



Tax Espresso – Special Alert

Tax incentives updates

Tax incentives – Income Tax and Promotion of Investments Orders

Introduction

As a member of the Organisation for Economic Cooperation and Development (OECD) Inclusive Framework, Malaysia is committed to adhere to the minimum standards of Base Erosion Profit Shifting (BEPS). One of the standards is countering harmful tax practices under BEPS Action 5. This requires, among others, the alignment of taxation of profits with substance for a preferential regime.

Recent development

In view of the above, the Ministry of Finance issued numerous income tax orders (the Orders) relating to tax incentives. Amongst these are:

- a) Income Tax (Exemption)(No.2) 2009 (Amendment) Order 2018 [P.U.(A) 381/2018] and Income Tax (Exemption)(No.17) 2007 (Amendment) Order 2018 [P.U.(A) 395/2018], governing BioNexus incentive (BioNexus);
- b) Income Tax (Exemption)(No.6) 2016 (Amendment) Order 2018 [P.U.(A) 393/2018] and Income Tax (Exemption)(No.7) 2016 (Amendment) Order 2018 [P.U.(A) 394/2018], governing incentives related to the East Coast Economic Region (ECER);

- c) Income Tax (Exemption)(No.20) 2007 (Amendment) Order 2018 [P.U.(A) 382/2018], governing incentives related to the Iskandar Development Region (IDR); and
- d) Promotion of Investments (Promoted Activities and Promoted Products for High Technology Companies)(Amendment) Order 2018 [P.U.(A) 336/2018], governing High Technology Companies (HiTech).

Orders (a) to (c) were issued on 31 December 2018 while Order (d) was issued on 20 December 2018. These Orders share three common features; (i) introduction of substantial activity requirement (ii) exclusion of intellectual property (IP) income from exemption (iii) introduction of grandfathering provision.

Order	Substance requirement	Exclusion of IP Income and inclusion of grandfathering clause	Others
BioNexus – P.U.(A) 381/2018	✓	✓	Note 1
BioNexus – P.U.(A) 395/2018	✓	✓	Note 2
ECER – P.U.(A) 393/2018	✓	✓	
ECER – P.U.(A) 394/2018	✓	✓	Note 3
IDR – P.U.(A) 382/2018	✓	✓	Note 4
HiTech – P.U.(A) 336/2018		✓	

Note 1: Although substance requirement was not specified in the Order, the Principal Order makes reference to a BioNexus status company as a company that has been given an exemption from the payment of income tax under the Income Tax (Exemption)(No.17) Order 2007, which has been amended via P.U.(A) 395/2018. In turn, P.U.(A) 395/2018 states that a BioNexus status company shall fulfill the substance requirement

Note 2: The Order includes a new Schedule that lists the qualifying activities as activities in industrial biotechnology, healthcare biotechnology and agricultural biotechnology

Note 3: The Order includes a new Schedule that is reproduced in Table 1 below

Note 4: The Order includes a new Schedule that is reproduced in Table 2 below. In addition, the Ministry of Finance is empowered to withdraw the exemption from the date in the basis period for the year of assessment the IDR status company fails to comply with any condition imposed. Lastly, the cut-off date for an IDR status company to commence its business has been extended from 31 December 2015 to 31 December 2020

Substantial activities requirement

The substantial activity requirement in the context of non-IP regimes are:

- a) Has an approved adequate number of full-time employees in Malaysia to carry out the qualifying activity; and
- b) Incurs an approved adequate amount of annual operating expenditure to carry out the qualifying activity or an approved adequate investment in fixed asset in Malaysia to carry out the qualifying activity.

The term "operating expenditure" is not defined in the Orders. However, MIDA's "Guideline on Application for Incentive and/or Expatriate Posts for Green Technology" dated 1 July 2018 states the following (emphasis ours):

*Company must incur adequate amount of operating expenditure annually in Malaysia to undertake the proposed green services / projects for business purposes. This operating expenditure should include local services for insurance, legal, banking, ICT and transportation; if those services could be sourced from local/domestic service providers. **However, this amount shall not include the cost of goods sold, depreciation, interest on borrowings and expenses that are not directly involved in the company's proposed activities.***

We trust the scope of "operating expenditure" will be standardised for every tax incentive. A clearly specified minimum number of full-time employees and operating expenditure for each incentive would also provide greater clarity to investors.

Exclusion of IP income

Royalties and other income derived from certain IP rights cease to be incentivised. Please refer to the grandfathering rule below.

Grandfathering rule

Royalties and other income derived:

- a) on or after 1 July 2018 but before 1 July 2021 from **new** IP rights that the qualifying person owns (BioNexus, ECER & IDR) / owns or is a licensee (HiTech) (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 that the qualifying person owns (BioNexus, ECER & IDR) / owns or is a licensee (HiTech);

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.

Table 1 – Schedule 2 in P.U.(A) 394/2018

No	Exempt Years of Assessment	Exemption Rate (%)	Types of product or Special Qualifying Activity	Minimum amount of Annual Operating Expenditure (RM)	Minimum number of full-time employees
1	10	70	New product or special qualifying activity in East Coast Economic Region which is promoted for the	1 million	4

			benefit of East Coast Economic Region		
2	10	100	1. New product or special qualifying activity in East Coast Economic Region which is promoted for the benefit of East Coast Economic Region; or 2. High technology product without research and development activity	2 million	10
3	15	100	Project located in Malaysia-China Kuantan Industrial Park	200 million	100
			Project located in industrial park within the East Coast Economic Region	1 million	10

Table 2 – Schedule in P.U.(A) 382/2018

No	Sector	Qualifying Activity
1	Creative industries and related services	<ul style="list-style-type: none"> a) Creative and design services; b) Creative talent management services; c) Film and television: <ul style="list-style-type: none"> i) Pre-production; ii) Production; iii) Post-production; and iv) Distribution; d) Games and animation: <ul style="list-style-type: none"> i) Content creation; ii) Production; iii) Post-production; and iv) Distribution; e) Online and mobile content generation and advertising; f) Online and mobile content aggregation and enablers; g) Creative research and development; h) Distribution and marketing of creative content; i) Integrated media and content services; and j) Visual and performing arts.
2	Educational services	<ul style="list-style-type: none"> a) Universities; b) Colleges; c) Skills training institutions; d) Research and development institutions; and e) Regional training centres.
3	Healthcare and related services	<ul style="list-style-type: none"> a) Hospitals and alternative medicine (traditional and complementary medicine) centres; b) Integrated dental and orthodontic services;

		c) Healthcare research and development; and d) Integrated laboratory services.
4	Logistics services	a) Integrated supply chain services; and b) High value supply chain services and solutions.
5	Tourism	a) Hotels; b) Theme parks, amusement and family entertainment centres and cultural centres; c) Conference centres and exhibition centres; and d) Regional operation of hotel and leisure services.
6	Global business services	a) Information technology outsourcing; b) Business process outsourcing; and c) Knowledge process outsourcing.

Moving forward

Public Ruling No. 8/2018 on Tax Incentives for BioNexus Status Companies needs to be revised accordingly. It also remains to be seen whether the above incentives will be revamped again to include the Nexus Approach to incentivise IP income, or if an entirely new IP regime will be introduced. Either way, the grant of tax exemption on IP income should further catalyse investments into research and development and the creative sector.

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

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