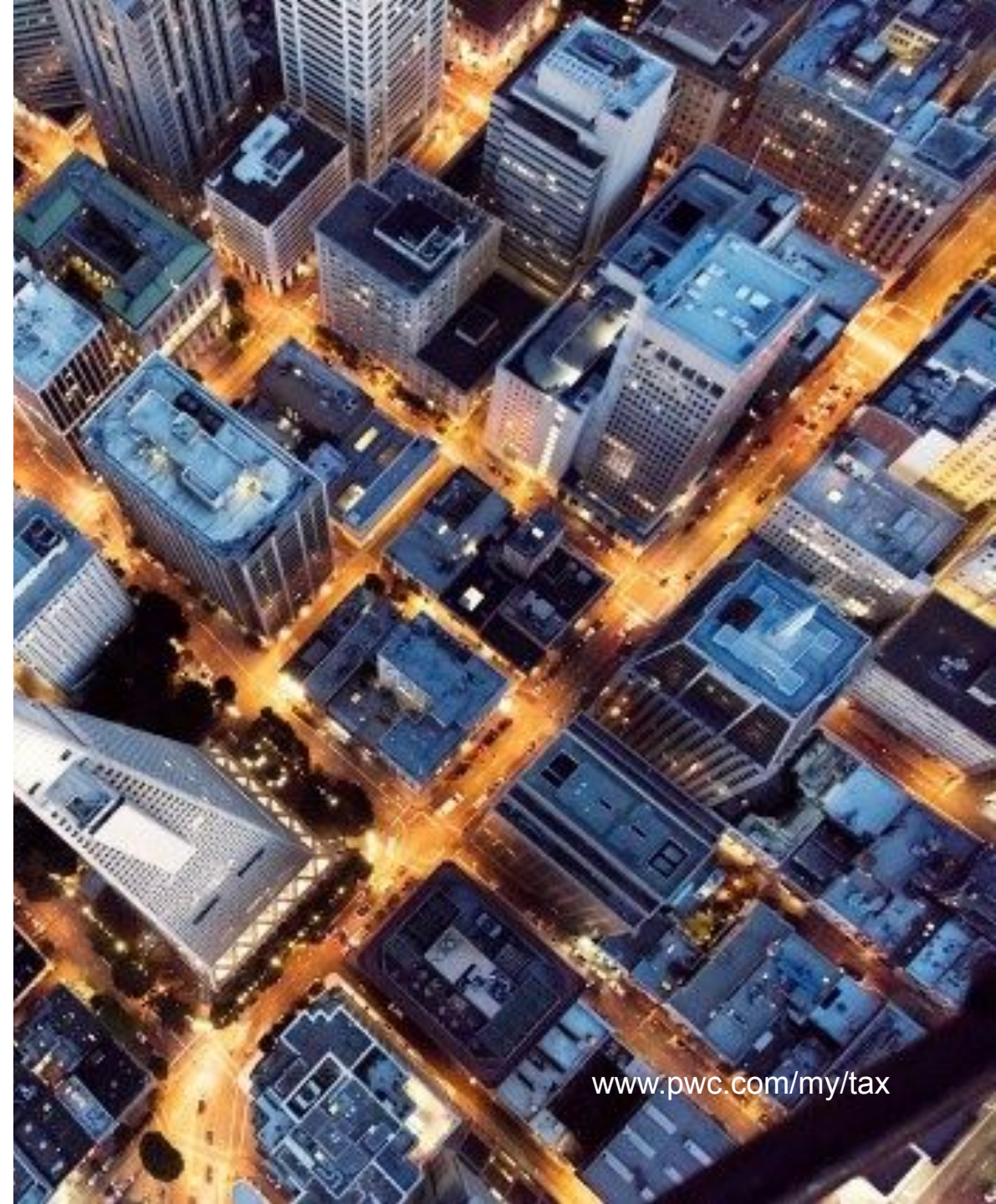




# Taxavvy

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## Principal Hub 2.0 guideline



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## Principal Hub 2.0 guideline

The Principal Hub (PH) incentive was introduced in 2015 with the objective of strengthening Malaysia's position as a competitive regional and global operation base. Since its introduction, the PH incentive had been progressively enhanced, the latest being the concessionary income tax rate of 10% on the overall statutory income relating to the PH's activities of existing companies (including those with IPC / RDC / OHQ approved status), for 5 years, as announced in Budget 2019.

The Malaysian Investment Development Authority (MIDA) has now issued a new PH 2.0 guideline that incorporates the Budget 2019 announcement.

The PH 2.0 guideline which supersedes the PH 1.0 guideline, is effective for applications received by MIDA from 1 January 2019 to 31 December 2020.

The guideline is available on MIDA's website [www.mida.gov.my](http://www.mida.gov.my) (Resources > Forms and Guidelines > Services Sector).

Similar to the previous PH 1.0 guideline dated 20 February 2019, the PH 2.0 guideline sets out the incentive and requirements for the following categories of companies:

- 1: New company;
- 2: Existing company (with IPC / RDC / OHQ approved status), with or without incentive; and
- 3: Existing company.

Under the PH 2.0 guideline, tax incentives have generally been enhanced for the various categories of eligible companies and increased incentive commitments have been incorporated. The following are the main changes in the PH 2.0 guideline:

Enhanced	<b>Tax incentive</b> The tax exemption given to existing companies (including those granted IPC / RDC / OHQ approved status), with approved PH status was previously computed on the value added income from PH activities. This has been replaced with a concessionary flat tax rate of 10% applicable to the statutory income from PH activities.
Relaxed	<b>Servicing of network companies outside Malaysia</b> Under PH 1.0, there was initially a requirement for a PH to provide services to network companies in 3 countries outside Malaysia.  This requirement had been relaxed retrospectively from Year of Assessment (YA) 2018 in the PH 1.0 guideline, and this relaxation continues to be reflected in the PH 2.0 guideline.  <b>Clawback of PH incentive</b> Under PH 2.0, where a PH fails to comply with the conditions in a YA, the exemption will not be given for that YA. Previously under PH 1.0, the incentive will be clawed back from year 1.

Abbreviations:

IPC refers to "International Procurement Centre", RDC refers to "Regional Distribution Centre", OHQ refers to "Operational Headquarters"

Removed

### **Tier 3 exemption**

PH 1.0 had previously made available, a 10% tax exemption (Tier 3) for new companies. This is no longer available under PH 2.0.

### **5 year extension of incentive period**

Previously under PH 1.0, existing companies without incentives that are granted the PH incentive may enjoy a 5 year incentive period, which is extendable for another 5 years. Under PH 2.0, the 5 year extension period has been removed.

### **Commodity based companies**

Commodity based companies are no longer eligible for the PH incentive.

### **Serve and control network companies**

PHs are required to serve and control a specified minimum number (10 or 15) of network companies. However, these companies are not required to be located in countries outside Malaysia. Network companies are:

- Related companies or entities within the same group (subsidiary, branch, joint venture); or
- Non-related companies which have contractual agreement with the PH or its ultimate company with regards to PH's business and supply chain for at least 3 years.

Stricter conditions

### **Compulsory activities**

Apart from Regional P&L / Business Unit Management, Strategic Business Planning & Corporate Development has been added as another compulsory core income generating activity which is mandatory to a PH.

### **Increased annual sale of goods**

The minimum annual sale of goods is increased from RM300 million to RM500 million for companies applying exemption on their trading income.



Stricter conditions (con't)

**Increased annual operating expenditure**

For existing companies, there is an increased commitment amount of annual operating expenditure to be incurred. For example, for existing companies (i.e. Category 3 companies), the annual operating expenditure has been increased from RM5 million to the higher of RM10 million or the average operating expenditure for the 3 years + 30 percent. Operating expenditure specifically excludes cost of goods sold, depreciation and interest on borrowings.

New condition

**Training**

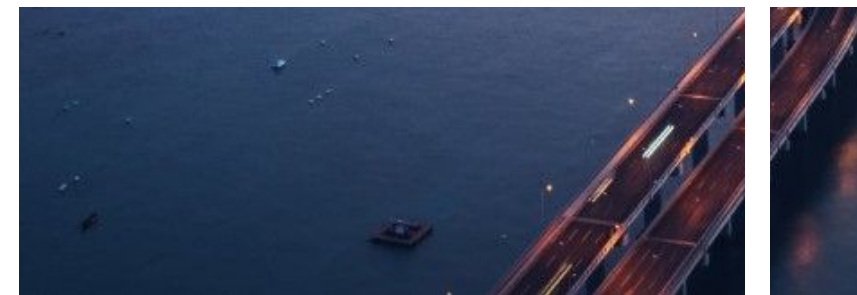
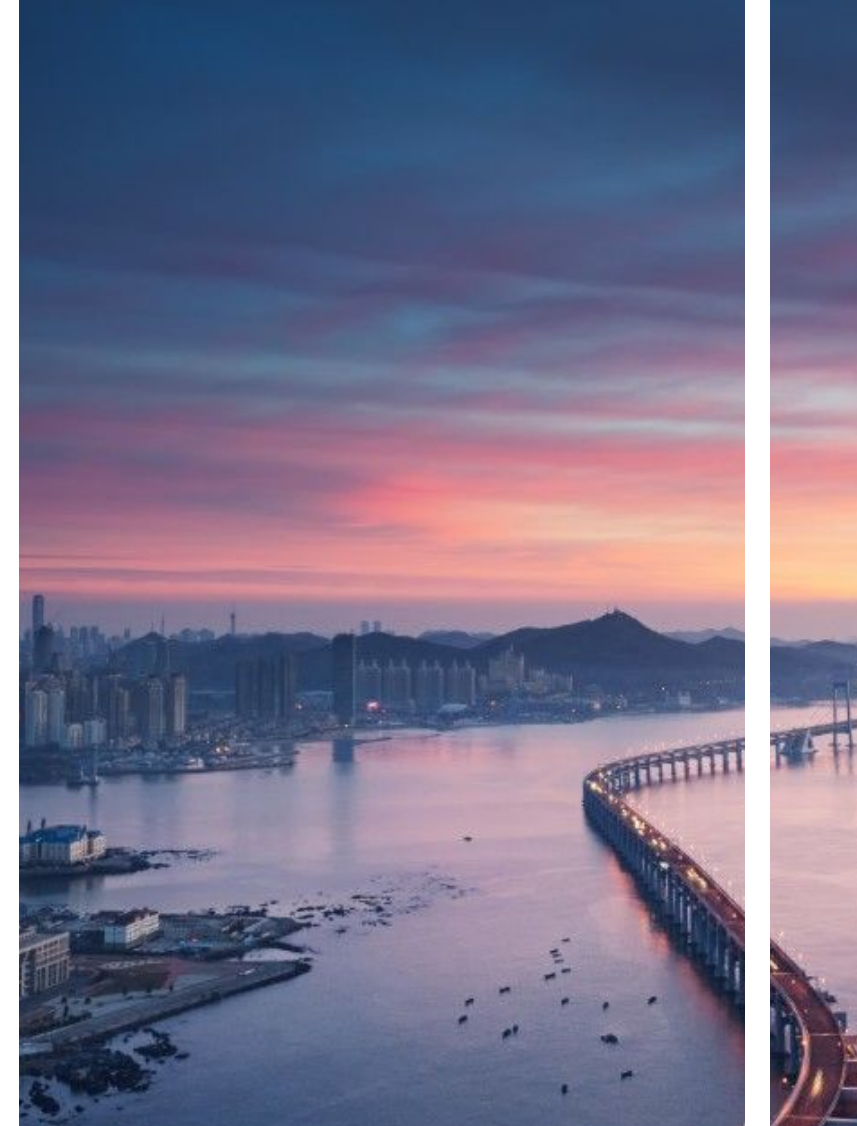
Existing companies which are granted the PH incentive are required to conduct structured internship programme or equivalent training schemes introduced by TalentCorp, and structured training programmes for their own workforce. This new condition is introduced to accelerate the creation of more high value jobs and increase the talent pool in Malaysia.

Exclusions

Royalties and other income derived from intellectual property rights are excluded from the PH incentive in line with the recommendation from the review by the Forum on Harmful Tax Practices to comply with the Base Erosion Profit Shifting (BEPS) Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance. The Government is currently formulating the specific laws on the tax treatment of IP income and will be issuing them in due course.

It is stated in the PH 2.0 guideline that the PH-Compliance Assessment Form must be submitted within 6 months from the financial year end or the extended period as approved by MIDA.

The new requirements under PH 2.0 would apply for applications received by MIDA from 1 January 2019, as well as pre-January 2019 applications which have not been approved yet. Applications for PH 2.0 must be submitted to MIDA by 31 December 2020.



## Our comments

In general, the eligibility conditions pertaining to substance requirements under PH 2.0 have been made more stringent. However, there is some relaxation of the requirements under PH 1.0; example, the requirement for the PH to provide services to network companies in three countries outside Malaysia. With this relaxation, local groups which do not have sufficient presence outside Malaysia may now be eligible for the PH incentive.

Companies that could potentially be eligible for the PH 2.0 incentive:



- **Sizeable Multinational Companies (MNCs)** (both foreign and local) in Malaysia which are already carrying out the relevant PH qualifying activities; or MNCs which are considering locating additional activities such as supply chain management, research and development activities, etc, in Malaysia.



- **Foreign MNCs** new to Malaysia seeking to establish regional or global hub for manufacturing or trading; or services; or both; or relocating part of their current operations to Malaysia.

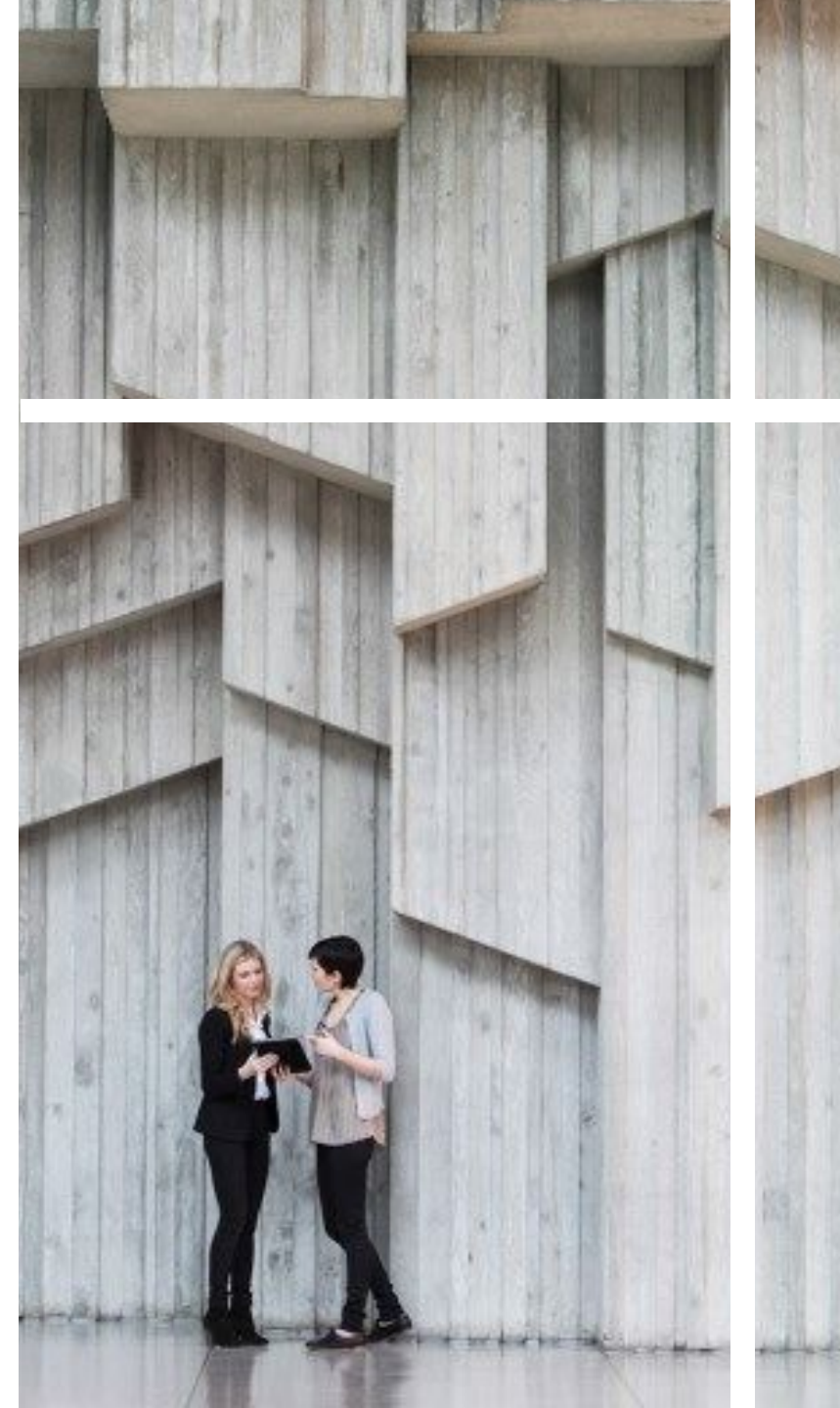


- **Large local groups** (both in the manufacturing or service sectors) currently with limited foreign presence, planning to consolidate existing value chain functions, with the view to facilitate business expansion.



- **IPC / RDC / OHQ approved status** companies which have completed their tax incentive period.

A comparison of the incentive and qualifying conditions for each category of companies under the PH 1.0 and PH 2.0 guidelines are set out in the following section.



Category 1 - New companies		
	PH 1.0 guideline	PH 2.0 guideline
<b>Eligible companies</b>	<ul style="list-style-type: none"> <li>Manufacturing &amp; services company; and</li> <li>Commodity based company that integrates the supply chain management for upstream and downstream activities under its PH operations.</li> </ul>	Manufacturing & services company.
<b>Incentive</b>	Exemption on statutory income from trading & services income (5+5 YAs), resulting in effective tax rates of 0% (Tier 1), 5% (Tier 2) and 10% (Tier 3).	Similar to PH 1.0 but Tier 3 has been removed.
<b>Incentive commitment</b> <i>Serve and control of network companies</i>	N/A	Tier 1: 15 (including 4 related companies) Tier 2: 10 (including 3 related companies)
<i>Annual sales of trading goods (for companies applying exemption on trading income)</i>	RM300 million by end of year 3	RM500 million with no time frame stated
<i>Qualifying services</i>	Regional P&L / Business Unit Management + 2 other qualifying services	Similar to PH 1.0 + Strategic Business Planning & Corporate Development services
<i>High value jobs</i>	<ol style="list-style-type: none"> <li><b>Tier 1</b> <ul style="list-style-type: none"> <li>First 5 YAs: 50 high value jobs (including 5 key positions)</li> <li>Second 5 YAs: PH base commitment + 20%</li> </ul> </li> <li><b>Tier 2</b> <ul style="list-style-type: none"> <li>First 5 YAs: 30 high value jobs (including 4 key positions)</li> <li>Second 5 YAs: PH base commitment + 20%</li> </ul> </li> <li>At least 50% must be held by Malaysians by end of year 3</li> </ol>	<ol style="list-style-type: none"> <li>Similar to PH 1.0</li> <li>Similar to PH 1.0 with no time frame stated.</li> </ol>

Category 2 - Approved OHQ / IPC / RDC status companies, with or without incentive				
	PH 1.0 guideline		PH 2.0 guideline	
<b>Incentive</b>	Income exemption on value added income computed based on a specified formula: <ul style="list-style-type: none"> <li>• 5 + 5 YAs (companies without incentive) or</li> <li>• 5 YAs (companies with incentive)</li> </ul>		10% tax rate on statutory income from qualifying PH activities (trading & services) for 5 YAs.	
	Approved without incentive	Approved with incentive	Approved without incentive	Approved with incentive
<b>Incentive commitment</b> <i>Serve and control of network companies</i>	N/A		10 (including 4 related companies)	15 (including 5 related companies)
<i>Qualifying services</i>	Regional P&L / Business Unit Management + 2 other qualifying services		Similar to PH 1.0 + Strategic Business Planning & Corporate Development services	Similar to PH 1.0 + Strategic Business Planning & Corporate Development services + 1 additional other qualifying service
<i>Annual operating expenditure (opex)</i>	First 5 YAs: RM10 million Second 5 YAs: PH base commitment + 30%	To be met by end of year 3	RM13 million	RM10 million or average opex for past 3 years + 30%, whichever is higher. No time frame stated.
<i>High value jobs</i>	1. First 5 YAs: Existing commitment + 20% Second 5 YAs: PH base commitment + 30% 2. At least 50% must be held by Malaysians by end of year 3	1. 60 high value jobs 2. At least 50% must be held by Malaysians	1. Existing number of high value jobs + 30% 2. Similar to PH 1.0 with no time frame stated	1. 60 high value jobs or existing number of high value jobs + 20%, whichever is higher 2. Similar to PH 1.0
<i>Training</i>	N/A		To conduct structured internship programmes or equivalent training schemes introduced by Government (i.e. Talent Corporation), and structured training programme for its workforce.	

Category 3 - Existing companies		
	PH 1.0 guideline	PH 2.0 guideline
<b>Eligible companies</b>	<ul style="list-style-type: none"> <li>Manufacturing &amp; services company; and</li> <li>Commodity based company that integrates the supply chain management for upstream and downstream activities under its PH operations.</li> </ul>	Manufacturing & services company.
<b>Incentive</b>	<p>Income exemption on value added income computed based on a specified formula:</p> <ul style="list-style-type: none"> <li>5 + 5 YAs (companies without incentive) or</li> <li>5 YAs (companies with incentive).</li> </ul>	10% tax rate on statutory income from qualifying PH activities (trading & services) for 5 YAs.
<b>Incentive commitment</b> <i>Serve and control of network companies</i>	N/A	Minimum 10 (including 5 related companies)
<i>Qualifying services</i>	Regional P&L / Business Unit Management + 2 other qualifying services	Similar to PH 1.0 + Strategic Business Planning & Corporate Development services
<i>Annual operating expenditure (opex)</i>	<p>First 5 YAs: RM5 million            Second 5 YAs: PH base commitment + 30% } to be met by end of year 3</p>	RM10 million or average opex for past 3 years + 30%, whichever is higher. No time frame stated.
<i>Annual sales of trading goods (for companies applying exemption on trading income)</i>	RM300 million	Average sales turnover for past 3 years or RM500 million, whichever is higher
<i>High value jobs</i>	<ol style="list-style-type: none"> <li>First 5 YAs: 30 high value jobs (including 4 key positions)            Second 5 YAs: PH base commitment + 30%</li> <li>At least 50% must be held by Malaysians by end of year 3</li> </ol>	<ol style="list-style-type: none"> <li>30 high value jobs or existing number of high value jobs + 30%, whichever is higher (including 5 key positions)</li> <li>At least 50% must be held by Malaysians, with no time frame stated</li> </ol>
<i>Training</i>	N/A	To conduct structured internship programmes or equivalent training schemes introduced by Government (i.e. Talent Corporation), and structured training programme for its workforce.

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