Tax, Trade and Wealth Management
Kuala Lumpur

Member Firm of
Baker & McKenzie International

Client Alert

15 July 2019

For further information, please contact:

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

Krystal Ng
Partner
+603 2298 7937
krystal.ng@wongpartners.com

Syn Joe Ong
Associate
+603 2299 6518
synjoe.ong@wongpartners.com

Restriction on the Deductibility of Interest

In Malaysia, in computing the adjusted income for a person in a basis period of a year of assessment ("**YA**"), interest expenses are generally deductible against the gross income of a person provided certain conditions are met. The Income Tax (Restriction on Deductibility of Interest) Rules 2019 ("**Rules**") has recently been gazetted and came into operation on 1 July 2019. Consequently, there is now a maximum cap on the allowable deduction on interest expense for a YA in the context of group financing.

In this alert, we discuss the key features of the restriction on deductibility of interest in Malaysia ("**Restriction**") mechanism as well as the main implications arising from the legislation and guidelines which implement the Restriction.

Key Features of the Restriction Mechanism

Key Features	Description
Timing of Application	• In force on 1 July 2019; • Applies on a business source where the basis period commences on or after 1 July 2019.
Scope of Application	• Apply to any person who has been granted financial assistance in a controlled transaction. • Limits the Restriction to cross border related party financial assistance only, where the interest expenses are paid to: (i) an associated person outside of Malaysia (or where the foreign associated person has a permanent establishment in Malaysia); or (ii) a foreign third party where the financial assistance is guaranteed by any enterprise within the same group. • Interest expenses include: (i) Interest on all forms of debt; or (ii) Payments economically equivalent to interest (excluding expenses incurred in connection with the raising of finance).
Exception	The Rules do not apply: (i) where total interest expense is less than RM500,000 in a YA; (ii) to certain classes of excluded persons (e.g., individuals, property developers, certain banks and insurers, etc.); and (iii) certain interest expenses excluded under the Guidelines. *Note that the threshold of RM500,000 is on a cumulative basis in the event a person has multiple business sources, but the

Key Features	Description
	calculation of interest restriction is made separately on each business source.
Maximum Amount of Interest Expenses	An amount equal to 20% of the tax-EBITDA of that person from each of his sources consisting of a business for a YA. Tax-EBITDA is ascertained as follows: Adjusted income before Restriction + Allowable qualifying deductions + Total interest expense incurred
Carry forward of interest expense	Excess interest expense not deducted in a particular YA can be carried forward to be deducted against the adjusted income for subsequent YAs until the whole amount of that excess has been fully utilized, provided the shareholders of the company remain substantially the same for the relevant periods.

Implications to Multinational Enterprises ("MNE")

It is crucial for MNEs to invest time and effort in reviewing and assessing their current financial arrangements to determine whether the arrangement and interest expense are caught by the Restriction Instrument and if so, determine whether the amount of expense falls within 20% of the tax-EBITDA. Where MNEs are impacted by the Restriction, there may be a need to consider alternative financing arrangements and structures which are more tax efficient to optimise positions in respect of its financing structures.

What We Can Do to Help

Our team is ready to support you in the following ways:

(a) Review your intercompany financing agreements and pricing policies; and

(b) Analyze and assess the impact of the new Restriction rules in the context of your interest expenses incurred from intercompany loans and financial assistance and consider alternative financial arrangement where required.

www.wongpartners.com

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