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May 2018

Greetings from Deloitte Malaysia Tax Services

Quick links: *Deloitte Malaysia*
Inland Revenue Board of Malaysia

Takeaways:

1. Earning Stripping Rules (ESR) presentation at the Malaysian Tax Conference
2. Public Ruling No. 2/2018: Tax Incentive for Returning Expert Programme
3. Iskandar Coast Sdn Bhd v KPHDN (High Court)

Upcoming events:

1. *Chapter 3 - Tax Audit and Investigation Workshop Series*

Important deadlines:

Task	Due Date
	31 May 2018
1. 2019 tax estimates for companies with June year-end	√
2. 6th month revision of tax estimates for companies with November year-end	√
3. 9th month revision of tax estimates for companies with August year-end	√
4. Statutory filing of 2017 tax returns for companies with October year-end	√
5. Due date for 2018 CbCR notification for companies with May year-end	√

Earning Stripping Rules (ESR) presentation at the Malaysian Tax Conference 2018

Overview

It was announced in Budget 2018 that earning stripping rules (ESR) would take effect from 1 January 2019, to replace the Thin Capitalisation Rules (TCR). The TCR, although introduced via Section 140A(4) of the Income Tax Act 1967 (the ITA) during Budget 2009 with delayed implementation to 1 January 2018, was never in operation as TCR was also abolished on 1 January 2018.

The ESR is intended to reduce the use of interest deduction by businesses, especially multinationals, to reduce domestic tax. The simplest form of profit-shifting technique which is easy to exercise is to adjust interest deduction, including the ability of multinational enterprises to selectively place higher levels of third party debt in high tax countries and to use intercompany loans to generate interest deduction in excess of the group's actual third-party interest expense.

Inland Revenue Board of Malaysia's (IRBM) approach on ESR

The IRBM had shared their approach on ESR during the recent Malaysian Tax Conference 2018, which is summarised below.

The types of interest expense under ESR would include interest on all forms of debts. It would also include other financial payments that are economically equivalent to interest, but would not include expenses incurred in connection with the cost of raising of finance. Under ESR, interest paid / payable to related party and specific 3rd party interest which are cross-border transactions and where the total amount of interest exceeds RM500,000 would be subject to the earning stripping rules.

The ESR will thereby limit the net interest deductions claimed by an entity to a fixed percentage, i.e., a maximum of 20% of Tax-Earnings Before Interest, Tax, Depreciation and Amortisation ("Tax-EBITDA"). Tax-EBITDA is thereby computed as shown below:

Tax-EBITDA = Adjusted Business Income + Qualifying Deductions (e.g., double deduction) + Interest Expenses claimed in Business Income.

What to do?

Apart from entities that would be exempted from ESR, e.g., banks / Islamic banks, with the ESR implementation coming soon, businesses should consider the following questions:

- What is your current position in terms of interest payments?
- Do you have the financial information for the implementation of the ESR?
- Will the current ESR draft rules affect your business?

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Public Ruling No. 2/2018: Tax Incentive for Returning Expert Programme (PR 2/2018)

The IRBM has issued PR 2/2018 on 2 May 2018 to explain the tax treatment in respect of tax incentives in relation to the Returning Expert Programme (REP) to attract Malaysian citizens who work overseas as professionals to return to work in Malaysia.

Various examples are provided in this PR.

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Iskandar Coast Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (KPHDN) (High Court)

Issues:

1. Whether the leave for judicial review granted to the taxpayer on 5 September 2016 should not have been granted since there was no existence of exceptional circumstances and there was an alternative remedy available under the ITA; and

2. Whether the taxpayer was taxable for the compensation for the compulsory acquisition of its parcel of lands.

Decision:

The High Court had first dealt with the preliminary issue (i.e., Issue No. 1) raised by Director General of Inland Revenue (DGIR) before dealing with the issue raised by the taxpayer (i.e., Issue No. 2). The High Court then proceeded to dismiss the judicial review application by the taxpayer with the following grounds of judgement:

Issue 1

1. The leave application was granted to the taxpayer on 5 September 2016 in the absence of the DGIR. Therefore the leave **should not have been granted** to the taxpayer since the DGIR was not able to present its objection. The DGIR was not invited to attend and make representations as to whether or not leave should be granted. The record also showed that leave application was granted because there was no objection from the Attorney General Chambers. In revenue cases, the Attorney General did not act for the DGIR. The "no objection" from the Attorney General Chambers **could not be an exceptional circumstance** meriting the granting of leave for judicial review.

2. In the High Court's opinion there must be grounds such as the "error of law" or "abuse of power" going to the legality of the conduct of the decision-making authority that would be considered as exceptional circumstances to grant leave for judicial review. Although the High Court had granted the taxpayer's leave application, it was always at the discretion of the court to make an order that the judicial review application was not available to the taxpayer where there was clear fact that there was an alternative remedy.

3. The High Court's view was that had the taxpayer filed an appeal before the Special Commissioners of Income Tax (SCIT), where the onus was on the taxpayer to establish their position, they would have been accorded every opportunity to show where the DGIR went wrong. The High Court held that it would be much easier to determine the issue of law based on the proven facts found by the SCIT in their case stated. The cases referred to by both the DGIR and the taxpayer showed that the decisions derived by the SCIT depended on the facts of the case. As for this case, the DGIR would then have had the opportunity to prove to the SCIT that the taxpayer when obtaining the land had knowledge that it would be acquired by the government, and the taxpayer too, would then have had the opportunity to undo what the DGIR had done before the SCIT.

4. The High Court referred to the principles laid down in *Ta Wu Realty Sdn Bhd v. KPHDN & Another [2008] 6 CLJ 235* where it was held that SCIT were the proper forum to decide on the merits of an assessment. Also, in any event, the door for the taxpayer to bring the matter to High Court on any question of law would not be entirely closed. The decision of the SCIT would be appealable to the High Court by way of a case stated.

   The High Court also added that, based on the doctrine of stare decisis, the decision made by the Federal Court in rejecting the taxpayer's claim as the remedy available had not been exhausted by the taxpayer in the case of Bandar Nusajaya (supra) and Alcatel-Lucent (supra) [i.e., *Bandar Nusajaya Development Sdn Bhd v KPHDN (Rayuan Sivil No: 01(f)-5-02/201S(W)* and *KPHDN v Alcatel-Lucent (M) Sdn Bhd (Civil Appeal No. 01(f)-18-08/2012(W)*] was binding on all Courts of this land. Therefore, it was also binding upon this Court.

5. The High Court found that that there were no exceptional circumstances for the court to allow the judicial review application by the taxpayer and hence dismissed the application.

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We invite you to explore other tax-related information at:
http://www2.deloitte.com/my/en/services/tax.html

Tax Team - Contact us

Service lines / Names	Designation	Email	Telephone
Business Tax Compliance & Advisory			
Yee Wing Peng	Managing Director	wpyee@deloitte.com	+603 7610 8800
Julie Tan	Executive Director	jultan@deloitte.com	+603 7610 8847
Stefanie Low	Executive Director	gelow@deloitte.com	+603 7610 8891
Choy Mei Won	Director	mwchoy@deloitte.com	+603 7610 8842

Business Process Solutions			
Julie Tan	Executive Director	jultan@deloitte.com	+603 7610 8847
Gabriel Kua	Director	gkua@deloitte.com	+606 281 1077
Shareena Martin	Director	sbmartin@deloitte.com	+603 7610 8925
Capital Allowances Study			
Chee Pei Pei	Executive Director	pechee@deloitte.com	+603 7610 8862
Sumaisarah Abdul Sukor	Associate Director	sabdulsukor@deloitte.com	+603 7610 8331
Global Employer Services			
Ang Weina	Executive Director	angweina@deloitte.com	+603 7610 8841
Chee Ying Cheng	Director	yichee@deloitte.com	+603 7610 8827
Michelle Lai	Director	michlai@deloitte.com	+603 7610 8846
Government Grants & Incentives			
Tham Lih Jiun	Executive Director	ljtham@deloitte.com	+603 7610 8875
Thin Siew Chi	Executive Director	sthin@deloitte.com	+603 7610 8878
Indirect Tax			
Tan Eng Yew	Executive Director	etan@deloitte.com	+603 7610 8870
Senthuran Elalingam	Executive Director	selalingam@deloitte.com	+603 7610 8879
Chandran TS Ramasamy	Director	ctsramasamy@deloitte.com	+603 7610 8873
Larry James Sta Maria	Director	lstamaria@deloitte.com	+603 7610 8636
Wong Poh Geng	Director	powong@deloitte.com	+603 7610 8834
International Tax & Value Chain Alignment			
Tan Hooi Beng	Executive Director	hooitan@deloitte.com	+603 7610 8843

Mergers & Acquisitions			
Sim Kwang Gek	Executive Director	kgsim@deloitte.com	+603 7610 8849
Private Wealth Services			
Thin Siew Chi	Executive Director	sthin@deloitte.com	+603 7610 8878
Chris Foong	Director	tfoong@deloitte.com	+603 7610 8880
Tax Audit & Investigation			
Chow Kuo Seng	Executive Director	kuchow@deloitte.com	+603 7610 8836
Stefanie Low	Executive Director	gelow@deloitte.com	+603 7610 8891
Transfer Pricing			
Theresa Goh	Executive Director	tgoh@deloitte.com	+603 7610 8837
Subhabrata Dasgupta	Executive Director	sudasgupta@deloitte.com	+603 7610 8376
Philip Yeoh	Executive Director	phyeoh@deloitte.com	+603 7610 7375
Gagan Deep Nagpal	Director	gnagpal@deloitte.com	+603 7610 8876
Justine Fan	Director	jufan@deloitte.com	+603 7610 8182
Vrushang Sheth	Director	vsheth@deloitte.com	+603 7610 8534
Yvonne Sing	Director	ysing@deloitte.com	+603 7610 8079

Sectors / Names	Designation	Email	Telephone
Automotive			
Stefanie Low	Executive Director	gelow@deloitte.com	+603 7610 8891
Financial Services			
Chee Pei Pei	Executive Director	pechee@deloitte.com	+603 7610 8862
Gooi Yong Wei	Executive Director	ygooi@deloitte.com	+603 7610 8981
Mark Chan	Director	marchan@deloitte.com	+603 7610 8966
Mohd Fariz Mohd Faruk	Director	mmohdfaruk@deloitte.com	+603 7610 8153

Oil & Gas			
Toh Hong Peir	Executive Director	htoh@deloitte.com	+603 7610 8808
Kelvin Kok	Director	kekok@deloitte.com	+603 7610 8157
Real Estate			
Tham Lih Jiun	Executive Director	ljtham@deloitte.com	+603 7610 8875
Telecommunications			
Thin Siew Chi	Executive Director	sthin@deloitte.com	+603 7610 8878

Branches / Names	Designation	Email	Telephone
Penang			
Ng Lan Kheng	Executive Director	lkng@deloitte.com	+604 218 9268
Au Yeong Pui Nee	Director	pnauyeong@deloitte.com	+604 218 9888
Everlyn Lee	Director	evelee@deloitte.com	+604 218 9913
Monica Liew	Director	monicaliew@deloitte.com	+604 218 9888
Tan Wei Chuan	Director	wctan@deloitte.com	+604 218 9888
Ipoh			
Ng Lan Kheng	Executive Director	lkng@deloitte.com	+604 218 9268
Lam Weng Keat	Director	welam@deloitte.com	+605 253 4828
Melaka			
Julie Tan	Executive Director	jultan@deloitte.com	+603 7610 8847
Gabriel Kua	Director	gkua@deloitte.com	+606 281 1077
Johor Bahru			
Chee Pei Pei	Executive Director	pechee@deloitte.com	+603 7610 8862
Thean Szu Ping	Director	spthean@deloitte.com	+607 222 5988

Kuching			
Tham Lih Jiun	Executive Director	ljtham@deloitte.com	+603 7610 8875
Philip Lim Su Sing	Director	suslim@deloitte.com	+608 246 3311
Chai Suk Phin	Associate Director	spchai@deloitte.com	+608 246 3311

Kota Kinabalu			
Tham Lih Jiun	Executive Director	ljtham@deloitte.com	+603 7610 8875
Cheong Yit Hui	Manager	yicheong@deloitte.com	+608 823 9601

Yee Wing Peng

Julie Tan

Stefanie Low

Chee Pei Pei

Ang Weina

Tham Lih Jiun

Thin Siew Chi

Tan Eng Yew

Senthuran Elalingam

Tan Hooi Beng

Sim Kwang Gek

Chow Kuo Seng

Theresa Goh

Subhabrata Dasgupta

Philip Yeoh

Gooi Yong Wei

Toh Hong Peir

Ng Lan Kheng

Choy Mei Won

Gabriel Kua

Shareena Martin

Chee Ying Cheng

Michelle Lai

Chandran TS Ramasamy

Larry James Sta Maria

Wong Poh Geng

Chris Foong

Gagan Deep Nagpal

Justine Fan

Vrushang Sheth

Yvonne Sing

Mark Chan

Mohd Fariz Mohd Faruk

Kelvin Kok

Au Yeong Pui Nee

Everlyn Lee

Monica Liew

Tan Wei Chuan

Lam Weng Keat

Thean Szu Ping

Philip Lim Su Sing

Sumaisarah Abdul Sukor

Chai Suk Phin

Cheong Yit Hui

Deloitte.