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Client Alert

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Update on the Implementation of the Earning Stripping Rules in Malaysia

Introduction

In the 2018 Budget speech in October 2017, the Malaysian Government proposed the introduction of Earning Stripping Rules, similar to those recommended under the OECD's BEPS Action 4 final report. To address base erosion and profit shifting concerns involving interest deductions and other financial payments, the BEPS Action 4 final report recommended the application of a fixed ratio rule, which seeks to limit an entity's deduction for interest expenses to a percentage of its earnings before interest, taxes, depreciation and amortization ("**EBITDA**").

Please refer to our BEPS Newsletter on BEPS Action 4 **here** for more details. This alert discusses the recent developments in this area, which will be relevant to multinational enterprises ("**MNEs**") carrying on business in Malaysia.

When will the Earning Stripping Rules be implemented?

During the recent National Tax Conference 2018, the Malaysian Inland Revenue Board ("**IRB**") shared some information on the proposed Earning Stripping Rules. It is expected that the final form of the Earning Stripping Rules will be made available in November 2018, and will take effect from 1 January 2019 onwards.

Key Features of the Earning Stripping Rules

Based on the IRB's update, the key features of the Earning Stripping Rules are expected to be as follows:

- the rules will apply to business source income only, and in relation to cross-border related party transactions;
- the fixed ratio will be set at 20% of the company's EBITDA;
- there will be a *de minimis* threshold (it remains to be seen how the suggested threshold of RM 500,000 will be applied, for e.g., if this relates to the level of net interest expense of the group in Malaysia);
- some entities such as financial institutions and Labuan entities may be excluded from the rules;
- there will be no group ratio rule;
- there will be no carry forward of disallowed interest expense and unused interest capacity for use in future years; and
- there will be no grandfathering provisions.

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How should MNEs prepare for the Earning Stripping Rules?

Given the short lead time between the publication of the Earning Stripping Rules and the implementation date, it would be prudent for MNEs to start reviewing their current loan and financing arrangements, to determine whether the amount of interest expense falls within the proposed fixed ratio under the Earning Stripping Rules.

If there is a possibility that the amount of interest expense will exceed the fixed ratio, MNEs may need to consider possible changes to their existing financing arrangements and alternative financing structures. Moving forward, MNEs should take into account the proposed Earning Stripping Rules when planning their financial arrangements.

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