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Tax Espresso – Special Alert
MSC Malaysia Tax incentive status update

Introduction

As an Associate Member of the OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS), Malaysia is committed to implementing and adhering to the BEPS Action Plan minimum standards.

In line with the above, the Malaysia Digital Economy Corporation (MDEC) which oversees the MSC Malaysia initiative, had previously issued an announcement that the tax incentives under the regime will be reviewed and amended to align with the minimum standards under Action 5 of the BEPS Action Plan.

Our comments on the above announcement and Forum of Harmful Tax Practices' (FHTP) recommendations in relation to MSC Malaysia tax incentive were published in our Special Alert dated 11 July 2018.

Recent developments

Following the review, the Government has recently issued four MSC Malaysia-related regulation and gazette orders (collectively referred to as "the Orders") as follows:

a) Income Tax (Exemption) (No. 10) Order 2018 dated 31 December 2018 [P.U.(A) 389];
b) Income Tax (Exemption) (No. 2) 2015 (Amendment) Order 2018 dated 31 December 2018 [P.U.(A) 396];

c) Promotion of Investments (Exclusion of Income for MSC Status Company) Regulations 2018 dated 20 December 2018 [P.U.(A) 332]; and
d) Promotion of Investments (Determination of Assets under Section 29B in respect of MSC Status Companies) (Revocation) Order 2018 dated 20 December 2018 [P.U.(A) 335].

The Orders set out, among others, the promoted activities for MSC, exclusion of IP income in respect of MSC status companies, conditions to qualify for income tax exemption under the incentive, including substance and operational requirements. These changes are detailed below and will not only impact companies looking at the MSC Malaysia incentive, but also companies who are currently enjoying the MSC Malaysia incentive.

New Conditions for Applications made on or after 1 January 2019

Based on P.U.(A) 389 which comes into operation on 1 January 2019, the following activities are promoted activities for income tax exemption purposes under the MSC Malaysia tax incentive.

Promoted Activities Before 1 January 2019	Promoted Activities After 1 January 2019
1. Infotech 2. Global business services 3. Creative content and technology 4. Institute of higher learning (IHLs) 5. Startups 6. Incubators	1. Big data analytics 2. Artificial intelligence 3. Financial technology 4. Internet of Things 5. Cybersecurity (technology/ software/ design and support) 6. Data centre and cloud (technology/ software/ design and support) 7. Blockchain 8. Creative media technology 9. Sharing economy platform 10. User interface and user experience 11. Integrated circuit design and embedded software 12. 3D printing (technology/ software/ design and support) 13. Robotic (technology/ software/ design) 14. Autonomous (technology/ software/ design and support) 15. Systems or network architecture design and support 16. Global business services or knowledge process outsourcing excluding: a) Non-technical; b) Low value call centre; c) Data entry; and d) Recruitment process outsourcing.

Depending on the profile of the company, the incentive and conditions will differ as set out below:

Qualifying company	Category 1		Category 2		Category 3	
Location where core income generating activities are carried out	Designated premises within MSC cyber city or cyber centre		Within MSC cyber city or cyber centre		Not subjected to location condition	
Percentage of income tax exemption	100%				70%	
Exemption period	5 years				5 years	
Extension of exemption period	5 years				May apply for an extension provided that the qualifying company changes from Category 3 to Category 1 or 2, and fulfills the conditions imposed	
Substance Requirements:						
Minimum number of full time employees	50	30	50	30	30	20
	Data Centre: 5					
Minimum amount of monthly base salary for full time employee (RM)	5,000	10,000	5,000	10,000	5,000	8,000
	Data Centre: 5,000					
Minimum amount of annual operating expenditure and investment in fixed asset (RM)*	3,500,000				1,000,000	
	Data Centre: 10,000,000					

** Currently, it is uncertain whether the above minimum amount has to be achieved annually or over a specified number of years (per the past policy), or a combination of both.*

<u>Amendments to tax incentive for existing companies</u>

Meanwhile, for existing qualifying companies which have been granted Pioneer Status (PS) under the Promotion of Investments Act 1986 (PIA) or income tax exemption under Income Tax (Exemption) (No. 2) Order 2015 [P.U.(A) 50/2015] (specifically for MSC status companies located outside of the designated cyber city or cyber centre), the Ministry of Finance has vide P.U.(A) 332 and P.U.(A) 396 respectively imposed similar FHTP requirements which are summarised below:

Criteria	PS under PIA	Tax Exemption under P.U.(A) 50/2015

1. Substance requirement	• Not addressed in P.U.(A) 332.	• Have an approved adequate number of full-time employees in Malaysia to carry on the qualifying activity; and • Incur an approved adequate amount of annual operating expenditure to carry on the qualifying activity or an approved adequate investment in fixed asset in Malaysia to carry on the qualifying activity.
2. Income from royalty / IP right	• For the period on or after 1 July 2018 but before 1 July 2021, royalty and other income derived from a **new** IP right (but not from an existing IP right) of which the MSC status company is the owner or licensee shall be excluded from the tax exemption. • For the period on or after 1 July 2021, royalty and other income derived from **all** IP rights of which the MSC status company is the owner or licensee shall be excluded from the tax exemption. • The proposed Nexus Approach treatment on such income has not been effected at this stage.	• Same as *PS under PIA*.
3. Grandfather -ing rules **	• If the MSC status company has been granted PS on or before 16 October 2017: (i) Non-IP income derived after 30 June 2021 shall be excluded from the tax exemption; and (ii) Non-IP income derived after 31 December 2018 from any promoted activity approved from 16	• If the qualifying company has been granted an exemption on or before 16 October 2017, it shall be exempted from fulfilling the above substance requirements until 30 June 2021. • However, where the qualifying company carries on a new qualifying activity after 16 October 2017, the

	October 2017 as the pioneer business of the MSC status company shall be excluded from the tax exemption. • If the MSC status company has been granted PS after 16 October 2017, non-IP income derived after 31 December 2018 shall be excluded from the tax exemption.	above exemption from fulfilling substance requirements shall not apply. Instead, the tax exemption in relation to that new qualifying activity shall be granted until 31 December 2018. • If the qualifying company has been granted an exemption after 16 October 2017, it shall be exempted from fulfilling the new substance requirements until 31 December 2018.

*** P.U.(A) 389 has a Special Provision whereby the Minister may grant income tax exemption for a period (or extension period) to be determined by the Minister to existing MSC status companies which were granted PS under PIA or income tax exemption under P.U.(A) 50/2015 before 1 January 2019.*

Investment Tax Allowance (ITA)

With the issuance of P.U.(A) 335, the Promotion of Investments (Determination of Assets under Section 29B in respect of MSC Status Companies) Order 2001 [P.U.(A) 50/2001] which determines the qualifying capital expenditure of MSC status companies for ITA under PIA is revoked effective from 1 January 2019.

However, P.U.(A) 335 provides that any ITA given under Section 29B of PIA to any MSC status companies immediately before the effective date of the above revocation, shall be continued as if P.U.(A) 50/2001 has not been revoked.

The above may be an indication that ITA is no longer granted to new MSC status companies under PIA. Likewise, it does not appear that existing MSC status companies enjoying ITA is subject to grandfathering rules.

Moving forward

Whilst awaiting the amended MSC Guidelines to be issued, we hope that the Government will provide further clarity on the minimum requirements for new MSC Malaysia applications, as well as address the future of Investment Tax Allowance (ITA) granted under MSC Malaysia status and incentive for IP regimes.

It may also be possible for existing MSC status companies whose tax incentive period is shortened due to the grandfathering rules to extend their tax incentive period subject to meeting the new requirements.

In summary, it is timely for all companies to review their affairs to ascertain if they are affected by the changes and to re-examine their business models to align with the requirements moving ahead.

For more information or for any further enquiries regarding the above, kindly contact our tax experts:

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