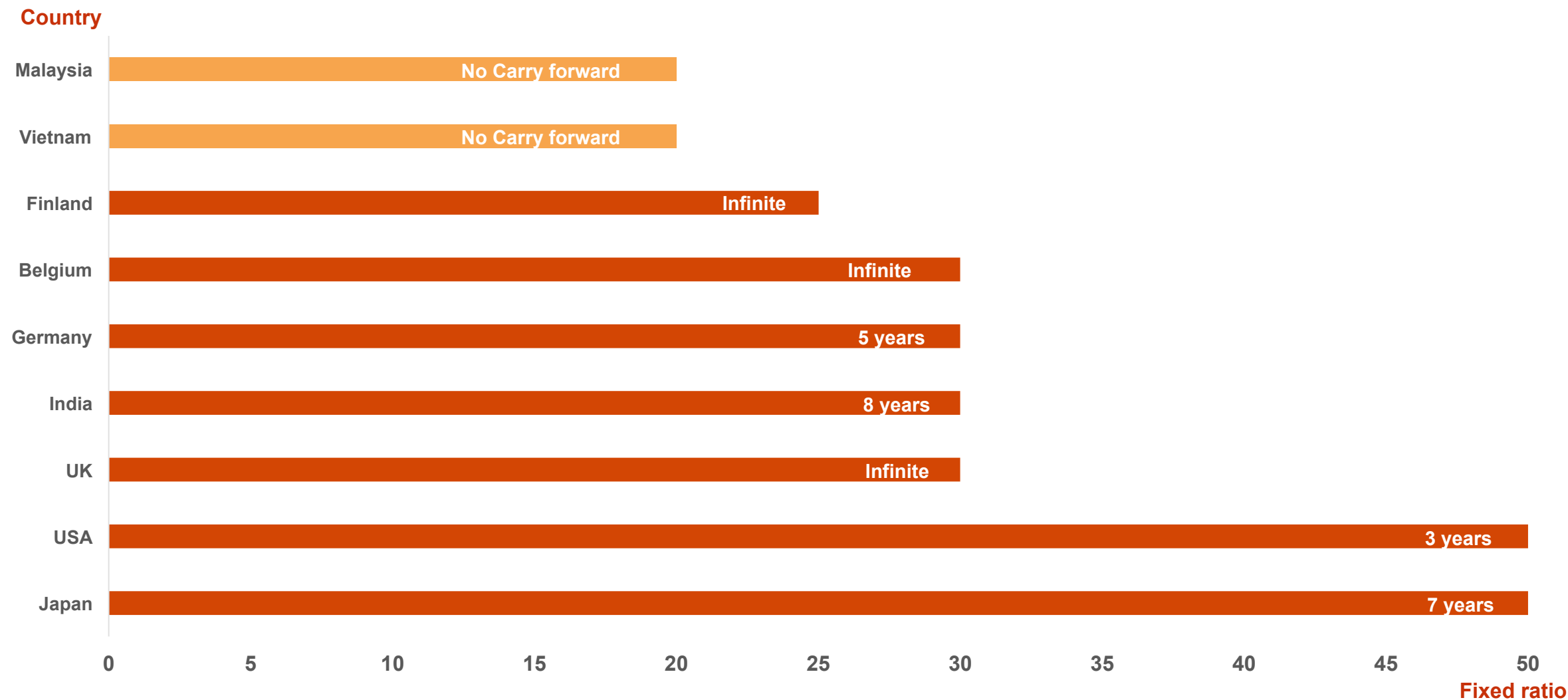
Fixed ratio rule

- Limit's an entity's net deductions for interest / payments economically equivalent to interest
 - Fixed ratio is equivalent to a percentage of the entity's EBITDA
 - Recommends a corridor of fixed ratios of between 10% and 30%
 - Suggestions : increase fixed ratio from 20% to 30%
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Carry forward of disallowed interest/ unused interest capacity

- Carry forward of disallowed interest expense (where actual net interest is **above** maximum permitted)
 - Carry forward of unused interest capacity (where actual net interest is **below** maximum permitted)
 - **Suggestion : allow carry forward of disallowed interest and unused capacity for use in future years**
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ESR – Fixed ratio and carry forward – Key Jurisdictions



Group ratio rule

- *Recommended approach proposes a group ratio rule alongside the fixed ratio rule*
 - *A country may decide to apply a fixed ratio rule in isolation. Where it does not apply a group ratio rule, it should apply the fixed ratio rule consistently to entities in multinational and domestic groups, without improper discrimination*
 - Countries allowing group ratio: UK, Netherlands
 - Suggestion: introduce group ratio rule in order to exempt domestic intra-group interest payments
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“Equity escape” rule


- Alternative to earnings-based group ratio
 - Compares entity's level of equity and assets to those held by its group (equity/total assets)
 - Countries with this rule : Germany and Finland
 - Suggestion : include “equity escape” rule in order to exempt domestic intra-group interest payments
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Illustration of rules

Fixed Ratio Rule	
ABC Sdn Bhd	
Net Interest expense (A)	150
Tax EBITDA (B)	500
Fixed ratio of ABC Sdn Bhd (A/B)	30%
Fixed ratio allowed	20%
Interest allowed (20%xB)=C	100
Disallowed interest (A-C)	50

Group Ratio (earnings)	
ABC Group	
Net interest expense (A)	1,000
Accounting EBITDA (B)	4,000
Group ratio (A/B)	25%
ABC Sdn Bhd	
Net interest expense	150
Allowable interest based on group ratio (25% of 500)	125
	25
Disallowed interest	Higher group ratio is allowed

Group ratio (Equity escape)	
ABC Group	
Equity (A)	100,000
Total assets (B)	250,000
Group equity/ total assets (A/B)	40%
ABC Sdn Bhd	
Equity (A)	10,000
Total assets (B)	20,000
Equity/ total assets (A/B)	50%
	0
Disallowed interest	Equity/asset ratio of group is higher than that of ABC Sdn Bhd

Grandfathering / transition

Countries	Year to implement	Transition Year	Transition period
Belgium	31/12/2018	31/12/2023	5
Czech Republic	31/12/2018	31/12/2023	5
Denmark	31/12/2018	31/12/2023	5
Finland	31/12/2018	31/12/2023	5
France	31/12/2018	31/12/2023	5
Germany	31/12/2018	31/12/2023	5
Hungary	31/12/2018	31/12/2023	5
Italy	31/12/2018	31/12/2023	5
Japan	01/04/2012	01/04/2013	1
United kingdom	31/12/2018	31/12/2023	5
Malaysia	01/01/2019	?	?

Payments economically equivalent to interest

Profit participating
loans

Zero coupon bonds

Convertible bonds

Islamic finance

Finance lease

Capitalized
interest /
amortization

Funding return
under TP rules

Guarantee fees

Arrangement /
similar fees

Derivative
instruments

Forex gains and
losses on
borrowings

Operating lease
payment

Accrued interest on
defined benefit
pension plan


Payment equivalent to interest

Payment not equivalent to interest


Definition of control

Section 139 ITA	OECD
<p><i>Section 139(1) A person shall be taken to have control of a company –</i></p> <p><i>(a) Exercises or is able to exercise or is entitled to acquire control (whether direct or indirect) over the company's affairs and in particular...if he possesses or is entitled to acquire the greater part of the share capital or voting power in the company</i></p> <p><i>(b) if he possesses or is entitled to acquire ...</i></p> <p><i>(iii) such redeemable share capital as would entitle him to receive on its redemption the greater part of the assets which, in the event of winding up, would be available for distribution among members</i></p> <p><i>(c) In the event of a winding up he would be entitled to the greater part of the assets available for distribution among members</i></p> <p>Section 139(5)</p> <p><i>For the purposes of subsection (1)(b)(iii) and (c), any person who is a loan creditor of a company (otherwise than in respect of any loan capital or debt issuedin the ordinary course of a business of banking carried on by him) may be treated as a member, and the references to share capital may be treated as including loan capital</i></p>	<p>Para 45</p> <p><i>An entity is part of a group if the entity is directly or indirectly controlled by a company, or the entity is a company which directly or indirectly controls one or more other entities</i></p> <p>Para 46</p> <p><i>Where a country applies a group ratio rule alongside the fixed ratio rule,.....the country may instead determine that an entity is part of a group where (i) the entity is included on a line-by-line basis in the consolidated financial statements of any company.....</i></p>

Interaction with other provisions of ITA, 1967

- Interest disallowance [Section 33(1), (2),(4)]
 - Withholding tax on interest payments (Section 109)
 - Arm's length tests (Section 140A)
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Our asks

1. Increase threshold to RM1m
 2. Increase fixed ratio to 30%
 3. Allow carry forward of disallowed interest expense/unused interest capacity
 4. Allow group ratio
 5. Allow grandfathering
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Thank You