

Frequently Asked Questions

17/07/2019

A. Scope of Application

1. ESR only applies to controlled transactions and hence the clarification is required on whether inter-company borrowings should be evaluated separately from third party borrowings when computing interest restriction under the existing rule.

Yes. Any interest expenses from financial assistance as listed below should be evaluated separately from any other borrowings when computing interest restriction under any existing rule:

- (i) Interest paid/ payable to its associated person outside Malaysia;
- (ii) Interest paid/payable to its associated person outside Malaysia which operates through a permanent establishment in Malaysia; or
- (iii) Interest paid/ payable to a third party outside Malaysia where the financial assistance is guaranteed by its holding company or any other enterprises under the same MNE Group (regardless of the tax residence country of the guarantor).

2. Who would be affected? Based on the rules which are law, it appears that the ESR applies to not only cross-border financial assistance, but also domestic financial assistance.

Based on Section 140C, ITA1967 and Income Tax (Restriction on Deductibility of Interest) Rules 2019 (the Rules), the interest restriction provisions apply to controlled transactions and do not distinguish between cross-border or domestic controlled transactions. However, the Director General of Inland Revenue (the DGIR) has provided further guidance that this interest restriction provisions will only apply to persons according to Para 4 of the Restriction on Deductibility of Interest Guidelines (the Guidelines).

APPLICATION OF INTEREST RESTRICTION BASED ON THE TYPES OF FINANCIAL ASSISTANCE	Section 140C, ITA1967 (01.01.2019)	Income Tax Rules 2019 (01.07.2019)	Guideline (05.07.2019)
Controlled transaction	Yes	Yes	Yes
Cross-border financial assistance	Yes	Yes	Yes
Domestic financial assistance	Yes	Yes	No

3. Is restriction on deductibility of interest applicable to company only having operation in Malaysia?

Please refer to the Scope of Application under Para 4 of the Restriction on Deductibility of Interest Guidelines.

Specifically under sub-para 4(b), the company will be subjected to Section 140C, ITA1967 if it has the following transactions:

- (a) Payment of interest to its associated person outside Malaysia;
- (b) Payment of interest to its associated person outside Malaysia which operates through a permanent establishment in Malaysia; or
- (c) Payment of interest to a third party outside Malaysia where the financial assistance is guaranteed by its holding company or any other enterprises under the same MNE Group (regardless of the tax residence country of the guarantor).

B. Calculation of Tax-EBITDA

1. Refer to page 18 of the guidelines, why the interest expenses of RM40,000 paid to local bank without guarantee (on loan made to provide loan to related party) not included in (C) in calculation ?

Any payment of interest to local associated person or local third party will not be subjected to the restriction as provided under Para 4 of the Guidelines.

C. Non-Application

1. Clarification will be required on the non-inclusion of a person enjoying special tax holiday in the guide while the rules do include.

Para 2(3)(k) in the Rules states that any person who has been granted an exemption under paragraph 127(3)(b) or subsection 127(3A) of the Act in respect of the adjusted income of the person will be exempted from the application of the Rules. Although it is not mentioned in the Guidelines, the same exemption applies.

D. Others

1. One question arises on the validity of the guide as it is not a law whereas the rules are. In this regard, clearly there is a legitimate expectation that the guide will be respected.

Although the Guidelines do not have force of law, they provide guidance on how Section 140C, ITA1967 and the Rules will be administered and will be binding on the DGIR.