



Tax Espresso – Special Alert Changes in MSC Malaysia Tax Incentive following Malaysia's commitment in implementing international tax standards

The Ministry of Finance has recently reiterated its commitment in adhering to the OECD taxation initiatives. Malaysia joined the OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) as an Associate Member and has committed to implement and adhere to the BEPS Action Plan minimum standards.

One of these minimum standards, Action 5, deals with identification of no or low preferential corporate tax rate (preferential regimes)

that can be categorised as harmful tax practices. It focuses on the requirement of substantial activities for any preferential regimes. The Forum on Harmful Tax Practices (FHTP) has identified jurisdictions, which provide preferential regimes for geographically mobile income related to intellectual property (IP) and/or financial or other services (Non-IP). It does **not** focus on income from manufacturing operations. Similar to other countries that are members of the Inclusive Framework, the FHTP would evaluate certain Malaysian incentives to determine if they have features of a harmful regime. The incentives currently under evaluation and those already evaluated are as follows:

Regime	Status
<i>IP incentives</i>	<i>As of 9 May 2018</i>
Principal Hub	In the process of being amended
Pioneer Status (High Technology)	In the process of being amended
Biotechnology Industry (BioNexus)	In the process of being amended
MSC Malaysia	In the process of being amended
<i>Non-IP incentives</i>	
Biotechnology Industry (BioNexus)	In the process of being amended
MSC Malaysia	In the process of being amended
Principal Hub	In the process of being amended
Pioneer Status (Contract R&D)	In the process of being amended
Treasury Management Centre	Abolished
Economic Development Regions	In the process of being amended
Approved Services Project	Out of scope
Green Technology Services	Not harmful
Labuan Leasing Services	Amended
Labuan Financial Services	In the process of being amended
Foreign Fund Management	Not harmful
Inward re-insurance and offshore insurance	In the process of being amended
Malaysian International Trading Company	Out of scope

The criteria for evaluating the aforementioned tax incentives and the timelines for aligning them with the FHTP recommendations under BEPS Action 5 are summarised in the table below.

IP Incentives	Non-IP Incentives
<p><u>Nexus Approach</u> The IP income of a taxpayer can be exempted only to the extent that the taxpayer itself incurred qualifying R&D expenditure that gave rise to such IP income.</p> <p>Segregate embedded technology IP income from manufacturing/trading income.</p> <p>Segregate embedded marketing IP income from manufacturing/trading income (marketing IP income cannot be incentivised).</p>	<p><u>Substantial Activities</u></p> <p>I. Adequate investment amount or annual business operating expenses incurred in Malaysia; and</p> <p>II. Adequate number of full-time job employment in Malaysia.</p> <p><u>Ring Fencing</u> No distinction on tax treatment including transaction and currency restrictions between residents and non-residents, i.e., the tax result for a wholly domestic transaction should not be different from that arising for a cross border transaction.</p>
<p>Legislation to amend existing IP incentives to be gazetted by 31 December 2018.</p>	<p>Legislation to amend Non-IP incentives to be gazetted by 31 December 2018.</p>
<p>Effective 1 July 2018, IP incentives are subject to Nexus Approach criteria. No new approval will be granted for existing IP incentives that do not comply with Nexus Approach criteria.</p>	
<p>Existing IP incentives approved on or before 30 June 2018 that do not comply with FHTP criteria – grandfathering will be allowed until 30 June 2021. Need to comply with Nexus Approach criteria beyond 30 June 2021, to continue enjoying incentive.</p>	<p>I. Incentive approved on or before 16 October 2017 - grandfathering period is up to 30 June 2021; or</p> <p>II. Incentive approved after 16 October 2017 - grandfathering period is up to the date of gazette or 31 December 2018, whichever earlier.</p>

Considering the foregoing, MDEC will be adhering to the above timelines as well. This would mean the following for companies enjoying MSC Malaysia Tax Incentive:

New company	Existing company with MSC Incentive
No new approval for MSC application will be granted starting 1 July 2018.	No new approvals will be granted starting 1 July 2018, for applications for extension of income tax exemption period or applications to add new MSC Malaysia Qualifying Activities.
	<p>Options available:</p> <p>a) Continue to enjoy the income tax exemption granted under existing MSC Malaysia Status until 30 June 2021; OR</p> <p>b) Subject to the new legislation and guidelines coming into force, to move into the new regime and be subjected to the new criteria.</p>
	If approval for MSC Malaysia Status has been granted on or after 17 October 2017 for non-IP income, grandfathering period will end on 31 December 2018.
New approvals and extension of the income tax exemption period will only be considered once the new legislation and guidelines come into force, by 31 December 2018.	

With these developments, what should companies do if they:

a) Have submitted an application for MSC Malaysia Tax Incentive (under review)

For companies that have submitted an application and pending for approval, they may choose to withdraw the application and wait for the new criteria/conditions to be announced, and get a refund of the application fee. If they choose not to withdraw, their application will not be processed now, and will be re-evaluated later based on the new criteria/conditions.

b) Plan to submit an application for MSC Malaysia Tax Incentive, or want to assess if they would qualify for the incentive following the FHTP criteria

To seek professional advice to familiarise with BEPS Action 5 recommendations, as the new criteria will be designed based on this standard. With sound professional advice, companies would be able to do a proper assessment of their business model and prepare an appropriate business case for the application.

Way Forward

Pending the release of the new legislation and guidelines for the MSC Malaysia incentive, companies should re-assess their positions and review the impact of the developments on their current and proposed business models which might have been structured earlier pursuant to the existing MSC Malaysia incentive. Such a review should not be limited to those only looking at the MSC Malaysia incentive but should extend to all who are currently enjoying or looking to pursue the other existing tax incentives which are also under review by the relevant authorities in Malaysia (e.g., principal hub, pioneer status, etc).

In addition, for companies that are already enjoying tax incentives, one would expect intensified audits to be carried out and there could be clawback of the tax holiday if a company is found to be non-compliant with the conditions imposed for the approval of the tax incentives. As such, it might be timely to carry out a health check of the company and implement controls in place to manage tax risks moving ahead.

To summarise, given these developments, all companies enjoying IP or non-IP income related incentives in Malaysia or other countries that are members of the Inclusive Framework should re-look at their existing business model and value-chain to ensure that they do not fall short of the impending revisions in the incentive regimes globally. The run-up to the regulatory revisions could include, among others, revamping IT and accounting systems for segregation of IP income from manufacturing/trading income, revisiting tax estimates, revising transfer pricing policy setting and testing approaches, etc.

For any queries or assistance, feel free to reach out to the following contacts:

Government Grants & Incentives

Tham Lih Jiun
Executive Director
ljtham@deloitte.com
+603 7610 8875

Thin Siew Chi
Executive Director
sthin@deloitte.com
+603 7610 8878

International Tax

Tan Hooi Beng
Executive Director
hooitan@deloitte.com
+603 7610 8843

Transfer Pricing

Subhabrata Dasgupta
Executive Director
sudasgupta@deloitte.com
+603 7610 8376



Get in touch



Deloitte Tax Services Sdn Bhd

Level 16, Menara LGB
1, Jalan Wan Kadir
Taman Tun Dr Ismail
60000 Kuala Lumpur
Malaysia

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 264,000 people make an impact that matters at www.deloitte.com.

About Deloitte in Malaysia

In Malaysia, services are provided by Deloitte Tax Services Sdn Bhd and its affiliates.

Disclaimer

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2018 Deloitte Tax Services Sdn Bhd