



# Taxavvy

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## Principal Hub legislation – amendments

The law pertaining to Principal Hub (PH) incentive was legislated on 31 December 2018 via 3 gazette orders (refer to [TaXavvy 2/2019](#)) which cover the following:

1. Companies which are already operating in Malaysia,
2. New companies set up in Malaysia, and
3. Companies granted approved Operational Headquarters (OHQ), International Procurement Centre (IPC) or Regional Distribution Centre (RDC) status

The gazette orders have now been amended predominantly in respect of the qualifying conditions for the PH incentive.

### The original PH gazette orders

One of the qualifying conditions requires a company to provide at least 3 qualifying services to its network companies which are located in 3 countries outside Malaysia.

### The amendment orders

The above-mentioned condition has now been removed from the said 3 gazette orders. Consequently, a company may be eligible for the PH incentive even when all its network companies are based in Malaysia.



In addition, one of the conditions for extending the PH incentive has been amended in the third gazette order relating to PH incentives (i.e. the gazette order for companies granted approved OHQ / IPC / RDC status). The condition in relation to full time employees and annual operating expenditure are to be fulfilled at the time when application is made (i.e. from 1 January 2018 to 31 December 2020), and not at the end of the last year of the exempt period. This amendment is made in order to be consistent with the other two PH incentive gazette orders.

Correction has also been made to the third gazette order in Schedule 2 relating to a PH company with OHQ / RDC / IPC status and which has been granted the corresponding approved incentive. The correction is to address the typo error: 13,000,000,00.00 in respect of the minimum amount of annual operating expenditure.

## MIDA guidelines – revised guidelines for manufacturing and research & development sectors

The Malaysian Investment Development Authority (MIDA) has revised the guidelines in relation to:

- Application for manufacturing licence and incentive for manufacturing projects.
- Application for incentives for contract research & development (R&D) and R&D companies.



### Application for manufacturing licence and incentive for manufacturing projects

The original guideline has been split into 2 guidelines (both dated 28 January 2019):

1. [Guideline on application for manufacturing licence](#)
2. [Guideline on incentive application for manufacturing project](#)

#### 1. Guideline on application for manufacturing licence

The guideline states that the definition of “manufacturing” is as per the Industrial Coordination Act 1975 (ICA) –

*“... the making, altering, blending, ornamenting, finishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal and includes the assembly of parts and ship repairing but shall not include any activity normally associated with retail or wholesale trade”*

In addition, a company must fulfil the following criteria in order to be eligible for a manufacturing licence:

- I. Shareholders’ funds of RM2.5 million and above; or 75 or more full-time paid employees;
- II. Project capital investment per employee of at least RM140,000;
- III. At least 80% of the full-time workforce must comprise of Malaysians. Employment of foreign workers including outsourced workers is subject to current policies;
- IV. At least 25% of company’s full-time workforce are managerial, technical and supervisory staff with degree and / or diploma / certificate; **or** product’s value added is at least 40%; and
- V. Project must be consistent with the country’s national economic and social objectives and promotes an orderly development of manufacturing activities in Malaysia.

Items II to V were not stated in the original guideline.

The terms “shareholders’ funds” and “full-time paid employees” are also explained:

- Shareholders’ funds – aggregate of paid-up capital, reserves, balance of share premium account and balance of profit & loss appropriation account.
- Full-time paid employees – persons normally working for at least 6 hours per day and at least 20 days per month for 12 months during the year and receive a salary.

## 2. Guideline on incentive application for manufacturing project

Similar to the original guideline, this new guideline continues to state the relevant application forms for manufacturing sector incentives.

## Application for incentives for contract R&D and R&D companies

Following the revision made last year to conform to the substantial activity requirements under BEPS Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance (refer to [TaXavvy 8-2018](#)), the [guideline](#) has now been updated as follows:

### Definition of R&D

#### Old guideline (dated 1 July 2018)

[text deleted / replaced is denoted in colour]

#### New guideline (dated 20 February 2019)

[text added is denoted in colour]

**The definition of R&D in the old guideline has been replaced with the new definition as introduced via the Finance Act 2018.**

R&D means any systematic **or intensive study** carried out in the field of science or technology with the objective of using the results of the study for the production or improvement of materials, devices, products, produce or processes. **The R&D activities undertaken to generate R&D services (core income) may include the following:**

- **Experimental or other work aimed at the discovery of new knowledge or the advancement of existing knowledge,**
- **The search for applications of research findings or other knowledge,**
- **The formulation and design of possible new or improved product or process alternatives, and**
- **The design, construction and testing of prototypes and models.**

R&D means any systematic, **investigative and experimental study that involves novelty or technical risk** carried out in the field of science or technology with the object of **acquiring new knowledge** or using the results of the study for the production or improvement of materials, devices, products, produce, or processes.

**Old guideline (dated 1 July 2018)**

[text deleted / replaced is denoted in colour]

**New guideline (dated 20 February 2019)**

[text added is denoted in colour]

**The list of activities not considered to be R&D activities has been expanded**

R&D activities does not include:

- Quality control or routine testing of materials, devices, **products or produce**,
- Research in the social sciences or the humanities,
- Routine data collection,
- Efficiency surveys, and
- Market research or sales promotion

R&D activities does not include:

- Quality control or routine testing of materials, devices **or products**,
- Research in the social sciences or the humanities,
- Routine data collection,
- Efficiency surveys **or management studies**,
- Market research or sales promotion,
- **Routine modification or changes to materials, devices, products, processes or production methods, or**
- **Cosmetic modifications or stylistic changes to materials, devices, products, processes or production methods.**

**Treatment of tax incentive approvals**

Companies granted incentive approval from 16 October 2017 without the substantial activities requirement can only enjoy the existing incentive until **27 December 2018** (i.e. date of legislation of the Finance Act 2018).

The updated guideline is effective from 27 December 2018.



# Labuan – FAQs on Substantial Activity Requirements

The [Labuan Business Activity Tax \(Requirements for Labuan Business Activity\) Regulations 2018](#) (“Substance Regulations”) was legislated on 31 December 2018 to set down the substantial activity requirements imposed on Labuan entities carrying on Labuan business activity.

The substantial activity requirements specify the minimum requirement in respect of:

- Number of full time employees in Labuan; and
- Amount of annual operating expenditure in Labuan

The Labuan Financial Services Authority (“Labuan FSA”) has now issued [Frequently Asked Questions](#) (FAQs) on the substantial activity requirements for Labuan entities, dated 25 January 2019.

## Broad overview of the substantial activity requirements

<p><b>Entities required to comply</b></p>	<ul style="list-style-type: none"> <li>• Labuan entities as listed in the Substance Regulations.</li> <li>• An Investment Holding Company which fulfils the definition of a Holding Company under the Labuan Companies Act 1990, i.e. a company which has:             <ul style="list-style-type: none"> <li>- more than 50% shareholding in its subsidiaries, and</li> <li>- has control over these subsidiaries through the board of directors and via voting rights.</li> </ul> </li> <li>• Newly incorporated / registered entities that want to enjoy the preferential tax treatment.</li> </ul> <p>Entities which do not meet the substantial activity requirement will not be able to enjoy the preferential tax rate of 3% under the Labuan Business Activity Tax Act 1990 (LBATA) and will instead be taxed under the Income Tax Act 1967 (ITA).</p>
<p><b>Entities which need not comply</b></p>	<ul style="list-style-type: none"> <li>• Dormant companies (i.e. Labuan entities which have no business income)</li> <li>• Labuan entities not taxed under the LBATA (i.e. entities which have made an irrevocable election to be taxed under the ITA, or Labuan entities with income derived solely from intellectual property rights).</li> <li>• Islamic window of a Labuan financial institution (as they are not regarded as separate from the Labuan financial institution).</li> </ul>
<p><b>Employment requirements</b></p>	<ul style="list-style-type: none"> <li>• A full time employee means one who is employed by the Labuan entity to serve the entity in Labuan.</li> <li>• There are no minimum qualifications or criteria for employees that are engaged by the Labuan entity.</li> </ul>

<b>Operational office requirements</b>	<ul style="list-style-type: none"><li>• Labuan entities are expected to have dedicated physical office with dedicated entrance, signage, etc.</li><li>• Labuan entities within a group may share a physical office.</li><li>• The operational office has to be in Labuan to enjoy the LBATA's preferential tax treatment.</li></ul>
<b>Annual operating expenditure requirements</b>	<ul style="list-style-type: none"><li>• Operating expenditure is to be incurred in Labuan by the Labuan entities.</li><li>• Examples of expenses that would qualify include professional and statutory fees, salaries, lease rental, service providers' fees, licence fees to Labuan FSA.</li><li>• For newly incorporated / registered entities, this requirement can be pro-rated from the date of commencement of business.</li></ul>

For a captive setup, including a protected cell company, the Labuan FSA will provide clarification on the substantial activity requirements in due course.

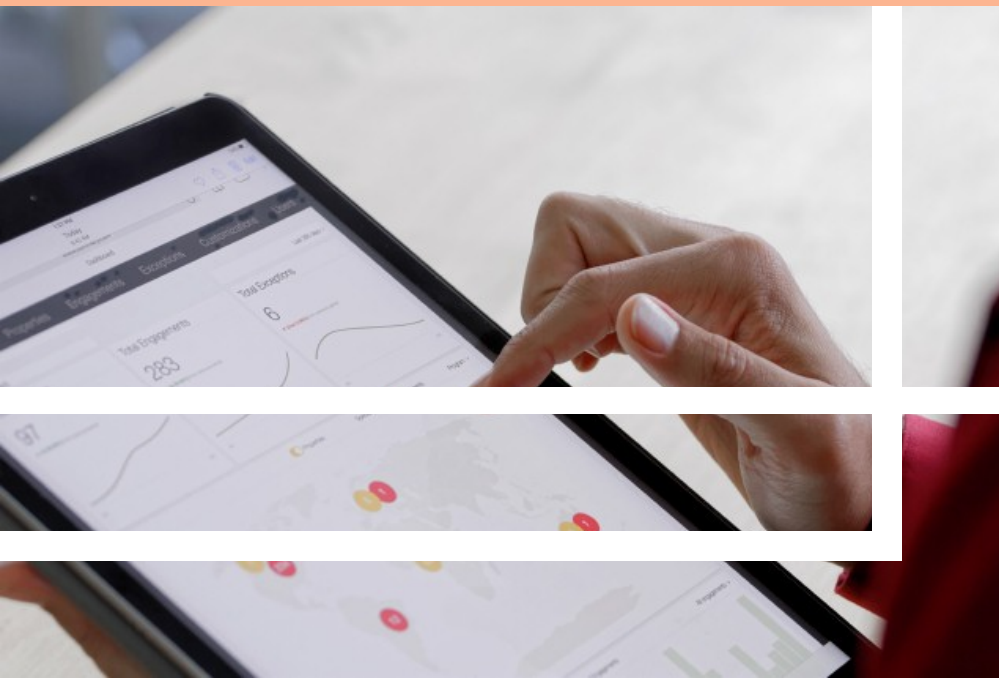
The Labuan FSA has also stated that as the LBATA is under the purview of the Inland Revenue Board (IRB), any further clarification on the new Finance Act 2018 and tax regulations which are related to Labuan entities can be sought from the IRB.

Group companies which have entities in Labuan would need to review their operational structure and ensure that the substantial activity requirements are met.



## Special Voluntary Disclosure Programme – FAQs

The [FAQs for the Special Voluntary Disclosure Programme](#) (SVDP) has been updated with the insertion of additional FAQs. The additional questions mainly relate to transfer pricing and income deposited overseas.



### Broad overview of the additional FAQs

#### **Income earned from Malaysia and deposited in a bank account abroad. (Q.7)**

- Such income is subject to tax in Malaysia although deposited in bank accounts abroad.
- The taxpayer is responsible to report such income.
- Taxpayers who have not reported such income can make a voluntary disclosure under the SVDP. The same SVDP procedures will apply.
- Furthermore, IRB will be receiving on an annual basis, information on financial accounts of Malaysian taxpayers held overseas following the 2018 implementation of the Automatic Exchange of Information.
- Information received by IRB will include:
  - money deposited in bank accounts,
  - interest, dividend, unit trust,
  - cash value insurance contract or annuity contract,
  - proceeds from the sales or redemption of financial assets and shares.

#### **Voluntary disclosure for transfer pricing (TP) issues. (Q.59 to Q.63)**

- Voluntary declaration for TP issues will be handled based on the procedures outlined in the [Transfer Pricing Audit Framework](#) (“the Framework”) dated 1 April 2013.
- The FAQs broadly outline the procedures as follows:
  - Taxpayers may request for a pre-submission discussion to agree on the suitability of the comparable companies / TP methods used, provide information on the activities of the company and propose a suggested timeline for the case.

**Voluntary disclosure for transfer pricing (TP) issues (con't). (Q.59 to Q.63)**

- The following documents should be submitted before 1 July 2019:
  1. TP Documentation (comprehensive and with sufficient information on the business activities) for the respective years together with the financial information on the comparables.
  2. Information regarding the omitted/undeclared income or expenses over claimed and the supporting documents for the respective years.
- IRB will discuss the timeframe for settlement during the negotiation because of the complexity of TP issues.
- Upon completion of the review and negotiation, IRB will issue a letter to set out the tax computations and to state that IRB has accepted the disclosures made based on the information submitted.
- Any penalty imposed by IRB will be in accordance with the Framework dated 1 April 2013.
- As long as comprehensive TP Documentation has been submitted and the auditor is satisfied with the information provided, IRB will only carry out a minimum audit process.
- The IRB intends to revise the Framework effective 1 July 2019. The penalty rates for TP issues will be increased from that date.



## Tax exemption – rental income received by Malaysian resident individuals from a residential property

The [Income Tax \(Exemption\) \(No 2\) Order 2019](#) was legislated on 27 February 2019 pursuant to the Budget 2018 proposal on 50% tax exemption on income received from rental of a residential property (i.e. a house, condominium unit, flat or an apartment which is built as a dwelling house).



The salient points of the above-mentioned exemption are as follows:

### Qualifying person

- A citizen who resides in Malaysia.
- Holds the title to the residential property.

### Effective period

- Year of assessment 2018.  
(Note: This was originally proposed in Budget 2018 to cover the years of assessment 2018 to 2020.)

### Exemption

- 50% of statutory income of a residential property rented out for any period from 1 January 2018 to 31 December 2018.
- Each residential property shall be treated as a separate and distinct source of rent.

### Conditions

- Monthly rental for each residential property shall not exceed RM2,000.
- The rental is made under a duly stamped rental agreement which comes into effect on or after 1 January 2018.

## Stamp duty – guidelines on application for stamp duty relief

The IRB has issued 2 new guidelines on 26 February 2019 to provide guidance on the qualifying conditions to be fulfilled and the procedures to be followed, when applying for stamp duty relief in respect of:

- Instruments made in relation to corporate restructuring schemes, i.e. reconstruction or amalgamation of companies (section 15 relief).
- Instruments made in relation to the transfer of property between associated companies (section 15A relief).

The 2 new guidelines also take into account amendments made via Finance Act 2018 (refer to [TaXavvy Budget 2019 Edition - Part 2](#)). Salient points from the guidelines include:

### **Instruments made in relation to corporate restructuring schemes (Section 15 relief)**

The retention period for holding of shares transferred has been increased from 2 years to 3 years.

(Refer to [Guideline on stamp duty relief under Section 15 of the Stamp Act 1949](#) for details).

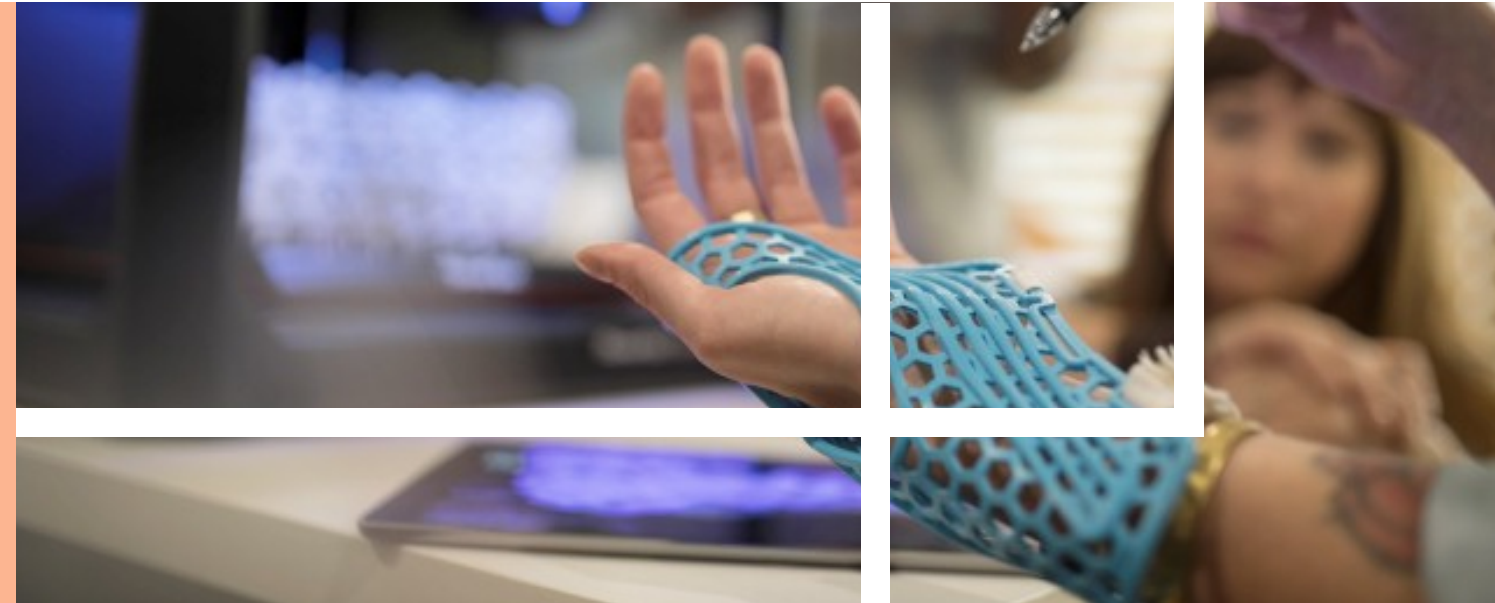
### **Instruments made in relation to the transfer of property between associated companies (Section 15A relief)**

- Consideration for transfer of property is to be settled in full at the time of execution of the instrument.
- In the case of a transfer of business, section 15A relief is only available for instruments of transfer of stocks, shares or marketable securities.
- The requirement to achieve greater efficiency in operation is to be met by both transferor and transferee.

(Refer to [Guideline on stamp duty relief under Section 15A of the Stamp Act 1949](#) for details).

## Status of outstanding gazette orders for proposals from previous Budget announcements

Following dialogues / correspondences between the professional bodies and the Ministry of Finance (MOF), the MOF has provided a status of the outstanding gazette orders for proposals made during previous Budget announcements (Budget 2014 to Budget 2018). The update was provided via MOF's letter dated 14 February 2019 to the Chartered Tax Institute of Malaysia. MOF informed that the gazette orders for most proposals are currently being drafted, except for the following few proposals.



### Halal products

#### Budget 2017 proposal

Expansion of the scope of halal products (nutraceutical and probiotic) eligible for incentives for halal industry players, for applications received by the Halal Development Corporation (HDC) on or after 22 October 2016.

#### Status

This incentive cannot be legislated yet because the HDC Act is not yet legislated.

### 4 and 5 star hotels

#### Budget 2018 proposal

Extension of application period for pioneer status and investment tax allowance for investments in new 4 and 5 star hotels in Peninsula Malaysia, Sabah and Sarawak for another 2 years, for applications received by MIDA from 1 January 2019 to 31 December 2020.

#### Status

No new gazette orders will be issued as this incentive is given under:

- Income Tax (Exemption) (No 11) Order 2006 [PU(A) 112/2006], and
- Income Tax (Exemption) (No 12) Order 2006 [PU(A) 113/2006].

### Green Sustainable and Responsible Investment Sukuk

#### Budget 2018 proposal

Income tax exemption on the Green Sustainable and Responsible Investment Sukuk grant, for applications received by the Securities Commission of Malaysia from 1 January 2018 to 31 December 2020.

#### Status

The exemption will be granted through Ministerial approvals under section 127(3A) of the ITA.

## Public Ruling 1/2019 – Professional Indemnity Insurance

IRB has issued [Public Ruling 1/2019 - Professional Indemnity Insurance](#) (“PR 1/2019”) which supersedes Public Ruling 8/2017 - Professional Indemnity Insurance. The key changes in PR 1/2019 is the insertion of new paragraphs and examples, as set out below.



### Recognition of foreign professional bodies

Professional bodies outside of Malaysia with which professionals are registered, must be recognised by written law or statute in Malaysia.

(Paragraph 5.1 and example 1)

### Taxation of excess insurance proceeds

Insurance proceeds received in excess of compensation payments will be taxed as gross income of the taxpayer under section 22(2)(a)(ii) [gross income under a contract of indemnity] of the ITA.

(Paragraph 8.4 and example 14)

### Taxation of insurance proceeds where tax deduction is not claimed for the insurance premiums

Insurance proceeds will be taxed as gross income of the taxpayer under section 22(2)(a)(ii) even though the taxpayer did not claim tax deduction on the insurance premiums.

(Paragraph 8.5 and example 15)

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