

Tax e-Alert

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Impact of BEPS 5 On MSC Companies in Malaysia

On 17.8.2018, the Ministry of Finance (**MoF**) announced its commitment to implementing the Base Erosion and Profit Shifting (BEPS) Action 5, i.e. “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance”, introduced by the Organisation of Economic Cooperation and Economic Development (OECD).

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What is BEPS Action 5?

This action plan identifies no or low preferential corporate tax rate (preferential regimes) that can be categorised as harmful tax practices. It focuses on improving transparency through the exchange of information on tax matters and requirement of substantial activities for any preferential regimes.

In this regard, tax incentives available in Malaysia for MSC companies will need to be evaluated to determine whether such incentives establish a jurisdiction with a preferential tax regime. MSC companies enjoy certain tax incentives, and some of these are guaranteed by the government under the MSC Malaysia Bill of Guarantees (BoG). BoG No 5 states as follows:

“To provide competitive financial incentives, namely Pioneer Status (100 percent tax exemption) for up to ten years or an Investment Tax Allowance for up to five years and no duties on the importation of multimedia equipment.”

These incentives can be summarised as such:

- Pioneer status: 100% exemption on taxable statutory income in respect of promoted activity of promoted product for a period of up to five years.
- Investment tax allowance: 100% deduction of qualifying capital expenditure in respect of

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promoted activity or promoted product against taxable statutory income.

Criteria for FHTP evaluation of MSC incentives

Under the Forum on Harmful Tax Practices (**FHTP**) evaluation, tax incentives are categorised into Intellectual Property (**IP**) and Financial or other services (non-IP) incentives. They are evaluated based on the following criteria:

IP Incentives	Non-IP Incentives
<p>1. Nexus approach Only R&D expenditures incurred in Malaysia are eligible for Income tax exemption.</p> <p>2. Transparency Incentives that comply with the FHTP's requirement must be gazetted by 31 December 2018.</p>	<p>1. Ring Fencing No distinction on tax treatment including transaction and currency restrictions between residents and non-residents.</p> <p>2. Transparency Incentives that comply with the FHTP's requirement must be gazetted by 31 December 2018.</p> <p>3. Substantial Activities Requirements under the FHTP are as follows:</p> <ol style="list-style-type: none"> i. adequate investment amount or annual business operating expenses incurred in Malaysia; and ii. adequate number of full-time job employment in Malaysia.

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Implementation of BEPS 5 and impact on MSC incentives

Under the FHTP commitment, legislation to amend existing IP and non-IP incentives have to be gazetted by next month, 31.12.2018. In the interim, in respect of incentives approved on or before 16.10.2017, such MSC companies would continue to

enjoy the incentives until 30.6.2021 (i.e. the grandfathering period).

Malaysia is still in the midst of reviewing the best way to ensure compliance with BEPS 5. Through our informal engagements with the MoF, the Inland Revenue Board and other government agencies, our Tax, SST & Customs Practice has made representations that Malaysia could adopt Singapore's approach by carving out IP income entirely from the incentives it provides. However, this should only be an interim measure followed by the swift implementation of a new BEPS test incorporating both the nexus and transparency elements. Otherwise, Malaysia would stand to lose out on local and foreign direct investments in companies that rely heavily on the creation and maintenance of their IP assets for income production.

We have experience in advising clients on applications for tax incentives and MSC status where we work closely with our Regulatory & Compliance partner, Adlin Abdul Majid. If you have queries pertaining to the above, please contact our tax partners Datuk D P Naban or S Saravana Kumar at tax@lh-ag.com

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