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Malaysian developments

Ministry of Finance issues Pre-Budget Statement and seeks public feedback for Budget 2022

On 31 August 2021, the Ministry of Finance (MoF) published a Pre-Budget Statement (Statement), ahead of Budget 2022 which will be tabled on 29 October 2021. Please see our EY Special Tax Alert No. 6/2021 dated 2 September 2021 for more details.

The MoF subsequently released the following four (4) Public Consultation Papers (PCP) on 3 September 2021, for public input:

- ▶ Improvement of government procurement policy on local goods/services and procurement policy for Bumiputeras
- ▶ Improvement of cash assistance programmes
- ▶ Review of tax incentives
- ▶ Drafting of the Fiscal Responsibility Act

Some of the details on the PCP for review of tax incentives are discussed below.



As highlighted in our earlier tax alert, a review of the tax incentive framework is being undertaken to ensure that the tax incentives offered to foreign and local investors remain relevant to the current business landscape, whilst continuing to maintain the country's competitiveness in attracting quality investments and providing positive returns to the country's economy and fiscal position (see *Special Tax Alert No. 6/2021*).

The PCP explains the existing tax incentive framework in Malaysia, including the governing legislation, governing agencies and application process for certain tax incentives. The PCP also outlines certain issues in the existing framework and recommendations for improvements. The recommendations include the following:

- ▶ To undertake a holistic review and revamp of the Income Tax Act 1967 (ITA) and Promotion of Investments Act 1986 (PIA), with the intention to eventually combine both ITA and PIA into a single piece of legislation. This is to facilitate the effective management of tax incentives and investment promotion.
- ▶ To streamline the existing legislation under a specific administration to ensure tax incentives are transparent, easy to understand and administered based on the following categories:
 - General incentives
 - Sector-based incentives
 - Location-based incentives
 - Special incentive package
- ▶ To increase coordination between the Investment Promotion Agencies (IPA)
- ▶ To reiterate the functions of the National Committee on Investment (NCI) and the Malaysian Investment Development Authority (MIDA) as the

main platforms for the evaluation of investment proposals, particularly for foreign investments

- ▶ To have an incentive framework that is flexible and adaptable to the latest tax developments, including global tax requirements such as the Base Erosion and Profit Shifting (BEPS) 2.0 initiative
- ▶ To balance Foreign Direct Investments with Domestic Direct Investments, to ensure continuous investment in Malaysia and to ensure that existing investors are supportive of the country's investment agenda

The PCP also outlines six (6) questions for the public's feedback. The questions, translated from the original Bahasa Malaysia text, are set out below.

1. Through the review of tax incentives, the Government will reassess and establish a comprehensive piece of legislation to facilitate reviews of proposed investments and make it easier for investors to understand and comply with the relevant investment legislation. What are the legislative aspects that need to be improved to create a more investor-friendly environment which is able to attract strategic investments into Malaysia?
2. Currently, incentives offered to investors are in the form of fiscal incentives. However, based on recent trends, investors are also applying for non-fiscal incentives. What are the non-fiscal incentives which the Government can provide to attract new investments into Malaysia?
3. To improve the Government service delivery system to investors, the Government is proposing to implement an automated and self-regulated evaluation of tax incentives, to reduce the bureaucracy for investors claiming tax incentives. In your opinion, would such a self-regulated

approach be investor-friendly and increase the efficiency of evaluating investments?

4. One aspect of the review is to re-examine the functions and roles of the various IPAs, as well as providing MIDA with a coordination role. Would this proposal be appropriate in the current investment ecosystem? What are the suggestions to reduce bureaucracy, inconsistent processes and procedures as well as the overlapping roles of the IPAs in Malaysia?
5. The introduction of attractive and competitive investment incentive packages has increased the competition between ASEAN countries in attracting strategic investments to their respective countries. In this review, should the Government consider offering incentives that are comparable to other countries?
6. In line with the National Investment Aspirations (NIA) spearheaded by the Ministry of International Trade and Industry (MITI), Malaysia is one of the main investment destinations for investors from developed countries such as America and China. What are the strategic investment sectors which should be prioritized by the Government, and what criteria and conditions should be imposed for those selected sectors?

The feedback is to be submitted by 5 p.m. on 15 September 2021, through the MoF's website via the following link: [Public Consultation Papers](#)

The PCPs can also be downloaded from the above-mentioned link.

Tax incentive for tour operators extended

Under the Strategic Programme to Empower the People and Economy (PEMERKASA) unveiled on 17 March 2021, the Government announced that the tax

incentives for tour operators will be extended until the year of assessment (YA) 2022 (previously YA 2020) (see *Special Tax Alert No. 2/2021*).

To legislate the proposal, the Income Tax (Exemption) (No. 9) Order 2021 [P.U.(A) 344] was gazetted on 23 August 2021. The Order provides that a qualifying person is exempted from the payment of income tax in respect of statutory income derived from a qualifying activity (i.e. tour operating business which provides domestic tour packages for travel within Malaysia undertaken by local and foreign tourists, inclusive of transportation by air, land or sea and accommodation).

The exemption will only apply if the qualifying activity is participated by not less than 200 local tourists for a YA. The Order also provides that the number of local and foreign tourists for the qualifying activity must be verified in writing by the Ministry of Tourism, Arts and Culture Malaysia.

The following terms have been defined in the Order:

(a) Qualifying person

A Malaysian resident company which is licensed under the Tourism Industry Act 1992 to carry out a tour operating business and a qualifying activity.

(b) Local tourists

Individuals who are Malaysian citizens or Malaysian residents

(c) Foreign tourists

Individuals other than local tourists, who are neither Malaysian citizens nor Malaysian residents

(d) Tour operating business

Same meaning assigned to it under the Tourism Industry Act 1992

The Order stipulates that the exemption granted does not absolve the qualifying person from any requirement to submit any return, statement of

accounts or any other information as required under the ITA. The qualifying person is also required to maintain a separate account for the income exempted under the Order. The exempted income is to be treated as a separate and distinct source of business income.

The Order is effective from YA 2021 to YA 2022.

Extension of time for submission of tax returns under the Labuan Business Activity Tax Act 1990 (LBATA) for YA 2021

The Labuan Branch of the Inland Revenue Board (IRB) issued a letter dated 23 August 2021 to the Association of Labuan Trust Companies (ALTC) to confirm that Labuan entities would be granted an extension of time (EOT) until 29 October 2021 to submit their tax returns (under Sections 5 and 10 of the LBATA) for YA 2021 (based on the financial year ended in 2020), **subject to conditions and application.**

The extension will only apply to Labuan entities which are up to date with their tax filings (i.e. until YA 2020) and payments. The Trust Companies or Tax Agents were required to apply for the extension of time before 30 August 2021, in a prescribed format.

The letter also stipulates the following:

- ▶ Dormant Labuan entities with a business activity under the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 [P.U.(A) 392] and Labuan Business Activity Tax (Requirements for Labuan Business Activity) 2018 (Amendment) Regulations 2020 [P.U.(A) 375] are allowed to submit their return forms (Form LE1) under the LBATA.
- ▶ The return form will be considered incomplete if the dormant Labuan entity fails to complete the

business activity code section under Column A12 of the Form LE1.

Updated guidelines on tax deduction under Section 34(6)(h) of the ITA for contributions to a charity or community project to tackle the COVID-19 pandemic

Under the National People's Well-Being and Economic Recovery Package (PEMULIH), the Government announced that the scope of tax deductions allowed for contributions to approved COVID-19 related community and charitable projects would be expanded to include contributions to vaccination centres (PPVs) (see *Special Tax Alert No. 5/2021*).

Following the above, the MoF has issued updated Guidelines, in Bahasa Malaysia, titled "Garis Panduan Khas Permohonan Potongan Cukai Pendapatan Bagi Projek Komuniti / Amal Untuk Menangani Wabak COVID-19" (Guidelines) dated 2 August 2021.

Like the earlier guidelines, the new Guidelines explain the criteria and procedures to apply for a tax deduction under Section 34(6)(h) of the ITA for the above-mentioned contributions. Some of the key changes are outlined below.

- ▶ Qualifying contributions now include:
 - ▶ Air purifiers or filtration equipment
 - ▶ Fresh or ready-to-eat food (e.g. rice, oil, sauces, sugar, canned food etc.)
 - ▶ Rental costs for the provision of temporary infrastructure (e.g. marquee tents)
 - ▶ Provision of COVID-19 vaccination facilities (e.g. halls) and services, equipment and supplies for vaccination centres

- ▶ Qualifying recipients now include:
 - ▶ Universities and educational institutions
 - ▶ PPVs managed by the COVID-19 Immunisation Task Force (CITF) and private sectors with CITF approvals

- ▶ For tax deductions in respect of contributions to PPVs:
 - ▶ The deductions apply to contributions made from 19 April 2021 until the date the pandemic is declared by the Government to have ended.
 - ▶ Tax deductions can be made from YA 2021.
 - ▶ An application for deduction will need to be submitted to the MoF **within 30 days** from the date the contribution is made.

- ▶ A checklist of documents to be submitted together with the application for tax deduction under Section 34(6)(h) is outlined in Appendix A of the Guidelines.

“Potongan Khas Kepada Pembayar Cukai Yang Memberi Pengurangan Sewa Premis Perniagaan Kepada Perusahaan Kecil Dan Sederhana (PKS) Dan Bukan PKS” dated 3 September 2021.

The two key changes are outlined below.

1. The FAQs have been updated to stipulate that the special deduction is applicable to rental reductions given in the following periods:
 - ▶ **Small and medium enterprises (SME) tenants**
 - April 2020 to December 2021 (previously up to June 2021)
 - ▶ **Non-SME tenants**
 - January 2021 to December 2021 (previously up to June 2021)

2. In the earlier FAQs, an SME Status Certificate issued by SME Corporation Malaysia (SME Corp) to substantiate a tenant’s SME status would need to be retained as one of the supporting documents for a taxpayer to qualify for the special deduction on reduced rental given to SME tenants.

The FAQs have been updated to stipulate that for the period between January 2021 and December 2021, the certificate is no longer required as a supporting document in cases where the certification has not yet been issued by SME Corp.

Overseas developments

Thailand: VAT rate to remain at 7% for an additional two years

On 24 August 2021, the Thai Cabinet approved the extension of the reduced Value Added Tax (VAT) rate of 7% for another two years to sustain the economic stability of the country. The 7% VAT rate will therefore continue to be applied for sales of goods, provisions

Frequently Asked Questions on special deduction on rental discounts given to tenants

As highlighted in earlier tax alerts, it has been proposed that a special deduction be given to property owners who provide at least 30% rental discounts to tenants (see *Special Tax Alert No. 6/2020*, *Special Tax Alert No. 9/2020*, *Take 5: COVID-19: Short-term Economic Recovery Plan*, *Tax Alert No. 22/2020* and *Special Tax Alert No. 1/2021*). Under the Supplementary Strategic Programme to Empower the People and Economy (PEMERKASA Plus) unveiled on 31 May 2021, the Government announced that the special deduction will be extended until 31 December 2021 (see *Special Tax Alert No. 4/2021*).

Following the above, the IRB has published an updated version of the Frequently Asked Questions (FAQs) document in Bahasa Malaysia, titled

of services and imports of goods from 1 October 2021 until 30 September 2023.

Swiss authorities release statement on application of Most Favored Nation clause in India-Swiss tax treaty

The Swiss competent authorities have released a statement clarifying that, on the basis of the Most Favored Nation (MFN) clause in the India-Switzerland tax treaty (the Treaty), Lithuania's and Colombia's accession to the Organisation for Economic Co-operation and Development (OECD) has the effect of retroactively reducing the residual tax rate for dividends in the source State from 10% to 5% for qualified participations under the Treaty.

The statement and implications for taxpayers are summarized below.

Detailed discussion

Under the Treaty, dividends paid by Indian companies to residents of Switzerland, who are beneficial owners of such dividends, and vice-versa, are subject to withholding tax at a rate not exceeding 10%. The protocol of the Treaty contains an MFN clause which states that if India enters into a tax treaty on a later date with a third country which is an OECD member that provides a more beneficial rate of tax or restrictive scope for taxation of dividends, interest, royalties, etc., a similar benefit should be accorded under the India-Switzerland tax treaty as well.

Some Indian tax treaties with OECD member countries such as Lithuania and Colombia provide for a lower withholding tax rate of 5% for dividends, subject to conditions. However, these countries were not OECD members when the respective tax treaties were entered into by India and became OECD members only at a later date.

There has been a lack of judicial guidance in India on whether the beneficial tax rate under the tax treaties with Lithuania and Colombia could be applied to other tax treaties with the MFN clause until recently, when an Indian Court (the Delhi High Court) ruled in two separate cases in favor of the taxpayers on the issue of the withholding tax rate applicable to dividend income earned by the taxpayers under the India-Netherlands tax treaty and the India-Switzerland tax treaty.

The Swiss competent authorities have now issued a statement clarifying the applicability of the MFN clause as follows:

- ▶ Article 11 of the amending protocol dated 30 August 2010 in the Treaty contains an MFN clause, limiting taxation at source on dividends, interest, royalties or fees for technical services to a lower rate as prescribed in any subsequent tax treaty with an OECD member country.
- ▶ Following the signing of the amending protocol, India concluded two new tax treaties: (1) with the Government of the Republic of Lithuania dated 26 July 2011; and (2) with the Government of the Republic of Colombia dated 13 May 2011 (which are now OECD members as of 5 July 2018 and 28 April 2020, respectively), which granted lower tax rates with respect to dividends.
- ▶ On the basis of the MFN clause between Switzerland and India, Lithuania's and Colombia's accession to the OECD has the effect of retroactively (from 5 July 2018 for qualified participations or from 28 April 2020 for all participations) reducing the residual tax rate for dividends from 10% to 5% in the source State, under the Treaty.
- ▶ Thus, under the provisions of the Treaty, Indian tax residents receiving dividends from a Swiss source can claim, as of 5 July 2018 or as of 28 April 2020 (see above) and subject to the conditions set forth in the Treaty, a refund of the (additional) withholding tax in accordance with established procedures. Any refund for civil year 2018 (for qualified participations) should be

claimed before the statute of limitations lapses on 31 December 2021.

- ▶ For Swiss tax residents benefitting from this reduced withholding tax rate on Indian-sourced dividends, the foreign tax credit, if any, would be correspondingly reduced.
- ▶ The Swiss competent authorities reserve the right to reverse the retroactive interpretation and to readjust the treaty rates prospectively from 1 January 2023 if India were to have a different view to Switzerland.

Implications

The statement from the Swiss competent authorities provides additional guidance on the potential for applying lower withholding tax rates pursuant to the MFN clause amid the recent adoption of the classical system of dividend taxation in India from the tax year 2020-21 onwards.

The clarification from the Swiss competent authorities confirms that the MFN clause between India and Switzerland has automatic application and there is no requirement for any notification to trigger the MFN clause. Swiss tax residents who have already received dividend income from Indian companies subject to 10% withholding may explore options to seek a refund of additional tax withheld by filing their Indian tax return.

This clarification, along with the recent Indian judicial pronouncements, is a significant development. Many tax treaties entered into by India, with countries such as the Netherlands, France, Switzerland, Sweden, and Hungary, have comparable MFN clauses.

Furthermore, as the MFN clauses also apply to income in the nature of interest, royalties and fees for technical services, it is recommended that multinational companies with Indian investments through these countries or operations in these countries evaluate the impact of this favorable development on dividends and other streams of income.

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Important dates

15 September 2021	Due date for monthly instalments
30 September 2021	6 th month revision of tax estimates for companies with March year-end
30 September 2021	9 th month revision of tax estimates for companies with December year-end
30 September 2021	Statutory deadline for filing of 2021 tax returns for companies with February year-end. As a concession, this deadline is extended to 30 November 2021 pursuant to the RF Filing Programme (Amendment 4/2021).
15 October 2021	Due date for monthly instalments
31 October 2021	6 th month revision of tax estimates for companies with April year-end
31 October 2021	9 th month revision of tax estimates for companies with January year-end
31 October 2021	Statutory deadline for filing of 2021 tax returns for companies with March year-end. As a concession, this deadline is extended to 31 December 2021 pursuant to the RF Filing Programme (Amendment 4/2021).

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