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# Doing Business in Malaysia

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# Doing Business in Malaysia

## **Abstract**

[Excerpt] Malaysia is a federation of thirteen states and two federal territories in West (Peninsular) Malaysia and East Malaysia with a population of over 20 million. It is rich in natural resources (including oil and natural gas) and is a major producer of palm oil, natural rubber, tin and tropical hardwoods. The Government encourages industry and foreign investment, particularly in high technology and resource-based export-oriented industries. Malaysia has attracted much interest from multi-national companies due to its economic growth and future potential.

## **Keywords**

Malaysia, foreign investment, trade, commerce, business, law, imports

## **Disciplines**

Business | International Business

## **Comments**

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# Doing Business in Malaysia

June 2005

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*The law is stated as at June 2005.*

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## 1. INTRODUCTION

Malaysia is a federation of thirteen states and two federal territories in West (Peninsular) Malaysia and East Malaysia with a population of over 20 million. It is rich in natural resources (including oil and natural gas) and is a major producer of palm oil, natural rubber, tin and tropical hardwoods. The Government encourages industry and foreign investment, particularly in high technology and resource-based export-oriented industries. Malaysia has attracted much interest from multi-national companies due to its economic growth and future potential.

## 2. LEGAL BACKGROUND

For historical reasons, the Malaysian legal system is English based. Many Malaysian statutes are modeled on their English counterparts. Unless there are provisions to the contrary in the written laws of Malaysia, there is continuing reception of English mercantile law generally as it stands in the states of Malacca, Penang, Sabah and Sarawak, and as it stood on 7 April 1956 in the rest of West Malaysia. English law continues to be strongly persuasive in the practice of Malaysian common law.

There is equal protection under the law for foreigners and foreign-owned companies. Court procedure is very similar to that in England. Foreign judgments of superior courts of reciprocating countries i.e. the U.K., the Special Administrative Region of the People's Republic of Hong Kong, Singapore, New Zealand, Sri Lanka, India (excluding the State of Jammu and Kashmir, State of Manipur, Tribal areas of the State of Assam, Scheduled areas of the States of Madras and Andhra) and Brunei Darussalam are directly enforceable in accordance with the Reciprocal Enforcement of Judgments Act 1958. It may be possible to enforce a judgment obtained from a superior court of a non-reciprocating country by bringing a fresh action on the judgment in the Malaysian courts. Commercial disputes may also be resolved by arbitration conducted either ad hoc or under the auspices of the Regional Centre for Arbitration in Kuala Lumpur whose rules are based on the UNCITRAL rules. Malaysian law gives effect to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

## 3. TYPES OF PRESENCE

In Malaysia, a business may be carried on through several different possible vehicles which in practice are limited by the necessity to comply with the government guidelines which are discussed below:

- (i) branch office;
- (ii) wholly-owned subsidiary;
- (iii) joint-venture company with Malaysian shareholders; and
- (iv) representative office.



## 4. FOREIGN INVESTMENT AND LOCAL EQUITY PARTICIPATION

The National Development Policy (“NDP”) of the Malaysian government which was adopted in the 1970s has an objective to ensure that at least 30% of Malaysian companies and businesses should be owned by Bumiputras (the indigenous people of Malaysia), 40% by other Malaysians and 30% by foreigners. Foreign ownership of the Malaysian economy is controlled by legal and non-legal (or administrative) means.

### Non-legal (Administrative) Control

In general, non-legal (or administrative) control is effected by the Foreign Investment Committee (“FIC”) through its guidelines (“FIC guidelines”). The FIC is a watch-dog committee with representatives from at least 13 government departments or statutory bodies and it implements the NDP.

Prior to the recent liberalisation in the Malaysian government policy on foreign equity participation which occurred in 2003 and 2004 (discussed in more detail below), the previous FIC guidelines stated that approval from the FIC is required for, *inter alia*:

- (i) any proposed acquisition by foreign interests of any substantial fixed assets in Malaysia;
- (ii) any proposed acquisition of assets or any interests, mergers and take-overs of companies and businesses in Malaysia by any means, which will result in ownership or control passing to foreign interests;
- (iii) any proposed acquisition of 15% or more of the voting power by any one foreign interest or associated group, or by foreign interests in the aggregate of 30% or more of the voting power of a Malaysian company and business;
- (iv) control of Malaysian companies and businesses through any form of joint venture agreement, management agreement, and technical assistance agreement or other arrangements;
- (v) any take-over or merger of any company or business in Malaysia whether by Malaysian or foreign interests; and
- (vi) any other proposed acquisition of assets or interests exceeding in value of RM5 million, whether by Malaysian or foreign interests.

The FIC guidelines are not law and are a reflection of governmental policy only. While there are no legal sanctions against non-compliance with the FIC guidelines, they are usually enforced administratively through government departments which generally conform to the views of the FIC, for example, in the application for stamp duty exemption, the Stamp Office has indicated that such exemptions will generally not be granted unless, where applicable, the approval of the FIC has been obtained. Further, companies wishing to obtain contracts from various government departments, statutory bodies and

government-owned companies are generally required to have some local equity participation and, in some cases, majority Bumiputera ownership.

Previously, if the approval of the FIC were sought for any acquisition pursuant to the previous FIC guidelines, the FIC would generally have imposed equity conditions which largely mirror the equity components required under the NDP i.e. by limiting foreign equity participation to 30%.

## Introduction of new FIC Guidelines in 2004

Notwithstanding the NDP, which remains a general policy of the Malaysian government, in recent times the Malaysian government has acknowledged that Malaysia needs to do more to enhance the country's competitiveness and promote further investments into Malaysia.

Effective 21 May 2003, the previous FIC Guidelines on Acquisitions of Assets, Mergers and Takeovers (1974) were replaced with:

FIC Guidelines on Acquisition of Property by Local and Foreign Interests ("**FIC Property Guidelines**") and FIC Guidelines on Acquisition of Assets, Mergers and Takeovers by Local and Foreign Interests ("**FIC M&A Guidelines**").

The FIC Property Guidelines are discussed in greater detail in paragraph 10(i) below.

The FIC M&A Guidelines continue to have relatively wide application. The guidelines apply to, amongst other acquisitions, the following types of transactions:

- (i) any proposed acquisition of interests in a local company or business in Malaysia which is valued at RM10 million or more and this applies regardless of whether the acquisition is by a local or a foreign entity (note that with the new FIC M&A Guidelines, FIC approval need only be sought for acquisitions by foreign and Malaysian interests in excess of RM10 million instead of RM5 million under the previous set of FIC guidelines).
- (ii) any proposed acquisition of interest in a local company or business in Malaysia by whatever means which has the effect of transferring ownership or control to foreign interests;
- (iii) any proposed acquisition of interest by:
  - (a) any foreign interest of 15% or more of the voting rights of any local company of business in Malaysia; or
  - (b) any associated or non-associated group of foreign interests, in aggregate of 30% or more of the voting rights of any local company or business in Malaysia,

regardless of whether the value is less than RM10 million with the exception of open market acquisitions on Bursa Malaysia Berhad ("**Bursa Malaysia**") meant for short term holdings;

- (iv) any proposed acquisition of interest and control of more than 50% of the voting rights in any local company or business in Malaysia by local interests, regardless of whether the value is less than RM10 million;
- (v) any proposed merger or take-over of any local company whether by a local or foreign entity;
- (vi) any proposed control of a local company through any form of management agreement, technical assistance agreement or other form of arrangements; and
- (vii) any proposed joint venture involving 2 or more parties in a local company;
- (viii) the charging of shares of a local company to a foreign entity where the value of the loan or the market value of the shares is RM10 million or more.

Certain acquisition are exempted from the FIC M&A Guidelines and they include any acquisition of interests in:

- (a) manufacturing companies licensed by the Malaysian Ministry of International Trade and Industry;
- (b) companies with Multimedia Super Corridor status;
- (c) companies which have been granted the status of International Procurement Centre, Operational Headquarter, Representative Office, Regional Office and Labuan offshore company.

Where the FIC M&A Guidelines apply, the FIC may impose certain equity, share capital and employment conditions to be met:

- (a) The equity condition that will be imposed by the FIC would be to require the local company in question to have at least 30% Bumiputera equity (the remaining 70% can be held by foreign interests or other Malaysian non-Bumiputera interest or by both).

Where the companies already have Bumiputera equity shareholding of 30% or more but less than 51%, the companies must maintain at all times a minimum of 30% Bumiputera equity. For companies which already have Bumiputera equity shareholdings of 51 % or more, they are required to maintain at all times a minimum of 51 % Bumiputera equity.

This policy will be implemented across all sectors of the economy save for sectors which are the subject of specific regulatory regimes. In those sectors, the FIC will defer to the policies on foreign ownership which the regulators may have specifically adopted for each specific sector e.g. banking, insurance, manufacturing etc. In sectors where there is no specific regulatory or licensing authority, the FIC will apply the liberalised policy on foreign ownership contained in the FIC M&A Guidelines.

- (b) The FIC also imposes certain share capital conditions. For a local company with a paid-up capital of less than RM250,000 which held by a foreign interest, the issued share capital of the local company must be increased to at least RM250,000 within 6 months from the date of FIC's approval letter. For local companies held by local interests and have an issued share capital of less than RM100,000, the company will be required to increase its share capital to RM100,000 within 6 months from the date of FIC's approval letter.

As with the previous set of FIC guidelines, the new FIC guidelines set out in the FIC Property Guidelines and FIC M&A Guidelines are not law and are a reflection of governmental policy only. There are no legal sanctions against non-compliance with the guidelines but they can be enforced administratively through government departments exercising a regulatory role in the granting of relevant licences, approvals, permits etc.

## Legal Control

Legal control is through administrative discretion conferred under statutes or subsidiary legislation. Thus, equity ownership can be controlled through the issuance of licences, permits and employment passes or in the purchase of real property and acquisitions of any interest in real property. For instance, where the intended operations of a company or business in Malaysia requires certain operating licences, equity conditions or restrictions may be imposed through the approval and issuance of such licences granted by government or statutory bodies, or by the Securities Commission on initial public offerings.

## Investment in the Share Capital of Malaysian Companies

There is no legislation prohibiting foreign ownership of the share capital of Malaysian companies. However, as stated above, foreign equity in private companies is regulated by the FIC in accordance with the FIC M&A Guidelines. It should be noted, however, that in certain instances, the operations of a company or business in Malaysia may require certain licences, permits or other governmental approvals for its business operations, and the relevant government department may require or stipulate certain equity conditions. Certain examples are listed below:

### (a) Manufacturing

Manufacturing companies are required to be licensed under the Industrial Coordination Act 1975 ("ICA") which is regulated by the Ministry of International Trade and Industry ("MITI"). (Companies with shareholders' funds of less than RM2.5 million or less than 75 full-time paid employees are exempted from the licensing requirements of the ICA). There may be equity conditions annexed to a licence. It is difficult for a branch of a foreign company to obtain a manufacturing licence, and therefore a foreign company wishing to establish a manufacturing operation must generally incorporate a subsidiary.

Previously, foreign equity participation in manufacturing companies had been governed by the level of exports. The Malaysian government has in the past

few years taken various steps to liberalise the restrictions on foreign participation in the manufacturing industry in Malaysia.

One of the most significant measures to liberalise restrictions on foreign investment in Malaysia was announced in 2003. MITI announced in June 2003 that it has lifted all restrictions on foreign participation in the manufacturing industry, including export and equity conditions, with effect from 17 June 2003.

Under this new policy, 100% foreign equity will be allowed for all new investments, as well as investments for expansion and diversification by existing licensed manufacturers. Unlike the previous liberalisation measures, no sectors in the manufacturing industry are excluded from the liberalisation policy and there is currently no time limit imposed on the policy.

Whilst equity and export conditions imposed on existing licensed manufacturing companies prior to the new policy will be maintained, MITI has left open the possibility of removal of any such existing conditions. MITI has said that some flexibility will be given to requests made for such removals, and that each request will be considered based on the merits of each case.

### **(b) Trading**

Foreign interests engaging in wholesale or retail trade (i.e. the re-sale of goods without transformation) are required to incorporate a subsidiary which complies with the NDP. This is enforced through refusal to register branches of foreign companies engaged in such trade, and through licensing, immigration pass, business premises permits requirements.

### **(c) Petroleum - Upstream Activities**

Petronas, which licenses upstream activities, generally requires local and Bumiputra equity ownership.

## **5. INVESTMENT INCENTIVES**

Investment incentives are contained mainly in the Promotion of Investments Act, 1986 (“PIA”) and the Malaysian Income Tax Act 1967 (“MITA”). Some of these incentives are outlined in the Appendix.

## **6. ESTABLISHING A PRESENCE AND CORPORATE LAW**

### **(a) Branch of a Foreign Corporation**

Under the Malaysian Companies Act 1965 (“CA”), the registration of a branch is at the discretion of the Companies Commission of Malaysia (“CCM”) who has the power to impose conditions on such registration. Prior to 1993, branches of foreign corporations were rarely registered because CCM required a letter of support from MITI which was only given if the foreign corporation was awarded a contract with a government body. In 1993, CCM began to allow the registration of branches without such letters of support, but it was announced at the end of 1995 that branches for the purpose of wholesale or

retail trade would not be registered. This is pursuant to the Distributive Trade Guidelines (“DTG”) by the Malaysian Ministry of Domestic Trade and Consumer Affairs (“MDTCA”).

Under the DTG, all new wholesale and retail companies with foreign interest must be incorporated as local companies and foreign equity participation was limited to 30% with the remaining 70% being held by Malaysians and at least 30% of which must be held by Bumiputera investors.

The DTG are only guidelines and have no force of law. There are no legal sanctions for non-compliance, but the MDTCA can enforce them administratively through withholding the relevant business permit licences required by companies engaged in wholesale or retail trade.

### **(b) Wholly-Owned Subsidiary**

As discussed above, there is no statutory prohibition against the establishment of a wholly foreign-owned subsidiary so long as no licences, permits or passes are needed. Where licences, permits and passes are required, such subsidiaries have been approved subject to a condition of future partial divestment of equity to Malaysian shareholders. With regard to employment passes for expatriate employees, the Immigration Department will generally require the applicant company to comply with the NDP. The procedure for incorporating a company are described in Paragraph 6(c) below.

### **(c) Joint-Venture Company**

Where it is not possible to conduct the business through a wholly foreign-owned subsidiary, the foreign party may wish to enter into a joint venture with Malaysians. The joint venture may be documented by way of a joint venture agreement which will provide for ownership and capital structure of the joint venture company, transfer of shares, composition of the board of directors, requirements concerning meetings of the company, financial policies, and termination of the agreement. The terms of a joint venture agreement (and Articles of Association of the joint venture company to conform with such terms) should be considered with care as these documents are crucial in protecting the interests of a foreign shareholder, in particular a minority shareholder. There would often also be agreements dealing with such matters as trademarks, trade names and patent licences, technical assistance and know-how, marketing, management and other matters.

The incorporation of a Malaysian company is relatively simple. The proposed name of the company must first be approved by CCM and the incorporation can generally be completed within two months. A private limited company must have the words “Sendirian Berhad” or the abbreviations “Sdn. Bhd.” at the end of its name to signify that it is a private limited company. The company must be incorporated with at least two shareholders, but a parent company can be the sole shareholder. There is no minimum capitalisation requirement but for practical purposes most companies incorporate with an initial authorised capital of RM100,000, of which only two shares of RM1 need to be issued. No-par value and bearer shares are not permitted. Two resident directors are required, and they may be expatriate employees with employment passes.

It will cost approximately RM4,000 (inclusive of secretarial and registration fees but not legal fees) to incorporate a company with an authorised share capital of RM100,000. Alternatively, it may be quicker to acquire an existing shelf company, but the previous name of the shelf company must appear below the new name on all documents for a year after the change of name.

#### **(d) Representative Office**

Foreign companies are permitted to establish representative offices in Malaysia. Representative offices are not regulated by CCM, but are instead established under the guidelines of the Malaysian Industrial Development Authority (“MIDA”). The permitted activities of a representative office are fairly limited and a representative office is set up mainly for the purposes of conducting market research and feasibility studies and for liaising and co-ordinating the activities of a foreign company in the region. It is not allowed to engage in any business transactions or conduct any business activities in Malaysia, or derive income from its operations. It therefore cannot be used for sales promotion or servicing activities of the foreign company as these are in the nature of business activities.

The representative office is allowed to be set up for an initial period of two years, subject to extension upon application.

#### **(e) Nominee Shareholdings**

Foreign companies may wish to control local companies by trust arrangements with nominee shareholders. If the arrangements are for an improper purpose, e.g. avoiding the FIC guidelines or government policy, or to mislead public authorities, the arrangements may be unenforceable.

#### **(f) Takeovers and Mergers of Companies**

The Malaysian Code on Takeovers and Mergers 1998 (“Code”) came into effect on 1 January 1999. Under the Code, an acquirer who has obtained control in a company (“control” is defined as the acquisition or entitlement to exercise control of voting shares of more than 33% in a company) or an acquirer who holds more than 33% but less than 50% of the voting shares of a company and such acquirer acquires in any period of 6 months more than 2% of the voting shares of the company, will be required to undertake a general offer for the remainder of the shares in the company which it does not already own.

The Code also prescribes numerous Practice Notes which clarify the requirements, interpretation and application of the Code and have to be read in conjunction with the body of the Code. Of significance, are the various exemptions prescribed under the Practice Notes which exempts an acquirer from having to undertake a mandatory general offer. There are 10 prescribed exemptions and are generally applied very strictly by the Malaysian Securities Commission which administers the Code and the Practice Notes.

## 7. TAXATION IN MALAYSIA

### (a) General

The Malaysian system of taxation is territorial in nature. Income is taxed in Malaysia if the income is sourced (i.e. accrued in or derived from) in Malaysia or received in Malaysia from outside Malaysia (subject to certain exemptions).

Foreign sourced income received in Malaysia by a resident company has been (and continues to be) exempt from tax since the year of assessment 1998. However, this exemption does not extend to a company carrying on the business of banking, insurance, shipping or air transport.

Presently, income remitted into Malaysia by non-resident individuals, a resident company and a unit trust is exempt from tax. Effective from year of assessment (“YA”) 2004, to enhance domestic investment, income remitted by any person including a resident individual, a trust body, a cooperative and a Hindu joint family will be exempted from tax.

The rate of income tax for resident and non-resident companies (save for small and medium scale companies (“SMEs”)) in Malaysia is 28%. With effect from YA 2004, SMEs with a paid up capital of not more than or equal to RM 2.5 million are subject to income tax at the rate of 20% on the first RM500,000 of its chargeable income. The remaining chargeable income will continue to be taxed at the rate of 28%. Dividends distributed will be given a tax credit of 28% in the hands of shareholders.

There is no capital gains tax except in relation to real estate (see below) but a gain which has the characteristics of income or is deemed to be an adventure in the nature of trade may be subject to income tax. Gains arising from the sale of assets which have enjoyed capital allowances and are sold for more than their written-down value are also taxable as income.

Losses can be carried forward indefinitely but can only be set off against business income.

Expenses “wholly and exclusively” incurred in the production of taxable income are generally deductible (including pre-operation training costs and interest on money borrowed and employed in the production of income). Double deduction for the following expenses may be available - revenue expenditure incurred on research, expenditure incurred on approved training by manufacturing companies and companies carrying on a hotel or tour operating business, approved outgoings and expenses incurred for the promotion of exports from Malaysia, expenditure incurred for promotion of export of services, etc.

Depreciation is not allowed as a deduction against the income. Instead, a company is allowed to claim capital allowances for the assets purchased.

Capital allowances are categorised into 3 classes and rates of capital allowances are as follows:



<u>Type of Asset</u>	<u>Initial Allowance Rate</u>	<u>Annual Allowance Rate</u>
Office equipment, furniture and fittings	20%	10%
Plant and machinery (general)	20%	14%
Heavy machinery and motor vehicles	20%	20%

Computer and pollution control equipment which have been currently given special allowance at rates exceeding 20% will continue to be enjoy the higher rate. Industrial buildings which were granted an initial allowance rate of 10% followed by an annual allowance rate of 2%, will now enjoy an annual rate of 3% with effect from the year of assessment 2002.

Unutilised capital allowances can be carried forward indefinitely but can only be set off against income from the same business.

The recent 2005 Budget proposed that *zakat* on business income paid by all other companies (apart from just Labuan offshore companies) to Islamic religious authorities be allowed as a deduction for the computation of income tax not exceeding 2.5% of aggregate income. This proposal will come into force from the year of assessment 2005.

The 2005 Budget also proposed a tax exemption on interest income derived by non-resident companies from:

- (i) Ringgit-denominated Islamic securities and debentures (excluding convertible loan stocks) approved by the Securities Commission; and
- (ii) securities issued by the Government of Malaysia.

## **(b) Self Assessment System of Taxation**

The 1999 Malaysian Budget made several important changes to the general system of taxation. Income tax in Malaysia has always been assessed by the Malaysian Inland Revenue Board (“**IRB**”) on an Official Assessment System (“**OSA**”). Under the OSA, the IRB is responsible for calculating the tax payable by the taxpayer.

The 1999 Budget started the change towards the Self-Assessment System (“**SAS**”). Depending on the category of the chargeable persons (i.e. taxpayers), the effective dates for implementation of the SAS are:

<u>Category</u>	<u>Year of Implementation</u>
Companies	2001
Businesses, partnerships and co-operatives	2004*
Salaried employees	2004

\* The implementation of the SAS for businesses, partnerships and cooperatives has been deferred from the year 2003 to 2004.

Companies are now under the SAS. The taxpayers are expected to complete their tax returns fully and accurately and to assess their own tax liability. The IRB will from time to time audit the companies to ensure compliance.

As a result of the SAS, some companies may have made excess income tax payments. The 2005 Budget proposed the establishment of a Fund for Tax Refund to provide for expedited income tax refunds. Under the proposal, excess payments will be offset against the current year tax liability of the company, but in the case of companies with no income tax liability in the current year, refunds of excess payments will be made to the companies from the Fund.

### **(c) Review of Consumption Tax (Sales and Service Tax, and Introduction of Goods and Services Tax in 2007**

The 2005 Budget proposed the review and abolition of the current consumption tax, which in its present form consists of sales tax and service tax and to replace it with a single consumption tax, namely the Goods and Services Tax (“GST”), which is based on the value-added concept beginning 1 January 2007.

Sales tax is levied on goods at the point of import or at the manufacturers’ level whilst service tax, is imposed on selected services, including those provided by certain professionals, as well as operators of hotels and restaurants.

The government envisages that the GST will be more comprehensive, efficient, transparent and effective, thereby enhancing tax compliance. The introduction of the GST will also provide the government with the opportunity to reduce corporate and individual income tax rates.

The implementation of the GST should not increase the cost of doing business in Malaysia for most enterprises as businesses merely act as revenue collection agents for the government as GST is after all a tax on the consumers rather than on businesses.

To ensure that the low-income group will not be burdened by the implementation of GST, the Budget proposed that goods and services considered as basic needs will either be zero-rated or exempted. In addition, small businesses may also be exempted from this tax.

### **(d) Dividends**

Malaysia has an imputation system of taxation of corporate distribution. So far as a foreign shareholder is concerned, the main practical result of the dividend taxation rules is that dividends paid by a Malaysian resident company out of profits which have been subject to full Malaysian taxation will not be subject to any further Malaysian tax in the hands of the foreign shareholder.

**(e) Withholding Taxes**

Malaysia imposes a withholding tax on certain payments to non-residents such as royalties, technical fees, installation fees and rental of moveable property. The rate of withholding tax is generally 10% and this is considered a final tax unless the non-resident files a return and claims deductions for losses and expenses. This, however, is not normally done.

However, following the proposals in the 2003 Budget, payments to nonresidents for services performed *outside* Malaysia were exempted from withholding tax with effect from 21 September 2002. The exemption applies specifically to services rendered in respect of technical advice, assistance or technical services in relation to the management or administration of any project, or services rendered in connection with the use of property or rights belonging to, or the installation or operation of any plant machinery or apparatus purchased from the non-resident.

For fees paid to non-resident contractors, consultants or professionals in respect of services under a contract performed in Malaysia, the rate of withholding tax has been reduced in the 2003 Budget from 20% to 13% (10% of the contract payment on account of tax payable by the non-resident and 3% on account of tax payable by employees of the non-resident (eventually to be refunded on filing of their tax returns)) effective 21 September 2002. This is not a final tax and any excess of withholding over the final tax will be refunded.

Withholding tax at the rate of 15% is also imposed on interest payments to non-residents.

**(f) Anti-Avoidance**

There are wide anti-avoidance provisions in the Income Tax Act modeled on former Australian legislation. In addition there is a specific antiavoidance provision which is designed to catch dealings between residents and non-residents such as those on terms which are not arms-length, e.g. transfer pricing.

The IRB has also recently issued the Transfer Pricing Guidelines on 8 July 2003, which seek to provide multi-national corporations and other corporate taxpayers with information on the relevant existing domestic legislation, methodologies that may be used in determining arm's length price and administrative regulations relating to taxpayers involved in transfer pricing arrangements.

**(g) Real Property Gains Tax ("RPGT")**

The sale of real property situated in Malaysia is subject to RPGT. Real property is defined as "any land situated in Malaysia and any interest, action or right in or over such land", and includes buildings or structures attached to land.

The rate of tax depends on the number of years the real property has been held by the disposer of the real property. It ranges from a maximum of 30% of chargeable gains for chargeable assets disposed of within 2 years of their acquisition to nil (for individuals) or 5% (for both resident and non-resident companies) if disposed of in the sixth year after acquisition or thereafter.

This sliding scale also applies to the gains of an individual who is not a Malaysian citizen or a non-permanent resident, save that gains from the disposal of real property after the fifth year will be taxed at the rate of 5%.

### **(h) Real Property Companies**

This is an anti-avoidance device intended to prevent persons from avoiding RPGT by using a company to acquire land, and selling shares in the company instead of selling the land.

A real property company (“**RPC**”) is a controlled company which owns land with a defined value of not less than 75% of its total tangible assets. Capital gains on the disposal of shares in RPCs will be subject to tax in the same way as capital gains on the disposal of land.

There may be, with the prior approval of the Director General of the Inland Revenue, an RPGT exemption where an asset is:

- (i) transferred between companies in the same group to bring about greater efficiency in operation and for a consideration consisting more than 75% of shares in the transferee company;
- (ii) transferred between companies in any scheme of reorganisation, reconstruction or amalgamation for any consideration but in connection with a scheme whereby the transferee company is being restructured to comply with government’s policy on capital participation in industry; or
- (iii) distributed by a liquidator under a scheme of reorganisation, reconstruction or amalgamation for any consideration but in connection with a scheme whereby the transferee company is being restructured to comply with government’s policy on capital participation in industry.

### **(i) Tax Treaties**

Malaysia has concluded treaties to mitigate double taxation with about 53 countries, including Argentina, Australia, Belgium, Canada, China, Denmark, France, Germany, India, Ireland, Indonesia, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Pakistan, Philippines, Saudi Arabia, Singapore, Sweden, Switzerland, Thailand, the United Kingdom and the United States of America. However, the treaties with Argentina, the United States of America and Saudi Arabia are of restricted application, dealing only with the profits of shipping and/or air transport undertakings.

## **8. EXCHANGE CONTROL**

The legislation in Malaysia governing exchange control is the Exchange Control Act 1953 (“**ECA**”). The Controller of Foreign Exchange has, under Section 39 of the ECA, issued Exchange Control of Malaysia Notices (“**ECM Notices**”) which embody his general permissions and directions. Bank Negara Malaysia, which is the central bank of Malaysia (“**Bank Negara**”), has also released a number of clarifications to clarify issues which arise from the ECM Notices. The ECM notices (together with the clarifications) set out the

circumstances in which the specific approval of the Controller of Foreign Exchange within Bank Negara, must be obtained by residents and non-residents to remit funds to and from Malaysia.

A “resident” is defined as a citizen of Malaysia (excluding a person who is a permanent resident of a foreign country and is residing outside Malaysia), a non-citizen of Malaysia who has obtained permanent resident status in Malaysia and is residing permanently in Malaysia, or a person (whether body corporate or unincorporate, and whether head office or branch) incorporated or registered with or approved by any authority in Malaysia.

A “non-resident” is defined as any person other than a resident, an overseas branch, an overseas subsidiary, a regional office, a sales office, a representative office of a resident company, embassies, consulates, high commissions, supranational or international organisations, or a Malaysian citizen who has obtained permanent resident status in a territory outside Malaysia and is residing outside Malaysia.

Bank Negara announced further liberalisation to its foreign exchange regime effective 1 April 2005, with changes to the thresholds for investment abroad, relaxation of the rules on hedging and retention of foreign currency by residents and increasing limits for foreign currency credit facilities obtainable by residents.

## ECM Notices

The following are some of the important restrictions that are imposed on residents and non-residents by the ECM Notices:

- (i) Residents can pay non-residents in either Ringgit or foreign currency up to RM50,000, without any prior approval being required unless it is for the import of goods and services or for investments abroad. Payments in Ringgit in excess of RM50,000 will require the approval of Bank Negara save for a number of specific exceptions, which include a remittance for the purchase of Ringgit instruments, securities registered in Malaysia transacted through an authorised depository or other asset in Malaysia.

Payments for import of goods and services in Ringgit would not be permitted unless prior approval of Bank Negara is obtained. All payments for exports must be in foreign currency.

Notwithstanding the above, we would highlight that all payments from Malaysia to a destination outside Malaysia must, at present, be in foreign currency because the Malaysian currency is not tradable outside Malaysia.

- (ii) Effective 1 April 2004, all permitted Ringgit lending limits for various purposes, by banking institutions to a non-resident (excluding a stockbroking company, custodian bank and correspondent bank) are consolidated into one aggregate limit and raised to RM10 million, to enhance access to Ringgit funds for business requirements in Malaysia.

The non-resident may use the Ringgit credit facilities for any purpose in Malaysia, excluding for financing or refinancing the purchase of construction of immovable properties.

Effective 1 April 2004, residents (banks and non-banks) may extend Ringgit credit facilities in aggregate up to three property loans to a non-resident to finance or refinance the purchase or construction of immovable properties in Malaysia, excluding the purchase of land only. Prior to this, only financial institutions and employers may extend property loans to a non-resident.

- (iii) With regard to overseas investments, effective 1 April 2005:
- (a) Residents without domestic credit facilities can invest abroad in foreign currency either from their own foreign currency or conversion of ringgit funds.
  - (b) Individuals with domestic credit facilities can invest abroad in any amount of their foreign currency funds or convert ringgit up to RM100,000 per annum.
  - (c) Corporations with domestic credit facilities can invest in foreign currency assets using their foreign currency funds or convert their ringgit up to RM10 million per annum. Such corporations must have a minimum shareholders' fund of RM100,000 and have been in operation for a minimum of one year.
  - (d) The threshold for investing funds abroad attributed to residents by a unit trust company is increased to 30% of the Net Asset Value of all resident funds managed by the unit trust company.
  - (e) Fund managers may invest abroad any amount of funds belonging to non-resident clients and resident clients that do not have any domestic credit facilities.
  - (f) Fund managers may invest abroad up to 30% of the funds of their resident clients who have domestic credit facilities.

For the purposes of these provisions, "domestic credit facilities" exclude trade credits extended by suppliers of goods, forward exchange contracts, (certain) personal and housing loans, credit card facilities, and inter-company borrowings (excluding amounts owed to shareholders). Bank Negara also requires all remittance of funds in excess of RM50,000 for investments abroad to be registered with it.

- (iv) Effective 1 April 2005, for foreign currency credit facilities:
- (a) Resident corporations, on a per corporate group basis, may obtain foreign currency credit facilities up to an aggregate of RM50 million equivalent. The foreign currency borrowing may be used to finance overseas investment of up to RM10 million equivalent.

- (b) Resident individuals may obtain foreign currency borrowings up to an aggregate of RM10 million equivalent. The funds may be used for any purposes, including financing overseas investments.
- (c) Prepayments of foreign currency borrowings may be made freely without the prior approval of the Controller.
- (d) Onshore trade financing in foreign currency may be freely obtained irrespective of tenure.

Additionally, foreign currency accounts (“FCA”) are now allowed:

- (e) Residents may open a FCA onshore or offshore (except for export FCA) without specific prior permission.
- (f) There is no limit on the amount of foreign currency funds a resident is able to retain onshore or offshore.
- (g) A resident without any domestic credit facilities may convert any amount of his ringgit funds for credit into his FCA maintained onshore or offshore.
- (h) A resident with domestic credit facilities may convert ringgit for credit into FCA as follows:

***For education or overseas employment purposes***

Up to USD150,000 for credit into onshore FCA or FCA maintained with offshore banks in Labuan; and

Up to USD50,000 for credit into overseas FCA.

***For other purposes***

Up to RM100,000 per annum.

- (i) A resident corporation with domestic credit facilities is allowed to convert ringgit up to RM10 million in a calendar year for credit into its FCA.
- (j) Exporters may retain any amount of their foreign currency export proceeds onshore with licensed banks. All proceeds are still required to be repatriated to Malaysia onshore.

Note that the procurement of any foreign currency credit facility exceeding RM1 million has to be registered with Bank Negara.

- (v) All Ringgit securities are required to be deposited with authorized depositories and must be transacted through an authorized depository for good delivery. Ringgit securities in this context include bills of exchange, private debt securities, treasury bills, and all shares listed on the Bursa Malaysia Securities Berhad (*formerly known as the Kuala Lumpur Stock Exchange*).

- (vi) Limits have also been imposed on the import and export of currency by residents and non-residents into and out of Malaysia. Residents and non-residents are allowed to import and export Ringgit up to RM1,000. Residents and non-residents are allowed to import foreign currency of any amount. However, residents are allowed to export foreign currency only up to RM10,000 equivalent. Non-residents are allowed to export foreign currency up to the amount of foreign currency they brought in to Malaysia.
- (vii) Companies with multimedia super corridor status will continue to be exempted from all exchange control rules to meet their own requirements.
- (viii) Rules for domestic borrowing by non-resident controlled companies are fully liberalised. There is no longer a RM50 million limit or 3:1 gearing ratio requirement.
- (ix) Effective 1 April 2005, non-residents are allowed to hedge:
  - (a) current account transactions, i.e. committed payments and receipts are permitted to be settled in Ringgit with residents, and
  - (b) capital account transactions, i.e. committed inflows and outflows related to investments in (certain) Ringgit assets.

Note that proposals by residents to enter into forward foreign exchange contracts to hedge current account transactions on an anticipatory basis including all transactions under financial account transactions exceeding the equivalent of USD10 million have to be registered with Bank Negara.

- (x) Fixed deposits placed by non-SME corporations and non-residents, regardless of the amount, will be on a fully-negotiated basis. The previous floor rates prescribed by BNM no longer apply.

However, fixed deposits placed by individuals, SMEs and other depositors of up to RM1 million for tenures of 1-12 months will still be subject to the prescribed floor rates, i.e. at 3% per annum for 1 month and 3.70% per annum for 12-month deposits.

A company in Malaysia may maintain inter-company accounts with any non-resident company (except in connection with Israel), but monthly returns must be submitted to Bank Negara. The resident company may debit and credit inter-company accounts and settle net balances of accounts arising from the offsetting of payables against receivables with the non-resident company. However, the prior permission of Bank Negara is required for offsetting payables against receivables that are export proceeds or external credit facilities extended to the resident company and all inter-company settlements must be made in foreign currency only. Further, where any inter-company settlement exceeds the equivalent of RM10,000 in foreign currency, Bank Negara must be informed.



## 9. LABUAN - INTERNATIONAL OFFSHORE FINANCIAL CENTRE

Labuan (an island located off the state of Sabah in East Malaysia) which is a federal territory of Malaysia, became a special international offshore financial centre in 1990. Labuan has her own offshore legislation to facilitate offshore trading activities such as banking, insurance, trading, management, licensing (excluding shipping) and offshore non-trading activities such as those relating to the holding of investments in securities, stocks, shares, loans, deposits and immovable properties. Offshore activities are required to be carried out with persons non-resident in Malaysia, and in foreign currencies except for the purposes of defraying administrative and statutory expenses.

The definition of “offshore business activity” has been extended to include the business of money-broking or leasing carried out by an offshore company with Malaysian residents. In addition, with effect from the year of assessment 1999, the Minister of Finance is now empowered to approve a specific offshore trading or offshore non-trading activity to be carried on with residents or to approve transactions to be carried on in Malaysian currency.

An offshore company carrying on an offshore trading activity can elect either to pay tax at a rate of 3% of its net audited profits or RM20,000 in any year of assessment. Income derived from an offshore non-trading activity is exempt from tax.

Dividends paid by an offshore company in respect of income derived from an offshore business activity and distributions made by an offshore trust are not subject to tax in the hands of the recipients. Dividends received by an offshore company are exempt from income tax.

Royalties, interest and technical or management fees paid by an offshore company to a non-resident person or another offshore company, and any interest paid by a Malaysian resident to offshore banks in Labuan are not subject to withholding tax.

## 10. MISCELLANEOUS

### (a) Licences

Licences may be required for certain activities, for example, manufacturing, as already noted, or the import of certain goods.

### (b) Employment of Expatriates

Non-Malaysians require employment passes prior to taking up employment in Malaysia. The Malaysian government’s objective is that Malaysians will be trained so that they may be involved in all levels of employment. Therefore, in certain industries, for example manufacturing, only certain “key posts” designated and approved in advance may be permanently filled by foreigners. Generally, approval of expatriate posts is normally granted only where the paid-up capital of Malaysian companies are at least RM350,000. Registered branches of foreign companies are generally only permitted one expatriate post

unless compelling reasons are given for further posts. Normally applications for expatriate posts in manufacturing companies are submitted to the Malaysian Industrial Development Authority (“**MIDA**”) before final submission to the Immigration Department. Other executive posts requiring professional qualifications and practical experience may be filled by expatriates for a maximum period of ten years, subject to the condition that Malaysians are eventually trained to take over such posts. Non-executive posts which require technical skills and experience may be filled by an expatriate for five years subject to the same condition.

### **(c) Employment Laws**

The Employment Act 1955 (“**EA**”) governs all matters relating to employment in West Malaysia and (with the exception of public servants and those employed in statutory bodies) applies to all employees (“**Employees**”) whose wages do not exceed RM1,500 a month and all those engaged in manual labour (who may or may not earn more than RM 1,500 a month in wages). All other workers are governed by their employment contracts and the common law - the terms and conditions of employment of such employees are left to be agreed between the employee and the employer, although the common law imposes certain basic obligations on employees and employers.

The main areas covered by the EA concern termination, payment of wages, liability of principals and contractors for wages, employment of women, maternity protection, days and hours of work, annual leave, sick leave, public holidays, termination and lay-off benefits, inspection of places of employment and method of dealing with complaints and domestic enquiries. There are generally no statutory minimum wages (except for employees in certain occupations e.g. cinema workers, shop assistants, hotel and catering workers, cargo-handlers and stevedores) and actual conditions of employment are usually left to be agreed upon, subject to the minimum terms set out in the EA.

Termination and lay-off benefits in respect of Employees are prescribed under the Employment (Termination and Lay-Off Benefits) Regulations 1980. With regards to other employees, arrangements relating to retrenchment or redundancy can be addressed in a contract of service or collective agreement (although the employer’s right to retrench an employee by reason of redundancy or re-organisation is a non-negotiable issue in collective bargaining).

A vendor of a business will be liable to pay termination benefits to Employees unless the purchaser, within 7 days of the change of ownership of the business, offers to continue to employ the Employees under terms and conditions no less favourable than those the Employees were employed under and the Employees unreasonably refused the offer.

Dismissal of any employee must be for a just cause or excuse and even for cause, must follow certain inquiry procedures, failing which, the employee may appeal to the Minister of Human Resources, and through him to the courts. The employer is also required to notify the Director General of Labour of the retrenchment of any employees at least one month prior to the retrenchment exercise.

The Employees Provident Fund (“**EPF**”) Act 1991 requires contributions by both employer and employee to a provident fund for retirement of the employee at the age of 55 years. Currently, the employer’s contribution in respect of an employee is 12% of the employee’s wages while the employee contributes 11% towards his own account. The EPF Board credits interest to the contributions annually. Expatriates employed in Malaysia who earn more than RM2,500 a month need not contribute to EPF but may elect to do so. Also exempted are foreign workers who are Thai citizens entering Malaysia with a Border Pass, and seamen.

Employers with one or more employees whose wages do not exceed RM2,000 a month are required to insure their employees against injury and invalidity under the Employees’ Social Security Act 1969. The total amount of contribution by the employer under this Act for this insurance is approximately 1.75% of the employee’s wage. The employee would also have to contribute approximately 0.5% of his wage to this insurance.

#### **(d) Import and Export Controls**

Tariff protection will be granted in appropriate cases to industries which are in a position to supply a major portion of the domestic market. In special cases temporary import restrictions may also be imposed, e.g. to protect a new project in a start-up phase.

Import duties are payable on a wide variety of imported goods. However, exemption from, or drawback of, import duty can generally be claimed in respect of raw materials and components used in products manufactured for export. Exemption can also be claimed where products are manufactured for the domestic market if the manufacturing company has complied with government policy.

All imports of heavy machinery and parts will require the approval of the Ministry of International Trade and Industry. Such machinery, subject to approval, will include ships derricks, cranes, fork-lift trucks, bulldozers, excavating and boring machinery and special purpose motor vehicles. Approval will only be given for those machinery which are not available locally.

Dutiable goods on arrival into Malaysia may be deposited into a warehouse (not being a customs or licensed/bonded warehouse), usually for a period of 5 days although the statutory maximum is 10 days, after which they may be removed at the expense of the owner to a customs or licensed/bonded warehouse. Non-perishable goods may remain in a customs warehouse without payment of duty for a period of 1 month but subject to payment of warehouse rent. Further periods of not less than one month at a time and not exceeding six months in aggregate may be extended to the owner of the goods at the discretion of the senior customs officer after which the goods would be forfeited. Licensed/bonded warehouses are warehouses licensed for storing dutiable goods without payment of duty indefinitely until such time as they are removed to be sold or disposed to the Malaysian market.

**(e) Free Zones (“FZ”)**

There are several designated FZs in Malaysia. There are two types of FZs: Free Industrial Zone (“**FIZ**”) and Free Commercial Zone (“**FCZ**”). Only manufacturing activities are permitted in the FIZs. The types of activity permitted in FCZs are limited to commercial activities, which include trading (excluding retail trade), breaking bulk, grading, repacking, relabelling and transit. The objective of these FZs is to enable industries to enjoy minimum customs control and formalities in the import of raw materials, parts, machinery and equipment.

Companies eligible for location in FZs are those whose entire exports are meant for export and whose materials/components have to be imported. In exceptional cases, companies exporting not less than 80% of their products can also be considered for location in the FZs (although the Malaysian government encourages FZ companies to use local raw materials or components wherever possible).

Goods and services of any description may be brought into, produced, manufactured or provided in a FZ without payment of any customs duty, excise duty, sales tax or service tax. Companies in the FZ wishing to sell their products in the domestic market may apply to the Ministry of Finance for exemption of the import duty for such products.

**(f) Licensed Manufacturing Warehouse (“LMW”)**

Where there is no convenient FZ, a company may apply to the Royal Customs and Excise Department to set up an LMW. The LMW system is based on the same policy as that governing the establishment of the FZs in Malaysia, namely, to provide exemption from duty and other incentives for export-manufacturers on an automatic basis. LMWs are essentially factories operating in a manner similar to the FZ factories. The same considerations for eligibility in respect of FZ apply to an LMW. Differences however exist. Where FZs are more or less permanent in terms of locality, area and permitted activities, the LMW manufacturer has a choice of location when he opts for the LMW system.

**(g) Intellectual Property Law**

Malaysian law provides for the protection of Intellectual Property which is generally in line with international standards and obligations.

Patent protection in Malaysia is available by registering the invention or utility innovation in Malaysia. A patent expires in 20 years (renewable yearly) from the date of its application. The initial duration of protection for a utility innovation is 10 years from the date of filing of application (with two permitted extensions of 5 years upon the expiry of the initial 10 years). Malaysia acceded to the Paris Convention on 1 January 1989.

Protection of computer programmes or compilations of computer programmes is available under the Copyright Act 1987. On 1 October 1990, Malaysia acceded to the Berne Convention and enacted regulations which effectively extended copyright protection in Malaysia to certain works first published in other countries which are also members of the Berne Convention or which are created by nationals of Berne Convention members. Industrial designs are protected through registration in Malaysia under the Industrial Designs Act

1996. Trade and service marks may also be registered in Malaysia, although the registration process can be lengthy (as it may take up to three years to obtain registration). The Trade Marks Act 1976 is modelled on the previous United Kingdom trade mark law i.e. the Trade Marks Act 1938. The common law actions of breach of confidence under the law of confidentiality and passing-off where appropriate, are also available.

In line with Malaysia's obligations under TRIPS (Agreement on Trade Related Aspects of Intellectual Property Rights), protection is now available for the layout design of integrated circuits under the Layout-Designs of Integrated Circuits Act 2000. Furthermore, geographical indications are also protected under the Geographical Indications Act 2000.

The Optical Discs Act 2000 was enacted to deal with the problem of piracy and the copying of copyrighted works (principally software, film and music) in the form of optical discs such as, VCDs, DVDs and CDs. This law regulates the manufacture of optical discs and requires such manufacturers to be licensed.

#### **(h) Communications and Multimedia Act 1998**

The Communications and Multimedia Act 1998 and its raft of supporting regulations, guidelines and directions provide a comprehensive regulatory and licensing framework for the converging telecommunications, broadcasting, multimedia and IT industries. One of the objectives of this Act is to make Malaysia a major global centre for these industries and to spur the local development in these areas.

To-date the Commission has issued regulations on *inter alia*: licensing requirements under the Act and the applicable exemptions; requirements for spectrum and apparatus assignments; and technical standards and certification for communications equipment. Guidelines have also been issued on competition within the communications market, provisioning of wireless LAN services, advertising and broadcasting. The Commission frequently issues discussion papers on various topics (such as the Electronic Addressing and Numbering Initial Issue Paper) affecting the communications market to solicit constructive responses from the public.

The regulatory regime is regulated by the Malaysian Communications and Multimedia Commission, while overall policy continues to be determined by the Ministry of Energy, Communications and Multimedia.

#### **(i) Restrictions on Ownership of Real Properties**

In addition to the FIC Property Guidelines, under the Malaysian National Land Code, except for industrial land, foreigners must obtain the prior approval of the relevant state authority before acquiring real property in West Malaysia. However, industrial land is often held under leasehold title, and state authorities may impose conditions relating to foreign ownership in the title.

From 16 October 1997, the conditions imposed on the acquisition of residential property by foreign interests are as follows:

- (i) The quota on sale of condominiums priced more than RM250,000 to foreign interests will be increased from 30% to 50% for projects which have commenced construction as of 16 October 1997;
- (ii) Each foreign interest will be allowed to acquire two units of condominiums or one condominium unit and one landed property. Any further acquisition will be subject to the condition of having to incorporate a company to make the acquisition; and
- (iii) A permanent resident will be allowed to acquire property priced below RM250,000 but above RM60,000, if his or her spouse is a Malaysian citizen or has applied for Malaysian citizenship.

However, due to the economic downturn in Malaysia, the FIC announced in May 2001, that:

- (i) Foreigners are now allowed to acquire property costing more than RM250,000 without having to set up a company with local equity. The liberalization applies to all residential and commercial properties. This threshold has however been reduced to RM150,000 as part of the Package announced in May 2003;
- (ii) Acquisition of property costing less than RM10 million by local Malaysians is exempted from FIC approval;
- (iii) Sales of the following categories of properties that are less than RM20 million only need to be reported to the FIC for record purposes:
  - (1) Bumiputera (Malays and other indigenous races) to Bumiputera;
  - (2) Non-Bumiputera to Bumiputera;
  - (3) Non-Bumiputera to non-Bumiputera; and
  - (4) Foreign interests to Malaysian.
- (iv) Foreign manufacturers who have been exempted from obtaining a manufacturing licence may purchase industrial lots or factories for their own manufacturing activities without equity conditions;
- (v) Foreign companies incorporated in ASEAN countries wishing to set up joint ventures or carry out trading or commercial activities in Malaysia are allowed to own offices or office space (costing more than RM250,000 per unit) without equity conditions; and
- (vi) To encourage the establishment of Headquarters and Regional Offices, companies are permitted to own any number of offices or office space, including branch offices (costing more than RM250,000 per unit) without equity conditions.

Where any property acquisition does not fulfill the above criteria, it would be subject to existing FIC guidelines.

With the coming into effect of the FIC Property Guidelines on 21 May 2003, the FIC exempted the following acquisitions of real property from the requirement of obtaining its approval:

- (i) an acquisition of property valued at less than RM 10 million by Malaysians or a locally incorporated company with 50% or more of its equity interest held by Malaysians;
- (ii) acquisitions by companies having the status of “Multimedia Super Corridor Company” with the condition that the property acquired or to be acquired will be used for the operational activities of the company;
- (iii) an acquisition of residential units under the “Malaysia My Second Home” Programme;
- (iv) a transfer of property pursuant to a will and court order; and
- (v) an acquisition of industrial property by a manufacturing company for the company’s manufacturing provided the company is licensed by MITI.

Other salient provisions in the FIC Property Guidelines are as follows:

- (i) FIC approval must be sought for the acquisition of property, leasing of property for a term of 10 years or more and charging of property in Malaysia by a foreigner, a foreign company or a locally incorporated company with more than 50% of its equity interest being foreign-held (collectively, “**foreign interest**”);
- (ii) Local manufacturing companies which are owned by foreign interest can acquire residential units valued at less than RM150,000 (USD1.00 = RM3.80) but more than RM60,000 subject to the unit being used by the employees of the companies;
- (iii) Foreign interest can acquire commercial units without having to incorporate a local company for that purpose provided that the value of the property is less than RM10 million and the property is for the use of the company or the individual concerned; and
- (iv) For the acquisition of industrial property by a foreign interest, the FIC does not impose any price limit but requires the acquisition to take place through a locally incorporated company and there are equity conditions to be adhered to.

#### **(j) Environmental Laws**

The Environmental Quality Act 1974 (“**EQA**”) and the regulations thereunder have established standards for controlling air emissions, effluents and other wastes. An environmental impact assessment must be conducted prior to the implementation of certain projects.

## 11. MULTIMEDIA SUPER CORRIDOR AND ITC DEVELOPMENTS

Malaysia's Multimedia Super Corridor ("MSC") is a 15 kilometres wide by 50 kilometres long zone extending south from Malaysia's present national capital and business hub, Kuala Lumpur. There were previously 5 designated cybercities within the MSC and they include Cyberjaya, Petronas Twin Towers, Technology Park Malaysia, KL Tower, UPMMTDC Technology Incubation Centre 1 and E-Village. The MSC zone has been extended to Bayan Lepas, Prai Pinang and Kulim High-Technology Park, Kedah under the 2005 Budget. For companies wishing to be accorded MSC status, one of the conditions that must be fulfilled is the requirement to locate within one of the above cybercities.

MSC status is the recognition by the Malaysian Government through the Multimedia Development Corporation ("MDC") to participate and undertake ICT activities in the MSC. Companies with MSC status are entitled to operate tax free for up to 10 years or receive a 100% investment tax allowance for up to 5 years, and enjoy other financial and non-financial incentives and benefits backed by the Malaysian Government's Bill of Guarantees.

The Malaysian leadership is strongly committed to the MSC project and view it as being vital to achieving Vision 2020, Malaysia's economic agenda for the 21<sup>st</sup> century and the development of a knowledge-based economy. The Prime Minister heads the National Information Technology Council and the International Advisory Policy committee.

The Government has identified several flagships applications for the MSC and has committed through the Bill of Guarantees to the following: -

- Provide a world-class physical and information infrastructure.
- Allow unrestricted employment of local and foreign knowledge workers.
- Ensure freedom of ownership by exempting companies with MSC Status from local ownership requirements.
- Give the freedom to source capital globally for MSC infrastructure, and the right to borrow funds globally.
- Provide competitive financial incentives, including no income tax for up to 10 years or an investment tax allowance, and no duties on import of multimedia equipment.
- Become a regional leader in intellectual property protection and cyberlaws.
- Ensure no Internet censorship.
- Provide globally competitive telecommunications tariffs.



- Tender key MSC infrastructure contracts to leading companies willing to use the MSC as their regional hub.
- Provide an effective one-stop agency - MDC.

Supporting the MSC is a high-capacity digital telecommunications infrastructure of international standard which includes a fibre-optic backbone of 2.5 gigabits per second capacity.

In fulfilling the commitment to provide a comprehensive framework of cyberlaws and intellectual property laws to facilitate the development of the IT and multimedia industries, the Government has enacted the Digital Signature Act 1997, Copyright (Amendment) Act 1997, Computer Crimes Act 1997, Communications and Multimedia Act 1998 and the Telemedicine Act 1997. In addition, the Government is in the process of drafting a personal data protection law to regulate the collection, use, handling and disclosure of personal data. This new law aims to protect personal data and safeguard privacy and establish a set of rules for the handling and treatment of such personal data. However, to date, no time table has been set for the enactment and coming into force of this personal data protection law.

## APPENDIX

### 1. Incentives for the Manufacturing Sector

Some of the incentives available to the manufacturing sector are:

#### (a) Pioneer Status

A manufacturing company may apply for Pioneer Status if it engages in specified “promoted activities” or produces “promoted products”. A manufacturing company granted Pioneer Status will enjoy partial exemption from the payment of income tax. It will only have to pay tax on 30% of its statutory income. The period of tax exemption is 5 years, commencing from the Production Day as determined by the Minister of International Trade and Industry. As an added incentive, manufacturing companies granted Pioneer Status and located in the States of Sabah, Sarawak and the Federal Territory of Labuan (only applicable to the hotel business and tourist industry) and the designated “Eastern Corridor” (which covers the States of Kelantan, Terengganu, Pahang and the district of Mersing in the State of Johor) of Peninsular Malaysia, be exempt from tax on 100% of their statutory income during the tax exemption period of 5 years. This enhanced tax incentive for promoted areas was announced in the Budget 2004 and will be effective for applications received by the Malaysian Industrial Development Authority (MIDA) on or after 13 September 2003.

To further reduce the costs of doing business in Sabah, Sarawak and the “Eastern Corridor”, the government proposed in the 2005 Budget that existing companies which relocate their manufacturing activities to the promoted areas will (for applications received by MIDA from 11 September 2004) be given a second round of Pioneer Status with tax exemption of 100% of statutory income for a period of 5 years.

#### (b) Investment Tax Allowance (“ITA”)

As an alternative to Pioneer Status, manufacturing companies may apply for ITA. The applicant may include Pioneer Status companies applying for ITA for promoted products or promoted activities other than those for which Pioneer Status or ITA has been granted.

A company granted ITA will be given an allowance of 60% in respect of qualifying capital expenditure incurred within 5 years from the date on which the first qualifying expenditure is incurred. The allowance can be used to offset against 70% of the statutory income in the year of assessment. Any unutilised allowance can be carried forward to subsequent years until the whole amount has been used up. The balance 30% of the statutory income will be taxed at the prevailing company tax rate.

As an added incentive, companies located in the States of Sabah, Sarawak and the Federal Territory of Labuan (only applicable to the hotel business and tourist industry) and the designated “Eastern Corridor” (which covers the States of Kelantan, Terengganu, Pahang and the district of Mersing in the State of Johor) of Peninsular Malaysia, will be granted an allowance of 100% in respect of the qualifying capital expenditure incurred. The allowance can be

used to offset against 100% of the statutory income in the year of assessment. This enhanced tax incentive for promoted areas was announced in the Budget 2004 and will be effective for applications received by the MIDA on or after 13 September 2003. Companies which have been granted approval for this incentive but have not commenced commercial production, or applications under consideration, are also eligible. All project applications received by 31 December 2005 will be eligible for this enhanced incentive.

As discussed above, under the 2005 Budget a second round of ITA (of 100% of the qualifying capital expenditure incurred within a period of 5 years) will also be given to companies which relocate their manufacturing incentives to promoted areas. The allowance can be used to set-off up to 100% of statutory income in each year of assessment.

### **(c) Reinvestment Allowance (“RA”)**

RA is granted to manufacturing companies which have been in operation for at least 12 months and incur qualifying capital expenditure for the expansion of production capacity, modernisation and upgrading of production facilities, diversification into related products and automation of production facilities.

The RA is in the form of an allowance of 60% of capital expenditure incurred by the companies, and will be given for a period of five years from the year the first reinvestment is made. The allowance can be used to offset against 70% of the statutory income in the year of assessment. Any unabsorbed allowance can be carried forward to the following years until it is fully utilised. The RA can only be claimed on completion of the qualifying project (i.e. after the building is completed or when the plant/machinery is put to operational use). However, assets acquired from the reinvestment cannot be disposed within 2 years of reinvestment.

A company can offset the RA against 100% of its statutory income for the year of assessment if:

- (i) the company undertakes reinvestment projects in the promoted areas i.e. the States of Sabah, Sarawak and the designated “Eastern Corridor” of Peninsular Malaysia; or
- (ii) the company attains a productivity level exceeding the level determined by the Ministry of Finance.

To encourage investors to reinvest, the 2002 Budget proposed that the RA be extended from 5 to 15 consecutive years commencing from the year the first reinvestment is made. The extension of RA to 15 years is effective from the year of assessment of 1998.

As part of its proposal to extend the RA to 15 years, the government has also introduced restrictions on the amount of RA claimable on the transfer price of an asset in the case of a controlled transfer. As of the year of assessment 2002, RA claimable on transfers of assets acquired under control transfer is restricted to the residual value of the asset at the date of disposal.

With effect from 21 September 2002, any Pioneer Status company which intends to undertake reinvestment before the expiry of its Pioneer Status, is eligible for RA provided that its Pioneer Status is surrendered.

#### **(d) Accelerated Capital Allowance**

After the 15-year period of eligibility for RA, companies that reinvest in the manufacture of promoted products are eligible to apply for Accelerated Capital Allowance (“ACA”). The ACA on capital expenditure is to be utilised within three years, i.e. an initial allowance of 40% and an annual allowance of 20%.

#### **(e) Industrial Adjustment Allowance (“IAA”)**

Manufacturing companies in operation before 31 December 1990 in the wood-based, textile, machinery and engineering sectors are eligible for certain incentives when undertaking or participating in approved industrial adjustment programmes.

For purposes of these incentives, industrial adjustment has been defined as any activity proposed to be undertaken by a particular sector in the manufacturing industry to restructure by way of reorganisation, reconstruction or amalgamation within that particular sector with a view to strengthening the basis for industrial self-sufficiency, improving industrial technology, increasing productivity, and enhancing the efficient use of natural resources and the efficient management of manpower.

Manufacturing companies undertaking approved industrial adjustment programmes are eligible for IAA. The IAA provides for an allowance of up to 100% in respect of qualifying capital expenditure incurred in efforts at undertaking industrial adjustment within 5 years from the date of approval of the incentive. Companies enjoying ITA will only be eligible to apply for IAA in respect of the capital expenditure on which ITA has not been granted. Companies granted IAA will not be eligible for RA in respect of the same expenditure.

#### **(f) Incentives for Export**

Manufacturers producing for the export market are eligible to apply for the following:

##### **(i) Double Deduction for Promotion of Exports**

The following are some of expenses incurred by resident companies for the purpose of seeking opportunities for export of products manufactured in Malaysia which are eligible for double deduction - overseas advertising, export market research, preparation of tenders for supply of goods overseas, supply of technical information abroad, services rendered for public relations work connected with exports, fares in respect of travel overseas by employees of companies for business, and cost of maintaining sales offices overseas for the promotion of exports.

The 2002 Budget proposed that the double deduction incentive for the promotion of exports of goods be extended to expenses incurred for

participation in virtual trade shows and trade portals for the promotion of local products and the cost of maintaining warehouses overseas.

A single deduction will also be allowed on payments for registration of patents, trade marks and product licensing overseas and hotel accommodation for a maximum of 3 nights to companies providing hospitality to potential importers invited to Malaysia as a follow-up to trade and investment missions organised by government agencies or industrial and trade associations.

This incentive is effective from the year of assessment 2002.

Companies whose manufactured goods achieve a significant increase in exports will be given a tax exemption of statutory income equivalent to 30% of the value of increased exports of manufactured goods from the year of assessment 2003. Companies who succeed in penetrating new export markets will be eligible for a tax exemption of statutory income equivalent to 50% of the value of increased exports of manufactured goods from the year of assessment 2003.

(ii) Tax Exemption on the Value of Increased Exports

The following incentives are available effective from the Year of Assessment 2003:

- (a) To promote exports, manufacturing companies in Malaysia qualify for:
- a tax exemption on the statutory income equivalent to 10% of the value of increased exports, provided that the goods exported attain at least 30% value-added; or
  - a tax exemption on the statutory income equivalent to 15% of the value of increased exports, provided that the goods exported attain at least 50% value-added.
- (b) To further encourage the export of Malaysian goods, a locally-owned manufacturing company with Malaysian equity of at least 60% is eligible for:
- a tax exemption on the statutory income equivalent to 30% of the value of increased exports, provided the company achieves a significant increase in exports;
  - a tax exemption on the statutory income equivalent to 50% of the value of increased exports, provided the company succeeds in penetrating new markets; or
  - a full tax exemption on the value of increased exports, provided the company achieves the highest increase in export in its category.

(iii) Export Credit Refinancing (“ECR”) Scheme

In line with the Malaysian Government’s objective to promote the exports of manufactured goods, Malaysian exporters can avail themselves of ECR which provides short-term credit at preferential rates of interest.

This facility is operated by the commercial banks, while the Export-Import Bank of Malaysia (“**Exim Bank**”) will refinance those commercial banks which have extended export credit to eligible exporters. The exporter may invoice his exports in any currency but financing is made available only in Malaysian ringgit. There are two types of facilities available under the scheme: the pre-shipment ECR facility which provides working capital to direct and indirect exporters (i.e. domestic suppliers of inputs to final exporters) and the post-shipment ECR facility which enables Malaysian exporters to obtain immediate funds upon shipment of eligible goods sold on credit terms.

To be eligible for the ECR facility, exported goods should not be listed in the “negative list” and it should have a minimum value added of 20% and a minimum domestic resource content of 30%. For products that do not fulfill these requirements, exemption is given by Exim Bank on a case-by-case basis.

The eligible amount of the pre-shipment facility is 70% or 80% of the value of the exports depending on whether the order-based method or the certificate of performance method is used. For the post-shipment facility, the eligible amount of financing is 100% of the invoice value. The minimum amount for ECR financing is RM10,000 and the minimum drawdown is RM2,000.

(iv) Industrial Building Allowance (“IBA”)

Expenditure incurred in the construction or purchase of industrial buildings qualifies for Industrial Building Allowance (IBA). Currently, for purposes of IBA there is a difference in the tax treatment of a building which is constructed and purchased as follows:

## IBA for constructed buildings

(i)	Initial allowance	-	10%
(ii)	Annual allowance	-	2%
(iii)	Claim period	-	45 years

## IBA for purchased buildings

(i)	Initial allowance	-	not provided
(ii)	Annual allowance	-	2%
(iii)	Claim period	-	50 years

Apart from the above treatment, there are other buildings which have been granted a higher rate of IBA with an annual allowance of 10% or 20% to enable the entire expenditure to be claimed within 10 or 5 years. For hotels, IBA can be claimed only by hotels that enjoy Pioneer Status or Investment Tax Allowance.

As a measure to reduce the cost of doing business, the 2002 Budget proposed that the eligibility for initial allowance of 10% be extended to purchased buildings. In addition, annual allowance of 2% be increased to 3% so as to shorten the period for claiming IBA from 45 years to 30 years. It is further proposed that IBA be extended to all hotels on condition that they are registered with the Ministry of Culture, Arts and Tourism.

The proposal is effective from the year of assessment 2002.

The 2005 Budget also proposed to make the tax administration more efficient by amending the method of computing industrial building allowances on the purchase of used buildings, such that it will be based on the purchase price of the building instead of the original cost incurred by the seller in the construction of the building. This proposal is effective from year of assessment 2005.

(v) Incentives for outsourcing manufacturing activities

To reduce the cost of doing business and enhance competitiveness, the 2005 Budget proposed that owners of Malaysian brands who outsource manufacturing activities be given import duty and sales tax exemptions on raw materials which are not manufactured locally and semi-finished goods imported from contract manufacturers abroad. The foregoing incentive is effective for applications received by MIDA from 11 September 2004.

## 2. Tax Incentives for Manufacturing Related Services

Companies eligible for incentives are those providing the following value added manufacturing related services:

- (i) **Integrated logistic services** comprising the entire supply chain management, including procurement of software and hardware, warehousing, distribution (transportation and freight services), packaging activities and customs clearance;
- (ii) **Integrated market support services** comprising the activities of brand development, consumer development, packaging design, advertising and promotion; and
- (iii) **Integrated central utility facilities** which provide services including the supply of steam, demineralised water and industrial gas.

As a measure to increase the efficiency in distribution, to promote more aggressive marketing and to reduce production costs by adopting Just In Time practice, companies providing the above value-added manufacturing related services will be given the following tax incentives:

- (i) income tax exemption of 70% of the statutory income for a period of 5 years; and
- (ii) income tax exemption of 85% of the statutory income for a period of 5 years for projects in the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak.

### **3. Incentives for the Machinery and Equipment Industry.**

Currently, a company which intends to produce machinery and equipment is eligible for Pioneer Status with 70% income tax exemption for a period of 5 years or Investment Tax Allowance of 60% for a period of 5 years. These incentives are available only if the project complies with:

- (i) the value added criteria of at least 30%; and
- (ii) the Managerial, Technical and Supervisory Index of at least 15%.

To increase investments in machinery and equipment industry, so as to reduce dependence on imports, it is proposed that:

- (i) for a company undertaking activities relating to the production of machinery and equipment, the value added criteria for the purposes of granting Pioneer Status with 70% income tax exemption or Investment Tax Allowance of 60% be reduced to a minimum of 20%. The Managerial, Technical and Supervisory Index criteria be maintained at a minimum of 15%; and
- (ii) companies undertaking activities in the production of the following specialised machinery and equipment:
  - machine tools;
  - plastic injection machines;
  - material handling equipment;
  - robotics and factory automation equipment; and
  - parts and components of the above machines and equipment

be granted the following incentives:

- (a) Pioneer Status with tax exemption of 100% of statutory income for a period of 10 years; **or**
- (b) Investment Tax Allowance of 100% on qualifying capital expenditure incurred within a period of 5 years with the allowance deducted for each year of assessment to be set off against 100% of statutory income.

These incentives are to be granted on condition that the companies comply with the value added criteria of at least 30% and the Managerial, Technical and Supervisory Index criteria of at least 15%.



The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 20 October 2001.

In the 2003 Budget, it was proposed that to further develop the machinery and equipment industry, the tax incentives above be extended to manufacturers of the following categories of specialised machinery and equipment:

- specialised/process machinery or equipment for specific industries;
- packaging machinery;
- plastic extrusion machinery; and
- parts and components for the above machinery and equipment.

The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 21 September 2002.

In the Budget 2004, the following additional incentives were granted to existing locally owned companies which reinvest in the production of machinery and equipment (including specialised machinery and equipment and machine tools):

- (a) Pioneer Status with tax exemption of 70% (100% for promoted areas) on the increased statutory income arising from reinvestment for a period of 5 years; **or**
- (b) Investment Tax Allowance of 60% (100% for promoted areas) on additional qualifying capital expenditure incurred within a period of 5 years with the allowance deducted for each year of assessment to be set off against 70% (100% for promoted areas) of statutory income.

The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 13 September 2003.

#### **4. Incentives for Research and Development (“R&D”)**

Under the Promotion of Investments Act 1986, R&D is defined as “any systematic or intensive study carried out in the field of science or technology with the object of using the results of the study for the production or improvement of materials, devices, products, produce or processes, but does not include quality control of products or routine testing of materials, devices, products or produce, research in the social sciences or humanities, routine data collection, efficiency surveys or management studies, and market research or sales promotion.”

##### **(a) Tax Exemptions and Capital Allowances**

A contract R&D comp (i.e. a company which provides R&D services in Malaysia only to companies other than its related companies) is eligible to apply for Pioneer Status with full income tax exemption at statutory income level for 5 years or an ITA of 100% on qualifying capital expenditure incurred within 10 years. The ITA can be utilised to offset against 70% of the statutory income in the year of assessment.

An R&D company (i.e. a company which provides R&D services in Malaysia to its related companies or to any other companies) is eligible to apply for an ITA of 100% on qualifying capital expenditure incurred within 10 years. The ITA can be utilised to offset against 70% of the statutory income in the year of assessment. Effective from 21 May 2003, R & D companies will be given a second round of Pioneer Status for another five years or Investment Tax Allowance for a further 10 years.

Contract R&D and R&D companies are eligible to apply for the various incentives provided they fulfill the following criteria:

- research undertaken should be in accordance with the needs of the country and bring benefit to the economy;
- at least 70% of the income of the company should be derived from R&D activities;
- for manufacturing-based R&D, at least 50% of the workforce of the company must be appropriately qualified personnel performing research and technical functions; and
- for agriculture-based R&D, at least 5% of the workforce of the company must be appropriately qualified personnel performing research and technical functions.

Companies which carry out in-house research in Malaysia (i.e. R&D carried out within a company for the purpose of its own business) are eligible to apply for ITA of 50% on qualifying capital expenditure incurred within 10 years. The ITA can be utilised to offset against 70% of the statutory income in the year of assessment.

IBA in the form of an initial allowance of 10% and an annual allowance of 2% is available for buildings used for the purposes of approved R&D. Machinery/equipment, materials, raw materials/component parts and samples used for R&D purposes are eligible for exemption from import duties, sales tax and excise duties.

### **(b) Double Deduction of Expenses**

Double deduction is allowed on revenue expenditure incurred by a person on research directly undertaken by him or on his behalf, which is approved by the Minister of Finance, and on payment for the use of services of approved research institutes, R&D companies or contract R&D companies, as well as cash contributions made to approved research institutes.

From 21 May 2003, approved R&D expenditure incurred during the Pioneer period will be allowed to be accumulated and carried forward to be given another deduction after the Pioneer period. Expenditure on R&D activities undertaken overseas, including the training of Malaysian staff, will be considered for a double deduction on a case-by-case basis.

### **(c) Incentives for Researchers to Commercialise Research Findings**

Effective from the year of assessment 2004, researchers who undertake research focused on value creation will be given a 50% tax exemption for five years on the income that they receive from the commercialisation of their research findings. The undertaking has to be verified by the Ministry of Science, Technology and Environment.

In order to encourage Malaysian-owned companies to spearhead the commercialization of local R&D findings, the 2005 Budget proposed that a locally-owned company which invests and owns at least 70% equity in the company that undertakes commercialisation projects will be granted:

- (i) tax deductions equivalent to the amount of actual investment; and
- (ii) Pioneer Status of 100% for a period of 10 years.

Applications for this incentive should be made through a committee at the Malaysian Industrial Development Authority (MIDA) that includes a representative from the Ministry of Science, Technology and Innovation. The proposal is effective for applications received from 11 September 2004.

## **5. Incentives for the Agricultural Sector and Tourism Industry**

Incentives similar to those available in the manufacturing sector in respect of Pioneer Status, ITA, RA, double deduction for promotion of exports, tax exemption on the value of increased exports, IBA, and ECR scheme, are also available to the agricultural sector. There are additional incentives for companies engaged in certain industries such as deep sea fishing, processing of promoted food products, chicken and duck rearing and planting of rubberwood trees.

The 2005 Budget focused on revamping the agriculture sector as the third engine of growth in Malaysia after the manufacturing and services sectors. To this end, the Budget proposed major boosts to the private sector, especially government-linked companies, through the establishment of a RM300 million fund for seed capital and a further sum of RM1.5 billion is to be allocated for agricultural projects, especially projects benefiting smallholders.

The availability of several pre-existing tax incentives were also extended to 2010 to encourage food production such as vegetable farming, aquaculture and cattle rearing. The 2005 Budget proposed that the write off period for capital expenditure on machinery and equipment used in the agriculture sector be reduced from between 4 and 8 years to 2 years.

In the tourism industry, Pioneer Status, ITA and IBA are also available on the same basis as those available for the manufacturing sector.

Applications received by MIDA from 13 September 2003 from companies to reinvest in the expansion, modernisation and renovation of hotels and tourism projects will be given another round of Pioneer Status or Investment Tax

Allowance. However, hotels and tourism projects located in the promoted areas will enjoy the following enhanced incentives:

- (a) Pioneer Status, with 100% income tax exemption; or
- (b) Investment Tax Allowance of 100%. The allowance can be set-off against 100% of the statutory income in each year of assessment.

## **6. Approved Service Projects (“ASP”)**

Projects in the transportation, communications and utilities sub-sectors of the service sector, approved by the Minister of Finance are eligible for tax incentives. The incentives are as follows:

### **(a) Tax Exemptions**

A company undertaking an ASP will be granted partial exemption on 70% of the statutory income for five years (85% for an ASP in Sabah, Sarawak or the designated eastern corridor of Peninsular Malaysia). An ASP of national or strategic importance will be granted full exemption from income tax for 10 years.

### **(b) Investment Allowance**

A company undertaking an ASP will be granted a 60% Investment Allowance for qualifying capital expenditure incurred within 5 years from the date the capital expenditure is first incurred. The allowance can be used to set off against 70% of the statutory income (80% and 85% respectively for an ASP in Sabah, Sarawak or the designated eastern corridor of Peninsular Malaysia). An ASP of national or strategic importance will be granted a 100% Investment Allowance on the qualifying capital expenditure incurred within 5 years, which may be set off against 100% of the statutory income. Any unutilised investment allowance may be carried forward until it is fully utilised.

### **(c) Additional Incentives**

Imports of raw materials and components not available locally and used directly to implement ASPs are eligible for exemption from import duty and sales tax, while locally purchased machinery or equipment are eligible for exemption from sales tax and excise duty. Companies providing services in the transportation and telecommunications sectors, power plants and port operators can apply for import duty and sale tax exemption on spares and consumables that are not produced locally.

## **7. Operational Headquarters (“OHQ”)**

This incentive is available to a locally incorporated company, whether local or foreign-owned, which carries on business in Malaysia of providing qualifying services to its offices or its related companies outside Malaysia.

Companies granted OHQ status will enjoy 100% exemption from income tax for a period of 10 years for income from qualifying services rendered to, interest on foreign currency loans extended to, and royalties received from

R&D work carried out on behalf of their offices or related companies outside Malaysia.

In addition, expatriates working in an OHQ are taxed only on that portion of their chargeable income attributable to the number of days that they are in the country.

Effective from 21 May 2003 an existing OHQ will be given 100% income tax exemption for its remaining exemption period.

Effective from the year of assessment 2003, income from qualifying services provided by an OHQ to its related companies in Malaysia during its tax exempt period is exempted from tax provided such income does not exceed 20% of the OHQ income from qualifying services.

To be eligible for the incentives provided, the paid-up capital should be a minimum of RM500,000 and total business spending should be at least RM1,500,000 per year. The company should also carry out a minimum of three of the following qualifying services to its offices or related companies outside Malaysia:

- management and administrative services;
- treasury and fund management services;
- corporate financial advisory services;
- research and development; and
- training and personnel management.

Approved OHQs can also enjoy non-fiscal incentives as follows:

- Allowing a greater number of expatriate posts.
- Borrow freely from domestic sources in foreign currency without the approval of the central bank for treasury and fund management operations for their related companies outside Malaysia.
- Borrow freely from domestic sources in RM up to a maximum of RM50 million for use in Malaysia. Borrowing in excess of RM50 million requires prior approval from the central bank.
- Invest freely in foreign securities and lend to related companies outside Malaysia as long as the domestic borrowing in RM is within the RM50 million limit and the remittances are made in foreign currency equivalent.
- Approved OHQs can open foreign currency or multi-currency accounts with commercial banks in Malaysia to retain export proceeds in foreign currency up to an aggregate overnight balance equivalent to US\$70 million regardless of the amount of export receipts.

- Open foreign currency accounts with the designated banks in Malaysia, including the offshore banks in Labuan, or overseas banks for crediting foreign currency receivables other than export proceeds.
- Use the professional services of a foreign firm provided that such services are not available locally.
- A foreign-owned OHQ is allowed to acquire fixed assets as long as it is used for the purpose of carrying out the operations of the OHQ.

## 8. International Procurement Centres (“IPC”)

This incentive is available to a locally incorporated company, whether local or foreign-owned, which carries on a business in Malaysia to undertake procurement and sale of raw materials, components and finished products for its group of related and unrelated companies in Malaysia or abroad. In order to qualify for the IPC status, the company must have a minimum paid-up capital of RM500,000, a minimum total business spending (operating expenditure) of RM1,500,000 per year, incremental usage of Malaysian ports and airports and minimum annual sales turnover of RM50 million by the third year of operation.

In order to encourage the establishment of IPCs and to make Malaysia as a marketing and distribution center, the Government of Malaysia offers the following incentives for approved IPCs:

- 100% equity holding by the promoter;
- Expatriate posts based on the requirements of the IPC;
- Open one or more foreign currency accounts with any licensed commercial bank to retain its export proceeds without any limit;
- Enter into foreign exchange forward contracts with any licensed commercial bank to sell forward export proceeds based on its projected sales; and
- Bring in raw materials, components or finished products with customs duty exemption into free industrial zones, licensed manufacturing warehouses, free commercial zones and bonded warehouses for repackaging, cargo consolidation and integration before distribution to its final consumers.

An approved IPC status company is also eligible for the following tax incentives:

- Full tax exemption of its statutory income for 10 years; and
- Dividends paid from the exempt income will be exempted from tax in the hands of its shareholders.

However, to qualify for the above tax incentives, an approved IPC status company must also fulfill the following additional criteria:

- It must have an annual sales turnover of at least RM100 million;

- Sales to the domestic market are limited to 20% of its sales turnover. If sales to the domestic market exceed 20%, the additional sales will not be tax exempt;
- Sales to Free Zones (FZs) and Licensed Manufacturing Warehouses (LMWs) are considered as domestic sales;
- It must serve as a collection and consolidation centre for finished goods, components and spare parts from overseas or within the country to be distributed to dealers, importers or its subsidiaries or associated companies within or outside the country.

## 9. Regional Distribution Centre (“RDC”)

The RDC is a new incentive that was introduced in the 2002 Budget. A RDC is a collection and consolidation centre for finished goods, components and spare parts produced by its own group of companies for its own brand to be distributed to dealers, importers or its subsidiaries or other unrelated companies within or outside the country. Among the activities involved are bulk breaking, repackaging and labeling.

Similar to an IPC, this incentive is available to a locally incorporated company, whether local or foreign-owned, with a minimum paid-up capital of RM500,000, a minimum total business spending (operating expenditure) of RM1,500,000 per year, incremental usage of Malaysian ports and airports and minimum annual sales turnover of RM50 million by the third year of operation. The company must also be located in a free zone (free industrial zones or free commercial zones) or a licensed warehouses (public and private) or licensed manufacturing warehouse.

In addition, as a general rule, sales by an approved RDC to the domestic market is limited to not more than 20% of its annual sales value. A RDC is also allowed to source goods from outside Malaysia for shipment to overseas destinations via drop shipment for up to 30% of its annual sales turnover.

The facilities granted to an approved RDC are similar to that for approved IPCs.

An approved RDC status company is also eligible for the following tax incentives:

- Full tax exemption of its statutory income for 10 years; and
- Dividends paid from the exempt income will be exempted from tax in the hands of its shareholders.

However, to qualify for the above incentives, an approved RDC status company must also fulfill the following additional criteria

- It must have an annual sales turnover of at least RM100 million
- Sales to the domestic market are limited to 20% of its sales turnover. If sales to the domestic market exceed 20%, the additional sales will not be tax exempt.

- Sales to free zones (FZs) and licensed manufacturing warehouses (LMWs) are considered as domestic sales.

## 10. Infrastructure Allowance

Companies which are engaged in the manufacturing, agricultural, hotel or tourism or other industrial/commercial activities in East Malaysia and the designated eastern corridor of West Malaysia and which incur qualifying capital expenditure on infrastructure such as reconstruction, extension or improvement of any permanent structure including bridges, jetties, ports and roads, are eligible for an infrastructure allowance of 100%. The allowance can be used to set off against 85% of the statutory income in the year of assessment. The balance of that statutory income will be taxed at the prevailing company tax rate. Any unutilised allowance can be carried forward to the subsequent years until it is fully utilised.

## 11. Incentives for High Technology Companies

High technology companies are companies engaged in promoted activities or in the production of promoted products in areas of new and emerging technologies. High technology companies are eligible for Pioneer Status with full tax exemption at statutory income level for a period of 5 years, or ITA of 60% on qualifying capital expenditure incurred within a period of 5 years (the allowance can be offset against the statutory income for each assessment year without any restriction).

The high technology company must incur local R&D expenditure to gross sales at least 1 % on an annual basis (companies are allowed a period of 3 years from the date of operation/commencement of business to comply with this requirement), and the percentage of science and technical staff having degrees or diplomas with a minimum 5 years experience in related fields should be at least 7% of total workforce.

## 12. Incentives for Software Development

Companies which develop both original and/or undertake major modifications of existing software are eligible to apply for Pioneer Status incentive for a period of 5 years. The computer software must be for a general purpose and not for a specific customer. For companies undertaking modification of existing software packages, the cost of acquiring the existing packages must not exceed 25% of the modification expenditure (which includes software tools, labour and equipment costs).

## 13. Incentives for Multimedia Super Corridor (“MSC”)

Companies with MSC Status are entitled to operate tax free for up to 10 years or receive a 100% ITA and enjoy some of the following incentives and benefits backed by the Malaysian Government’s Bill of Guarantee:

- allow unrestricted employment of knowledge workers from overseas;
- ensure freedom of ownership of companies;



- allow freedom of sourcing capital globally for MSC infrastructure and freedom of borrowing funds;
- no duties on the import of multimedia equipment; and
- eligibility for R&D grants (for majority Malaysian-owned MSC Status companies).

#### **14. Exemption from Import Duty on Direct Raw Materials/Components**

Effective from 1 January 1999, full exemption from import duty can be considered on raw materials/components irrespective of whether the finished products are sold in the domestic market or are exported, provided that the raw materials/components are not manufactured locally or where they are manufactured locally, are not of acceptable quality and price.

Hotel and tourism projects qualify for full exemption of import duty and sales tax on identified imported materials/equipment and exemption of sales tax and excise duty on identified locally purchased equipment.

#### **15. Incentives for Conservation of Energy**

Companies providing energy conservation services enjoy the following incentives:

- (a) income tax exemption of 70% on statutory income for 5 years, or ITA of 60% of qualifying capital expenditure incurred within 5 years. The ITA may be utilised against 70% of the statutory income in a year of assessment. The unutilised amount may be carried forward; and
- (b) companies incurring capital expenditure for conserving their own energy consumption are granted Accelerated Capital Allowance on related equipment which is to be written off within a period of 3 years.

These incentives are only applicable to applications made between 28 October 2000 to 31 December 2002. However it was proposed in the 2003 Budget that the incentives be extended for another 3 years until 31 December 2005 and the company is required to implement the project within 1 year from the date of approval of the incentive.

The incentive under (a) is also available for companies engaged in the generation of energy using biomass, the provision of cold room and refrigerated truck facilities and the use of other sources of renewable energy namely hydro power and solar power.

#### **16. Incentive for Utilisation of Oil Palm Biomass**

In the 2004 Budget, it was proposed that to further encourage the utilisation of oil palm biomass to produce value added products such as particleboard, medium density fibreboard, plywood, pulp and paper, new companies undertaking the foregoing activities will be eligible for Pioneer Status with full tax exemption at statutory income level for a period of 10 years, or ITA of 100% on qualifying capital expenditure incurred within a period of 5 years.

Existing companies that reinvest will be eligible for the following incentives:

- (a) Pioneer Status with tax exemption of 100% on the increased statutory income arising from reinvestment for a period of 10 years; **or**
- (b) Investment Tax Allowance of 100% on additional qualifying capital expenditure incurred within a period of 5 years with the allowance deducted for each year of assessment to be set off against 100% of statutory income.

The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 13 September 2003.

In order to promote the generation of energy from renewable and environment friendly resources, such as biomass, the 2005 Budget proposed that the period of capital allowance for expenses incurred by companies in generating energy from renewable and environment friendly resources for their own use, be reduced from between 4 and 8 years to one year.

## **17. Tax Incentive for Offshore Trading via Websites in Malaysia**

To encourage the usage of information and communication technology (ICT) in trade and to establish Malaysia as an attractive business location for international trade in a borderless global market, it is proposed that income received by companies undertaking offshore trading via websites in Malaysia, be taxed at a concessionary rate of 10% for a period of 5 years. Offshore trading is defined as buying and selling of foreign goods to non-residents.

The exemption requires approval from the Minister of Finance. It is also proposed that income after tax which is distributed to the shareholders be exempted from tax.

It is hoped that the measure will encourage more Malaysian companies to go online and to accelerate the adoption of e-commerce among local companies in the next few years. The proposed reduction of tax on income derived from offshore trading through websites in Malaysia is also focused on attracting companies to set up B2B (business to business) exchange sites locally and to spur e-business and e-trading. This tax incentive signals Malaysia's expectation that the Internet will be the key driver for the next phase of growth for the economy.

The proposal is effective for applications received by the Ministry of Finance from 20 October 2001.

## **18. Tax Deduction on the Cost of Developing Websites**

From the year of assessment 2002, the cost of developing websites be allowed as an annual deduction of 20% for purposes of income tax for 5 years.

## 19. Tax Incentives for the Implementation of the RosettaNet

*RosettaNet* is an open internet-based common business messaging standard for supply chain management link-ups with global suppliers.

Effective from year of assessment 2002, expenditure and contributions incurred by a resident qualifying company for the purposes of implementation of *RosettaNet* as verified by the Small and Medium Industries Development Corporation (SMIDEC) will be allowed as a deduction for purposes of income tax.

A qualifying company means:

- a company which is a member of *RosettaNet Malaysia Berhad* and which is assisting a local manufacturer to adopt and implement *RosettaNet*; or
- a company, association or statutory body which is a member of *RosettaNet Malaysia Berhad* and which is assisting *RosettaNet Malaysia Berhad*.

## 20. Tax Incentives for Knowledge-based Economy

It was proposed in the 2003 Budget that the following tax incentives be given to companies which invest in knowledge incentive activities:

Companies classified as a “Strategic Knowledge-Based Status Company” will be given the following incentives:

- Pioneer Status with full income tax exemption at statutory income level for 5 years; or
- ITA of 60% on qualifying capital expenditure incurred within 5 years to be offset against 100% of statutory income.

To be eligible for the above incentives, the company must be a knowledge intensive company with the potential to generate knowledge content, have high value added operations, high technology and a large number of knowledge workers. In addition, the company must have a Corporate Knowledge-based Master Plan.

To date, MIDA has yet to issue guidelines or an application form for this incentive but we understand that they are in the process of doing so.

## 21. Incentives for Waste Recycling Activities

Under the 2001 Budget companies undertaking waste recycling activities be given Accelerated Capital Allowance on expenses incurred for the purchase of waste recycling machinery and equipment. The allowance must be utilised within 3 years.

Companies undertaking waste recycling activities that are of high value added and use high technology are also eligible for Pioneer Status or ITA. These

activities include recycling of agricultural wastes of agricultural byproducts, chemicals and reconstituted wood-based panel boards or products. Activities located in the promoted areas i.e. the States of Sabah and Sarawak and the designated “Eastern Corridor” of Peninsular Malaysia are eligible for higher exemptions/ allowances under Pioneer Status or ITA in accordance with that given for promoted areas.

## 22. Real Estate Investment Trusts (“REITs”)

REITs, also known as Property Trust Funds (“PTFs”), are presently subject to income tax at the rate of 28% and the after-tax income distributed to unit holders is eligible for a tax credit. In order to promote the development of REITs or PTFs in Malaysia, the 2005 Budget proposed that REITs or PTFs approved by the Securities Commission be given the following tax treatment:

- (i) The REITs or PTFs be exempted from income tax on chargeable income distributed to unit holders whereas undistributed chargeable income will be taxed at 28%;
- (ii) income distributed to unit holders will be taxed at their respective tax rates. For non-resident unit holders, the tax payable at 28% will be withheld by the REIT or PTF; and
- (iii) the accumulated income that has been taxed and subsequently distributed is eligible for tax credit in the hands of unit holders.

A resident unit holder will need to declare his residence status to get full distributions from the REIT or PTF and pay tax on income received from the REIT or PTF.

## 23. Developing Halal Products

The 2005 Budget also makes provision to make Malaysia the leading producer and exporter of *halal* products in the world. The 2005 Budget proposed that:

- (i) double deduction incentives be given to producers of *halal* products on expenses incurred in meeting the standards to obtain *halal* certificates from the Jabatan Kemajuan Islam Malaysia (Malaysian Department for Islamic Development); and
- (ii) an Investment Tax Allowance of 100% for 5 years will also be granted to companies which produce *halal* food.

## 24. Developing the Islamic Financial System

In its aim of making Malaysia a hub for Islamic financial services, the 2005 Budget proposed the issuance of Islamic Treasury Bills by the Government as well as the increase of Government Investment Issues based on *syariah* principles, in 2005. Under the 2005 Budget, Islamic financial and capital market products will also enjoy specific tax treatment and duty exemptions provided they are approved by the Syariah Advisory Council of either Bank Negara Malaysia (i.e. the Central Bank) or the Securities Commission.

## 25. Banks and Financial Institutions

The Government proposed in the 2005 Budget to deem interest-in-suspense as a special provision of bad debts and be allowed as a deduction in the computation of income tax as a move to further strengthen the cash flow of financial institutions in the context of ensuring competitiveness and long-term resilience.

## 26. Tax Rebate On Zakat For Labuan Offshore Companies

Offshore companies in Labuan are subject to income tax of 3% of net profit or RM20,000 under the Labuan Offshore Business Activity Tax Act 1990. In addition, some offshore companies may also be required to pay zakat. To attract increased investments from offshore companies, especially those from Islamic countries to carry out offshore activities in Labuan, the 2004 Budget proposed that effective from YA 2004, offshore companies in Labuan will be given an income tax rebate equivalent to the amount of zakat paid to the Labuan religious authority, subject to a maximum of 3% of net profit or RM20,000.

## 27. Strategic Projects

Strategic projects involve products or activities of national importance and generally involve heavy capital investments with long gestation periods. Strategic projects should also have high levels of technology, generate extensive linkages and have significant impact on the economy. Such projects qualify for:

- (i) Pioneer Status with a tax exemption of 100% of the statutory income for a period of 10 years; or
- (ii) ITA of 100% on the qualifying capital expenditure incurred within 5 years from the date the first qualifying capital expenditure is incurred. This allowance can be offset against 100% of the statutory income for each year of assessment.

## 28. Industrial Linkage Program

To encourage large companies to participate in an Industrial Linkage Programme (“ILP”), expenditure incurred in the training of employees, product development and testing, and factory auditing to ensure the quality of vendors’ products, will be allowed as a deduction in the computation of income tax.

Vendors that propose to manufacture promoted products or participate in promoted activities in an ILP are eligible for the following incentives:

- (i) Pioneer Status with a tax exemption of 100% of the statutory income for a period of 5 years; or
- (ii) ITA of 100% on the qualifying capital expenditure incurred within 5 years from the date the first qualifying capital expenditure is incurred.

This allowance can be offset against 100% of the statutory income for each year of assessment.

Vendors in an approved ILP who are capable of achieving world-class standards in terms of price, quality and capacity, will be eligible for the following incentives:

- (i) Pioneer Status with a tax exemption of 100% of the statutory income for a period of 10 years; or
- (ii) ITA of 100% on the qualifying capital expenditure incurred within a period of five years which the company can offset against 100% of the statutory income for each year of assessment.

## **29. Automotive Component Modules**

New and existing companies that undertake design, R&D and production of qualifying automotive component modules or systems are eligible for:

- (i) Pioneer Status with a tax exemption of 100% of the statutory income for a period of 5 years; or
- (ii) ITA of 60% on the qualifying capital expenditure incurred within 5 years from the date the first capital expenditure is incurred.

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