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MALAYSIA NEWS FLASH

THINKING GLOBALLY

Issue:
July 2019

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Read in the issue:

→ New Earnings Stripping Rules

On 28 June 2019, the Income Tax (Restriction on Deductibility of Interest) Rules 2019 were gazetted to implement the Earnings Stripping Rules (ESR) under Section 140C of the Income Tax Act 1967 (ITA) which has first been announced during the presentation of the 2019 Budget to the parliament.

Generally, a restriction on deductibility of interest should prevent an excessive debt financing and the possibility of income shifting through it.

In this newsflash, we provide you with a general overview of the new Earnings Stripping Rules, which came into operation on **1 July 2019.**

APPLICATION REQUIREMENTS OF THE NEW RULES

Generally, the rules shall apply

- to persons having been granted any financial assistance in a controlled transaction, with the total amount of any interest expense for all such financial assistance exceeding MYR 500,000 in the basis period for a year of assessment (YA); and
- in respect of the basis period beginning on or after 1 July and subsequent basis periods.

If the basis periods for a YA shall consist of a period/periods as specified in the direction, the total amount of interest expense for such financial assistance is deemed to accrue evenly over that period/periods.

MAXIMUM AMOUNT OF INTEREST AND ASCERTAINMENT OF TAX-EBITAD

The maximum amount of interest referred to in Section 140C of the ITA is an amount equal to 20 per cent of the amount of tax-EBITDA of that person from each business source for the basis period.

The tax-EBITDA shall be ascertained in accordance to the formula A+B+C, with:

- A being the amount of adjusted income of the person from its business sources;
- B being the total amount of qualifying deductions allowed in ascertaining the amount of the adjusted income under A; and
- C being the total amount of interest expense incurred in relation to the gross income of the person for any financial assistance in a controlled transaction from its business sources.

“Qualifying deductions” is defined as the special deductions given under specific rules or provisions (i.e. deduction equivalent to 200 per cent of the amount incurred, and deduction according to the rules set up under Section 154 (1)(b) of ITA in ascertaining adjusted income).

CARRY FORWARD OF EXCESS INTEREST EXPENSES

The excess interest expense over the amount ascertained can be carried forward and deducted against the adjusted income of the company for subsequent YAs, until the whole amount has been fully utilized – provided that the shareholding structure substantially remains the same.

EXCEPTIONS OF THE RULES

The new Earnings Stripping Rules will not apply to:

- an individual;
- a licensed bank, licensed investment bank, licensed insurer or professional reinsurer as defined under the financial Services Act 2013;
- a licensed Islamic bank, licensed takaful operator or professional retakaful operator as defined under the Islamic Financial Services Act 2013;
- a Labuan bank or Labuan investment bank licensed under Part VI of the Labuan Financial Services and Securities Act 2010;
- a Labuan Islamic bank or Labuan Islamic investment bank licensed under Part VI of the Labuan Islamic Financial Services and Securities Act 2010;
- a Labuan insurer or reinsurer, including a Labuan captive insurance business licensed under Part VII of the Labuan Financial Services and Securities Act 2010;
- a Labuan takaful operator or retakaful operator, including a Labuan captive takaful business licensed under Part VII of the Labuan

Islamic Financial Services and Securities Act 2010;

- a development financial institution which is prescribed under the Development Financial Institutions Act 2002;
- a construction contractor as defined under the Income Tax (Construction Contracts) Regulations 2007;
- a property developer as defined under the Income Tax (Property Developer) Regulations 2007; or
- a person having been granted an exemption under paragraph 127(3)(b) or subsection 127(3A) of the ITA in respect of the adjusted income of the person.

THE ESR´ S POSSIBLE IMPACT ON YOUR BUSINESS

Given that the Earnings Stripping Rules came into operation on 1 July 2019, taxpayers should review their current loan and financing arrangements to determine whether the amount of interest expense falls within the ratio under the ESR.

We hope this comprehensive overview provided you with a more thorough insight on the general application of the new Earnings Stripping Rules (ESR).

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