Building a better working world

EY Tax Alert

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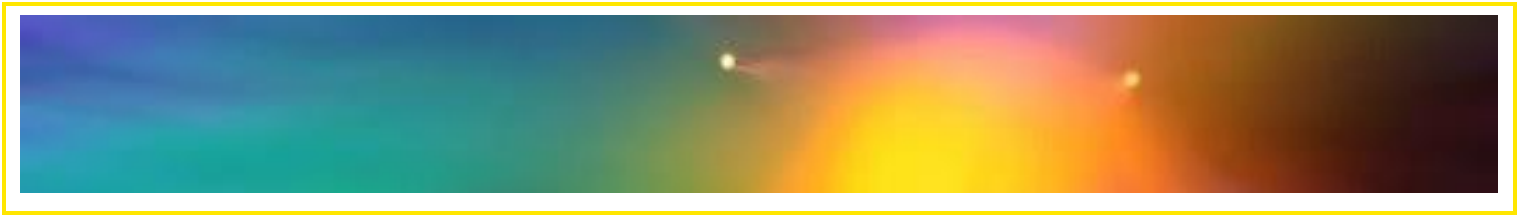
Malaysian developments

Guidelines on application for approval under Section 44(6) of the Income Tax Act 1967 (ITA) in relation to funds established for the construction of school buildings, contributions to schools and acquisition of buildings for religious schools

The Inland Revenue Board (IRB) has published on its website the following technical guidelines dated 28 April 2021, in Bahasa Malaysia:

- Garis Panduan Permohonan Untuk Kelulusan Ketua Pengarah Hasil Dalam Negeri Di Bawah Subseksyen 44(6) Akta Cukai Pendapatan 1967 Bagi Tabung Pembinaan Sekolah
- Garis Panduan Permohonan Untuk Kelulusan Ketua Pengarah Hasil Dalam Negeri Di Bawah Subseksyen 44(6) Akta Cukai Pendapatan 1967 Bagi Tabung Sumbangan Wang Awam Sekolah
- Garis Panduan Permohonan Untuk Kelulusan Ketua Pengarah Hasil Dalam Negeri Malaysia Di Bawah Subseksyen 44(6) Akta Cukai Pendapatan 1967 Bagi Tabung Pembelian Sekolah Agama



These Guidelines replace the earlier guidance provided in relation to school building funds, as outlined in the "Guidelines for application of approval under Subsection 44(6) of the ITA" issued in April 2005 (which were replaced by the latest "Guidelines for approval of Director General of Inland Revenue under Subsection 44(6) of the ITA" dated 30 January 2020, which do not discuss applications related to schools), and the "Garis Panduan Permohonan Untuk Kelulusan Di Bawah Subseksyen 44(6) Akta Cukai Pendapatan 1967 Bagi Tabung Sumbangan Wang Awam Sekolah" dated 16 July 2012.

All the Guidelines contain the following paragraphs:

1.0 Introduction
2.0 The eligibility criteria to apply for approval under Section 44(6) of the Income Tax Act 1967 (ITA)
3.0 The application procedure
4.0 Responsibilities after obtaining approval
5.0 Consequences of a breach of conditions
6.0 The approval period and application for extension
7.0 The power of the Director General of Inland Revenue (DGIR) over approvals and imposition of conditions
8.0 Tax treatment of donors
Appendices

Some details are outlined below.

The eligibility criteria to apply for approval under Section 44(6) of the Income Tax Act 1967 (ITA)

The respective Guidelines outline the eligibility conditions, including the following:

- Objectives of the establishment of the funds
- Types of schools that would qualify
- Considerations in assessing the approved fund amounts
- Approvals to be obtained before submitting the application for approval under Section 44(6)
- The composition of the committee members appointed to manage the funds

The application procedure

The respective Guidelines outline the application process, including the person to submit the application, the submission method and documentation required for the application (refer to the appendices to the Guidelines). The documents are to be submitted to the following address:

Ketua Pengarah Hasil Dalam Negeri
Lembaga Hasil Dalam Negeri Malaysia
Jabatan Dasar Percukaian
Aras 17, Menara Hasil
Persiaran Rimba Permai, Cyber 8
63000 Cyberjaya, Selangor

Responsibilities after obtaining approval

The respective Guidelines outline responsibilities of the committee members, which include the management of the funds, the requirement to set up a specific bank account for the funds, the preparation and submission of audited financial statements, notifying and obtaining the IRB's approval prior to the appointment of or change in the committee members, as well as the issuance of official receipts with the required details.

Consequences of a breach of the conditions of approval granted

In the event any of the conditions* of approval stated in the Guidelines or the ITA is breached, the DGIR has the discretion to revoke the approval granted.

*This includes conditions that are updated by the DGIR from time to time after the approval under Section 44(6) has been obtained.

The approval period and application for extension

The respective Guidelines outline the approval period for the funds and stipulate that any application for an extension of the approval period must be submitted within six months before the expiry of the approval period. The application for an extension of the approval period will only be reviewed if the relevant approval conditions have been met.

Practice Note No. 1/2021: Tax treatment on deduction of tax as final tax

The IRB has recently issued an eight-page Practice Note No. 1/2021 (PN) dated 3 May 2021, in Bahasa Malaysia, titled "Layanan Cukai Ke Atas Cukai Muktamad". The PN provides guidance on the tax treatment of monthly tax deductions (MTDs) as final tax for employment income received by employees. Pursuant to Section 77C of the ITA, effective YA 2014, taxpayers with only employment income and MTDs deducted throughout the year may opt not to submit annual income tax returns. In such cases, the total amount of MTDs will be treated as the final tax paid.

The PN explains and provides examples to demonstrate the conditions for taxpayers to be eligible to elect not to furnish their tax returns (i.e. to treat the MTDs paid as final tax) for YA 2014, YA 2015 and YA 2016 onwards.

The PN also clarifies and provides examples to demonstrate the tax implications under various scenarios. Some of the key points are outlined below.

(a) An eligible taxpayer opts not to furnish his tax return and does not furnish his tax return by the stipulated deadline:
- The taxpayer is deemed to have opted for the MTDs to be treated as the final tax.
- The taxpayer is not eligible for any tax refunds.

(b) Taxpayer has opted for MTDs as his final tax and the IRB obtains new or additional information on the taxpayer's income:
- The IRB has the power to raise an assessment or additional assessment, if applicable. In this case, the MTDs will no longer be deemed as the final tax paid.

(c) Taxpayer has opted for MTDs as his final tax but wishes to claim additional reliefs or a refund:
- The taxpayer is required to submit his income tax return.
- Penalties may be imposed where the income tax return is submitted after the stipulated deadline.

(d) Taxpayer has opted for MTDs as his final tax. However, it was subsequently discovered via an audit carried out on the employer that there was an underpayment of MTDs:
- The employer will be subject to a compound under Section 124 of the ITA and will be required to remit the underpaid MTDs to the IRB.
- The employee will be required to submit his income tax return to the IRB. Penalties may be imposed where the income tax return is not submitted by the stipulated deadline.

Extension of tax exemption on management fee income for Sustainable and Responsible Investment (SRI) funds

In Budget 2020, the Government proposed to extend the tax exemption for fund management companies managing Sustainable and Responsible Investment (SRI) funds for another three years (i.e. until the year of assessment (YA) 2023) (see *Special Tax Alert: Highlights of Budget 2020*).

To legislate this, the Income Tax (Exemption) (No. 5) Order 2021 [P.U.(A) 209] was gazetted on 4 May 2021. The Order provides that a company is exempted from tax on the statutory income derived from the business of providing fund management services for SRI funds in Malaysia.

"Company" refers to a fund management company which is:

- Resident in Malaysia
- Incorporated under the Companies Act 2016, and
- Licensed under the Capital Markets and Services Act 2007 (CMSA) or registered with the Securities Commission of Malaysia (SC) as a venture capital management corporation or a private equity management corporation

The exemption is on condition that the company obtains an annual certification from the SC that the following conditions have been fulfilled:

(a) The company provides fund management services for SRI funds in Malaysia.
(b) The company has incurred an annual operating expenditure of at least RM250,000 in Malaysia.
(c) The company that is:
    - Licensed under the CMSA has at least two full-time employees in Malaysia, where one of the employees holds a Capital Markets Services Representative licence under the CMSA, or
    - Registered with the SC has at least two full-time employees in Malaysia, where one of the employees is a responsible person approved by the SC

The Order stipulates that the exemption granted does not absolve the company from any requirement to submit any return, statement of accounts or any other information as required under the ITA. The company 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 also provides that Paragraphs 5 and 6 of Schedule 7A of the ITA will apply to the amount of exempted statutory income. However, the Order will not apply to a company if the company has been granted any incentive under Section 60G of the ITA or exemption under Sections 127(3)(b) or 127(3A) of the ITA for the YA.

The Order is effective from YA 2021 to YA 2023.

Double deduction on expenses incurred to conduct Professional Training and Education for Growing Entrepreneurs (PROTÉGÉ) - Ready to Work (RTW) Programme

Currently, pursuant to the Income Tax (Deduction for Training Costs under Skim Latihan 1Malaysia for Unemployed Graduates) Rules 2013 [P.U.(A) 260/2013], a qualifying company is given a double deduction in respect of expenses incurred for conducting the 1Malaysia training scheme approved by the Economic Planning Unit (EPU) under the Prime Minister's Department for a Malaysian unemployed graduate (see *Tax Alert No. 17/2013*].

In September 2019, the Skim Latihan 1Malaysia was rebranded to PROTÉGÉ, short for Professional Training and Education for Growing Entrepreneurs.

Following the above, the Income Tax (Deduction for Training Costs under the Professional Training and Education for Growing Enterpreneurs (sic) (PROTÉGÉ-Ready To Work (RTW)) Programme) Rules 2021 [P.U.(A) 228/2021] were gazetted on 11 May 2021 and are deemed to have come into operation on 11 September 2019.

The Rules provide that in ascertaining a qualifying company's adjusted income from its business for a YA, a double deduction shall be given for outgoings and expenses incurred by the qualifying company during that basis period to conduct the PROTÉGÉ-Ready To Work Programme (Training Programme) approved by the Ministry of Entrepreneur Development and Cooperatives (MEDAC). The Training Programme is conducted for the trainees for eight (8) to 12 continuous months.

The double deduction is given for the following outgoings and expenses:

(a) Monthly training allowance of not less than RM1,000 paid to the trainees for a maximum period of 12 months
(b) Expenditure incurred for the provision of training
(c) Expenditure incurred for food, travelling and accommodation allowances for the trainees during the Training Programme
(d) Fees paid to the person appointed to conduct soft-skills training under the Training Programme

For items (b), (c) and (d), the total deductions allowable for each trainee shall not exceed RM5,000 for each Training Programme.

The following terms have also been defined in the Rules:

1. **Qualifying company**
   A company:
   (a) Incorporated in Malaysia under the Companies Act 2016, and
   (b) Approved by MEDAC to participate in the Training Programme
2. **Trainee**
   A Malaysian citizen graduate undergoing the Training Programme, who is:
   (a) Unemployed, or
   (b) Employed in a job which does not commensurate with his qualification

The qualifying company claiming the deduction will also be required to provide a confirmation from MEDAC specifying that:

(a) The Training Programme has been approved, and the date of approval is between 11 September 2019 and 31 December 2025, and
(b) The implementation of the Training Programme shall commence within 12 months from the date of approval of the Training Programme

With this, P.U.(A) 260/2013 is revoked. However, any approval which has been granted under P.U.(A) 260/2013 before 11 September 2019 will remain in place and shall be deemed to be granted under P.U.(A) 228/2021. In addition, any application for deduction made before 11 September 2019 which is pending approval shall be dealt with as if P.U.(A) 260/2013 has not been revoked.

Overseas developments

India issues thresholds for triggering "significant economic presence" in India

On 3 May 2021, the Indian Tax Administration issued a notification prescribing revenue and user thresholds for the application of a new nexus rule on non-residents in the form of "significant economic presence" (SEP) which was introduced under the Indian Tax Laws (ITL) in 2018.

The notification prescribes a revenue threshold of INR20 million (US$270,000) for sales to Indian

persons or a user threshold of 300,000 (Indian users). If a non-resident exceeds either of these thresholds, the SEP rules will apply, resulting in taxation of the non-resident in India.

The development and implications for non-resident taxpayers are summarized below.

Detailed discussion

Background

The global technology revolution has changed the business landscape whereby entities can carry out business in any location without a physical presence. Recognizing the need to update the tax rules in line with the changes in the technology landscape, the taxation of the digital economy has become a key base erosion and profit shifting (BEPS) concern across the globe and a multilateral coherent solution is being discussed as part of the Organization for Economic Co-operation and Development (OECD)'s and G20's BEPS project.

Pursuant to BEPS discussions, India expanded the concept of "business connection" for taxability under the ITL to include a new nexus rule based on SEP in 2018.

Under the SEP provisions, a "business connection" will be created in India based on either of the following conditions:

1. **Revenue-linked condition:** Where any transaction in respect of any goods, services or property is carried out by a non-resident with any person in India, including the provision of data or software downloads in India, and the aggregate payments arising from such a transaction or transactions during the tax year exceed the prescribed amount
2. **User-linked condition:** Where the systematic and continuous soliciting of business activities or the interaction with users in India exceeds the prescribed amount

SEP will be determined independent of whether:

- Any agreement for such transactions or activities has been entered into within India
- The non-resident has a residence or place of business in India.
- The non-resident renders services in India.

Further, once the non-resident triggers a SEP in India, only so much of the income attributable to the transactions or activities referred to in condition 1) or 2) above will be taxable in India. Additionally, income attributable to transactions and activities referred to in condition 1) or 2) above will also cover income from all of the following:

- Advertisements which target a customer who resides in India or who accesses an advertisement through an internet protocol (IP) address located in India
- Sale of data collected from a person who resides in India or who uses an IP address located in India
- Sale of goods or services using data collected from a person who resides in India or who uses an IP address located in India

The SEP provisions were originally intended to become applicable from tax year 2018-19 onwards. However, considering the ongoing international discussions regarding the taxation of the digital economy, the SEP provisions were deferred and subsequently made applicable from the tax year 2021-22 onwards.

Current notification

The Indian Tax Administration has now issued a notification prescribing the revenue and user thresholds for the application of the SEP provisions as follows:

- **Revenue-linked condition:** threshold of INR20 million (US$270,000)
- **User-linked condition:** threshold of 300,000 Indian users

These thresholds are effective from 1 April 2022, i.e., tax year 2021-22 onwards, which aligns with the effective date of the SEP provisions.

Implications

As a result of the notification of the revenue and user thresholds, the Indian Tax Administration has activated the SEP provisions. The language of the SEP provisions is broad and is likely to impact conventional transactions and activities even if they are not carried out in a digital form. In addition, a number of practical issues arise from the language of the threshold limits, for instance: (1) whether the INR20 million revenue threshold should be determined on gross or net of sales returns, discounts, etc.; 2) how the 300,000 users (resident in India or with an IP address situated in India) should be determined; and 3) whether any distinction can be made between active and passive users. Industries may need to engage with the Indian Tax Administration to receive additional guidance on various practical aspects.

While the expanded scope of "business connection" does not override a tax treaty, which follows the traditional permanent establishment definition, this development will be of relevance to non-resident taxpayers who are resident in a jurisdiction which does not have a bilateral or multilateral tax treaty with India, or non-resident taxpayers who are not eligible for tax treaty benefits.

Once taxation is triggered in India, the payer is required to withhold any tax due and the non-resident is obligated to file a tax return. Non-compliance with the withholding obligations can trigger disallowance of deductions, and interest and penalties for the Indian payer. Furthermore, the Indian payer can also run the risk of being regarded as a representative assessee of the non-resident. In the absence of guidance on the SEP income attribution principles, the payer may need to liaise with the tax authorities to determine the appropriate sum which is taxable in order to comply with the withholding provisions.

The interaction of the equalization levy with the SEP will also need to be considered by non-resident taxpayers.

China clarifies procedures for processing payments for transfer pricing adjustments

Following the release of Huifa [2020] No. 14 (Circular 14) in August 2020, China's State Administration of Foreign Exchange (SAFE) recently provided guidance on the principles and procedures that banks should follow when verifying and processing requests for cross-border payments in certain scenarios, including cross-border payments relating to transfer pricing (TP) adjustments. The SAFE also clarified various administrative issues related to foreign currency receipts or payments categorized as services.

In the detailed guidance, the SAFE clarified that banks should verify the authenticity and legal compliance of the commercial transactions and ensure that requests for foreign currency receipts or payments are consistent with and reflective of the underlying transactions. The SAFE also specified the documentation requirements for the following three types of adjustments:

- For TP adjustments, supporting documents such as written documents from the tax authority or customs authority, profit adjustment agreements, invoices and other related documents should be submitted to the bank. The payments should be processed under the same category as that of the original commercial transaction (e.g., trade or services).
- For cost-sharing adjustments, banks should follow the same principles and review supporting documents, including distribution agreements, financial statements, invoices and other related documents.
- For other adjustments relating to profit true-ups or true-downs, banks are required to verify and process foreign currency receipts or payment

requests by following the same principles as noted in Circular 14.

Implications

The guidance provided by the SAFE is seen as a positive sign of increased flexibility for cross-border transactions, including TP adjustments. However, as the development of detailed documentation requirements is delegated to local SAFEs and banks, practical uncertainties still exist. For example, it is unclear if local SAFEs and banks would allow payments for TP adjustments initiated by taxpayers and their related parties (i.e., TP self-adjustments) in the absence of written documents from tax authorities. Moreover, customs duty and import VAT implications should also be considered for TP adjustments relating to buy/sell transactions.

Taxpayers should closely monitor developments in local practices and if necessary, revisit existing TP policies and documentation. Multinational corporations that intend to implement cross-border TP adjustments with their China subsidiaries should consider engaging professional advisors to coordinate and assist in negotiations with relevant government authorities and banks.

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Important dates

31 May 2021	6th month revision of tax estimates for companies with November year-end
31 May 2021	9th month revision of tax estimates for companies with August year-end
31 May 2021	Statutory deadline for filing of 2020 tax returns for companies with October year-end
15 June 2021	Due date for monthly instalments
30 June 2021	6th month revision of tax estimates for companies with December year-end
30 June 2021	9th month revision of tax estimates for companies with September year-end
30 June 2021	Statutory deadline for filing of 2020 tax returns for companies with November year-end

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