

## What do multilateral instrument and BEPS mean to Corporate Malaysia?

Jan 24 is a significant date for Corporate Malaysia to take note of. On that day, Deputy Finance Minister I Datuk Wira Othman Aziz represented Malaysia in signing the Multilateral Convention (the multilateral instrument or MLI) in Paris to implement tax treaty-related measures to prevent base erosion and profit shifting (BEPS).

What is the significance of BEPS and MLI? These terms must be understood by the chief financial officers (CFOs) of multinational corporations (MNCs), including the Malaysia-headquartered ones. A lack of understanding could be costly. Often asked is whether tax planning, including international tax efficiencies (ITE), is illegal.

No, it is not. Former chief justice of Borneo, the late Tan Sri Lee Hun Hoe, once commented that no commercial person in his right sense is going to carry out commercial transactions except on the footing of paying the smallest amount of tax and therefore, there is nothing wrong at all for a person to organise his affairs in such a way as to minimise taxes.

This holds true until today. However, complications arise when tax minimisation is the sole or main motive for a scheme or transaction. The taxmen may then invoke anti-avoidance rules to counter it. From the perspective of the MNCs, including the Malaysia-headquartered groups, seeking ITE is common.

How does ITE work? The reality is that there is likely to be an element of BEPS in it. BEPS simply means a strategy used by MNCs to achieve global tax efficiencies by taking advantage of the difference in taxation systems and treatment of income/expenses in different jurisdictions. While international tax planning is not illegal per se, tax authorities around the globe are certainly not prepared to lose their fair share of tax collection.

In 2012, the G20 commissioned the Organisation for Economic Co-operation and Development (OECD) to look into this area as it was believed that there was an annual revenue loss of US\$100 billion to US\$240 billion due to BEPS. At the time, many were sceptical of the OECD's ability to formulate a tax reform to plug the leakages. Well, in the span of three years, 15 actions have been identified to address this issue.

While Malaysia is neither a member of the OECD nor G20, it follows the anti-BEPS developments closely and has participated in the re-



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gional network meetings on the BEPS project. The OECD announced on March 6 last year that Malaysia had become the 94th country to join the Inclusive Framework on BEPS, which brings together a group of countries that have pledged to implement measures aimed at preventing tax avoidance. The measures were designed by the OECD and G20 countries during the 2015 anti-BEPS project.

As an associate of the Inclusive Framework, Malaysia has committed to adopt four anti-BEPS minimum standards that deal with areas of harmful tax practices, tax treaty abuse, country-by-country reporting requirements for transfer pricing, and improvements in cross-border tax dispute resolution.

To implement these anti-BEPS measures, the double taxation agreement (DTA) needs to be amended. But there are more than 3,000 treaties globally and it may take decades for those measures to be incorporated. Time is of the essence, hence the advent of MLI. MLI seeks to facilitate the implementation of tax treaty-related measures to counter BEPS. Signatories to the MLI can efficiently update their DTA to incorporate the measures, without the need to renegotiate each DTA.

On June 7 last year, over 70 ministers and other high-level representatives participated in the signing ceremony of the MLI. Signatories included jurisdictions from all continents and all levels of development. Significantly, at this point, Malaysia was not in the list. Some asked whether this meant we would have ample time to consider the impact of anti-BEPS measures and that there would not be a need to push the panic button. My response was simple: It will come, it is coming and we need to be prepared. My response was right. It arrived with the Paris signing.

Malaysia has submitted a list of agreements with 73 jurisdictions that it wishes to designate as Covered Tax Agreements (CTA), that is, to be amended through the MLI. Next, Malaysia will work towards the ratification of the MLI before the anti-BEPS measures take effect. It is crucial for Corporate Malaysia to understand the different positions adopted by the treaty countries to determine how the MLI affects a particular DTA.

What do CFOs or finance leaders need to do? They need to revisit their group's international holding, financing and licensing structures to ensure that they are BEPS-compliant. Malaysia

will soon adopt the Principal Purpose Test (PPT) to prevent treaty abuse.

Under the PPT, treaty benefits will be denied if it is "reasonable to conclude" from the facts 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). Reduced or zero foreign withholding tax rates on dividend, interest and royalty, or even capital gains tax exemption enjoyed in the past may no longer apply. Any additional tax costs must be factored in.

The foreign operating models of Malaysia-headquartered MNCs should be reviewed. A non-taxable presence position taken previously may no longer be valid. A marketing company structure in another country may now create a taxable presence there. The non-taxable presence argument on certain activities such as storage may no longer hold water if the activity can not be regarded as of a "preparatory or auxiliary" character.

The new anti-fragmentation rules require an analysis of the operations of a company and its related companies in another jurisdiction holistically to assess whether a taxable presence could arise as a result of the combination of activities. Where a taxable presence exists, the profit attribution exercise could be complex and is often subject to debate.

Malaysia will fully adopt the Mutual Agreement Procedure Article in its DTAs. When a Malaysian resident taxpayer encounters taxation that is not in accordance with the intended application of the DTA provisions, the taxpayer can seek assistance from the Inland Revenue Board of Malaysia to contact the treaty partner to resolve the dispute. Interestingly, Malaysia has opted not to adopt the mandatory arbitration provisions.

If you have not considered anti-BEPS aspects for your outbound investments, it is time to do so. The MLI is a major step in the anti-BEPS implementation process. The signing of the MLI signifies Malaysia's commitment to implement anti-BEPS action plans and reflects its serious intent to adopt international standards and combat international tax avoidance. ■

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