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Tax Espresso – Special Alert
Sabah Development Corridor incentive updates

Income Tax and Stamp Duty Exemption Orders

Introduction

Sabah Development Corridor (SDC), an economic corridor in Sabah, was launched on 29 January 2008 with an implementation blueprint spanning over a period of 18 years from 2008 to 2025. The economic focus areas under the SDC are tourism, logistics, agriculture and manufacturing with dozens of targeted sub-sectors. Prospecting businesses may avail itself to incentives in the form of income tax, stamp duty and customs duties exemptions that were introduced.

Recent development

Up until recently, prospecting businesses are guided by Sabah Economic Development and Investment Authority (SEDIA)'s guidelines. On 31 December 2018, the Ministry of Finance made several Orders governing SDC's incentives. These are:

a) Income Tax (Exemption)(No.11) Order 2018 granting the equivalent of investment tax allowance incentive (the ITA Order);
b) Income Tax (Exemption)(No.12) Order 2018 granting the equivalent of pioneer status incentive (the PS Order); and
c) Stamp Duty (Exemption)(No.8) Order 2018 granting stamp duty exemption for transfer of real properties.

The salient points of the ITA and PS Orders are as follows:

Criteria	ITA Order	PS Order	Deloitte's Comments
1) Commence-ment date	• 20 November 2012	• 20 November 2012 unless otherwise stated	• The PS Order contains provisions that come into effect on 16 October 2017 to address Base Erosion Profit Shifting (BEPS) concerns
2) Qualifying company	• Incorporated under Companies Act 2016 • Resident in Malaysia • Approved by the Ministry of Finance • Undertakes a qualifying activity for the SDC • Restricted to one claimant per group of companies in relation to the same qualifying activity	• Similar to the ITA Order, with the following additions: ✓ Has adequate number of full time employees in SDC; and ✓ Incurs adequate amount of annual operating expenditure in SDC. • The effective date for the two criteria above is 16 October 2017	• The determination of a related company is based on elements of control and minimum 20% shareholding link • Given the restriction of one claimant per group of companies, businesses are advised to review its medium to long term business plans in order to maximise its tax savings. Certain business models (e.g. joint venture with an incentivised group) may be disadvantaged
3) Type of exemption	• 100% of qualifying capital expenditure incurred for five years of assessment (YAs) for activities in Table 1 or 10 YAs for activities in Table 2, offset against 100% of SI	• 100% of SI for five YAs for activities in Table 3 or 10 YAs for activities in Table 4	• The types of sectors, activities and corresponding exemptions in the Orders are consistent with SEDIA's website
4) Effective date of exemption	• Not earlier than three years before the date of	• As stated in the incentive approval letter	• The ITA Order allows for a retrospective effective date

	application submitted to the authorities and not earlier than 20 November 2012		which is in line with the Promotion of Investments Act 1986
5) Application date	• Application should be submitted to the SDC between 20 November 2012 and 31 December 2020		• Phase 3 of the SDC blueprint spans from 2016 to 2025. The incentive may be subjected to further extension in the future
6) Person undertaking the qualifying activities	• The Orders shall apply to a qualifying company which undertakes a qualifying activity as an operator		• Only companies that undertake the business proper may benefit from the incentive • Certain business models (e.g. passive role in a joint venture, build-to-rent etc) and industries (e.g. hotel) may be at a disadvantage
7) Disposal of asset – impact to disposer	• Clawback of ITA if the underlying asset is disposed of within two years from the date of acquisition	• Not applicable	• The two year clawback period is consistent with other income tax orders made under the Income Tax Act 1967 but the recently amended Promotion of Investments Act 1986 extends it to five years from the date of acquisition
8) Disposal of asset – impact to acquirer	• Where an incentive claimant disposes an asset that has been subjected to ITA claims to its' related company, the amount of qualifying capital expenditure incurred by the related	• Not applicable	• The related company is unable to claim any allowance on the asset • Such restrictions are utilised in other income tax orders made under the Income Tax Act 1967

	company is deemed to be zero		
9) Substantial activities requirements	• No specific provision in the ITA Order	• Effective 16 October 2018 • The substantial activities requirements are (i) adequate number of full time employees in SDC and (ii) adequate amount of annual operating expenditure in SDC • If incentive approval is granted on or before 16 October 2017, the substantial activities requirements do not apply until 30 June 2021 • If incentive approval is granted after 16 October 2017, the substantial activities requirements do not apply until 31 December 2018	• There is a need to spell out the substantial activity criteria in the PS Order as expenditure can be minimised to generate higher profits / exempt income including staff cost (by way of secondment from related companies) • As for the ITA Order, the incentive granted depends on the quantum of capital expenditure incurred. The higher the capital expenditure the higher the amount of allowance available for exemption of SI. The company that incurs capital expenditure on a particular project would have satisfied the "substantial activity" criteria in terms of expenditure. Staff to carry out the project will also be on the payroll. So the substantial activity criteria is inherent in such a project and need not be spelt out • The PS Order does not state the minimum number of full

			time employees and amount of annual operating expenditure. These could be specified in the incentive approval letter instead
10) Exclusion of intellectual property (IP) income	• No specific provision in the ITA Order	• Effective 16 October 2018 • IP income derived from qualifying activities are excluded from income tax exemption. Please refer to the section on Grandfathering of IP Income below	• Under the PS Order, IP income that is treated as part of the business income is taxed separately from pioneer income and no exemption is given to IP income. Exemption is based on a period of time – 5 or 10 YAs and not on a fixed quantum • As for the ITA Order, IP income that is part of the business income would be given exemption based on the available allowance determined by the amount of capital expenditure incurred. In this case the available allowance has been reduced by the amount of IP income which otherwise would be available to exempt SI in the following years. There is no restriction to use the amount of allowance available determined based on the capital expenditure

			incurred until it is fully absorbed. There is no advantage on the quantum that is exempted which is fixed as a percentage of capital expenditure incurred. Any advantage is the timing difference
11) Treatment of pioneer losses	• Not applicable	• Adjusted loss incurred during the exempt YAs may be carried forward to post exempt YAs	• This mechanism is also applied in other tax incentives
12) Withdrawal of exemption	• The incentive will be withdrawn from the first year of the incentive period if the company fails to comply with any condition imposed		• This mechanism is also applied in other tax incentives
13) Non-application	• The incentive shall not apply to a company which has:- ✓ Engaged in the qualifying activity prior to applying to SDC ✓ Claimed reinvestment allowance or investment allowance ✓ Been granted any incentive under PIA or ITA in respect of the same qualifying activity ✓ Claimed deduction under rules made pursuant to Section 154 of ITA (some exceptions apply) • The ITA and PS Orders are mutually exclusive	• These restrictions are also applied to other tax incentives	• Non-application

Grandfathering of IP Income

Royalties and other income derived:

a) on or after 1 July 2018 but before 1 July 2021 from **new** IP rights that comes into ownership of the PH (i) on or after 1 July 2018, or (ii) after 16 October 2017 but before 1 July 2018; and

b) on or after 1 July 2021 from **all** IP rights,

shall be subjected to corporate income tax at the prevailing rate.

"Intellectual property right" means a right arising from any patent, utility innovation and discovery, copyright, trade mark and service mark, industrial design, layout-design of integrated circuit, secret processes or formulae and know-how, geographical indication and the grant of protection of a plant variety, and other like rights, whether or not registered or registrable.

Stamp Duty (Exemption)(No.8) Order 2018

This order comes into effect on 20 November 2012. It grants stamp duty exemption on instrument of transfer of real property. The conditions imposed are:

a) The property is used for a qualifying tourism project (i.e. as a hotel or resort within SDC and approved by the Ministry of Finance);
b) The instrument is executed between 20 November 2012 and 31 December 2020 (both dates inclusive); and

The person claiming the exemption shall produce a letter from SEDIA stating the instrument is for the purpose of a qualifying project.

Table 1 – Schedule 1 of the ITA Order

No	Sector	Qualifying activity	Qualifying capital expenditure
1	Hotel and resort	Hotel or resort business	Note 1
2	Creative	a) Design academy i) Product design ii) Fashion or accessories design b) Academy of art i) Art and crafts ii) Drawing iii) Sculpture c) School of performing arts i) Dance ii) Drama iii) Music	Note 2
3	Downstream manufacturing of livestock and animal feed	a) Cattle feed b) Dairy-based products c) Meat-based products	Note 3

4	Manufacturing downstream activities of palm oil products	a) Oleochemical b) Biofuel c) Trans fat free food products	Note 3
5	Manufacturing downstream activities of medium and heavy industries	a) Urea and ammonia production b) Solar panel c) Marine supply base and fabrication yard d) Iron ore pellets e) Hot briquette iron f) Combined cycle power plant	Note 3
6	Education hub	a) Private universities b) Private colleges c) Training centres d) Skill training centres	Note 2
7	Marine downstream activities	Manufacturing of aquatic product	Note 3
8	Shipping	Ship building repairs	Note 3

Note 1

a) Construction or purchase of hotel building of approved standard in Malaysia
b) Alteration, extension and renovation of hotel building
c) Provision of machinery, plant or other facilities

Note 2

a) Construction or purchase of building, machinery or plant

Note 3

a) Construction or purchase of factory
b) Construction or purchase of building
c) Provision of machinery or plant

Table 2 – Schedule 2 of the ITA Order

No	*Halal* product / process	Qualifying activity	Qualifying capital expenditure

1	Production of *halal* product		Note 1 Note 2 Note 3
	a) Downstream processing of agricultural produce	a) Pharmaceuticals or biopharmaceuticals b) Biodiagnostics c) Food or feed supplements d) Horticultural product e) Nutraceuticals f) Microbial and probiotics	
	b) Development and production of *halal* products	a) Cell or tissue cultures b) Biopolymers c) Biomaterials	
	c) Development of *halal* process	a) Biotechnology process for waste treatment	

<u>Note 1</u>

a) Construction or purchase of factory
b) Construction or purchase of building
c) Provision of machinery or plant

<u>Note 2</u>

"Development of *halal* process" and "Biotechnology process for waste treatment" are newly added categories.

<u>Note 3</u>

The only incentive offered for the above category of *halal* product / process and all its corresponding qualifying activity is 100% ITA for 10 YAs.

Table 3 – Schedule 1 of the PS Order

No	Sector	Qualifying activity
1	Creative	a) Design academy i) Product design ii) Fashion or accessories design b) Academy of art i) Art and crafts ii) Drawing iii) Sculpture c) School of performing arts i) Dance ii) Drama iii) Music
2	Shipping	Ship building and repairs

Table 4 – Schedule 2 of the PS Order

No	Sector	Qualifying activity
1	Hotel and resort	Hotel or resort business
2	Manufacturing downstream livestock products and animal feed	a) Cattle feed b) Dairy-based products c) Meat-based products
3	Manufacturing downstream activities of palm oil products	a) Oleochemical b) Biofuel c) Trans fat free food products
4	Manufacturing downstream activities of medium and heavy industries	a) Urea and ammonia production b) Solar panel c) Marine supply base and fabrication yard d) Iron ore pellets e) Hot briquette iron f) Combined cycle power plant
5	Education hub	a) Private universities b) Private colleges c) Training centres d) Skill training centres
6	Marine downstream activities	Manufacturing of aquatic product

Moving forward

We hope the SDC incentive would be extended to 2025 to coincide with Phase 3 of SDC's implementation blueprint. It also remains to be seen whether the SDC incentive will be revamped in the future to include the nexus approach or an entirely new IP regime will be introduced. Either way, the grant of income tax exemption on IP income should further catalyse the creative sector in SDC.

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

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