

## Client Alert

April 2015

### New Tax Incentives in the Malaysian Budget 2015

Following the announcement by the Malaysian Government of new tax incentives during the Budget 2015, the Ministry of International Trade and Industry ("**MITI**") has published detailed guidelines on four (4) new tax incentives:

- Incentive for the Establishment of Principal Hub;
- Incentive for Less Developed Areas;
- Incentive for Industrial Area Management; and
- Capital Allowance to Increase Automation in Labour Intensive Industries.

#### Incentive for the Establishment of Principal Hub

##### Definition of Principal Hub

A Principal Hub is defined as a locally incorporated company that uses Malaysia as a base for conducting regional and global businesses and operations to manage, control and support key functions including management of risks, decision making, strategic business activities, trading, finance, management and human resource.

The Principal Hub incentive will replace existing incentives given to International Procurement Centers ("**IPC**"), Regional Distribution Centers ("**RDC**") and Operational Headquarters ("**OHQ**"), as of 1 May 2015. No applications for the IPC, RDC or OHQ may be made after 30 April 2015.

##### Incentives available under the Principal Hub

The Principal Hub incentive will be provided pursuant to Section 127(3) of the Income Tax Act 1967 and approved through the National Committee on Investment (NCI).

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A company with approved Principal Hub status will be eligible for a 3-tiered corporate taxation rate as follows:

| Tiers    | Tier 3 |                 | Tier 2 |    | Tier 1 |    |
|----------|--------|-----------------|--------|----|--------|----|
| Years    | 5      | +5 <sup>1</sup> | 5      | +5 | 5      | +5 |
| Tax Rate | 10%    |                 | 5%     |    | 0%     |    |

Other benefits of the Principal Hub incentive include:

- 100% foreign ownership;
- expatriate posts based on requirements of the applicant company;
- acquisition of fixed assets by foreign companies in connection with the carrying out of business operations by the applicant company;
- use of foreign professional services where locally-owned services are not available;
- customs duty exemption for importation of raw materials, components or finished products into free industrial zones (FIZs), free commercial zones (FCZs), licensed manufacturing warehouses (LMWs) and bonded warehouses for production, re-packaging, cargo consolidation and integration before distribution to its final consumers; and
- foreign exchange administration flexibilities.

### Eligibility for Principal Hub Incentive

To qualify for the Principal Hub incentive, companies will have to satisfy the following criteria:

- Paid-up capital exceeding RM 2.5 million;
- Minimum annual sales turnover of RM 300 million (applicable only for goods-based companies);
- Serves and control "network companies"<sup>2</sup> in at least 3 countries outside Malaysia:
  - Tier 3: minimum of 3 countries;
  - Tier 2: minimum of 4 countries;
  - Tier 1: minimum of 5 countries.

<sup>1</sup> Incentive period extendable subject to compliance with existing conditions and commitment received by the company to increase annual business spending (30% increment from base commitment) and high-value jobs creation (20% increment from base creation).

<sup>2</sup> Means related companies or any entity within the group including subsidiaries, branches, joint ventures, franchises or any other company related to applicants' supply chain and business with contractual agreements.

- Carries out at least three (3) qualifying services including at least one strategic service;

| Strategic Services                                       | Business Services                                    | Shared Services  |
|--|--|--|
| 1. Regional P&L <sup>3</sup> / Business Unit Management  | 1. Bid and Tender Management                         | 1. Corporate Training and Human Resource Management    |
| 2. Strategic Business Planning and Corporate Development | 2. Treasury and Fund Management                      | 2. Finance & Accounting (Transactions, Internal Audit) |
| 3. Corporate Finance Advisory Services                   | 3. Research, Development & Innovation                | 3. General Administration                              |
| 4. Brand Management                                      | 4. Project Management                                | 4. IT Services   |
| 5. IP Management   | 5. Sales and Marketing                               |  |
| 6. Senior Level Talent Acquisition and Management        | 6. Business Development                              |  |
|  | 7. Technical Support and Consultancy                 |  |
|  | 8. Information Management and Processing             |  |
|  | 9. Economic / Investment Research Analysis           |  |
|  | 10. Strategic Sourcing, Procurement and Distribution |  |
|  | 11. Logistics Services                               |  |

- Tier 3: Strategic +2;
- Tier 2: Regional P&L +2;
- Tier 1: Regional P&L +2.

<sup>3</sup> P&L Management relates to growth of the company with direct influence on how company resources are allocated, determining regional/global direction, monitoring budget expenditure and net income, and ensuring every program generates a positive return of investment.

- Employment requirements:
  - Tier 3: 15 high value jobs<sup>4</sup>, including 3 key strategic / management positions<sup>5</sup>;
  - Tier 2: 30 high value jobs, including 4 key strategic / management positions;
  - Tier 1: 50 high value jobs, including 5 key strategic / management positions;

At least 50% of the high value jobs must be held by Malaysians by the end of Year 3.

- Annual business spending as follows:
  - Tier 3: RM 3 million;
  - Tier 2: RM 5 million;
  - Tier 1: RM 10 million.
- Significant use of Malaysia's banking and financial services and other ancillary services and facilities (e.g. trade and logistic services, legal and arbitration services, and finance and treasury services).
- Income tax exemption threshold received from services/goods based company inside and outside of Malaysia is based on the ratio of 30:70 (inside:outside).

Applications for the Principal Hub incentive are to be submitted to the Malaysian Investment Development Authority ("**MIDA**") from 1 May 2015 to 30 April 2018.

### Implications for existing IPC, RDC and OHQ status companies

Companies which are currently enjoying IPC, RDC or OHQ status may continue to enjoy tax incentives and facilities accorded under the relevant schemes for the full approved period ("**Approved Period**").

Upon expiration of the Approved Period, such companies may apply for the Principal Hub incentive for an additional period of 5 years under the Tier 1 category only with further commitments required in terms of annual business spending and creation of high-value jobs.

## Incentives for Less Developed Areas (LDA)

### Purpose of LDA Incentives

To ensure balanced and inclusive regional growth in the country, the Malaysian Government has announced further incentives to continue promotion of investments in less developed areas ("**LDA Incentives**").

### LDA Incentives

The LDA Incentives are provided pursuant to Section 127(3A) of the Income Tax Act 1967 and Section 80(1A) of the Stamp Act 1949. Decisions will be made by the NCI and recommendations forwarded to the Ministry of Finance for consideration and approval.

<sup>4</sup> "High value jobs" is defined as jobs that require higher and more diverse set of managerial / technical/professional skills such as management, analytics, communication, problem-solving, and proficiency in information technology.

<sup>5</sup> Minimum monthly salary for high-value jobs is at least RM5,000. Minimum monthly salary of key strategic / management positions is at least RM25,000

The LDA Incentives will be customized based on the merits of each application and will take the form of either:

- income tax exemption of 100% up to **15 years** (5+5+5) of assessment commencing from the first year of assessment the company derives statutory income; or
- income tax exemption equivalent to 100% of qualifying capital expenditure (Investment Tax Allowance) incurred within a period of **10 years**. The Investment Tax Allowance can be offset against 100% of statutory income for each year of assessment and unutilized allowances can be carried forward until fully absorbed.

The company is required to comply with the conditions set and achieve the relevant Key Performance Index (KPIs).

In addition to income tax exemption, the LDA Incentives also include:

- stamp duty exemption on transfer or lease of land or building used for development in relation to manufacturing and services activities;
- withholding tax exemption on fees for technical advice, assistance or services or royalty in relation to manufacturing and services activities up to 31 December 2020;
- import duty exemption on raw materials and components that are not produced locally and used directly in the manufacture of finished products subject to the prevailing policy, guidelines and procedures; and
- import duty exemption on machinery and equipment which are not locally produced and used directly in the activity for selected services sector subject to the prevailing policy, guidelines and procedures.

Applications must be received by MIDA from 1 January 2015 to 31 December 2020.

### Eligibility for LDA Incentives

This incentive package is categorized under the 'Strengthening Economic Growth' strategy and is available to companies who satisfy the following criteria:

- the applicant company has to be either:
  - an existing company expanding its operations (either in manufacturing or the provision of services) in less developed areas; or
  - a newly established company.
- undertaking manufacturing activities in less developed areas that will lead to substantial creation of employment and rural development; and
- complies with other conditions specified by the Minister of Finance including value added activities and local employment at the managerial, technical and supervisory level (MTS index).

## Incentives for Industrial Area Management (IAM)

### Purpose of IAM Incentive

Aimed at addressing the lack of proper management and upkeep of Industrial Estates ("IEs"), the Malaysian Government is offering the IAM Incentive to companies providing management, upgrading and maintenance activities within IEs.

By way of background, Malaysia has over 600 IEs which are specified areas zoned for industrial activity<sup>6</sup> in which infrastructure such as roads, power and other utility services are provided to facilitate growth of industries. Based on a study conducted by the Economic Planning Unit<sup>7</sup>, it was discovered that there was limited information available on the development, operations, performance and maintenance costs of IEs in Malaysia.

This made it difficult to determine the cost and quality index of IEs in the form of cost attractiveness of operating environment (leading to profitability) and quality of operating environment (leading to ease of doing business) to companies seeking to invest into the respective IEs in Malaysia.

As part of the study, the governance process for different stages of an IE was also mapped, from initiation, development, going to market, implementation, to operations and maintenance. The key takeaways from the study included implementing a dedicated policy and governance of an IE (as a majority of IE developers leave tenants after transfer of projects to local councils without accessible points of contact to address issues) which includes maintenance of IEs after project handovers.

As part of this policy, the IAM incentives were announced.

### IAM Incentives

The IAM Incentive comes in the form of 100% tax exemption on statutory income for 5 years commencing from the date the company commences its activities, pursuant to the Income Tax (Exemption) (No.11) Order 2006 and approved through the NCI.

The following criteria must be met in order to be eligible for the IAM Incentive:

- The IE for which the applicant company is providing management services must be gazetted by the State Authority as industrial land;
- The applicant company, whether as a newly established company or existing company appointed by a Local Authority, must have an agreement on the management of IEs;
- The applicant company must undertake the management of an existing IE specified by the Local Authority;
- The applicant company must be an incorporated company under the Companies Act 1965, and be approved and licensed by the Local Authority; and
- The applicant company must be self-funded.

<sup>6</sup> Manufacturing sectors and project types which MIDA actively promotes in the following sectors: (i) basic metal, (ii) electrical & electronics, (iii) engineering support; (iv) food processing; (v) machinery & equipment; (vi) medical devices; (vii) petrochemicals and polymer; (viii) pharmaceuticals; (ix) rubber products; (x) textiles & apparel; (xi) wood based.

<sup>7</sup> [http://www.epu.gov.my/c/document\\_library/get\\_file?uuid=f98ae2e5-e169-4233-ad6c-8f20ac5c6b71&groupId=283545](http://www.epu.gov.my/c/document_library/get_file?uuid=f98ae2e5-e169-4233-ad6c-8f20ac5c6b71&groupId=283545)

The applicant company must also undertake all of the specified management, upgrading and maintenance activities within the IE (as set out in the Management Services column of the table below), and may undertake any of the specified qualifying services (as set out in the Qualifying Services column of the table overleaf).

| Management Services   | Qualifying Services   |
|---|---|
| <p>Management, upgrading and maintenance activities of :</p> <ul style="list-style-type: none"> <li>• roads, street lightings and drainage systems;</li> <li>• common facilities;</li> <li>• landscaping including grass planting and cutting, tree planting, pruning, cutting and removal and garden maintenance;</li> <li>• waste collection, transfer and disposal; and</li> <li>• maintaining database on the industrial area, including information on tenants and industrial park.</li> </ul> | <ul style="list-style-type: none"> <li>• maintain and repair buildings;</li> <li>• security and personnel;</li> <li>• relevant consultation;</li> <li>• rental of common facilities;</li> <li>• rental of accommodations / hostels for factory workers;</li> <li>• relevant transportation;</li> <li>• environmental management;</li> <li>• construction of main infrastructure supports;</li> <li>• janitorial / cleaning services;</li> <li>• IT infrastructure;</li> <li>• recreational and relaxation areas for tenants and their workforce; and</li> <li>• any adapted facilities as required by tenants.</li> </ul> |

There is a further requirement that at least 70% of the annual income of the applicant company must be derived from the compulsory activities as specified in the "Management Services" column above.

Applications must be received by MIDA from 1 January 2015 to 31 December 2017. Importantly, it should be noted that the company must commence its operation not later than one (1) year from the date of application received by MIDA.

## Capital Allowance to Increase Automation in Labour Intensive Industries

### Purpose of Automation Incentives

Automation Capital Allowance will be afforded to encourage manufacturing companies to increase automation in the manufacturing sector by:

- engaging in innovative and productive activities;
- adoption of automation especially for labour intensive industries; and
- spurring automation initiatives.

### Automation Incentives

The Automation Capital Allowance scheme provides two categories of capital allowance targeted at different industries:

- **Category 1** - high labour intensive industries (i.e., rubber products, plastics, wood, furniture and textiles); and
- **Category 2** - other industries.

Under Category 1, companies will be provided automation capital allowance of 200% on the first RM 4 million expenditure incurred within the years of assessment 2015 to 2017.

Under Category 2, companies will be provided automation capital allowance of 200% on the first RM 2 million expenditure incurred within the years of assessment 2015 to 2020.

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## Eligibility for Automation Incentives

To be eligible for the Automation Capital Allowance, the following criteria must be satisfied:

- The applicant company must be a manufacturing company incorporated under the Companies Act 1965;
- The applicant company must possess a valid business license from a local authority and a manufacturing licence from MITI;
- The applicant company must reside in Malaysia and must have been in operation for at least thirty-six (36) months;
- The expenditure in connection with the Automation Capital Allowance must be incurred within the relevant years of assessment;
- The automation equipment in connection with the Automation Capital Allowance must be used directly in manufacturing activities;
- The automation equipment in connection with the Automation Capital Allowance should enhance the productivity such as reducing man hours, reducing workers and increasing volume of output; and
- The automation equipment in connection with the Automation Capital Allowance must adopt technology that is more advanced than the technology currently used by the company and verified by SIRIM (through a report on productivity level). For small and medium-sized enterprises (SMEs) however, acquiring similar types of machine and equipment is permissible in 2 years of acquiring the existing machine and equipment.

## Summary

The Principal Hub incentive could be one of the more eagerly awaited incentives this year, as many foreign multinational companies seek to locate or relocate their headquarters within the ASEAN region.

With the Principal Hub incentive, Malaysia is determined to position itself as a key location for companies to consider locating their regional hub to serve related entities around the region (including acting as trading hub, for goods-based companies).

The increase in investment commitments required would however mean that companies must be willing to create more high-value jobs in Malaysia and locate more key personnel in the country, in line with Malaysia's desire to attract higher-value investments and progressing towards a knowledge-based economy.

The roll-out of other manufacturing-related incentives also show the continued importance placed by the Malaysian Government on the manufacturing industry in the country which remains a key priority.