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## **Deloitte TaxMax – The 43<sup>rd</sup> series**


One bold step in the right direction

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By Deloitte Tax Academy


# What are we discussing today?

 01

**Emerging trends**

 02

**Key considerations**

 03

**Budget changes**

 04

**Manoeuvres**



# Emerging trends

## BEPS and beyond

# Base Erosion and Profit Shifting

## Malaysia's journey – continued increase in participation

### Current status:

104 countries are members of the Inclusive Framework (**includes Malaysia**)

65 countries have signed the CbC MCAA (**includes Malaysia**)

113 countries participating in CMAA (**includes Malaysia**)

71 countries have signed the OECD MLI (**does not include Malaysia**)

Actions 8-10: Strengthening existing international standards

- Profits to follow value creation
- Accurate functional analysis
- Conduct to prevail over contract

Action 13: Minimum standards

- **CbCR** - Information relating to the global allocation of the group's income and taxes paid, together with indicators of the location of economic activity

Action 13: Strengthening existing international standards

- **Master File** - high level standardised information relevant for all members of the MNE group, including information on IP activities, financing activities, supply chain, and overall value drivers
- **Local File** – detailed information and support of the controlled transactions of the local entity

### 2018 Budget Tax Measures – Appendix 9

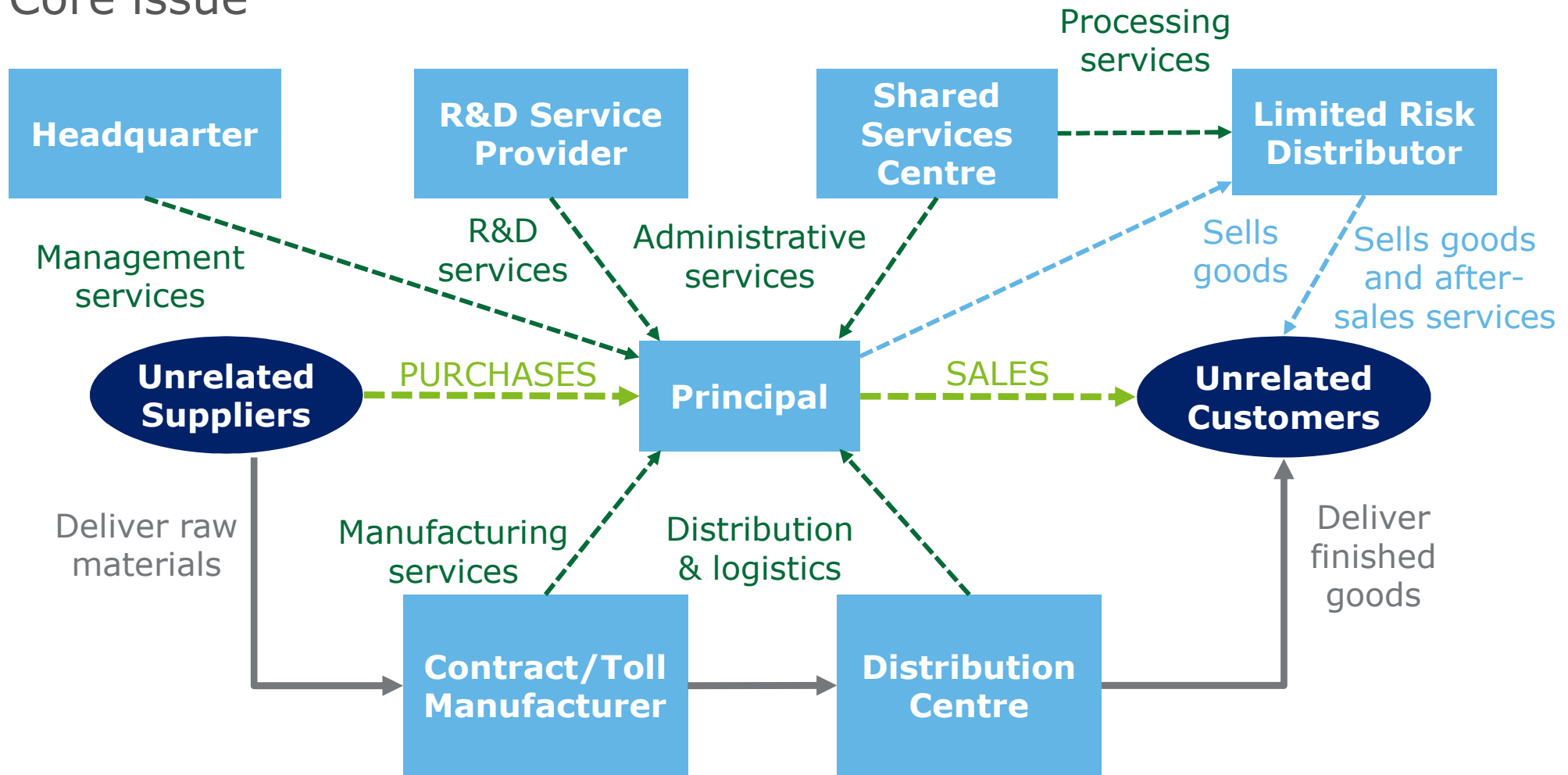
Reiterates Malaysia's commitment to adhere to internationally agreed standards on transparency and exchange of information for tax purposes

# Key considerations

## Supply chain position

# Base Erosion and Profit Shifting

## Core issue



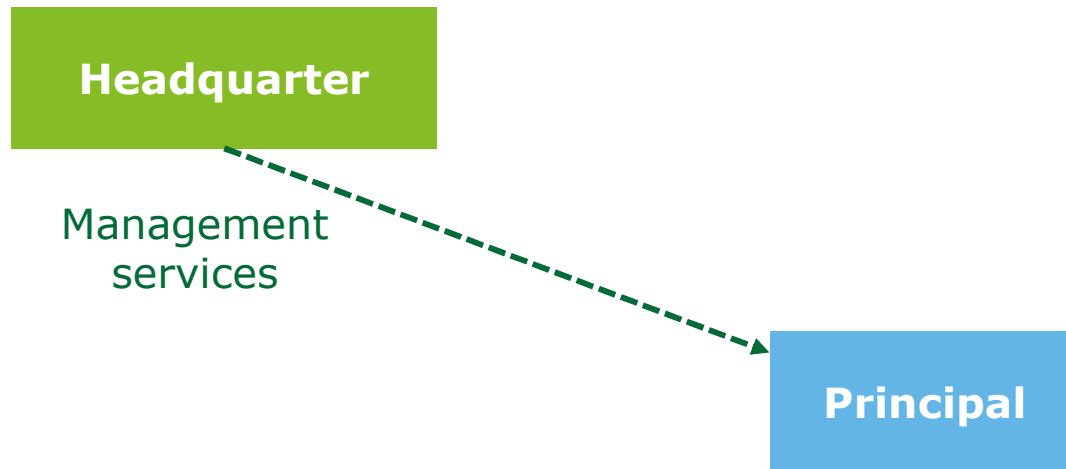
- > Legal title
- > Physical flow of goods
- > Services

### Fundamental questions:

- Who owns the unique intangibles?
- Who bears the economically significant risks?
- Who performs the most critical functions?

# Transfer pricing considerations

## Headquarter



- Specifically disallowed services
- IGS vs CCA
- Cost base and margin
- TP method



- Need Test, Rendition Test and Benefits Test
- Cost base, allocation and margin
- WHT



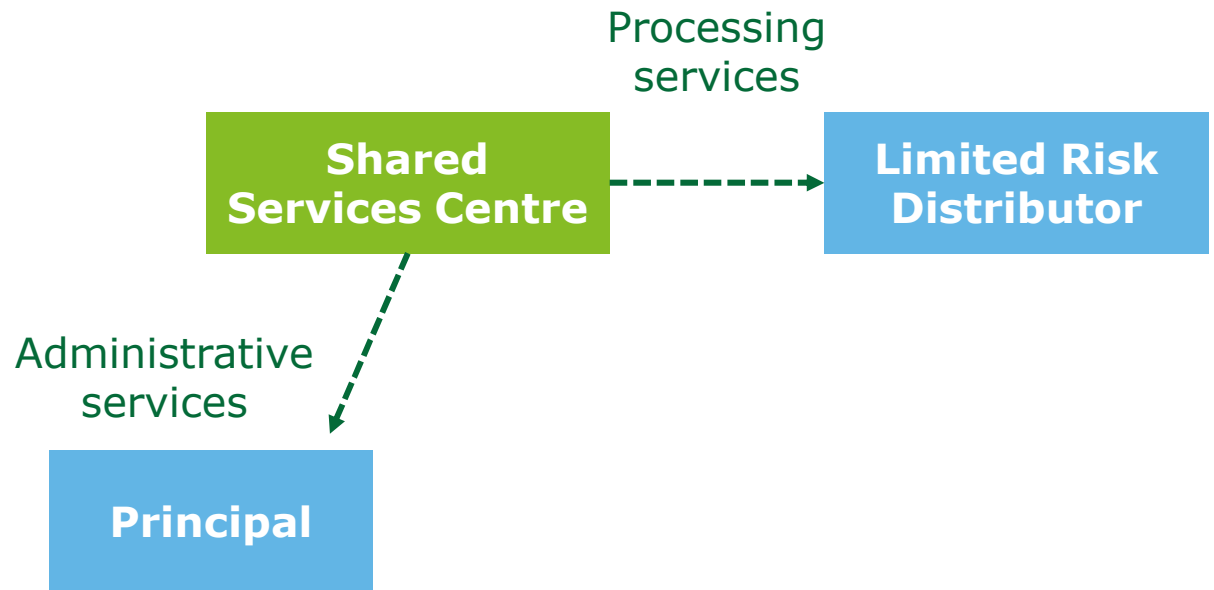
- Low value adding IGS
- Group synergies



- PE risk
- Treaty shopping

# Transfer pricing considerations

## Shared services centre



- IGS vs CCA
- Cost base and margin
- TP method



- Need Test, Rendition Test and Benefits Test
- Cost base, allocation and margin
- WHT



- Core vs non-core
- Value of "data"
- Sharing of benefits

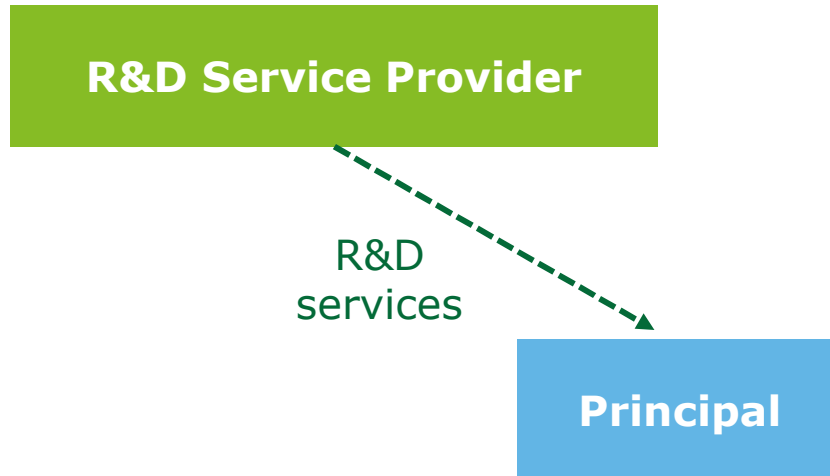


- Virtual PE



# Transfer pricing considerations

## R&D service provider



- Pricing policy
- TP method



- DEMPE (trade intangibles)
- Definition of control
- Financial capacity



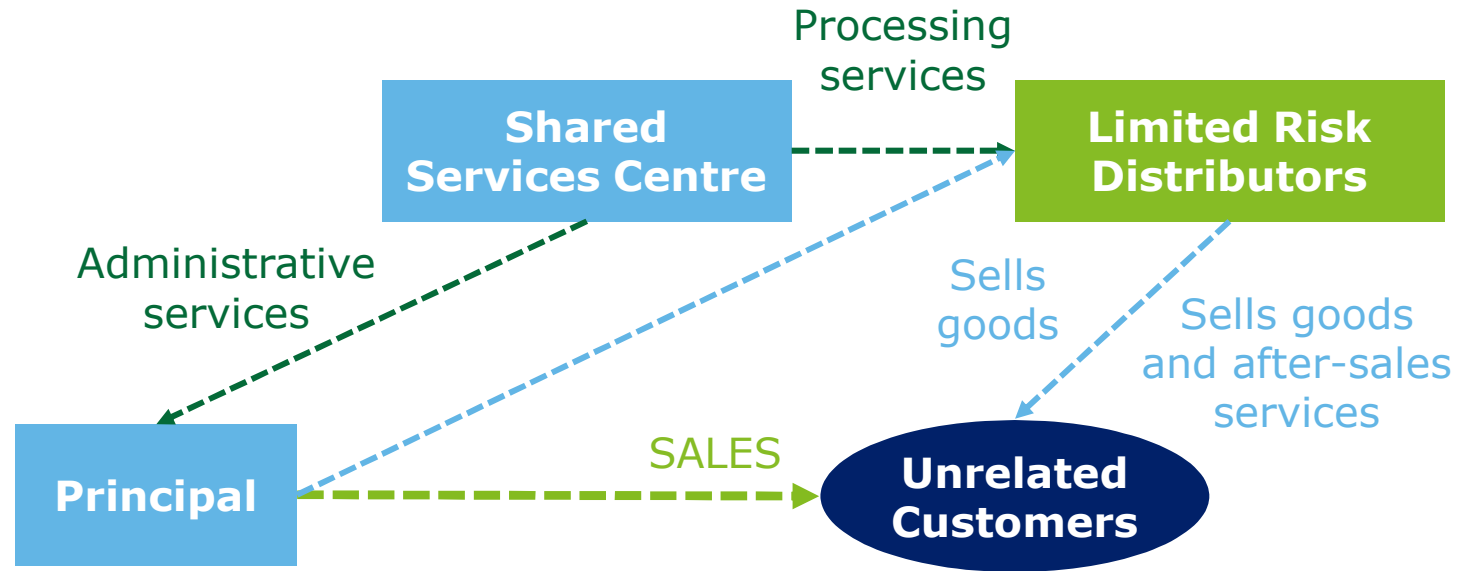
- Contractual allocation of risk
- Types of risk



- Economic ownership of IP
- Cash box

# Transfer pricing considerations

## Limited risk distributor



- Pricing policy
- TP method



- Residual royalty
- AMP
- Specific industries



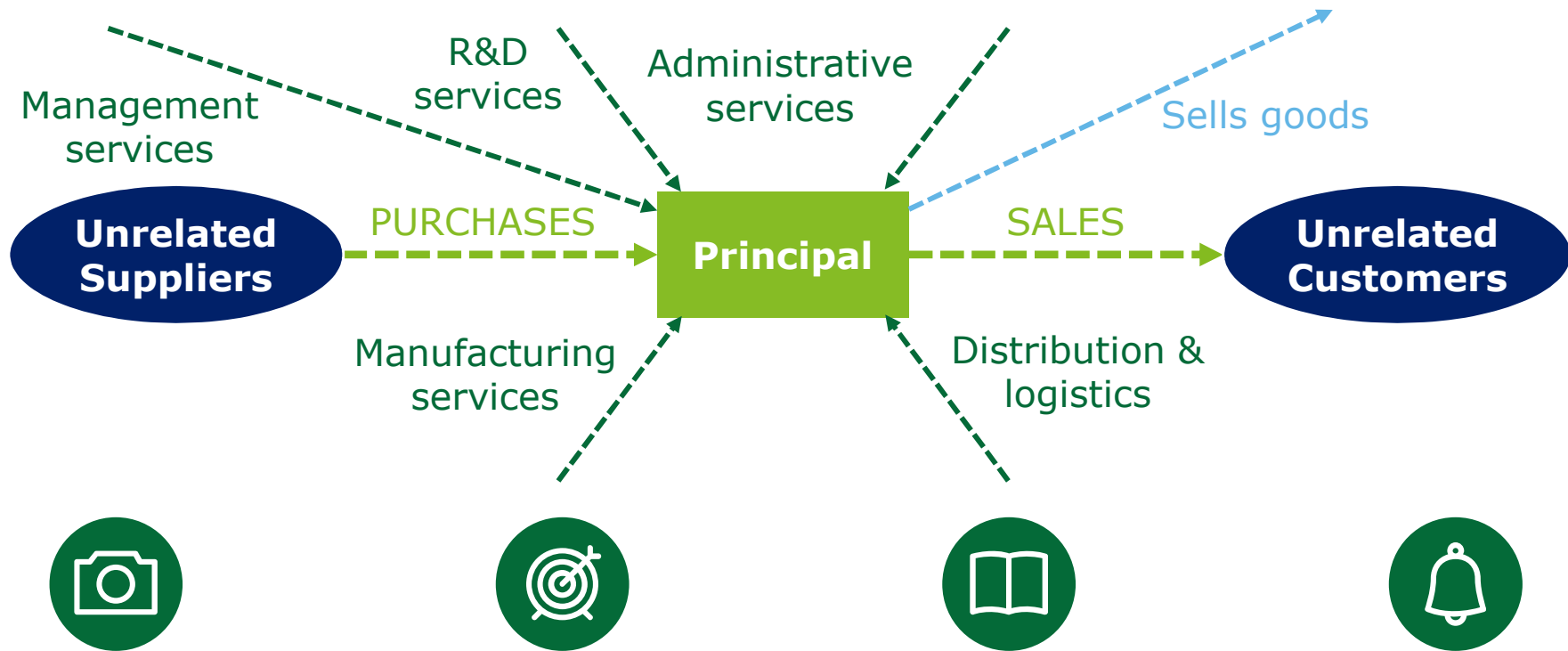
- Market characteristics
- Capital adjustments



- DEMPE (marketing intangibles)
- PE risk

# Transfer pricing considerations

## Principal hub co.



- Pricing policy – residual vs fragmented returns
- TP method – residual vs profit split

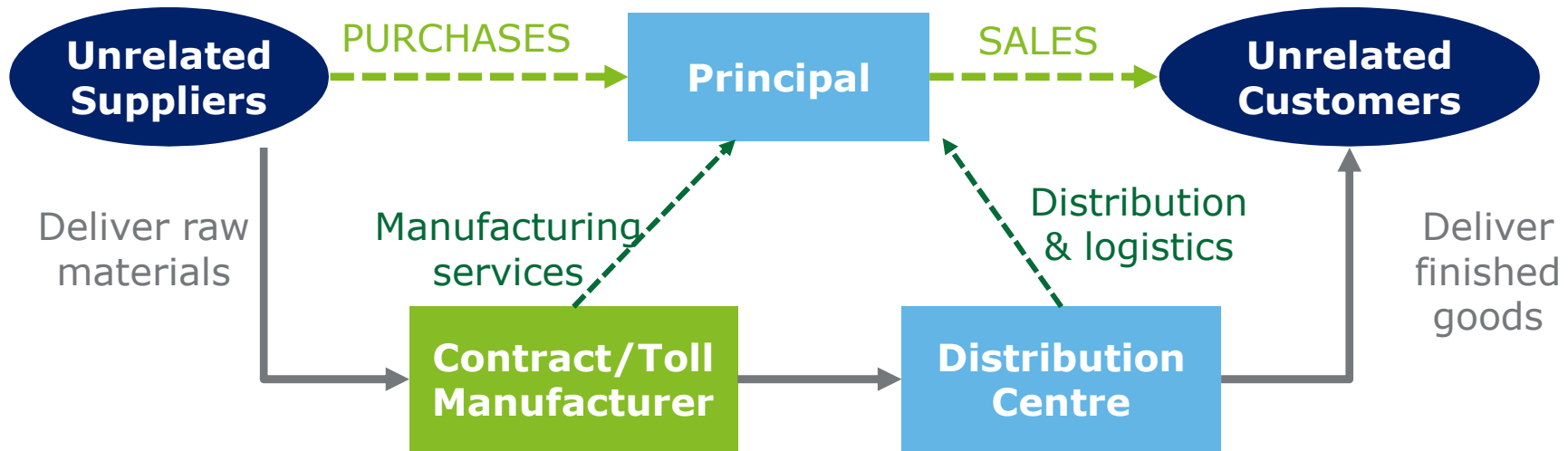
- Substance
- Performance of DEMPE functions
- Control of DEMPE functions

- Nexus approach
- Non-qualification of marketing intangibles

- Business case for restructuring
- Arm's length for each party
- Commercial rationality

# Transfer pricing considerations

## Contract/toll manufacturer



- Pricing policy
- TP method



- Process improvements
- Local enhancement of legacy know-how



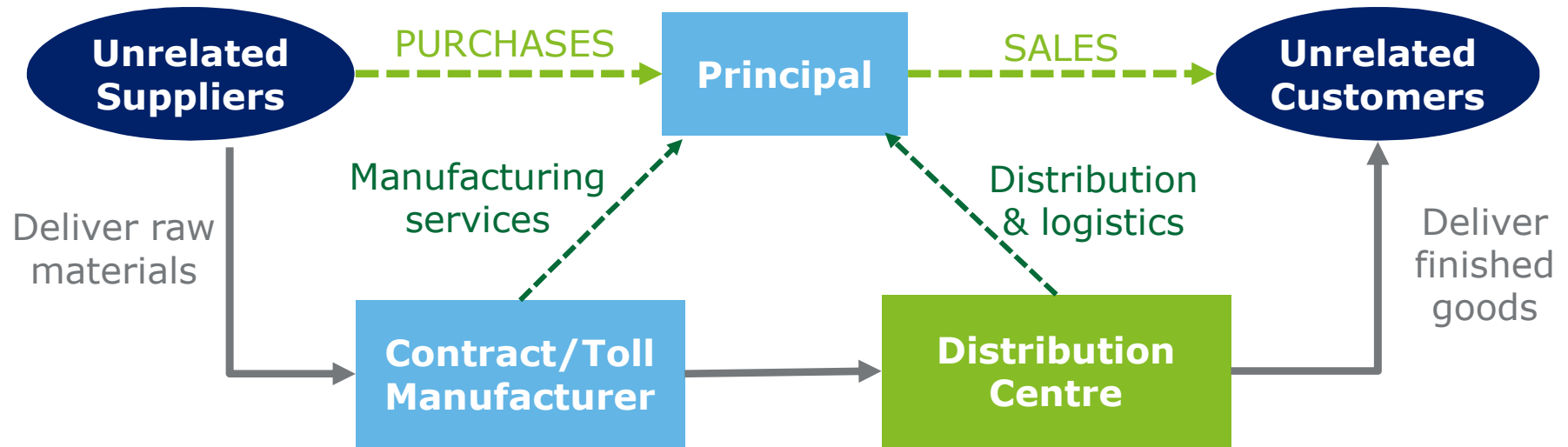
- Contractual allocation of risk
- Location savings



- Indefinite royalty
- PE risk

# Transfer pricing considerations

## Distribution centre



- Pricing policy
- TP method



- Industry and proximity
- Process enhancements



- Sharing of benefits
- Comparables



- PE risk
- Intentional fragmentation

# Budget changes

# Malaysia's commitment to BEPS and AEOI

- Malaysia became a member of BEPS Inclusive Framework on 27 January 2017 (104 members @ November 2017)
- Malaysia is now committed to BEPS minimum standards

S No.	Minimum standard	BEPS
1	Counter harmful tax practices	Action plan 5
2	Prevent treaty abuse	Action plan 6
3	Implement Country-by-Country reporting	Action plan 13
4	Enhance dispute resolution mechanism	Action plan 14

# Malaysia's commitment to BEPS and AEOI

## BEPS Action 5

- Streamline tax incentives with Forum on Harmful Tax Practices ("FHTP") criteria (Amendments to be gazetted before 1 January 2019)

<b>Tax incentive</b>	<b>Status</b>
Principal hub	In the process of being amended
Biotechnology industry	In the process of being amended
MSC Malaysia	In the process of being amended
Pioneer Status	In the process of being amended
Labuan Leasing	In the process of being amended
Special economic regions	In the process of being amended
Inward re-insurance and offshore insurance regime	In the process of being amended



# BEPS Action 13 - CbCR

Table 1: Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) before Income Tax	Income Tax Paid (on Cash Basis)	Income Tax Accrued – Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Table 2: List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Tax Jurisdiction	Constituent Entities Resident in the Tax Jurisdiction	Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence	Main Business Activity(ies)													
			Research and Development	Holding or Managing Intellectual Property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to Unrelated Parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding Shares or Other Equity Instruments	Dormant	Other <sup>1</sup>	
	1.															
	2.															
	3.															

# BEPS Action 13 - CbCR

## Effective tax risk assessment (OECD recommendation)

1. The footprint of a group
2. Group's activities limited to those that pose less risk
3. High value related-party revenues
4. Results deviate from potential comparable
5. Results do not reflect market trends
6. Significant profits but little substantial activity
7. Significant profits but low levels of tax accrued
8. Significant activities but low levels of profit (or losses)
9. Activities in jurisdictions that pose a BEPS risk
10. Mobile activities in low tax jurisdictions
11. Changes in a group's structure
12. IP separated from related activities
13. Marketing entities located outside its key markets
14. Procurement entities located outside its key manufacturing locations
15. Income tax paid consistently lower than income tax accrued
16. Dual resident entities
17. Entities with no tax residence
18. Stateless revenue
19. Inconsistency between CbCR and local file

# BEPS Action 4 – Interest deductions

## Earning Stripping Rules (“ESR”) - What

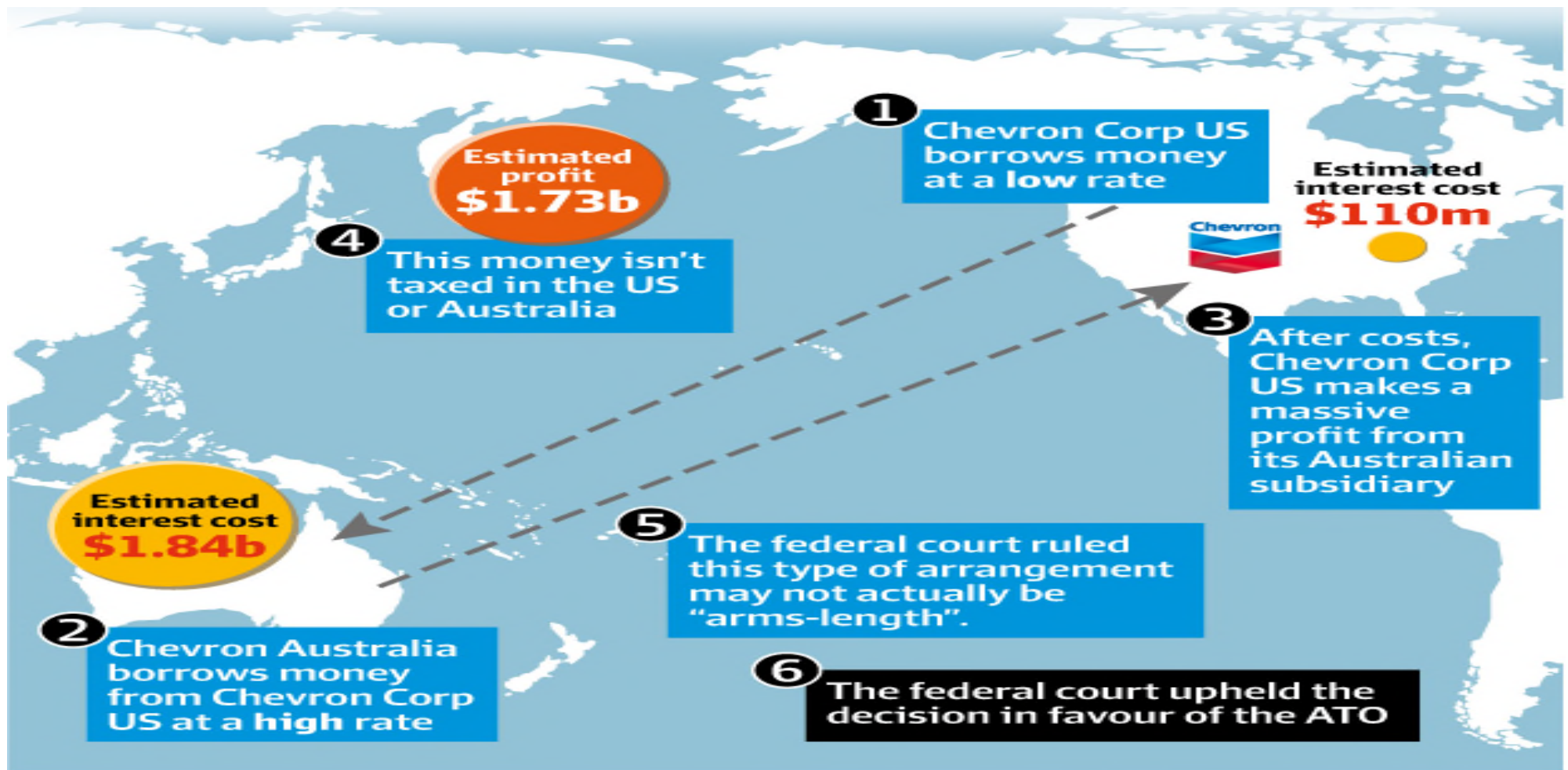
- Implementation of ESR in place of TCR (Thin Capitalisation Rules)
- ESR introduced by OECD to control excessive deduction of interest expense on loans between related parties  
*(Deletion of TCR – effective 1 January 2018)*  
*(ESR - effective 1 January 2019)*
- OECD recommended best practices for ESR

Rules	Brief description
<i>De minimis</i> rule	Monetary threshold to carve out entities which have low level of interest expense
Fixed ratio	Allows an entity to deduct net interest expense up to a benchmark interest over the EBITDA ratio with a range of 10-30%
Group ratio	Allows an entity net interest expense up to its group net interest over the EBITDA ratio
Carry forward	Allows carry forward or carry back of disallowed interest or unused interest capacity

# BEPS Action 4 – Interest deductions

## Earning Stripping Rules - Why

Inter-group financing is a widely used profit-shifting technique in international tax planning



SOURCE: FINANCIAL REVIEW

# BEPS Action 4 – Interest deductions

## Earning Stripping Rules – In different countries

S. no.	Name of country	Trigger point	Fixed ratio	Carry forward
1	Finland	EUR 500,000	<ul style="list-style-type: none"> <li>• 25% of EBITDA</li> <li>• TCR</li> </ul>	Indefinitely
2	India	INR 10 Million	30% of EBITDA	8 years
3	United Kingdom	GBP 2 million	<ul style="list-style-type: none"> <li>• 30% of EBITDA; or</li> <li>• Group's ratio</li> </ul> <p>Whichever is higher</p>	<ul style="list-style-type: none"> <li>• Indefinitely</li> <li>• Three years carry forward of excess capacity</li> </ul>
4	Germany	<ul style="list-style-type: none"> <li>• EUR 3 million; or</li> <li>• Net interest paid to related parties &gt; 10% of total interest.</li> </ul>	30% of EBITDA (Net interest payment to related and third party)	5 years
5	South Africa	Not specified	40% of EBITDA	Indefinitely

# 10 Manoeuvres

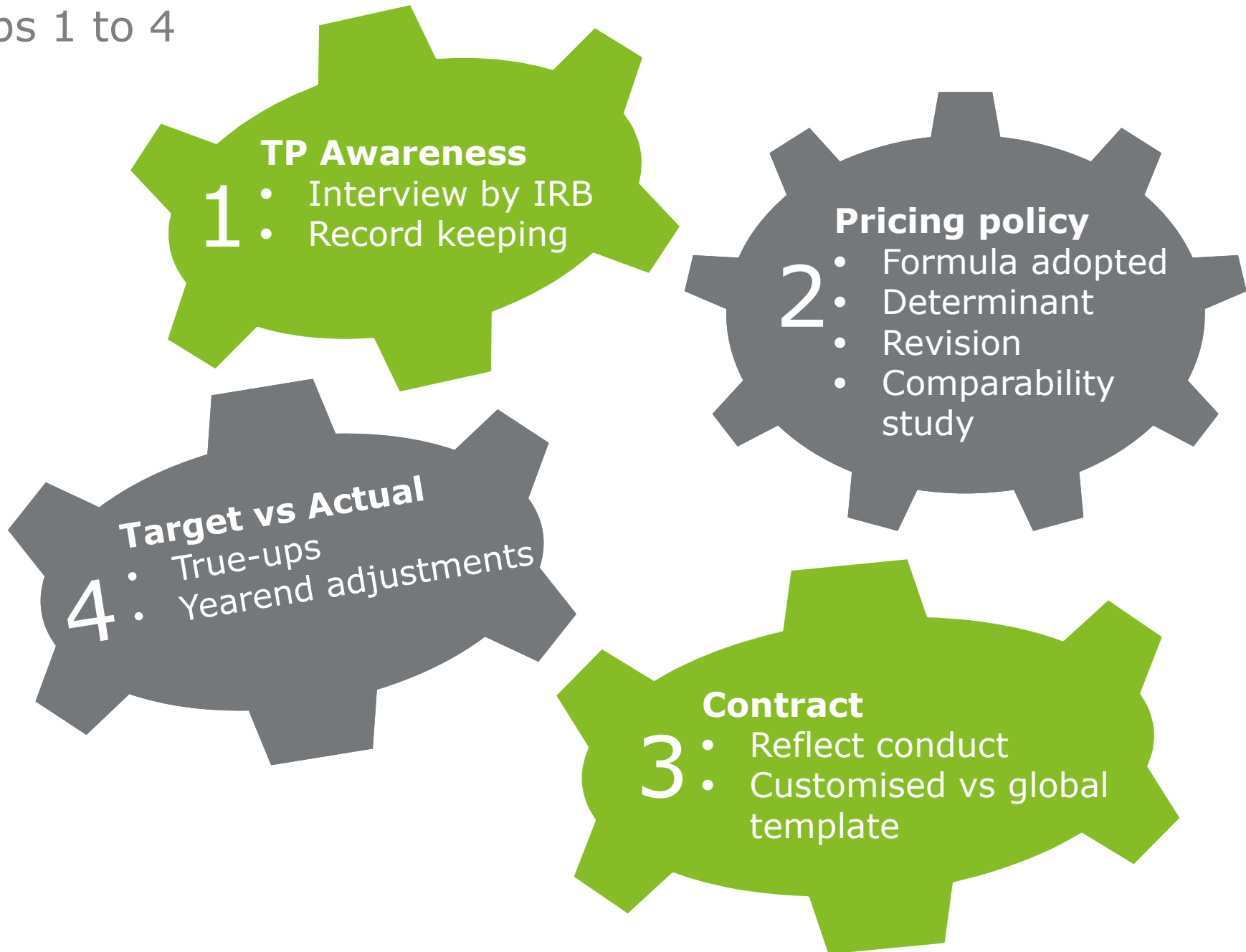
# Managing TP risks

## 10 steps



# Managing TP risks

## Steps 1 to 4





# Managing TP risks

## Steps 5 & 6

5

### **TP documentation – Amended MTPG**

- FAR must reflect actual conduct
- Written statement
- Double sided FAR
- Benchmarking 1 plus 2

6

- Special factor analysis
- Benefits test for intangibles & intragroup services

# Managing TP risks

## Steps 7 - 10

### 7 **Advance pricing agreement**

- Certainty
- No TP audit
- No penalty on self adjustments
- No TP doc requirement

### 8 **TP due diligence**

- Critical for M&A
- Assess TP risk of target
- TP documents & records
- Tax clause in agreement

### 9 **Tax incentives**

- TP aspect of restructuring
- Satisfaction of Arm's length condition

### 10 **CbCR**

- Accuracy of report
- Consistency within group & year to year
- Consistency with local file
- Use Table 3



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