WONG & PARTNERS
MEMBER FIRM OF BAKER & MCKENZIE INTERNATIONAL

Client Alert

April 2016

OECD BEPS Project - Where does Malaysia stand?

For further information, please contact:

Adeline Wong
+603 2298 7880
adeline.wong@wongpartners.com

Wong Kae Jeen
+603 2298 7855
kaejeen.wong@wongpartners.com

Tan Yi Lyn
+603 2298 7847
yilyn.tan@wongpartners.com

Amid growing concerns that tax laws have not kept pace with the global integration of corporations and the rise of the digital economy, the G20 had requested that the Organization of Economic Co-operation and Development ("OECD") consider and recommend specific action plans to tackle concerns on potential international tax avoidance mechanisms used by multi-national corporations ("MNCs") to reduce their tax burdens.

This resulted in the OECD's Action Plan on Base Erosion and Profit Shifting ("BEPS"), which identified 15 specific actions plans outlining the recommendations and measures which may be implemented to prevent improper profit shifting to low-tax or no-tax jurisdictions. The final report was published by the OECD in October 2015.

The key initiatives covered by the BEPS project include addressing the tax challenges of the digital economy, hybrid instruments, preferential tax rulings and incentives regimes, potential treaty abuse, artificial avoidance of permanent establishment status, as a well as a myriad of transfer pricing considerations.

Response by the Malaysian tax authorities

Notwithstanding that Malaysia is not a member of the G20 or OECD, Malaysia was an "invitee" to the OECD BEPS project and sat in on working parties to observe and participate in discussions on Action items.

The Malaysian Inland Revenue Board ("MIRB") released a media statement shortly after the publication of the BEPS final report, which confirmed that the MIRB is currently undertaking a review of the Malaysian tax legislations in light of the BEPS project. To that end, the MIRB set up a BEPS Action Committee to discuss findings from the BEPS meetings, consider potential follow-up actions and potentially make recommendations to the Government for legislative amendments. The MIRB has indicated that it will update and revise the Malaysian tax legislation to "align with international standards", to the extent such standards are applicable and relevant locally.

United Nations - BEPS Questionnaire

Malaysia also participated in a survey conducted by the United Nations in late 2014, which was aimed at obtaining feedback from developing countries regarding BEPS issues. Some of the key takeaways from Malaysia's response to the questionnaire are as follows:

- Malaysia is focusing on "profit-shifting structures" such as (i) excessive or unwarranted intra-group payments for interest, management fees, technical service fees or IP payments, (ii) supply chain restructuring exercises which result in the shifting of risks and profits contractually between members of an MNC group; and (iii) insufficient compensation for important functions such as R&D and marketing activities;

- the MIRB's main priority is currently Action 10 on aligning transfer pricing outcomes with value creation; and

- other action plans that are of relevance to Malaysia include Action 7 on the artificial avoidance of permanent establishment status and Action 2 on neutralising the effects of hybrid mismatch arrangements.

What does this mean for MNCs with operations in Malaysia?

The MIRB has indicated that transfer pricing remains one of its top priorities, and therefore we can expect the current trend of increasing number of transfer pricing audits to continue for the foreseeable future. It is also likely that there will be changes to the transfer pricing documentation requirements, following recent announcements that Malaysia intends to adopt the BEPS recommendation for country-by-country reporting suggested in Action 13.

Separately, whilst we have not yet seen a high degree of scrutiny by the MIRB of permanent establishment issues during tax audits, it is noteworthy that the MIRB mentioned Action 7 (i.e., preventing the artificial avoidance of permanent establishment status) as being relevant to Malaysia. This may signal a change in the MIRB's traditional attitude to permanent establishment concerns. It would be prudent for MNCs with operations in Malaysia to take a closer look at their supply chain and business models to determine whether there may be any potential tax exposures arising from a permanent establishment in Malaysia.

On the tax incentive front, the BEPS action plan focuses on the use of preferential rulings and grants, and in particular, whether the tax benefits correlate with substance requirements. Given that Malaysia's tax incentives are generally tied to substantial substance requirements in Malaysia (in terms of head count, capital investment, annual spend, etc.), we do not foresee the Malaysian tax incentive regime to be a specific target of the BEPS initiative.

www.wongpartners.com

Wong & Partners
Level 21, Suite 21.01
The Gardens South Tower
Mid Valley City
Lingkaran Syed Putra
59200 Kuala Lumpur