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Global Tax Deal: Where Does Malaysia Stand?

The plan is on: a minimum tax regime aimed at levelling the playing field so that Big Tech companies and multinationals pay more taxes.¹

Many of the largest economies have been on the back foot to tax the digital economy and COVID-19 has certainly aggravated matters. As one of my partners in the firm said recently, “*If there is a winner out of this pandemic, it is technology and Big Tech.*” This is absolutely true on many fronts, considering how the pandemic has accelerated the digitalization of the economy but tax authorities could not capitalise on it. As tax authorities continue to lick their wounds in search of unprecedented intervention, Big Tech giants are reported to have paid effective tax rates of 10% to 15% over the past year.

In comes the global tax deal, as the G7 economies seek to overhaul the international tax landscape by implementing a global minimum tax deal founded on two pillars.

Pillar One: Nexus and profit allocation rules

There are three primary components in Pillar One:

- i. Amount A: Allocation of a portion of a multinational's deemed residual profits and awarding of taxing rights of these profits to the market jurisdictions.
- ii. Amount B: Fixed return for certain marketing and distribution activities to be consistent with the arm's length principle.
- iii. Tax certainty: Mandatory dispute prevention and resolution for Amount A and approaches to enhance dispute prevention and resolution.

In this plan, multinationals will be made to pay taxes in the countries where they operate, not merely where they have their

¹ G7 UK, “G7 Finance Minister Agree Historic Global Tax Agreement” (2021)
<https://www.g7uk.org/g7-finance-ministers-agree-historic-global-tax-agreement/>

headquarters located. In other words, these multinationals will need to reallocate a share of their global residual profits to the countries where their customers are based, and those countries are awarded taxing rights of at least 20% of profits exceeding a 10% margin. This is regardless of whether the multinationals have physical presence in those countries. Further and, as part of the deal, the G7 also resolved to remove their respective digital services tax.

Pillar Two: Global minimum tax

The G7 also committed to a global minimum taxation rate of at least 15% determined on a country-by-country basis. This means that all participating countries would ensure that businesses with headquarters in their jurisdictions pay at least 15% corporate taxes on all domestic profits and pay a top-up tax on profits of their foreign subsidiaries taxed locally at less than 15%.

The top-up tax could be imposed by either the jurisdiction in which the parent company of an entity is located or by a jurisdiction from which deductible payments are made. It is also important to note that companies with affiliates located in low-tax jurisdictions that do not participate in Pillar Two would lose the benefit of that low tax. This is because they will have to pay the top-up tax in their home countries, which would in effect remove the advantage of shifting profits to those low-tax jurisdictions.

Is the global tax deal binding on Malaysia?

As presently constructed, the global tax deal is not legally binding on other countries as it is only an agreement reached among the G7 countries. Thus, it does not have any legal effect on Malaysia at the moment. The deal will have to be negotiated and approved more broadly at the OECD level, where Malaysia is a Member State.

In the event that an agreement is struck at the OECD level, Malaysia will then need to ratify and accede to such an agreement by enacting her own domestic legislation. The entire process could take years and it is still a long road ahead before it becomes legally binding on Malaysia.

Impact on Malaysia and other countries in the region

The broader implications remain to be seen but Asian countries with low tax rates or those that have been handing out tax incentives generously — which in turn resulted in lower effective tax rates — could be affected. A global minimum tax rate will mitigate the tax advantage that these countries have thrived on over the years. Singapore immediately comes to mind, while Malaysia, having handed various forms of tax incentives to inbound investors and multinationals over the years, could lose her competitive edge from a tax angle.

However, all is not lost for us. A multinational does not invest in a particular jurisdiction purely based on a tax advantage. Blessed with an abundance in natural resources, a strategic geographical location and a diverse economy and culture, Malaysia can be pitted against the best of Asia. But we desperately need to pair such great fundamentals with a stable political environment, sound economic policies and good governance to attract investments. A skilled workforce and low cost of living are equally crucial for us to withstand the imminent changes to international taxes.

Concluding remarks

Sweeping changes to the international tax landscape are imminent as countries look to clamp down on Big Tech companies and low-tax jurisdictions. It is now time for Malaysia to move away from our past reliance on tax incentives to bring in investments. We need to adapt immediately and restructure our investment policies before the tax reforms come to fruition.

Jason Tan Jia Xin and **Ong Lee Min** (Pupil-in-chambers)

If you have any queries pertaining to the possible implications of the G7 tax deal on your entities, please contact Tax, SST & Customs partners, [Dato' Nitin Nadkarni](#) and [Jason Tan Jia Xin](#), at tax@lh-ag.com

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