Highlights of the Malaysian Budget 2018

October 2017
Table of contents

Budget 2018 ...................................................................................................................................................... 1
1. Corporate Income Tax ...................................................................................................................................... 1
   1.1. Malaysia’s Participation in the Organisation for Economic Cooperation and Development (“OECD”) Initiatives .................................................................................................................. 1
   1.2. Implementation of Earning Stripping Rules .............................................................................................. 1
   1.3. Capital Allowance for Information and Communication Technology (“ICT”) Equipment and Software ................................................................................................................................. 2
2. Personal Income Tax ......................................................................................................................................... 2
   2.1. Reduction of Income Tax Rates .................................................................................................................. 2
   2.2. Tax Incentive for Women Returning to Work After Career Break .......................................................... 2
3. Goods & Services Tax (“GST”) Updates ............................................................................................................. 3
   3.1. Increase in de minimis value for goods imported via air courier services .............................................. 3
   3.2. Merger of the Customs Appeal Tribunal (“CAT”) and Goods and Services Tax Appeal Tribunal (“GST Tribunal”) ..................................................................................................................................... 3
   3.3. Streamlining of GST Treatment ................................................................................................................ 3
   3.4. Expanded GST Reliefs ................................................................................................................................ 4
4. General Tax Incentives ....................................................................................................................................... 6
   4.1. Extension of the Principal Hub Incentive ................................................................................................. 6
   4.2. Expansion of Tax Incentives for Hiring the Disabled .............................................................................. 6
   4.3. Extension of Incentives for New 4 and 5 Star Hotels ............................................................................. 6
   4.4. Extension of Tax Incentives for Tour Operating Companies ................................................................ 7
   4.5. Review of Tax Incentives for Venture Capital ......................................................................................... 7
   4.6. Extension of Tax Incentives for Angel Investors .................................................................................. 8
   4.7. Review of Tax Incentives for Automation .............................................................................................. 8
   4.8. Tax Incentive for Transformation to Industry 4.0 ................................................................................ 8
5. Healthcare Incentives ....................................................................................................................................... 9
   5.1. Extension of Period for Tax Incentive for Medical Tourism .................................................................... 9
   5.2. Expansion of Tax Incentive for Expenses Incurred in Obtaining Certification for Quality Systems and Standards ............................................................................................................ 9
   5.3. Review of Tax Incentives for Export of Private Healthcare Services .................................................. 10
6. Islamic Banking Incentives........................................................................................................10
   6.1. Income Tax Exemption on the Green Sustainable and Responsible Investments
        ("Green SRI") Sukuk Grant.........................................................................................10
   6.2. Tax Exemption on Management Fee Income for Sustainable and Responsible
        Investment ("SRI") Funds..........................................................................................10

7. Stamp Duty Updates...........................................................................................................11
   7.1. Stamp Duty Exemption for Trading of Exchange Traded Funds ("ETF") and
        Structured Warrants ("SW") ......................................................................................11
   7.2. Extension of Stamp Duty Exemption to Revive Abandoned Housing Projects..........11

8. Others ...................................................................................................................................11
   8.1. Declaration of Pulau Pangkor as Duty-Free Island.....................................................11
   8.2. Development of a Special Border Economic Zone in Bukit Kayu Hitam .................11
Budget 2018

On 27 October 2017, the Prime Minister and Minister of Finance, YAB Dato’ Sri Mohd Najib Tun Haji Abdul Razak unveiled the Malaysian Budget for the year 2018 (“Budget”). The theme of the Budget is "Prospering an Inclusive Economy, Balancing Between Worldly and Hereafter, for the Wellbeing of Rakyat, Towards the TN 50 Aspiration".

In conjunction with the 2050 National Transformation ("TN50") initiative plan, the Budget is centered on the wellbeing of the people by providing for opportunities to generate income and emphasising the importance of education and talent development.

Further, acknowledging the importance of automation and technology in this era, the Budget also focuses its attention on fortifying the fourth industrial revolution and the digital economy through the introduction of various tax incentives for investments in these sectors.

We set out below the highlights of the Budget:

1. Corporate Income Tax

1.1. Malaysia’s Participation in the Organisation for Economic Cooperation and Development ("OECD") Initiatives

It was announced in the Budget that Malaysia is committed to the implementation of the Automatic Exchange of Information ("AEOI") on tax matters in September 2018. To this end, the Income Tax (Automatic Exchange of Financial Account Information) Rules 2016 was introduced on 23 December 2016, which set out the requirements with respect to the exchange of the information of accounts opened and maintained by Malaysian financial institutions.

Separately, it was also announced that Malaysia is committed to fulfilling the OECD BEPS Action Plans, although no further details have been provided with respect to specific implementation measures.

1.2. Implementation of Earning Stripping Rules

It was previously proposed that thin capitalisation rules would be enforced from 1 January 2018 onwards. The thin capitalisation rules were intended to stipulate conditions under which deductions for interest charges would be disallowed, based on the debt to equity ratio of the entity.

It is now proposed that earning stripping rules ("ESR") similar to those proposed by the OECD in BEPS Action 4 be introduced, in replacement of the thin capitalisation rules. Under the ESR, the interest deduction on loans between related companies within the same group will be limited to a ratio to be determined by the Malaysian Inland Revenue Board ("MIRB"), ranging between 10% - 30% of the company's profit before tax. The ESR rules are proposed to be effective from 1 January 2019, and it is expected that more detailed rules and guidelines relating to the ESR will be released by the MIRB in due course.

*Rakyat is defined as the people, in Malay.*
1.3. Capital Allowance for Information and Communication Technology ("ICT") Equipment and Software

Presently, expenditure incurred on the purchase of ICT equipment and software (save for expenditure incurred on consultation fees, licensing fees and incidental fees for the development of customised software) is eligible for Accelerated Capital Allowance ("ACA") until the year of assessment ("YA") 2016.

To assist companies to remain competitive in the digital era, it is proposed that companies be allowed to claim capital allowances on qualifying expenditure as follows:

<table>
<thead>
<tr>
<th>Qualifying Expenditure</th>
<th>Capital Allowance Rate</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditure incurred on the purchase of ICT equipment and computer software packages</td>
<td>Initial Allowance 20%</td>
<td>From YA 2017</td>
</tr>
<tr>
<td>Expenditure incurred on development of customised software comprising consultation fees, licensing fees and incidental fees related to software development</td>
<td>Annual Allowance 20%</td>
<td>From YA 2018</td>
</tr>
</tbody>
</table>

2. Personal Income Tax

2.1. Reduction of Income Tax Rates

At present, resident individuals are subject to income tax on chargeable income at progressive rates ranging between 0% to 28%.

To increase the disposable income of the middle income group and address the rising cost of living, it is proposed that the income tax rates for resident individuals will be reduced by 2% for the following chargeable income bands:

<table>
<thead>
<tr>
<th>Chargeable Income Bands (RM)</th>
<th>Current Tax Rates (%)</th>
<th>Proposed Tax Rates (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20,001 - 35,000</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>35,001 - 50,000</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>50,001 - 70,000</td>
<td>16</td>
<td>14</td>
</tr>
</tbody>
</table>

2.2. Tax Incentive for Women Returning to Work After Career Break

In order to encourage women to return to the workforce, it is proposed that a 12-month income tax exemption be granted for women who return to the workforce after a career break of at least 2 years on 27 October 2017. Applications can be made to Talent Corporation Malaysia Berhad
3. **Goods & Services Tax ("GST") Updates**

3.1. **Increase in *de minimis* value for goods imported via air courier services**

Presently, any person importing any goods (except cigarettes, tobacco and intoxicating liquor) into Malaysia not exceeding RM 500 per consignment via air courier services are exempted from paying import duty and GST on the importation.

To encourage growth in the Malaysian e-commerce sector, it is proposed that the *de minimis* value for imports be increased from RM 500 to RM 800. No effective date was announced in the Budget for this proposal.

3.2. **Merger of the Customs Appeal Tribunal ("CAT") and Goods and Services Tax Appeal Tribunal ("GST Tribunal")**

Currently, appeals by taxpayers against the decision of the Director General of Customs for GST matters and customs-related matters (i.e., matters relating to the Customs Act 1967, Excise Act 1976, etc.) are made to the GST Tribunal and CAT respectively.

To facilitate a more efficient management of appeals and operations by the CAT and the GST Tribunal, it is proposed that the CAT and GST Tribunal be merged into a single tribunal. From 1 January 2019, all appeals relating to a decision of the Director General of Customs, whether relating to GST matters or other customs matters, will be heard by the CAT.

3.3. **Streamlining of GST Treatment**

To further improve the implementation of GST, the following measures have been introduced:

<table>
<thead>
<tr>
<th>Supplies</th>
<th>Current GST Treatment</th>
<th>Proposed GST Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reading materials</td>
<td>Pursuant to the GST (Zero-rated Supply) Order 2014 (&quot;Zero-Rated Supply Order&quot;), only certain reading materials such as printed books, newspapers and official government publications qualify for zero-rating treatment. Other reading materials are subject to GST at the standard rate of 6%.</td>
<td>The GST treatment of reading materials will be harmonised. Magazines, journals, periodical and comics will all be treated as zero-rated supplies. Proposed effective date: 1 January 2018</td>
</tr>
</tbody>
</table>
| Management and maintenance Services | Paragraph 20 of Schedule 2 of the GST (Exempt Supply) Order 2014 states that management and maintenance services provided by the joint management body and management corporation to owners of a residential building held under a strata title, are exempted from GST. Such supplies provided by housing developers are subject to GST at the standard rate of 6%.

The exempt supply treatment will be expanded to also apply to management and maintenance services supplied by housing developers.

Proposed effective date: 1 January 2018 |
| Supplies made by local authorities | Pursuant to Section 64 of the GST Act 2014 (“GST Act”), GST shall not apply to any supply of goods or services made by a local authority and statutory body, in respect of its regulatory and enforcement functions. Supplies made by local authorities which are not in respect of its regulatory and enforcement functions are regarded as taxable supplies for GST purposes.

All supplies made by local authorities, regardless of whether the supplies are related to regulatory or enforcement functions, will not be subject to GST.

Proposed effective date: 1 April 2018 or 1 October 2018 (as opted by the local authorities) |

### 3.4. Expanded GST Reliefs

Pursuant to Section 56(3) of the GST Act, the Minister of Finance may relief any person or class of persons from the payment of GST or from charging and collecting GST due and payable on a taxable supply. It is proposed that further GST reliefs be granted for various supplies and importation of goods and services, as set out below:

**(a) Supply of goods to local authorities**

Effective 1 April 2018 or 1 October 2018 (as opted by the respective local authorities), supplies of goods to local authorities (excluding the supply of petroleum, commercial buildings or land, and the importation of motor cars by local authorities) will be relieved from GST.

**(b) Supply of construction services for school buildings and places of worship**

It is proposed that GST relief be granted for construction services supplied for the construction of school buildings and places of worship financed through public donations, subject to the following conditions:

(i) the tax invoice for such services has not been issued;
(ii) approval under Subsection 44(6) of the Income Tax Act 1967 for the construction fund has been obtained;

(iii) approvals for the development and construction have been obtained from local authorities, the Ministry of Education Malaysia or State Religious Councils (for surau or mosques);

(iv) the construction of school building including hall and sports facilities are directly used for teaching and learning purposes;

(v) the relief does not apply to the purchase of commercial buildings; and

(vi) the contract for construction services was signed on or after 1 April 2017.

The GST relief above is proposed to be available for applications submitted to the Ministry of Finance ("MOF") from 27 October 2017 onwards.

(c) Supply of handling services rendered to operators of cruise ships

At present, under the Zero-Rated Supply Order, the supply of handling services (i.e., stevedoring, loading, unloading, reloading and inspection of cargo) provided by sea port operators are regarded as zero-rated supplies if supplied to a "ship". It is noted that the Ministry of Finance appears to have interpreted the term "ship" to exclude cruise ships.

In order to attract more cruise ships to make Malaysia as a part of call or home port, it is proposed that cruise ship operators are granted relief from payment of GST for handling services provided by sea port operators in Malaysia, from 1 January 2018 to 31 December 2020.

(d) Importation of aircrafts, ships and oil rigs

Currently, the importation of aircrafts, ships and oil rigs by companies in the aviation, shipping, and oil and gas industries are subject to 6% GST.

To enhance Malaysia's competitiveness in these industries, it is proposed that with effect from 1 January 2018, importation of such goods by aviation, shipping and oil and gas companies shall be relieved from GST, subject to terms and conditions to be determined by the MOF.

(e) Importation of goods by oil and gas companies under lease agreements from Designated Areas

Under the GST Act, the importation of goods under any lease agreement from a designated area (i.e., Labuan, Langkawi or Tioman) to Malaysia is subject to GST at the standard rate of 6%.

It is proposed that with effect from 1 January 2018, oil and gas companies importing goods from the designated areas to Malaysia under lease agreements will be granted GST relief. Specific details on the list of goods covered by the relief, and the terms and conditions to qualify for the relief, will be released by MOF at a later date.
4. General Tax Incentives

4.1. Extension of the Principal Hub Incentive

The Principal Hub incentive was initially launched in 2015 to provide income tax exemptions for companies which set up global operation centres in Malaysia.

Presently, this incentive is available for applications made to the Malaysian Investment Development Authority ("MIDA") by 30 April 2018.

In order to increase Malaysia's competitiveness as a global operations centre for multinational companies, it is proposed that this incentive be extended to applications received by 31 December 2020.

4.2. Expansion of Tax Incentives for Hiring the Disabled

Currently, employers are eligible to claim a deduction for the salary paid to disabled employees (as certified by the Department of Social Welfare).

In line with TN50's emphasis on safeguarding the welfare of all sectors of the population, it is proposed that with effect from YA 2018, companies are also allowed to claim a deduction for salaries paid to employees who have been affected by accidents or critical illnesses, subject to the Medical Board of the Social Security Organisation ("SOCSO") certifying that these employees are able to work within their capabilities.

4.3. Extension of Incentives for New 4 and 5 Star Hotels

Presently, tax incentives are granted to hotel operators who undertake investments in new 4 and 5 star hotels as follows:

<table>
<thead>
<tr>
<th>Incentive</th>
<th>Peninsular Malaysia</th>
<th>East Malaysia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pioneer Status Incentive</strong></td>
<td>Exemption of 70% of statutory income for 5 years</td>
<td>Exemption of 100% of statutory income for 5 years</td>
</tr>
<tr>
<td><strong>Investment Tax Allowance</strong></td>
<td>Allowance of 60% on qualifying capital expenditure incurred within 5 years, to be set off against up to 70% of statutory income</td>
<td>Allowance of 100% on qualifying capital expenditure incurred within 5 years, to be set off against up to 100% of statutory income</td>
</tr>
</tbody>
</table>

In line with the Malaysian Government's efforts to promote tourism in Malaysia and in conjunction with the Visit Malaysia 2020 campaign, it is proposed that the application period for the incentives above be extended from 31 December 2018 to 31 December 2020.
4.4. Extension of Tax Incentives for Tour Operating Companies

Currently, tour operating companies are granted a full income tax exemption on statutory income derived from the business of operating tour packages (i) within Malaysia and participated by not less than 1,500 local tourists annually, or (ii) to Malaysia and participated by not less than 750 foreign tourists annually. This incentive is available for YAs 2017 and 2018.

In conjunction with the Visit Malaysia Year 2020 campaign, it is proposed that the tax exemptions above will be extended until YA 2020.

4.5. Review of Tax Incentives for Venture Capital

It is proposed that the existing tax incentives available with respect to venture capital activities be amended as follows:

<table>
<thead>
<tr>
<th>No.</th>
<th>Current Incentive</th>
<th>Proposed Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Tax exemption on the income of a venture capital management corporation (&quot;VCMC&quot;) derived from the share of profits received on investments made by a venture capital company (&quot;VCC&quot;).</td>
<td>The scope of the tax exemption will also include income received from management fees and performance fees in managing the VCC funds.</td>
</tr>
<tr>
<td>2.</td>
<td>Tax exemption on statutory income of a VCC derived from all sources of income (except interest income from savings or fixed deposits and profits from Shariah-compliant deposits), for a period of 10 YAs or the YAs equivalent to the life of the fund established for investment in the venture company (&quot;VC&quot;), whichever is shorter. To qualify for the exemption, the VCC must: (a) be registered with the Securities Commission (&quot;SC&quot;); and (b) invest at least 70% of its seed, start-up and early stage funds in VCs or invest at least 50% of its invested funds in VCs in the form of seed capital.</td>
<td>The investment limit in a VC at the seed, start-up and early stage is reduced from 70% to 50%. The remaining 50% of the fund may be used for other investments.</td>
</tr>
<tr>
<td>3.</td>
<td>Tax deduction for companies or individuals with business income that invest in a VC, equivalent to the amount of investment made in the VC at the adjusted income level.</td>
<td>The tax deduction is subject to a maximum of RM 20 million per year for each company or individual.</td>
</tr>
</tbody>
</table>

It is proposed that these tax exemptions be granted for a period of 5 years from YA 2018 to YA 2022, for applications received by the SC from 1 January 2018 until 31 December 2018.
4.6. Extension of Tax Incentives for Angel Investors

Presently, angel investors who invest in investee companies by way of ordinary shares may submit an application to the MOF by 31 December 2017 for a tax exemption equivalent to the amount of investment made in the investee companies.

To encourage prospective angel investors to contribute to the start-up economy, it is proposed that the application period for this tax incentive be extended for a further 3 years ending on 31 December 2020.

4.7. Review of Tax Incentives for Automation

Presently, manufacturing companies are eligible for ACA and Automation Equipment Allowance ("AE") on expenses incurred in the purchase of automation equipment as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Tax Incentive</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 1: Labour-Intensive Industries (rubber, plastic, wood and textile products)</td>
<td>ACA of 100% and AE of 100% on first RM 4 million for qualifying expenditure incurred during YA 2015 - 2017</td>
<td>Applications submitted to MIDA between 1 January 2015 - 31 December 2017</td>
</tr>
<tr>
<td>Category 2: Other Industries</td>
<td>ACA of 100% and AE of 100% on first RM 2 million for qualifying expenditure incurred during YA 2015 - 2020</td>
<td>Applications submitted to MIDA between 1 January 2015 - 31 December 2020</td>
</tr>
</tbody>
</table>

To further promote automation in the manufacturing sector, it is proposed that the incentive period for Category 1 be extended for a further 3 years until 31 December 2020.

4.8. Tax Incentive for Transformation to Industry 4.0

In order to move up the value chain and increase productivity, companies are encouraged to adopt advanced technology (also known as Industry 4.0), which includes, among others, the following technology drivers:

(a) big data analytics;
(b) autonomous robots;
(c) simulation;
(d) industrial internet of things;
(e) cybersecurity;
(f) horizontal and vertical system integration;
(g) cloud computing;
(h) additive manufacturing;
(i) augmented reality; and
(j) artificial intelligence.

It is proposed that ACA and AE be granted on the first RM 10 million qualifying capital expenditure incurred by companies in the adoption of the above technology drivers during the period of YA 2018 to 2020. The ACA and AE are fully claimable within 2 YAs. Applications for the incentive should be submitted to MIDA between 1 January 2018 to 31 December 2020.

5. Healthcare Incentives

5.1. Extension of Period for Tax Incentive for Medical Tourism

Currently, companies providing private healthcare services that plan to establish new private healthcare facilities or undertake an expansion, modernisation or refurbishment of existing facilities may apply to MIDA by 31 December 2017 for an investment tax allowance of 100% on the qualifying capital expenditure incurred for a period of 5 years, which can be used to offset against 100% of the statutory income.

The conditions to qualify for this incentive include the following:

(a) the healthcare travellers shall form not less than 5% of its total patients for each year of assessment; and

(b) at least 5% of its gross income for each year of assessment is generated from healthcare travellers.

In order to promote medical tourism, it is proposed that the incentive shall be extended to applications submitted to MIDA by 31 December 2020. However, it is also proposed that the threshold for companies to qualify for the incentive be raised from 5% to 10% in respect of condition (a) and (b) above.

5.2. Expansion of Tax Incentive for Expenses Incurred in Obtaining Certification for Quality Systems and Standards

At present, expenses incurred by private healthcare companies registered with the Malaysia Healthcare Travel Council ("MHTC") in obtaining certification for quality systems and standards from an approved certification body (i.e., Malaysian Society for Quality in Health (Malaysia); Joint Commission International (United States of America); CHKS Accreditation Unit (United Kingdom); The Australian Council on Health Care Standard (Australia); and Accreditation Canada (Canada)) are eligible for double deduction.

It is proposed that effective from YA 2018, companies registered with MHTC that provide dental and ambulatory healthcare services shall also be eligible for double deduction in respect of expenses incurred in obtaining certification for quality systems and standards.
5.3. Review of Tax Incentives for Export of Private Healthcare Services

Private healthcare companies are currently eligible for an income tax exemption on income derived from the export of healthcare services to foreign patients. The tax exemption granted is equivalent to 50% of the value of increased exports of services, to be offset against 70% of statutory income.

To further promote the healthcare sector and establish Malaysia as a healthcare hub, it is proposed that from YA 2018 to YA 2020, the income tax exemption shall be increased from 50% to 100% of the value of increased exports of services.

However, private healthcare companies will have to meet additional conditions in order to be eligible for the tax exemption as follows:

(a) the healthcare travellers shall form not less than 10% of its total patients for each year of assessment; and
(b) at least 10% of its gross income for each year of assessment is generated from healthcare travellers.

6. Islamic Banking Incentives

6.1. Income Tax Exemption on the Green Sustainable and Responsible Investments ("Green SRI") Sukuk Grant

To encourage the issuance of Green SRI sukuk in Malaysia, it is proposed that an income tax exemption be granted to Green SRI sukuk issuers in respect of grants received from the Securities Commission ("SC") of Malaysia to finance external review expenditure. This exemption will apply to applications received by SC from 1 January 2018 to 31 December 2020.

6.2. Tax Exemption on Management Fee Income for Sustainable and Responsible Investment ("SRI") Funds

Presently, companies providing management services for approved Shariah-compliant funds, are granted a tax exemption on the following income:

(a) income from providing fund management services to foreign investors in Malaysia;
(b) income from providing fund management services to local investors in Malaysia; and
(c) income from providing fund management services to business trusts or real estate investment trusts in Malaysia.

It is proposed that the exemption shall be extended to also apply to management fee income from managing conventional and Shariah-compliant SRI funds approved by the SC, for YA 2018 to YA 2020.
7. **Stamp Duty Updates**

7.1. **Stamp Duty Exemption for Trading of Exchange Traded Funds ("ETF") and Structured Warrants ("SW")**

Presently, stamp duty is charged on a contract note at the rate of RM 1.00 for every RM 1,000 and part thereof for the trading of shares of listed companies on Bursa Malaysia, subject to a maximum of RM 200.

To further promote development of the Malaysian capital markets, it is proposed that stamp duty exemptions be granted in respect of contract notes for ETF and SW transactions executed between 1 January 2018 to 31 December 2020.

7.2. **Extension of Stamp Duty Exemption to Revive Abandoned Housing Projects**

Presently, a stamp duty exemption is given on the following instruments:

<table>
<thead>
<tr>
<th>Category</th>
<th>Instruments</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rescuing Contractors</td>
<td>(a) Loan agreements to finance the revival of the abandoned housing projects (b) Instruments of transfer of title for land and houses in abandoned housing projects</td>
<td>1 January 2013 - 31 December 2017</td>
</tr>
<tr>
<td>Original House Purchasers in the Abandoned Projects</td>
<td>(a) Loan agreements for additional financing (b) Instruments of transfer of the houses</td>
<td></td>
</tr>
</tbody>
</table>

To further encourage initiatives to revive abandoned housing projects, it is proposed that the existing stamp duty exemptions be extended for a further 3 years, i.e., to apply to loan agreements and memorandums of transfer executed from 1 January 2018 to 31 December 2020 for certified abandoned housing projects.

8. **Others**

8.1. **Declaration of Pulau Pangkor as Duty-Free Island**

It is proposed that Pulau Pangkor will be declared as a duty-free island. However, the duty-free status excludes products such as alcoholic beverages, tobacco and motor vehicles.

8.2. **Development of a Special Border Economic Zone in Bukit Kayu Hitam**

It has also been announced that a Special Border Economic Zone in Bukit Kayu Hitam will be developed to include a Free Industrial Zone.
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