Putting businesses on a stronger footing via tax relief

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As businesses started to recover under the new normal, the third wave of Covid-19 infections recently gripped the nation. Economic activities are expected to slow down, especially in the areas currently placed under the Conditional Movement Control Order (CMCO).

The government has done well in strengthening the economy by having banks grant a six-month automatic loan moratorium for individuals and small and medium enterprises (SMEs). Based on the 24th Laksana Report, as at Sept 25, 35% (RM34.04 billion) of the loan moratorium had been utilised by the business sector, out of the estimated total value of the moratorium of RM97.26 billion.

Companies will need to start repaying their loans, even those that qualify for the loan moratorium extension. As the nation grapples with the third wave of the pandemic, medium and large companies will not be spared from the impact either.

When companies face cash flow constraints in repaying borrowings to banks, typically, the holding company will need to step in to assist financially. If the situation does not improve, companies may need to take a more drastic approach by undertaking a business rationalisation exercise or embarking on internal realignment to achieve efficiencies, economies of scale and higher productivity. Some companies may also enter into mergers to survive as a result of the difficult market conditions.

As with any corporate restructuring exercise, one of the aspects to consider is the tax implications and the tax costs involved. Thus, it is important to assess and address any unfavourable tax consequences up front.

Waiver of debt

The level of debt is usually one of the considerations of a corporate restructuring exercise. When there are financial difficulties and companies find themselves unable to repay external borrowings, financial support from their holding company would be required to help them stay afloat. Such financial support could be through inter-company loans. When a company is adversely impacted financially and is unable to repay its holding company, debt forgiveness or waiver of debt may then come into play.

Generally, trade debts written off would be taxable to the debtor and deductible to the creditor, provided that the write-off rules have been met.

A waiver of non-trade debts (arising from inter-company loans) may not necessarily be as straightforward. In practice, there are situations where different positions have been adopted by the tax authorities in which they sought to tax such waivers of non-trade debts as trading income of the borrower. On the other hand, a tax deduction would likely be denied on the amount waived by the lender, particularly for waivers between related companies.

A potential mismatch in the tax implications could arise as a consequence of this, especially for group companies, as such waivers would potentially be taxable to the borrower but not deductible to the lender. This would lead to additional tax costs for group companies looking to embark on internal debt restructuring.

To assist group companies in minimising the tax costs involved in undertaking internal debt restructuring, the government should consider according tax neutrality for waiver of inter-company debts, where the borrower is not subject to income tax and no deduction is accorded to the lender.

It should be noted that such tax neutrality has been accorded in countries like the UK and New Zealand. In the case of the UK, specific provisions are in place to address the non-taxability and non-deductibility of waivers of debt in group companies, including situations that involve corporate rescue. In New Zealand, the borrower is treated as having "paid" and the lender is treated as having "been paid" when debt forgiven is between companies of the same group.

Tax losses

Another sobering thought is that for many companies, they may experience a less than stellar financial performance this year. Where a company experiences tax losses in a year, such tax losses can no longer be carried forward indefinitely. The new seven-year restriction on tax loss utilisation as well as the tightening of the group relief rules are likely to affect many companies with significant tax losses, where these tax losses that have been carried forward would be lost if not utilised.

Companies could be exploring business rationalisation, consolidation or merger exercises to survive the onslaught of lower demand. Such exercises are typically a costly affair and the government could assist by granting some tax incentives to alleviate the pain of such consolidations or mergers.

One possible tax measure is to allow the transfer of accumulated tax losses to the surviving entity within the same group of companies or in the situation of a commercial rescue scheme, for a specific period of time.

Take Singapore as an example — to facilitate corporate amalgamations, tax losses of the amalgamating company can be transferred across entities so long as the corporate amalgamation is undertaken for genuine commercial reasons.

An alternative would be to grant a merger tax credit based on the accumulated tax losses of the acquired entity to be claimable by the surviving entity. The concept of merger tax credit is not new and Malaysia had in the past granted 50% to 100% merger tax credit under the merger programme for domestic banking institutions in 1999 as a response to the Asian financial crisis.

Transaction cost

Transaction cost is another key consideration in a corporate restructuring exercise. The current tax legislation provides for stamp duty and Real Property Gains Tax (RPGT) relief under normal circumstances of group restructuring, subject to meeting certain conditions. In practice, it may be difficult for companies to meet the stringent conditions to avail themselves of such relief.

To facilitate mergers and acquisitions (M&A), the government had in the past accorded stamp duty and RPGT exemptions on mergers. These included the stamp duty and RPGT exemption accorded for the bank merger programme in 1999 and the recent stamp duty exemption for M&A for SMEs until June 30, 2021, as announced under the Short-Term Economic Recovery Plan (Penjana).

It is now timely for the government to widen the scope to cover all organisations and to extend such exemptions to cover both stamp duty and RPGT, at least for the short term, to facilitate business realignments within group companies and to minimise the transaction costs incurred.

In conclusion, undoubtedly, any tax relief granted would result in revenue loss to the government. However, this will go a long way in putting businesses on a stronger footing and contributing towards the overall recovery of the economy. E

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