

OECD Multilateral Convention on Base Erosion and Profit Shifting and Pillar Two – Are You Ready?

31 December 2020



**MAKING AN
IMPACT THAT
MATTERS**
since 1845

Foreword



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Base Erosion and Profit Shifting (“BEPS”) and Multilateral Convention to implement tax treaty related measures to prevent BEPS (“MLI”) are two burning issues in international tax.

Briefly, the MLI seeks to facilitate the implementation of tax treaty related measures to counter BEPS. Signatories to the MLI can efficiently update their Double Tax Agreement (“DTA”) to incorporate the measures, without the need to re-negotiate each DTA.

Malaysia has signed the MLI on 24 January 2018.

On 4 August 2020, the Malaysian Government has gazetted the Double Taxation Relief (Multilateral Convention to Implement Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting) Order 2020 [P.U.(A) 224/2020].

Malaysia has yet to deposit the instrument of ratification with the Organisation for Economic Co-operation and Development (“OECD”). As this is expected to be done in due course, it is crucial for multinational enterprises (“MNEs”) to understand the different positions adopted by the treaty countries to determine how the MLI affects a particular tax treaty.

MNEs, in this this context, refer to Malaysian based MNEs that have various operations and investments overseas as well as foreign based MNEs that have operations in Malaysia.

Other international tax issues in vogue would be the OECD’s blueprints for Pillar One and Pillar Two.

On 12 October 2020, the G20/OECD inclusive framework on BEPS released detailed blueprints on Pillar One and Pillar Two in relation to its ongoing work to address the tax challenges arising from the digitalization of the economy.

Given that the political consensus on Pillar Two is likely to be achieved first, we share with you some of our thoughts on the rules proposed under Pillar Two that may impact Malaysia.

Malaysia may need to consider whether changes are required to key features of its corporate tax system, including the territorial tax regime, the non-taxation of capital gains and various incentives offered in respect of particular classes of income and activities.

As 2020 comes to an end, we do not know when the COVID-19 pandemic will be over. What we know is that the international tax rules will continue to change and get more complex. We hope that our write-up will shed some light and more importantly, remind you that that MLI, Pillar One and Pillar Two are imminent.

Businesses should be aware of the changes and their potential impact. In short, prepare early!

Happy reading and Happy New Year!

MLI Implications on Malaysia's Tax Treaties

MLI



Background

Under the OECD/G20 Inclusive Framework on BEPS, more than 125 countries are collaborating to put an end to tax avoidance strategies that exploit gaps and mismatches in tax rules to avoid tax. Although Malaysia is neither a member of OECD nor G20, the Malaysian authorities are following the BEPS developments closely and indeed, have participated in the Regional Network meetings on BEPS project.

Inception of MLI

MLI is an outcome of BEPS Action Plan 15 of the OECD/G20 Inclusive Framework, which offers solutions for governments to plug loopholes in international tax treaties by transposing results from the BEPS project into bilateral tax treaties worldwide. More than 1,500 tax treaties are expected to be modified. In November 2016, the negotiation of the MLI was concluded and agreed upon by more than 100 participating jurisdictions (Malaysia was part of them).

How MLI works

MLI allows governments to modify application of its network of bilateral tax treaties in a synchronized manner without renegotiating each of these treaties bilaterally. MLI positions of two countries should match for MLI to modify bilateral tax treaty.

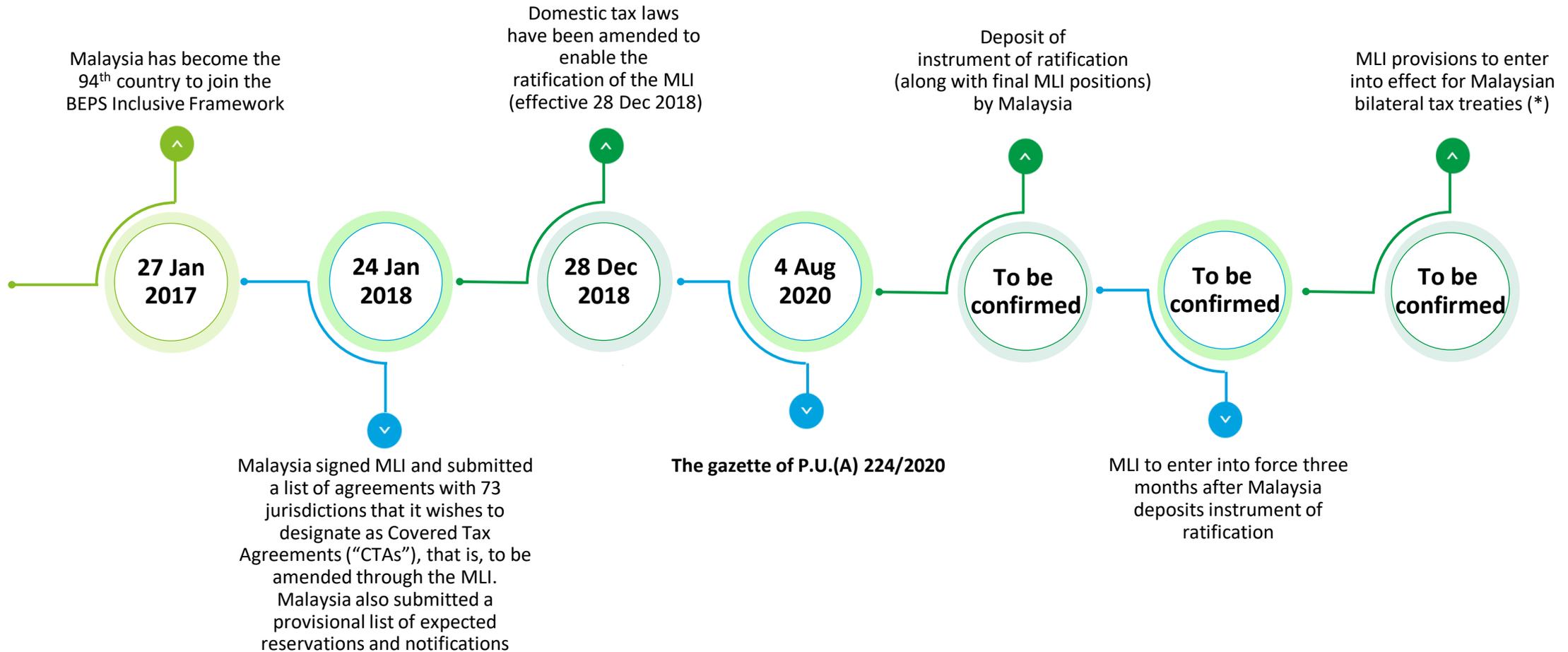
When

On 4 August 2020, the Malaysian Government has ratified the MLI vide the P.U.(A) 224/2020. It is now pending for Malaysia to deposit the instrument of ratification, acceptance or approval (along with final positions) with the OECD Secretariat.

Who MLI Impacts

Every person/entity undertaking cross border business or investment with/in Malaysia and outside of Malaysia.

MLI milestones



* That is, Malaysian tax treaties with jurisdictions that have already deposited their ratification instrument with the OECD Secretariat and have included tax treaty with Malaysia as CTA.

MLI entry into force and effect

- The MLI will **enter into force** after three months Malaysia deposits instrument of ratification with the OECD Secretariat.
- Please see example below - 31 December 2020 is used as the date of deposit of instrument of ratification for illustration purpose:

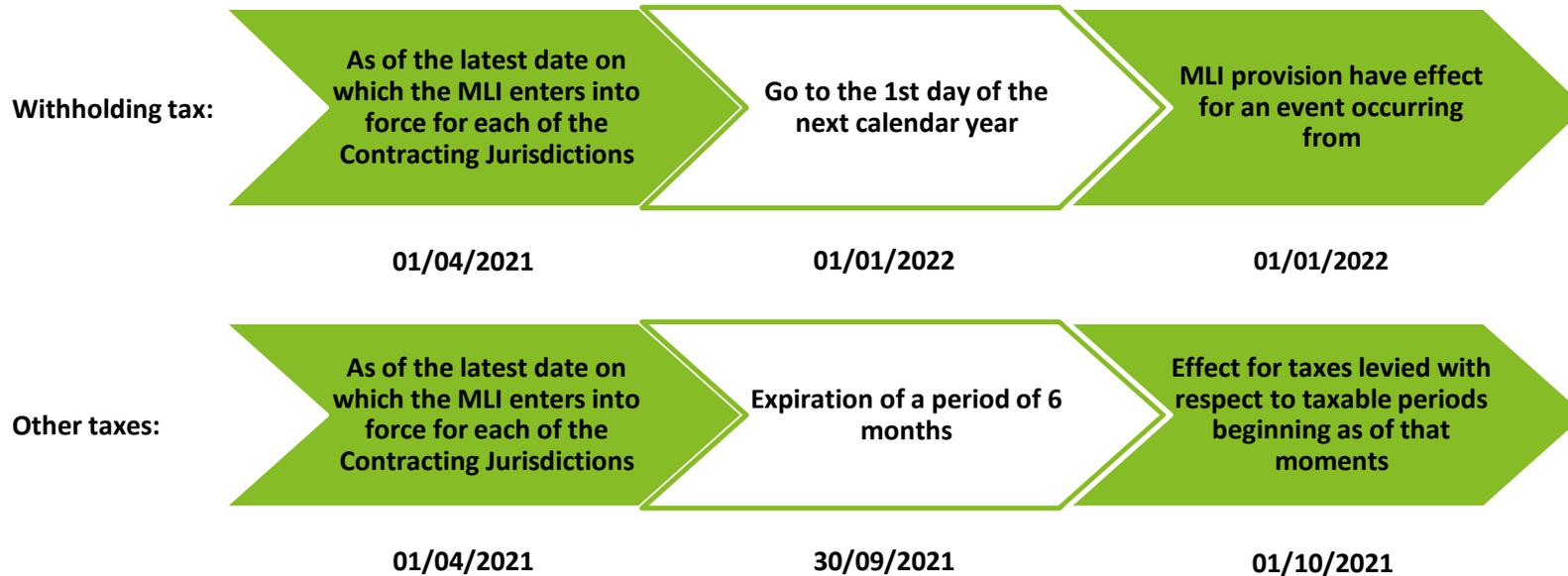


- Once the MLI enters into force, different rules apply as to how the MLI enters into effect for withholding tax ("WHT") and other taxes. MLI provisions generally will enter into effect in relation to a relevant treaty (CTA).
 - For **WHT**, the MLI provisions will become applicable on or after the first 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.

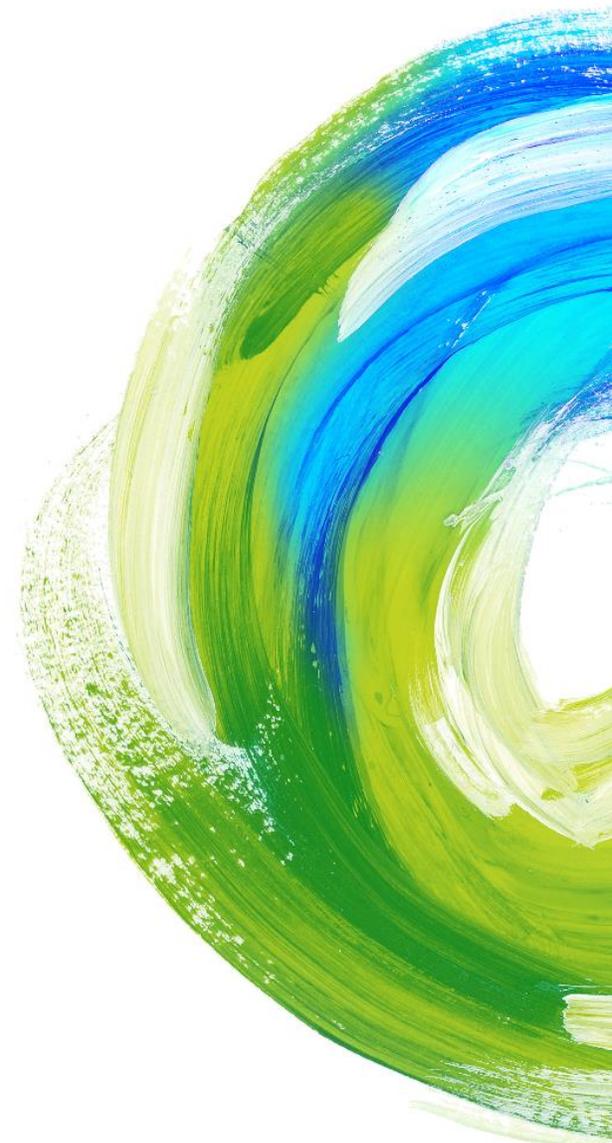
MLI entry into force and effect (cont'd)

Example: Where Malaysia deposits its instrument of ratification with OECD Secretariat on 31 December 2020.

Japan	Entry into Force – 01/01/2019
Malaysia	Entry into Force – 01/04/2021

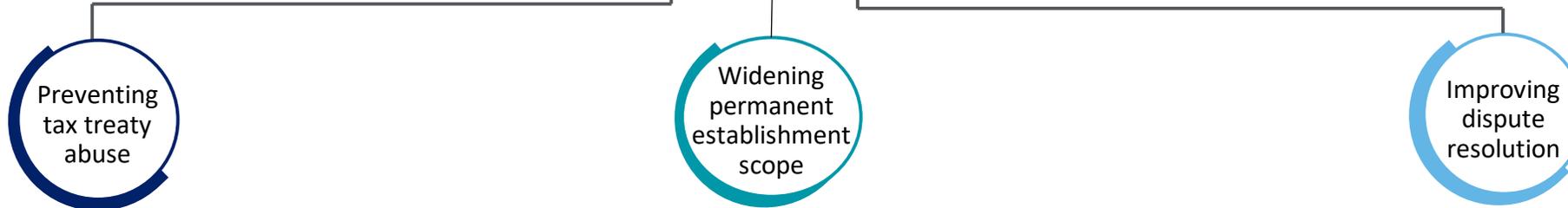


Our Commentary:
 In the above illustration, for treaty partner jurisdiction that deposits their MLI instruments of ratification, acceptance or approval with the OECD after 31 December 2020, the MLI provisions for the relevant CTA with Malaysia will take effect based on the date the MLI comes into force for the treaty partner jurisdiction.



Key impact areas vis-à-vis Malaysian tax treaties

Key prominent modifications in Malaysian bilateral tax treaties



Preventing tax treaty abuse

- Malaysia has opted to include a statement of intent that a DTA is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.
- Malaysia has also chosen to adopt **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).

Our Commentary:

Once the MLI for Malaysia and its treaty partners is effective, a company has to fulfill the PPT before it could claim any treaty benefit (e.g. relying on the reduced WHT rate as provided in the DTA etc.).

Widening permanent establishment scope

- Broader agency permanent establishment (“PE”) rule to apply to address **artificial avoidance of PE status through commissionaire arrangements and similar strategies**.
- Address avoidance of PE formation through **specific activity exemptions** and **anti-fragmentation rule**.

Our Commentary:

With the lowering of PE thresholds, certain activities carried on in Malaysia by a non-resident from treaty countries may, going forward, constitute a PE due to the following reasons:-

1. the activities are not preparatory or auxiliary in nature;
2. fragmented activities are being aggregated when considering whether a PE exists (anti-fragmentation rules);
3. the expansion of the agency PE definition such that sales / marketing activities may still trigger a PE where the agent plays a principal role leading to conclusion of contract without material modification.

Improving dispute resolution

- Malaysia will fully adopt the Mutual Agreement Procedures (“MAP”) provisions to its CTAs, another minimum standard under BEPS Action 14. When a Malaysian resident taxpayer encounters taxation, which is not in accordance with the intended application of the DTA provisions, the taxpayer could request for MAP to be presented to either competent authority to resolve the dispute.
- Malaysia has opted not to adopt the mandatory arbitration provisions.

Our Commentary:

Once the MLI for Malaysia and its treaty partners is effective, it is expected that the more effective MAP procedures could help to resolve cross border tax disputes.

In evaluating the extent of modification of the Malaysian tax treaty, Malaysia's MLI positions need to be compared with the MLI positions taken by its counterpart.

MLI impact on select Malaysian tax treaties - Snapshot

	Malaysia	United Kingdom	Treaty Impact
Wider agency PE rule			X
Specific activity exemptions (preparatory or auxiliary)	Option A	No Change	X
Anti-fragmentation rule			✓

	Malaysia	Japan	Treaty Impact
Wider agency PE rule			✓
Specific activity exemptions (preparatory or auxiliary)	Option A	Option A	✓
Anti-fragmentation rule			✓

Wider agency PE rule will not apply as UK has made a reservation not to apply the new agency PE rule.

Specific activity exemptions related provision will not apply as UK has not chosen any option.

Anti-fragmentation rule will apply as both UK and Malaysia have chosen to adopt.

Wider agency PE rule will apply since both Japan and Malaysia have chosen to adopt.

Specific activity exemptions related provision will apply as Japan has chosen same option as Malaysia.

Anti-fragmentation rule will apply as both Japan and Malaysia have chosen to adopt.

Malaysia DTA and MLI impact

Asia Pacific

Malaysia's DTA that would be impacted once the MLI enters into effect in respect of DTA between Malaysia and the treaty partner:

Other treaty jurisdictions – included Malaysia DTA as one of the CTA*		
Australia	Japan	Qatar
Bahrain	Jordan	Saudi Arabia
China	Kazakhstan	Singapore
Fiji	Kuwait	South Korea
Hong Kong	New Zealand	United Arab Emirates
India	Pakistan	
Indonesia	Papua New Guinea	

Malaysia's DTA that would not be impacted as the treaty jurisdictions have not signed the MLI as at 31 December 2020:

Other treaty jurisdictions – have not signed the MLI*		
Bangladesh	Lebanon	Syria
Brunei Darussalam	Mongolia	Thailand
Iran	Myanmar	Turkmenistan
Kyrgyzstan	Philippines	Uzbekistan
Laos	Sri Lanka	Vietnam

* As at 31 December 2020



Malaysia DTA and MLI impact (cont'd)

Europe

Malaysia's DTA that would be impacted once the MLI enters into effect in respect of DTA between Malaysia and the treaty partner:

Other treaty jurisdictions – included Malaysia DTA as one of the CTA*		
Albania	Ireland	San Marino
Belgium	Italy	Slovakia
Bosnia and Herzegovina	Luxembourg	Spain
Croatia	Malta	Sweden
Denmark	Netherlands	Turkey
Finland	Poland	United Kingdom
France	Romania	
Hungary	Russia	

Malaysia's DTA that would not be impacted as the treaty jurisdictions did not include Malaysia as CTA:

Other treaty jurisdictions – did not include Malaysia DTA in its list of CTA*		
Austria	Germany	Switzerland
Czech Republic	Norway	



* As at 31 December 2020

Malaysia DTA and MLI impact (cont'd)

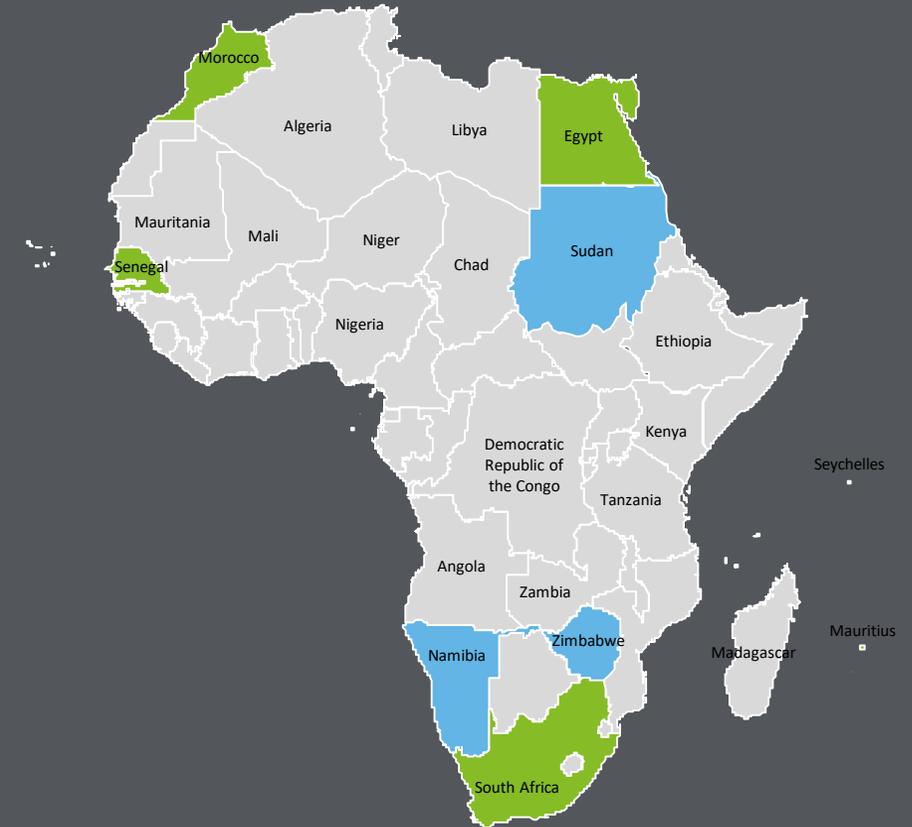
Africa

Malaysia's DTA that would be impacted once the MLI enters into effect in respect of DTA between Malaysia and the treaty partner.

Other treaty jurisdictions – included Malaysia DTA as one of the CTA*		
Egypt	Morocco	Seychelles
Mauritius	Senegal	South Africa

Malaysia's DTA that would not be impacted as the treaty jurisdictions have not signed the MLI as at 31 December 2020:

Other treaty jurisdictions – have not signed the Convention*		
Namibia	Sudan	Zimbabwe



* As at 31 December 2020

Malaysia DTA and MLI impact (cont'd)

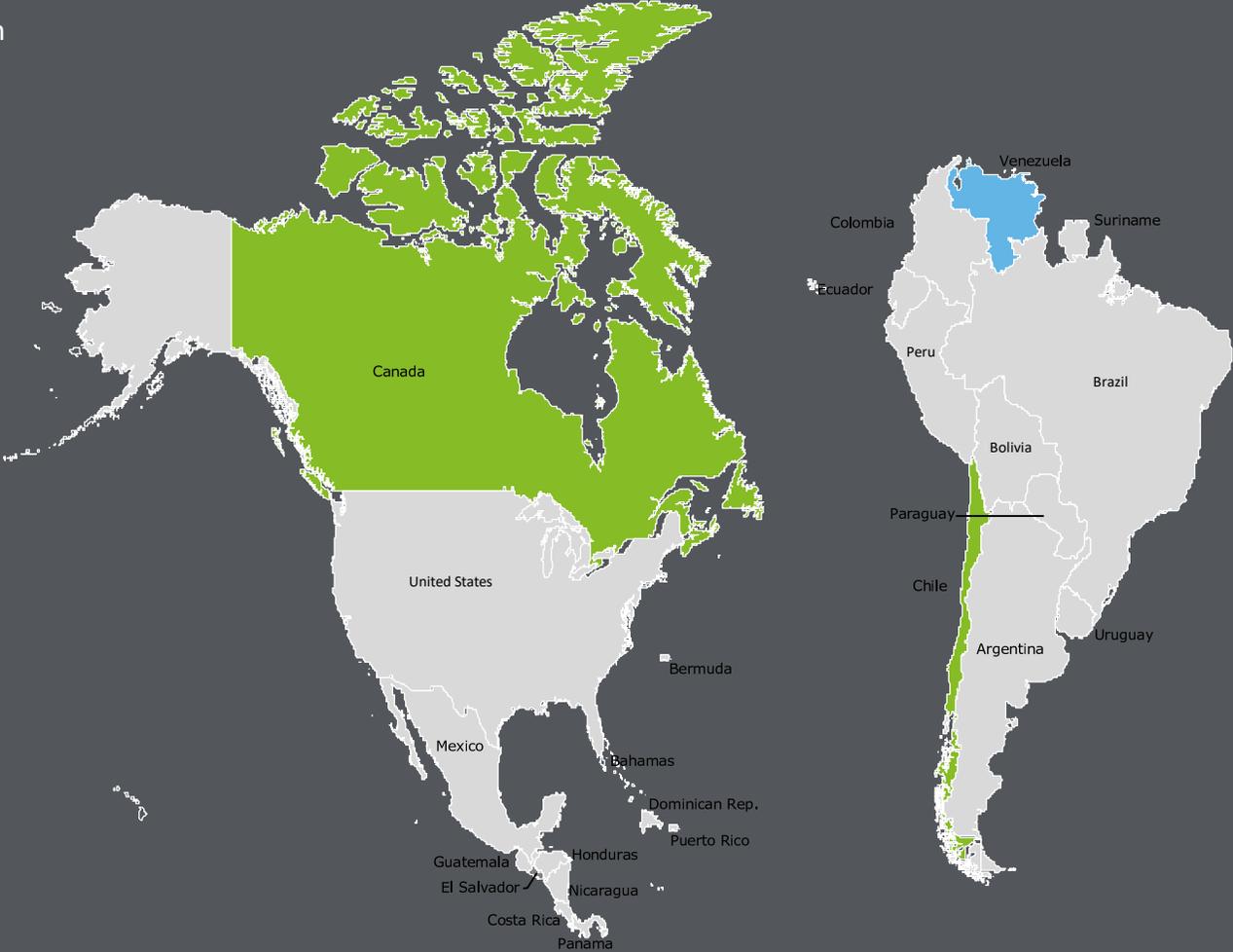
Americas

Malaysia's DTA that would be impacted once the MLI enters into effect in respect of DTA between Malaysia and the treaty partner.

Other treaty jurisdictions – included Malaysia DTA as one of the CTA*	
Canada	Chile

Malaysia's DTA that would not be impacted as the treaty jurisdictions have not signed the MLI as at 31 December 2020:

Other treaty jurisdiction – has not signed the Convention*
Venezuela

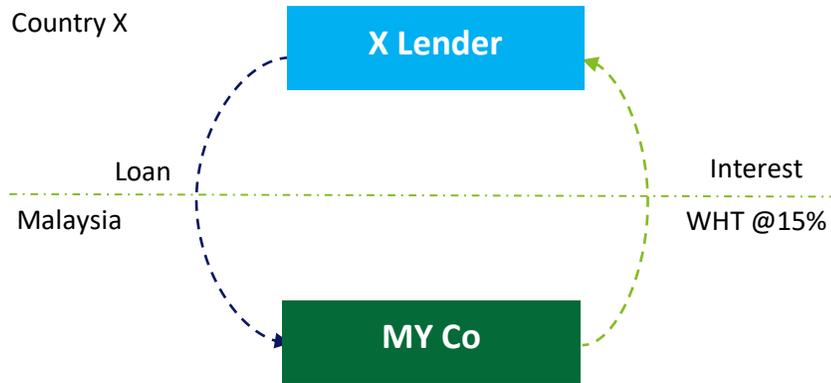


* As at 31 December 2020

Likely impacted business structure – Example 1

PPT rule (outbound interest) – lowering WHT payable

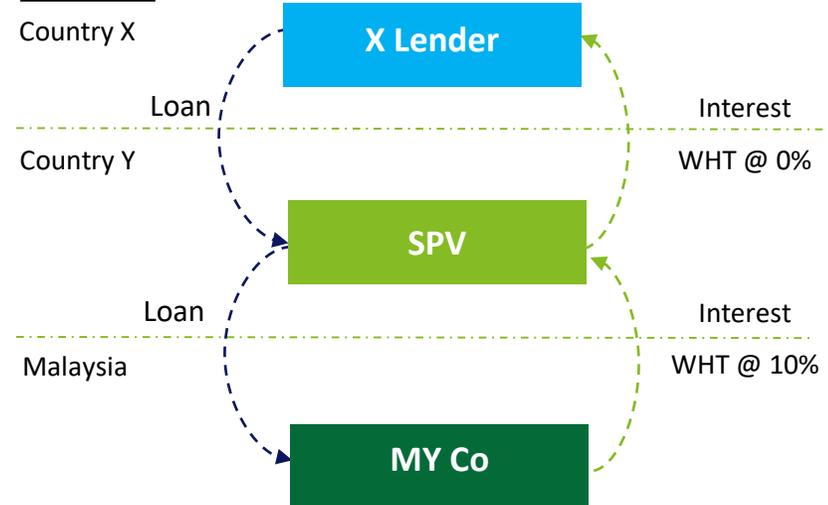
Structure I



Facts under Structure I:

- X Lender provides loan to MY Co.
- MY Co pays X Lender arm's length interest.
- Interest payment to X Lender is subject to WHT @ 15%.

Structure II



Facts under Structure II:

- X Lender provides loan to SPV. SPV pays X Lender arm's length interest.
- Interest payment from SPV to X Lender is not subject to WHT.
- SPV provides loan to MY Co.
- MY Co pays SPV arm's length interest. Assuming that the tax treaty between Malaysia and Country Y provides a reduced WHT rate of 10% on interest.

MLI implication

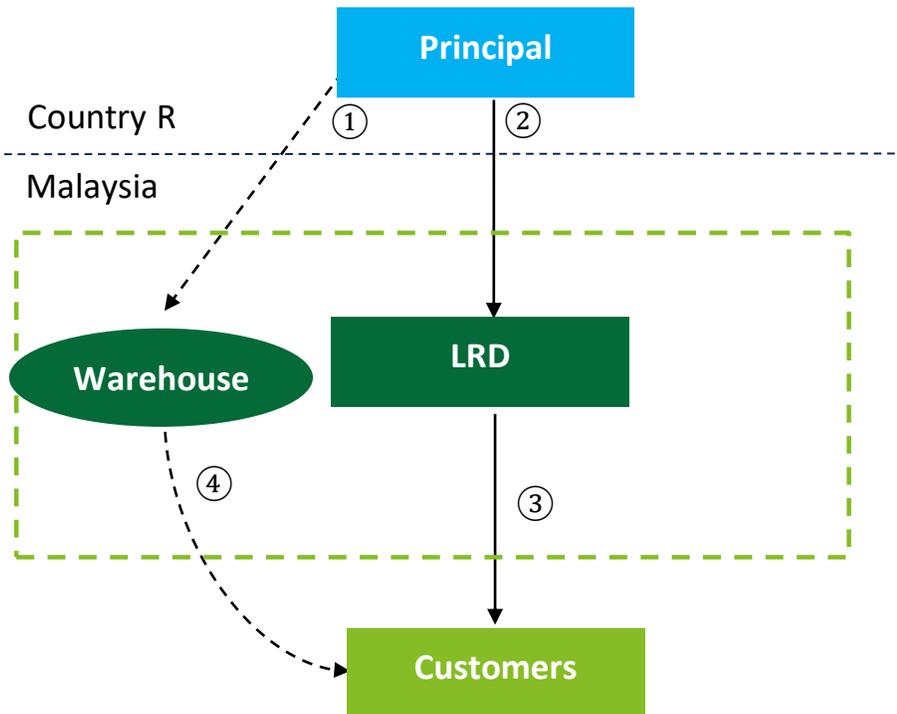
In the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes of setting up SPV is to obtain the benefit of the reduced WHT under the treaty, PPT provision would apply to deny that benefit.

Whilst the above illustrates the situation of outbound payment, the impact on inbound payment (e.g. Malaysian resident receiving interest income from a payer that is a tax resident elsewhere) would also need to be considered

Likely impacted business structure – Example 2

Article 5(4) - The specific activity exceptions from PE status

Article 5(4.1) – Anti-fragmentation rule



Key:

- > Physical movement
- > Sale

Business model

- 1: Physical movement of goods to warehouse owned by Principal in Malaysia.
- 2: Principal sells goods to Limited Risk Distributor (“LRD”) (a wholly owned subsidiary of Principal in Malaysia).
- 3: LRD enters into sales contracts with Customers.
- 4: Physical movement of goods to Customers. Risk transfers from Principal to LRD via Flash Title immediately before sale to Customers. Title and risk of loss transfers from LRD to Customer upon delivery.

PE consideration

- a) The activities carried out in the warehouse may not meet the preparatory or auxiliary test under Article 5(4).
- b) Even if the activities are preparatory or auxiliary in nature, anti-fragmentation rule may apply. The activities carried on by Principal in the warehouse and by LRD at its store constitute complementary functions that are part of a cohesive business operation.
- c) Fixed place PE would arise.
- d) Profit attributable to the PE needs to be considered.

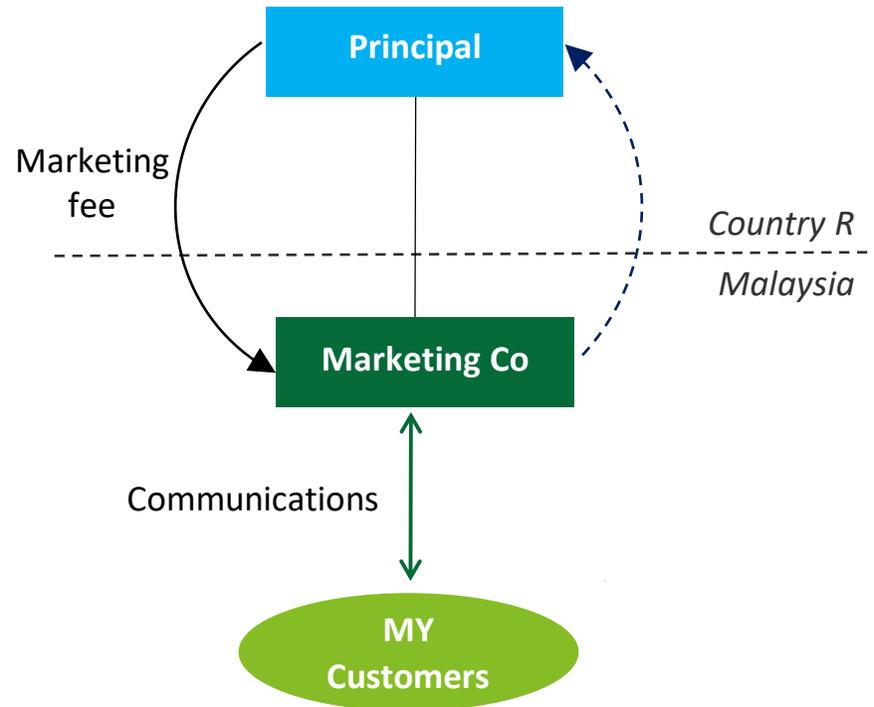


Our Commentary:

Companies in tax treaty countries should consider reviewing existing and future operating structure to ensure that there will be no unexpected PE consequences after the MLI takes effect, especially for companies that currently rely on an exception under the definition of a PE.

Whilst the above illustrates the situation of operations in Malaysia, the impact on operations overseas (e.g. Malaysian resident company selling goods to customers outside of Malaysia via foreign warehousing and LRD) that is, whether a PE outside of Malaysia would arise for the Malaysian resident company, would also need to be considered.

Likely impacted business structure – Example 3



Business model

- Marketing Co is a wholly owned subsidiary of Principal in Malaysia.
- Marketing Co provides marketing service in Malaysia to Principal only.
- Principal pays Marketing Co arm's length marketing fee.
- Marketing Co's employees do not conclude contract on behalf of principal.
- However, Marketing Co's employees actively negotiate contracts and meet Malaysian customers to convince them to buy Principal's products.

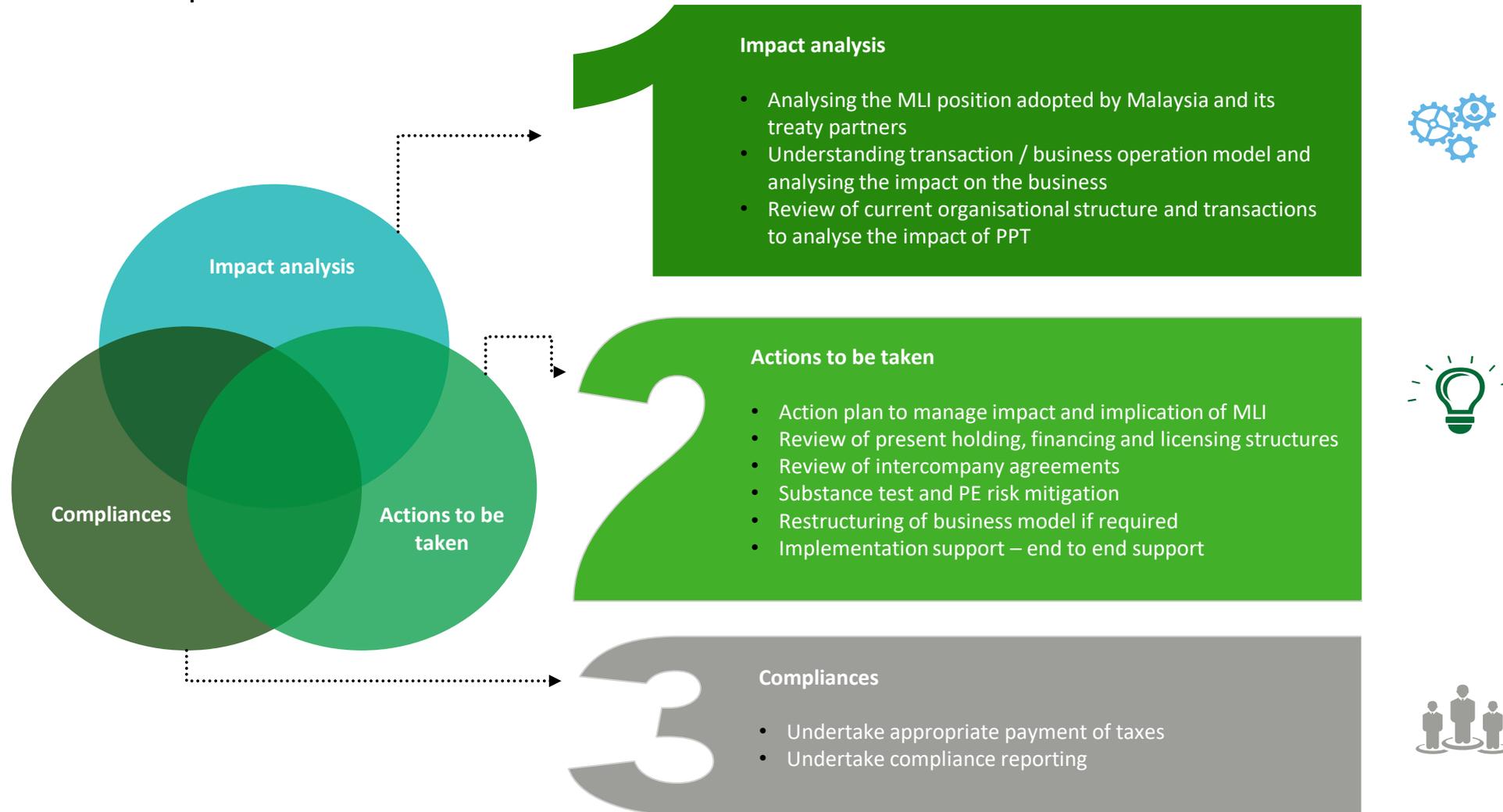
PE consideration

- Agency PE would arise if Marketing Co plays the principal role leading to conclusion of contract without material modification.
- Marketing Co would not be regarded as independent agent as it acts exclusively for Principal.
- Profit attributable to the PE needs to be considered.

Whilst the above illustrates the situation of operations in Malaysia, the impact on operations overseas (e.g. Malaysian resident company selling goods to customers outside of Malaysia via a foreign marketing company) that is, whether an agency PE outside of Malaysia would arise for the Malaysian resident company, would also need to be considered.

Way forward

How can we help?



OECD's Pillar Two Blueprint – The Malaysian Perspective



OECD's Pillar Two Blueprint – The Malaysian Perspective

On 12 October 2020, the G20/OECD inclusive framework on BEPS released detailed blueprints on Pillar One and Pillar Two in relation to its ongoing work to address the challenges arising from the digitalization of the economy.

The Pillar Two blueprint proposes a set of interlocking international tax rules designed to ensure that large MNEs pays a minimum level of tax on all profits in all jurisdictions. The OECD has invited comments on the blueprints and a virtual public consultation meeting will be held in January 2021. The OECD's aim is to bring the process to a conclusion by mid-2021.

The Pillar Two blueprint sets out proposals that do not yet have the political agreement of the inclusive framework countries, including the following key elements:

- **The income inclusion rule and the undertaxed payment rule (“GloBE”):** Connected rules that are intended to ensure large multinational groups pay tax at a minimum level in each jurisdiction in which they operate. These share common rules for scope, and for calculating effective tax rates (“ETRs”) and top-up amounts.
 - The principal rule is the income inclusion rule (“IIR”), which would trigger additional “top-up tax” payable in a group’s parent company jurisdiction where the profits of group companies in any one jurisdiction are taxed at an ETR below a minimum tax rate. A switch over rules would apply similarly to exempt branches.

- An undertaxed payment rule (“UTPR”) acts as a backstop for low-taxed group companies not controlled by a parent company subject to the IIR.

- **The subject to tax rule (“STTR”):** A separate rule that applies in priority to the IIR and UTPR. Paying (source) jurisdictions would be able to charge a top-up tax in respect of specific types of intragroup payments made to other group companies, where the recipient jurisdiction has a nominal tax rate less than a minimum tax rate. The rule would be applied on a payment-by-payment basis, but could be calculated and administered by way of an annual return.

This write-up assumes a basic knowledge of the Pillar Two blueprint to focus on highlighting the elements most relevant to groups operating in Malaysia.

Implications of the GloBE for Malaysia

When considering the implications of the GloBE to Malaysian taxpayers, it is useful to categorize taxpayers into the following groups:

A. Country-by-Country (“CbC”) reporting groups

The GloBE should only apply to multinational groups that satisfy the OECD's CbC reporting filing rules, i.e., those with consolidated global revenue of at least EUR750 million (or equivalent). Therefore, relatively small groups or purely domestic groups should not be affected.

B. Groups with jurisdictional ETRs above and below the minimum

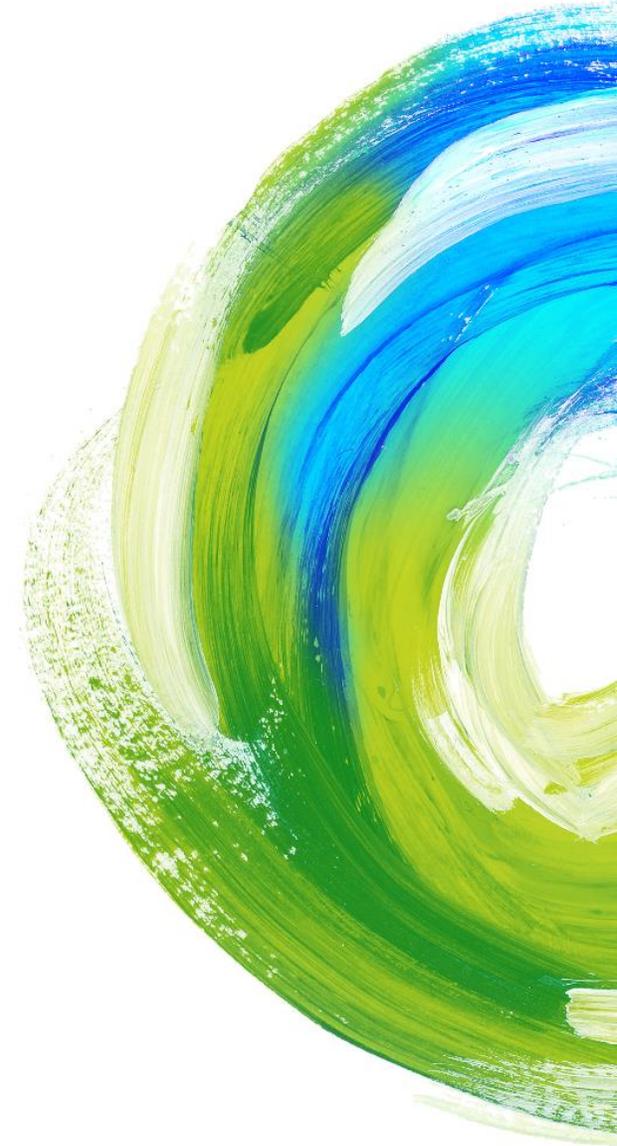
The GloBE would only apply where jurisdictional ETR falls below a certain minimum ETR at which point the IIR or UTPR would apply. Where the ETR exceeds the minimum, the GloBE would not apply. Consensus has not been reached on the final minimum ETR.

However, examples in the Pillar Two blueprint use various tax rates between 10% and 12.5%. While these rates are lower than Malaysia's tax rate of 24%, when computing ETR under GloBE, some Malaysia taxpayers may have an ETR below this range. This is due to a combination of factors, including the territorial nature of Malaysia's tax system (e.g. in general foreign sourced income would be exempted from tax), the non-taxation of capital gains, and various exemptions and incentives offered in respect of particular classes of income and activities. Taxpayers below the minimum ETR may not be able to benefit from certain favorable aspects of Malaysia's tax system. However, taxpayers with an ETR above the minimum may still wish to benefit from these favorable aspects and be attracted by the income tax exemption on foreign sourced income and tax free capital disposals, and benefit from various exemptions and incentives.

C. Inbound multinational group versus Malaysia headquartered groups

Group that are headquartered outside of Malaysia with Malaysian operations, will likely be subject to an IIR assuming that the IIR rule is implemented in either the ultimate parent jurisdiction or an intermediate parent jurisdiction. For example, if for a given year, the computed ETR for Malaysia is below the minimum rate, then the corresponding 'top-up tax' would be collected by the ultimate parent company jurisdiction (or an intermediate parent company jurisdiction). Therefore, the IIR provides a mechanism to collect the top-up tax for an entity in a low taxed jurisdiction based on a foreign parent's direct or indirect ownership of that low taxed entity.

The profits made in the jurisdiction of the ultimate parent entity are out of scope of the IIR since it only applies to the foreign profits i.e. profits made in all other jurisdictions outside of the parent jurisdiction. Therefore, the IIR would not apply to Malaysia profits of a Malaysia headquartered group. In this case, if the computed ETR in Malaysia falls below the minimum level for a given period, then the UTPR can apply to the profits made in Malaysia. This means that the 'top-up tax' in respect of Malaysia profits can be collected in the foreign jurisdictions that have implemented the UTPR.





D. US headquartered groups

The Pillar Two blueprint recognises that consensus would need to be reached as to how the US Global Intangible Low Taxed Income (“GILTI”) rules should interact with the IIR (e.g. in the case where there is an US intermediary company is involved). Whilst both GILTI and IIR should achieve the similar result, there are significant differences between them. The co-existence of the US GILTI and IIR may complicate the policy responses of jurisdictions to GloBE.

In this regard, further work would need to be carried out to address the issues arising from the co-existence of the US GILTI and IIR.

E. Excluded groups

Investment funds, pension funds, governmental entities, international organizations, nonprofit entities, and entities subject to tax neutrality regimes may be excluded from scope. The rules can apply instead to subgroups controlled by such excluded entities.

Implications of the STTR for Malaysia

The STTR operates on a stand-alone basis and in priority to the other Pillar Two rules discussed above. It operates on an individual payment basis and is therefore not based on the computed ETR in the jurisdiction of the recipient. Instead, the rule is applicable to payments that are subject to an adjusted nominal tax rate in the recipient jurisdiction that is below the agreed minimum tax rate. The effect of the STTR is to allow the payer jurisdiction to apply a top-up tax (in coordination with any existing WHT in the treaty) to bring the tax on the payment up to the agreed minimum rate.

The agreed minimum tax rate is yet to be determined, although the Pillar Two blueprint suggests that it should be below the minimum ETR used for the other Pillar Two rules in order to reduce instances of over-taxation.

The STTR will apply to only certain categories of payment between connected persons (i.e. this included interest, royalties and a defined set of other payments). The STTR is a treaty based rule. This means that the payer jurisdiction can impose a WHT on the specific payment at a rate that is equal to the difference between the agreed minimum tax rate and the adjusted nominal rate that is applicable to that payment in the recipient jurisdiction.

Implications of the STTR for Malaysia (cont'd)

Any top-up tax imposed under the STTR will be taken into account in determining the ETR in a jurisdiction for the purpose of the IIR and UTPR.

The adjusted nominal rate that is applicable to the entity in the recipient jurisdiction will be determined through making specific adjustments to the statutory tax rate in the recipient jurisdiction to reflect features of the local tax system that apply to that recipient entity, for example, a preferential tax rate or an exemption / exclusion that is linked directly to the entity receiving the payment.

Therefore, the STTR may have significant implications for Malaysia. It could apply even where the MNE group has an ETR above the minimum rate in relation to its Malaysia operation (under the other Pillar Two rules) due to its application on an individual payment basis. The following key areas may be impacted:

- Malaysia adopts a territorial taxation system (foreign sourced income is generally exempted from income tax). In this respect, the receipt of foreign income (e.g. royalty, interest payment) from related party outside Malaysia would be covered under the STTR and is likely to result in top-up tax if the adjusted nominal tax rate is lower than the minimum tax rate under STTR (unless the tax treaty rate is already higher than the agreed minimum tax rate, in which case the treaty rate would continue to apply).
- Tax incentives – income earned that is subject to a concessionary rate of tax / exempted from tax under Malaysia's incentive is also likely to be affected. The adjusted nominal tax rate of the Malaysia recipient would be reflective of any concessionary rate / tax exemption under an incentive that applies to that Malaysian recipient. As such, the payer jurisdiction would be able to impose a WHT on the payment to top-up the adjusted nominal tax rate on the payment to the agreed minimum rate. Therefore, this could be an area where Malaysia would be giving up its taxing rights to a foreign jurisdiction that has implemented the STTR. This may also make the incentive less attractive to the business.
- As STTR focuses on individual payments instead of the ETR of entities in a jurisdiction as a whole, no consideration is given to the deductibility, or non-deductibility of expenses. This could lead to a situation where tax charged on income under the STTR exceeds the economic profit earned (e.g. significant expenses are incurred to generate the income). For example, Malaysia has implemented earning stripping rules as proposed in BEPS Action 4. There would be significant impact to the group as a whole if the interest is not deductible for the Malaysian taxpayer and yet the interest is subject to STTR.





Implications of the STTR for Malaysia (cont'd)

- The application of the STTR would be limited to payments between related parties. In terms of the nature of payments, it would focus on interest, royalties, and a defined set of other payments. There could be a situation whereby, an intra-group arrangement is a genuine arrangement i.e. not for the purpose of taking advantage of low nominal rates of taxation in the state of recipient. Thus, without the exception to STTR provided in such a case, the payment received by Malaysian taxpayer would be subject to STTR.

As the STTR would apply to payments based on a nominal minimum tax rate, it would need to be considered even where the jurisdictional ETR exceeds the GloBE minimum. Groups may wish to evaluate their intragroup passive income flows to assess whether the application of treaties may be affected by the STTR.

Our commentary

Malaysia offers a wide range of tax incentives for the promotion of investments in selected industry sectors. Through tax incentives, the Government of Malaysia aims to attract foreign direct investment (“FDIs”) as investors from abroad need to be incentivised to relocate or set up their operations in Malaysia. Companies that are enjoying tax incentives in Malaysia may have lower ETR due to exemption on income, extra allowances on capital expenditure incurred, double deduction of expenses, special deduction of expenses, preferential tax treatments for promoted sectors etc.

Where MNEs have a jurisdictional ETR lower than the minimum, it is very likely that the group would be subject to top-up tax in respect of its Malaysian operations, which would represent an overall increase in taxation for the group. This may be problematic for Malaysia as its attractiveness may be eroded by the additional tax burden on the group.

Instead of the Malaysian tax authorities collecting the additional revenue, the fiscal authorities of another jurisdiction would do so. This is likely to be the headquarters jurisdiction, assuming that the jurisdiction has implemented IIR. As a result, MNEs would be subject to this additional tax burden in respect of Malaysian operations, which may be viewed as a “penalty” for operating in a tax jurisdiction that offers legitimate tax holiday etc.

Our commentary (cont'd)

In this connection, the Government of Malaysia may consider enhancing and /or introducing non-tax incentives in attracting FDIs. Furthermore, Malaysia may need to relook and revise the existing Malaysian tax system with a view to protecting its tax base. This is important given that the Government's revenue has been affected significantly by the COVID-19 pandemic and the abolishment of Goods and Services Tax.

Given that the top-up tax in respect of Malaysian based operations would likely be collected by the tax authorities of other jurisdictions, Malaysia may wish to consider introducing rules that would ensure that any such top-up tax to be paid in Malaysia. This should allow the jurisdictional ETR of the relevant multinational group to be raised to the minimum ETR through the payment of tax within Malaysia, as opposed to in another jurisdiction. While the additional tax burden on groups investing in Malaysia may be inevitable, introducing this measure would at least allow Malaysia to benefit from the additional revenue, which could be used to further incentivize investment in Malaysia.

The introduction of Pillar One and Pillar Two represent a significant re-write of the international tax systems. The introduction of Pillar One and Pillar Two stem from Action 1 of the BEPS project. However, the changes proposed under Pillar One and Pillar Two are likely to be more widespread and significant than all of the other actions from the BEPS project combined. Pillar Two could particularly have an impact on Malaysia and other jurisdiction that operate tax system with relatively low tax rates and where exemptions or incentives are available for certain types of income.

Both Pillar One and Pillar Two have yet to receive consensus among the inclusive Framework members. However, businesses should be aware of these changes and their potential impact, including the need to conduct an impact assessment if required.



Speak to us

If you have questions on the above or any cross-border tax matters, please get in touch with your usual contact at Deloitte or any of us from the International Tax Services Group:

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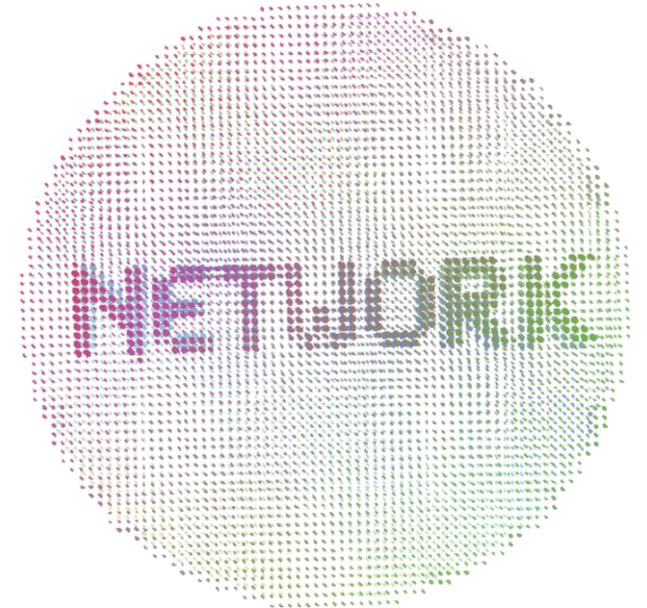
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