PKF
Accountants & business advisers

e-TAX NEWS

(July/2017)

Country-by-Country Reporting notification

The Organisation for Economic Co-operation and Development (OECD) has released its final reports on Base Erosion and Profit Shifting Project (BEPS Report) with 15 action plans to counter aggressive tax planning strategies that exploit gaps and mismatches in tax rules in different tax jurisdictions and to artificially shift profit to low tax jurisdictions. Country-by-Country Reporting (CbCR) is one of the minimum standards formulated by the OECD to counter Base Erosion and Profit Shifting (BEPS). On 27 January 2017, it was reported that Malaysia joined the inclusive framework for the global implementation of the BEPS Project.

The Income Tax (Country-by-Country Reporting) Rules 2016 were issued by the Malaysian Inland Revenue Board (MIRB) on 23 December 2016 to provide guidelines on CbCR under Action 13 of the BEPS Report. The above-mentioned Rules cover, among others, the conditions that require a multinational corporation (MNC) group to provide CbCR, details that should be reported in a CbCR, filing obligations, time for filing as well as use and confidentiality of the CbCR information. It came into operation on 1 January 2017 and applies to an MNC group where:

- any of its constituent entities have cross border transactions with its other constituent entities;
- the total consolidated group revenue in the financial year preceding the reporting financial year is at least RM3 billion;
- its ultimate holding company is incorporated under the Companies Act 1965 or under any written law and resident in Malaysia; and
- its constituent entities are incorporated or registered under the Companies Act 1965 or under any written law or under the laws of a territory outside Malaysia and resident in Malaysia.

The ultimate holding company or the surrogate holding company would be the one filing the CbCR and the CbCR must be submitted within 12 months from the last day of the reporting financial year (i.e. latest by 31 December 2018 for the financial year 2017).

Furthermore, a notification also needs to be given to the MIRB, in writing, on or before the last day of the reporting financial year under the following situations:-

- Any constituent entity of an MNC group that is resident in Malaysia shall notify the MIRB if it is the ultimate holding company or the surrogate holding company.

- Where a constituent entity of an MNC group that is resident in Malaysia is not the reporting entity, the constituent entity shall notify the MIRB of the identity and tax residence of the reporting entity. Therefore, Malaysian based subsidiaries of foreign MNC groups will have to notify the MIRB of the entity within the group who will be filing the CbCR.

Editor's comments:

The above CbCR requirements are not only affected the holding company of an MNC group that is resident in Malaysia but also any foreign subsidiary/branch of an MNC group that operates its business in Malaysia if the holding company is required to file a CbCR in the tax jurisdiction of its home country. Hence, any foreign subsidiary/branch of an MNC group in Malaysia is required to inform its head office on the above new requirement in Malaysia and to seek clarification whether its holding company is required to file a CbCR in its home country. Please advise us accordingly if the above CbCR notification to the MIRB of a foreign subsidiary/branch in Malaysia is applicable to your company and we will advise the Company on the next course of action.

Update on Transfer Pricing Guidelines 2012

The MIRB has updated the Transfer Pricing Guidelines 2012 (2012 Guidelines). Currently, the Guidelines are being updated to reinforce the existing standard and reformatted on its presentation to in line with Action 13 of OECD's BEPS report. The following chapters in the 2012 Guidelines have been updated and we have summarized below some of the salient points:

Chapter II — The Arm's Length Principle

- Contractual arrangements must reflect economic reality.
- MIRB will disregard transactions that are commercially irrational.
- Berry ratio is recognized as one of the choice of acceptable profit level indicator.
- Any increase in functions will increase the share of profit.
- Evaluation of risk assumed is critical in determining the arm's length price.
- The higher the risk assumed, the higher the expected return.

Chapter VIII — Intangibles

- Entities performing the development, enhancement, maintenance, protection and exploitation of the intangibles are entitled to a fair share of the intangible returns.
- Legal ownership and funding of the development of the intangibles may not lead to entitlement of a return from the exploitation.
- Taxpayer paying for royalty for the use of royalty must justify the underlying intangible, the utilization of the intangible, the benefit obtained, economically significant risk associated with the intangible and withholding tax.

Chapter X — Commodity transactions

- CUP method is the generally accepted method.
- The pricing policy used must be justifiable and documented in Transfer Pricing document.

- If operational conditions remain unchanged, the selected comparable companies must be updated every 3 years.
- Financial data and suitability of the existing comparable companies should be reviewed and updated every year.
- Master file must be prepared to be submitted with CbCR.
- Additional disclosure in Transfer Pricing documentation including pricing policy, risk analysis etc.

Editor's comments:

The revision of the Transfer Pricing Guidelines 2012 to be in-line with the BEPS report has reaffirmed the attention of the MIRB to prepare cotemporaneous Transfer Pricing documentation. The revision made under Chapter XI: Documentation, provides further clarity on the existing contents and also the additional disclosure requirements of the Transfer Pricing documentation to be in compliance with the above Guidelines. In addition, the comparable companies used in the Transfer Pricing documentation must be reassessed every 3 years even the operational conditions remain unchanged. Hence, it is crucial for the existing Transfer Pricing documentation to be reviewed in light of the above revision made by the MIRB.

In addition, the penalty provision for any Transfer Pricing adjustments invoked by the MIRB has been elaborated to include the following:

- Form and substance is not the same i.e. where the agreement does not reflect the actual conduct between the taxpayer and its associated person.
- Comparable companies selected by the taxpayer do not meet all of the economically relevant characteristics or comparability factors set out in the Rules.
- Inaccurate or misleading explanation of function, asset and risk; e.g. when a taxpayer claims that it does not bear the foreign exchange risk but in substance it does, and this reflected in its accounts.

MIRB issues Practice Notes on Withholding Tax

The MIRB has issued the following Practice Notes as follows:

No.	Reference	Issues
1	Practice Note No. 1/2017	To provide guidance on the implementation of the amendment to Section 15A of the Income Tax Act 1967 (ITA), relating to contracts signed and services performed outside Malaysia prior to the amendment coming into effect on 17 January 2017.
2	Practice Note No. 2/2017	To clarify the impact of the amendment to Section 15A of the ITA on the existing Double Taxation agreements (DTA).

Practice Note No 1/2017 explains the withholding tax implication in the following scenario:-

- For contracts signed before 17 January 2017 and services performed outside Malaysia before and after 17 January 2017:
  - No withholding tax applicable if service performance period is up to 16 January 2017.
  - Subject to withholding only when service performance period after 17 January 2017.

- For contracts signed and services performed outside of Malaysia before 17 January 2017 but payments made after 17 January 2017, withholding tax will not be applicable on such payment.

- For contracts signed and payments made before 17 January 2017 but services performed outside Malaysia after 17 January 2017, withholding tax is also not applicable on such payment.

Practice Note No 2/2017: The MIRB has the right to impose withholding tax for payment made to a non-resident of another country for technical services irrespective of whether the services are performed onshore or offshore. However, under certain DTAs concluded between Malaysia and other countries, Malaysia's right to tax is restricted as follows:

Contracting states	Implication
Singapore	Payment for services performed outside Malaysia are not subject to withholding tax
Spain	
Australia	Payments for services are not subject to withholding tax
Turkmenistan	

Editor's comments:

Due to the lack of clarity from the MIRB at this juncture on the changes of the withholding tax landscape in Malaysia, it is crucial for taxpayers to review their existing contracts with non-residents and any payment made to non-residents to identify any withholding tax exposure in order to avoid any future potential tax disallowance and tax penalty.

The widening of the definition of royalty and the scope of technical services for withholding tax may affect many taxpayers due to the wide usage of shared services within an MNC group that may have both elements of royalty and technical services, thus taxpayers are advisable to revisit any payment made to non-residents, especially those intra-group services which may be caught under the new scope of withholding tax in Malaysia.

Imposition of 100% penalty for failure to declare income and incorrect information

The MIRB has issued a clarification on the imposition of penalty at a rate of 100% of the tax payable on undeclared or under declared income under Section 113 of the ITA which will be implemented with effect from 1 January 2018.

The following are examples of cases which will be subject to the 100% penalty rate:

- Repeated offences of undeclared or incorrectly declared income received by way of a return form;
- Refusal to give full co-operation during an audit or investigation process;
- Failure to give information or documents requested to assist in an audit or investigation process;
- Carrying out an organised tax evasion scheme, or
- Failure to comply with the tax law even though the taxpayer has been audited or investigated before.

Editor's comments:

Our experience over the past 12 months had shown that the MIRB has conducted more tax audits on taxpayers to encourage tax compliance and also to curb aggressive tax planning strategies. Many taxpayers encountered cash flow problems due to the unexpected additional tax payable and tax penalties. In extreme cases, the MIRB has taken the following adverse actions on some taxpayers to recover the additional tax payable and tax penalties:-

- Forced sale of their assets;
- Initiate action to place a company under receivership or winding up; or
- Directors are personally liable to the tax liability of a company and are not allowed to leave the country.

As you are aware, a conventional tax compliance service is mainly restricted to the preparation of tax returns in accordance to tax laws based on the information and clarification provided by company. Identification of a company's potential tax risk and tax exposure can only be properly addressed if the accounting records and the relevant supporting documents are closely scrutinized. Our pre-field audit review serves as a mock field audit to assist taxpayers to manage and mitigate their tax risk. Please contact our tax team below if such an assistance is required.

Contact us:

PKF Tax Services Sdn Bhd
Level 33, Menara 1MK,
Kompleks 1 Mont' Kiara
No. 1, Jalan Kiara, Mont' Kiara
50480 Kuala Lumpur
Tel : +6 03 6203 1888
Fax : +6 03 6143 2213
Email : pkftax@pkfmalaysia.com
Website : www.pkfmalaysia.com

Our services	Name	Ext
Corporate Tax Compliance	Lim Chen Chiaw Weddy Kang Catherine Goh	603-62031888 – Ext 227 – Ext 223 – Ext 230
Individual & Expatriate Tax	Owen Tan	603-62031888 – Ext 414
Tax Audit/Investigation & Strategic Tax Planning	Lim Ai Chen Mohd Amirul Radzuan	603-62031888 – Ext 238 – Ext 227
Transfer Pricing & Tax Advisory	Owen Tan Phang Siew Ming	603-62031888 – Ext 414 – Ext 321
GST Compliance & Advisory	Fan Kah Seong Lim Ai Chen	603-62031888 – Ext 222 – Ext 238