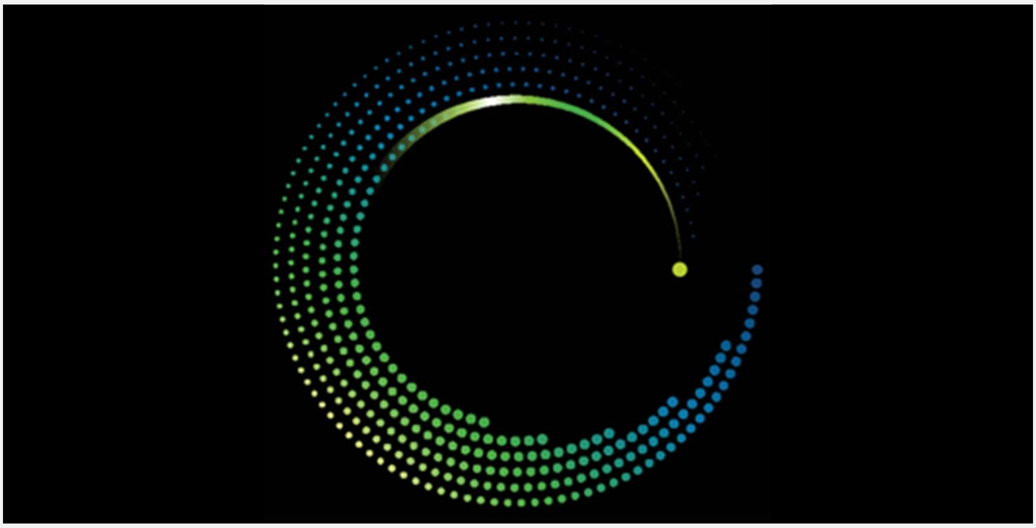
Malaysia | Tax | 5 April 2022



Tax Espresso – Special Alert

Entry into Effect of Malaysia’s MLI Provisions

Greetings from Deloitte Malaysia Tax Services

Malaysia deposited its instrument of ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“MLI”) on **18 February 2021.** The MLI for Malaysia entered into force on **1 June 2021**. Please refer to our Tax Espresso – Special Alert: “Malaysia deposits ratification instrument for MLI” for more information.

The date on which the provisions of the MLI (such as the application of the principal purpose test (“PPT”) to prevent treaty abuse) will enter into effect for

Malaysia's covered tax agreements ("CTAs") listed in the country's list of reservations and notifications to the MLI will generally depend on when Malaysia's treaty partners deposits the ratification instrument.

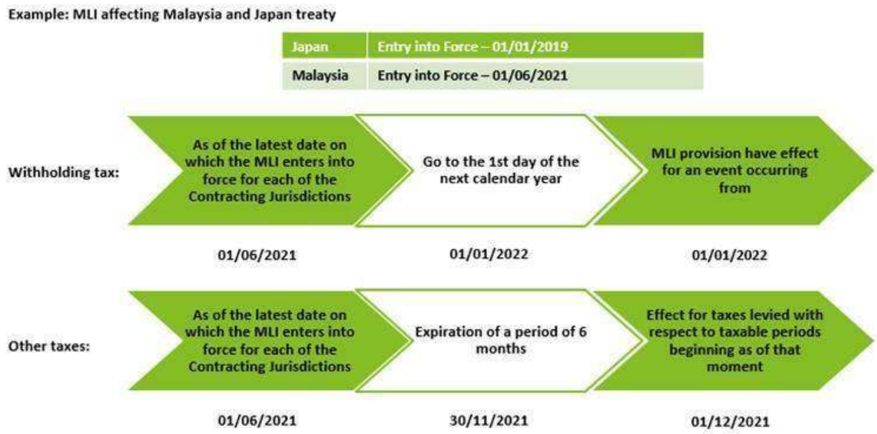
A recap on the relevant timeline

Once the MLI enters into force, different rules apply as follows:

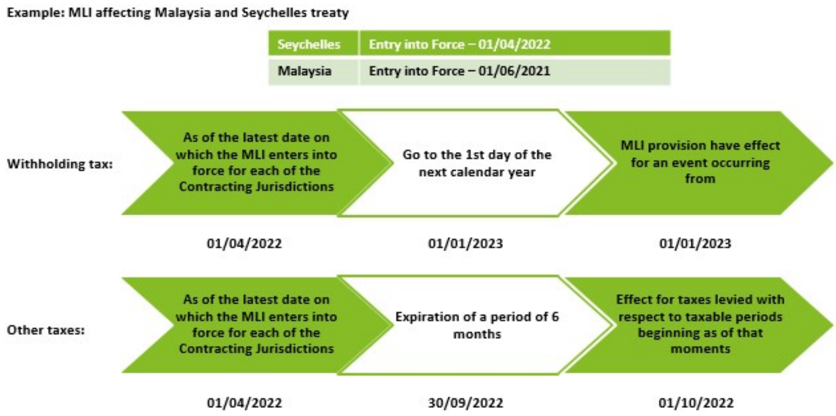
- For **withholding tax ("WHT"),** the MLI provisions will become applicable on or after the first day of the next calendar year that begins on or after the latest of the dates on which MLI enters into force for each of the party to the CTA.

- With respect to **all other taxes**, the MLI provisions will become applicable for taxes levied with respect to taxable period beginning on or after the expiry of six calendar months from the latest of the dates on which MLI enters into force for the treaty partners.

See example below on entry into effect date for MLI provisions for Malaysia and Japan treaty. Japan deposited the ratification instrument earlier than Malaysia.



See example below on entry into effect date for MLI provisions for Malaysia and Seychelles treaty. Seychelles deposited the ratification instrument later than Malaysia.



To-date, a total of 71 countries have deposited their ratification instruments for the MLI. A majority of these countries deposited their ratification instruments earlier than Malaysia. This means that the provisions of Malaysia's MLI (as listed in the list of reservations and notifications) would have entered into effect for a majority of Malaysia's CTAs (where the countries have deposited ratification instruments).

The list of signatories and the MLI Matching Database are available on the OECD website to provide information on the status of ratification and the impact of the MLI on the tax treaties.

Key takeaways

It is imperative that taxpayers take into account the impact of MLI position adopted by Malaysia and its treaty partners when applying the treaty relief / exemption.

As indicated in Malaysia's MLI position, Malaysia will adopt the PPT to prevent treaty abuse. Under the PPT, treaty benefits will be denied if it is "reasonable to conclude" from the fact that "the principal purpose or one of the principal purposes" of entering into a transaction or an arrangement was to obtain such tax benefits (unless the transaction is in accordance with the object and purpose of the treaty). Hence, where MLI provisions for Malaysian double tax agreements ("DTA") have entered into effect on 1 January 2022 with respect to WHT (e.g. DTA between Malaysia and Japan, DTA between Malaysia and UK, DTA between Malaysia and Australia etc), the non-resident would have to fulfill the PPT before it can claim the treaty benefit (e.g. relying on reduced WHT rate as provided in the tax treaty etc).

To-date, there is no further guidance on how the Malaysian Inland Revenue Board ("MIRB") would apply the PPT. We expect that the MIRB would issue further guidance on the application of PPT in due course.

Where Article 5 (Permanent Establishment) of the tax treaty is modified by the MLI provisions to adopt BEPS Action 7, corporations should assess if the existing operating models would create a permanent establishment ("PE") in a particular jurisdiction with the tightening of the PE threshold under BEPS Action 7. With regard to corporate taxes, the MLI provisions will become applicable with respect to taxable period beginning on or after the expiry of six calendar months from the latest of the dates on which MLI enters into force for the treaty partners (e.g. taxable period on or after 1 December 2021 in the case of Malaysia-Japan DTA).

Get in touch

We trust that you find this bulletin useful and welcome your feedback.

Should you have any comments or questions arising from the newsletter, please speak to your usual Deloitte contact or any member of the International Tax Services Group listed below.

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