



Tax Espresso – Special Alert Principal Hub incentive updates

Principal Hub – Income Tax Orders and Revised Guideline

Introduction

As a member of the Organisation of 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. One of the affected regimes in Malaysia is the Principal Hub (PH) incentive. The incentive has since undergone amendment as reflected in the 2017 Progress Report on Preferential Regimes and 2018 Peer Review Results on Preferential Regimes.

Recent development

The Malaysian Investment Development Authority (MIDA) recently released the updated PH guideline dated 31 December 2018 and dubbed '**PH 1.0**'. It serves as guidance for all five categories of PH, namely (i) new company, (ii) new commodity-based company, (iii) existing company with approved OHQ / IPC / RDC status, (iv) existing manufacturing / services company, and (v) existing commodity-based company. We present our comparison between the latest guideline and the immediately preceding version below:

Criteria	MIDA's Guideline	MIDA's Guideline Dated	Deloitte's Comments
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	Dated 07.07.2017	31.12.2018	
1) Incentives for PH	<ul style="list-style-type: none"> • Full tax exemption on value added income for PH under existing company categories. 		<ul style="list-style-type: none"> • The value added income mechanism is still in effect under the 2018 guideline. There may be further revamp to PH incentive before PH under existing company categories benefit from the Budget 2019 announcement; 10% income tax rate on the overall statutory income for five years.
	<ul style="list-style-type: none"> • No mention of Intellectual Property (IP) Income being excluded from tax exemption. 	<ul style="list-style-type: none"> • Royalties and other income derived from certain IP rights cease to be incentivised. Please refer to the section on Grandfathering of IP Income below. 	<ul style="list-style-type: none"> • The exclusion of IP Income from the scope of tax exemption renders the principal hub incentive a non-IP regime. • The 2018 guideline states that the modified nexus approach to be adopted will be addressed separately in due course.
	<ul style="list-style-type: none"> • New commodity based companies enjoy tax exemption on services income only • Existing commodity based companies enjoy tax exemption on trading and services income 	<ul style="list-style-type: none"> • New and existing commodity based companies enjoy tax exemption on services income only. 	<ul style="list-style-type: none"> • The 2018 guideline streamlines the scope of exemption enjoyed by new and existing commodity based companies.
2) Qualifying services	<ul style="list-style-type: none"> • Qualifying services include (i) brand management (ii) IP management 	<ul style="list-style-type: none"> • MIDA clarified that the aforesaid activities merely cover management services which 	<ul style="list-style-type: none"> • The clarification in the 2018 guideline is consistent with the exclusion of IP income from

	and (iii) research, development and innovation.	exclude any income related to IP such as royalty.	the scope of PH incentive.
3) Effective date of application	<ul style="list-style-type: none"> The deadline for new applications to be received by MIDA is 30 April 2018. 	<ul style="list-style-type: none"> The deadline is extended to 31 December 2020. 	<ul style="list-style-type: none"> The extension is in line with the announcement made in Budget 2018 unveiled on 27 October 2017.

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 subject 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.

Income Tax Orders

On 31 December 2018, the Ministry of Finance made three PH-related income tax orders (the Orders) that come into effect from the year of assessment 2018. These are:

- a) Income Tax (Exemption)(No.6) Order 2018 governing PH with existing manufacturing / services company / commodity-based company status;
- b) Income Tax (Exemption)(No.7) Order 2018 governing PH falling under new company and new commodity-based company status; and
- c) Income Tax (Exemption)(No.8) Order 2018 for PH under existing company with approved OHQ / IPC / RDC status.

The provisions of MIDA's guideline dated 31 December 2018 are consistent with the Orders, save for the exceptions below:

Criteria	MIDA's Guideline Dated 31.12.2018	The Orders	Deloitte's Comments
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<p>1) Definition of PH</p>	<ul style="list-style-type: none"> • A locally incorporated company that uses Malaysia as a base for conducting its regional or global businesses and operations to manage, control and support its key functions including management of risks, decision making, strategic business activities, trading, finance, management and human resource. • "Commodity based company that integrates the supply chain management for upstream and downstream activities under its PH operation" is merely one type of company that may qualify as a PH. 	<ul style="list-style-type: none"> • A company or, a commodity based company that integrates the supply chain management for upstream and downstream activities under its PH operation. 	<ul style="list-style-type: none"> • The legislated definition places more emphasis on supply chain management. • The guideline's definition is more in line with a conventional headquarter regime that requires taxpayers to undertake activities to related group companies.
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2) Eligibility criteria for PH incentive	<ul style="list-style-type: none"> Flexibility to achieve the high value jobs and annual business spending requirement by end of Year 3 (Note). 	<ul style="list-style-type: none"> The aforesaid requirements are to be complied with beginning from the third year of the exempt year of assessment. 	<ul style="list-style-type: none"> We hope MIDA could clarify on the flexibility accorded under the Orders as it may be interpreted as minimum number of jobs must be filled upon commencement of Year 3.
	<ul style="list-style-type: none"> The minimum number of high value jobs for approved OHQ / IPC / RDC without incentive is 'existing commitment + 20%'. 	<ul style="list-style-type: none"> The minimum number of high value jobs for approved OHQ / IPC / RDC without incentive is 18. 	<ul style="list-style-type: none"> The absolute figure under the Order eliminates any potential ambiguity but is not reflected in the guideline.
3) Effective date of application	<ul style="list-style-type: none"> Application for extension of exemption period must be submitted to MIDA six months before the expiry of the initial exempt period (Note). 	<ul style="list-style-type: none"> The aforesaid application shall be made not later than 60 days before the expiry of the initial exempt period. 	<ul style="list-style-type: none"> The Orders allow a later submission deadline.

Note: Not applicable to companies previously approved for OHQ / IPC / RDC status with incentive.

Moving forward

We hope the divergence between the 2018 guideline and the Orders are clarified. In addition, the PH incentive may be subject to further revamp as the 2018 guideline stated approvals granted effective from 1 January 2019 are subjected to the new **PH 2.0** guideline. Lastly, it is timely for groups of companies to perform health check and re-examine its business models in Malaysia and other countries that are members of the Inclusive Framework.

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

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