APPENDICES

Investors' Guide

I. Investment Incentives

Malaysia offers incentives for investments in promoted products and activities in the manufacturing, agriculture and services sectors. These incentives are contained in the Promotion of Investments Act 1986 and the Income Tax Act 1967. The incentives are designed to grant partial or to a limited extent total relief from the payment of income tax. Currently, the company income tax rate in Malaysia is 28%.

Apart from direct tax incentives which provide relief from income tax, indirect tax incentives are also given such as exemptions from import duty, sales tax and excise duty.

A. Promotion of Investments Act 1986

Promotion of Investments Acts 1986 provides incentives for the following sectors:

(i) Manufacturing;

(ii) Agriculture;

(iii) Tourism;

- *(a)* theme parks;
- *(b)* 1,2, and 3-star hotels;
- *(c)* expansion of existing hotels;
- *(d)* holiday camps and recreational projects including summer camps; and
- *(e)* convention centers with minimum capacity of 3,000 participants.

(iv) Research and Development (R&D);

(v) Technical or Vocational Training; and

(vi) Multimedia.

Companies intending to undertake activities in those sectors are eligible for the following tax incentives:

1. Pioneer Status or Investment Tax Allowance (ITA);
2. Double Deduction for Promotion of Exports; and
3. Infrastructure Allowance.

A1. Pioneer Status or Investment Tax Allowance (ITA)

Pioneer Status or ITA is given to companies undertaking the following activities:

(i) promoted products/activities;

(ii) high tech products/activities;

(iii) strategic products of national importance including companies given the Multimedia Super Corridor status;

(iv) research and development (R&D);

(v) technical or vocational training (ITA only);

(vi) activities/products of small scale industries (Pioneer Status only); and

(vii) intermediate goods of companies participating in an approved programme of industrial linkages.

Companies granted Pioneer Status or ITA will enjoy full or partial exemption from income tax depending on the activities undertaken as detailed below. Dividends paid out of tax-exempt income to shareholders will also be exempted from tax.

(i) **Promoted Products/Activities**

Companies that intend to produce "promoted products" or undertake "promoted activities" are eligible to apply for the Pioneer Status incentive. The promoted products and promoted activities are gazetted. Pioneer Status is granted taking into consideration the value added, local content, level of technology and the industrial linkages involved in the project. The list of promoted products and promoted activities is continuously reviewed and rationalised to reflect the current industrial policy.

A company given Pioneer Status for producing a promoted product/activity will be given tax exemption on 70% of its statutory income. The period of tax exemption is five years commencing from the Production Day as determined by the Minister of International Trade and Industry. However, companies in promoted areas, i.e. Sabah, Sarawak and the designated 'Eastern Corridor' of Peninsular Malaysia[1] will be exempted on 85% of its statutory income for five years from the Production Day.

As an alternative, the company could apply for ITA. A company granted ITA will enjoy an allowance of 60% with respect to qualifying capital expenditure, within five years from the date it was first incurred. The allowance can be used to set off 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 of the statutory income will be taxed at the prevailing company tax rate. However, companies in the promoted areas, i.e. Sabah, Sarawak and the designated 'Eastern Corridor' of Peninsular Malaysia will be granted an allowance of 80% with respect to the qualifying capital expenditure incurred. The allowance will be used to set off against 85% of the statutory income in the year of assessment.

(ii) **High Tech Products/Activities**

High technology companies, defined as companies engaged in promoted activities or in the production of promoted products in areas of new and emerging technologies, will be granted:

(a) Pioneer Status with 100% exemption of statutory income for a period of 5 years; or

(b) ITA of 60% on qualifying capital expenditure incurred within a period of 5 years. The allowance can be set off against 100% of statutory income for each assessment year.

The broad area identified as promoted products/activities in the new and emerging technologies include advanced electronics, equipment/instrumentation, biotechnology, automation and flexible manufacturing systems, electro-optics and nonlinear optics, advanced materials, opto electronics, software engineering, alternative energy sources and aerospace.

(iii) **Strategic Products of National Importance**

Projects involving strategic products of national importance will be granted:

(a) Pioneer Status with 100% exemption of statutory income for a period of 10 years; or

(b) An ITA of 100% on qualifying capital expenditure incurred within a period of 5 years. The allowance can be set off against 100% statutory income for each assessment year.

To qualify for this incentive, a project should involve heavy capital investment with long gestation period, high technology, integrated, generating extensive linkages and generally having significant impact on the economy.

Companies accorded Multimedia Super Corridor (MSC) Status are also eligible for this incentive in addition to other incentives under the Bill of Guarantees.

The tax incentive accorded to the MSC companies is also extended to multimedia faculties located outside the MSC. A multimedia faculty under the proposed incentive is referred to as a centre of learning which provides courses in media, computer, information technology, telecommunications, communications and contents relating to data, voice, graphics and images.

[1] 'Eastern Corridor' of Peninsular Malaysia covers Kelantan, Terengganu, Pahang and the district of Mersing in Johor.

(iv) Research & Development (R&D) Activities

Different incentives are given to companies specialising in R&D activities, i.e. incentives for "R&D Company" and incentives for "Contract R&D Company". For this purpose companies which carry out designing or prototyping as an independent activity are eligible.

"R&D Company" is a company that provides R&D services in Malaysia to its related company or to any other company. Such a company is eligible for ITA of 100% on the qualifying capital expenditure incurred within 10 years. The ITA can be utilised to set off against 70% 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.

"Contract R&D Company" is defined as a company that provides R&D services in Malaysia to a company other than its related company. Such a company is eligible for Pioneer Status with 100% exemption of statutory income for 5 years. Losses incurred can be accumulated and carried forward to the post tax relief period. As an alternative it is also eligible for ITA of 100% on the qualifying capital expenditure incurred within a period of 10 years to be set off against 70% of statutory income.

The Promotion of Investments Act 1986 also provides incentives for in-house R&D activities. An ITA of 50% is given for in-house R&D on qualifying capital expenditure incurred within 10 years from the date the first expenditure is incurred. This ITA can be used to set off against 70% 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.

Apart from the above incentives, in-house R&D expenditure is also eligible for double deductions as provided for in the Income Tax Act 1967. This will be elaborated later.

(v) Technical Or Vocational Training Activities (ITA Only)

ITA of 100% for a period of 10 years is given to companies that establish technical or vocational training institutes. This allowance can be used to set off against 70% of statutory income in the year of assessment. The balance of that statutory income will be taxed at the prevailing company tax rate.

Companies with existing technical or vocational training institutes and which incur new investment to upgrade their training equipment or expand their training capacities are also eligible for this incentive.

(vi) Activities/Products of Small Scale Industries (Pioneer Status Only)

Pioneer Status, with minimal evaluation, is granted to a small-scale company if it is at least 70% Malaysian owned and it manufactures products or undertakes activities promoted for small scale companies and complies with one of the following criteria:

(a) the company produces components or inputs for supply to the manufacturing industry; or

(b) the company's products are substituting imports and where the local content of the materials used is more than 50% in terms of value; or

(c) the company exports 50% or more of the total production where exports include sales to companies in the Free Zones or Licensed Manufacturing Warehouses; or

(d) the project contributes towards the socio-economic development of the rural population.

For purposes of enjoying tax incentives, a small scale company is defined as a company whose shareholders' funds does not exceed RM500,000.

(vii) **Intermediate Goods of An Approved Industrial Linkages Programme**

Effective from Budget Day 1997, SMIs which produce intermediate goods in an approved industrial linkages programme will be eligible for a Pioneer Status with 100% exemption for 5 years or an ITA of 100% for a period of 5 years. This incentive is similar to that given to high technology products. The eligible intermediate goods are gazetted.

The same SMIs will be granted Pioneer Status with 100% exemption for 10 years or an ITA of 100% for 10 years if the intermediate goods produced are capable of achieving world class standards in terms of price, quality and capacity. This incentive is similar to that given to strategic products. Companies that have already started operations are also eligible but the incentives will only be given on the additional income or the additional investment made by applying the following formula:

(i) For the first year commencing from Production Day:

$A(1+B)$

where:

A = average statutory income for 3 years before Production Day; and

B = inflation rate for the base year.

(ii) From the second year onwards:

$C(1+B)$

where:

B = inflation rate for the base year; and

C = basic income for the following year, adjusted for inflation.

A2. Double Deduction for Promotion of Exports

Certain expenses incurred by resident companies seeking opportunities for the export of manufactured products and agricultural produce are eligible for double deduction. The expenses that qualify are:

(i) overseas advertising;

(ii) supply of free samples abroad;

(iii) export market research;

(iv) preparation of tenders for the supply of goods overseas;

(v) supply of technical information abroad;

(vi) public relations work connected with exports;

(vii) exhibits and/or participation in local or international trade or industrial exhibitions approved by the Ministry of International Trade and Industry (MITI);

(viii) fares in respect of travel overseas by employees of companies for business;

(ix) accommodation and sustenance expenses incurred by Malaysian businessmen going overseas for business, subject to RM200 per day; and

(x) costs of maintaining sales office overseas for the promotion of exports.

This incentive is available to all resident companies and in the case of pioneer companies, the deductions can be accumulated and allowed against their post-pioneer income. As would be elaborated later, this incentive is also granted to companies which promote export services, including tourism.

A3. Infrastructure Allowance

Infrastructure allowance(IA) is available to any company resident in Malaysia engaged in manufacturing, agricultural, hotels, tourism or other industrial/commercial activity in Sabah, Sarawak and the designated 'Eastern Corridor' of Peninsular Malaysia.

A company granted IA will be given an allowance of 100% on capital expenditure incurred on infrastructure such as reconstruction, extension, or improvement of any permanent structure including a bridge, jetty, port or road. The allowance can be utilised 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.

B. Income Tax Act 1967

Income Tax Act 1967 also provides incentives to promote investment in the services sector, reinvestment and other activities.

B1. Incentives For The Services Sector

The incentives are for the following services:

(i) Approved Service Projects;

(ii) Export incentives;

(iii) Shipping Industry;

(iv) Operational Headquarters Company;

(v) International Procurement Centre; and

(vi) In-house Research & Development (Double Deduction).

(i) Approved Service Projects (ASP)

Projects in the transportation, communications and utilities sub-sectors of the services sector approved by the Minister of Finance are eligible for tax incentives either as exemptions given under Section 127 or Investment Allowance (IA) given under Schedule 7B of the Income Tax Act 1967. The quantum available to ASP are based on, among others, the level of investment and technology, its impact on balance of payments and contribution to the economy. The basis and quantum of exemption are as follows:

(a) Exemption Under Section 127, Income Tax Act 1967

The quantum of tax exemption varies between 70% and 100% of statutory income for a period of 5 to 10 years from the date of generation of income. The quantum of exemption available is as follows:

Generally companies undertaking ASP are eligible for exemption of 70% of the statutory income for 5 years. However companies undertaking ASP in Sabah, Sarawak and the designated 'Eastern Corridor' of Peninsular Malaysia will be eligible for exemption on 85% of the statutory income for 5 years. Companies undertaking ASP of national and strategic importance will be eligible for 100% exemption of statutory income for 10 years.

Dividends paid out of tax-exempt income to shareholders will also be exempted from tax. Capital allowances as well as losses unabsorbed have to be utilised during the exemption period and will not be allowed to be carried to the post exemption period.

(b) Investment Allowance (IA) Under Schedule 7B Income Tax Act 1967

The quantum of IA available to companies undertaking ASP varies between 60% and 100% of qualifying capital expenditure incurred within 5 years from the date the qualifying capital expenditure is first incurred. The allowance can be utilised to set off against 70% to 100% of the statutory income. The quantum of allowance available is as follows:

Generally companies undertaking ASP are eligible for IA of 60% on 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. However companies undertaking ASP in Sabah, Sarawak and the designated 'Eastern Corridor' of Peninsular Malaysia will be granted IA of 80% on qualifying capital expenditure incurred within 5 years from the date the capital expenditure is first incurred. The allowances can be utilised to set off against 85% of the statutory income; Companies undertaking ASP of national and strategic importance will be granted IA of 100% on qualifying capital expenditure incurred within 5 years from the date the capital expenditure is first incurred. The allowance can be utilised to set off against 100% of the statutory income.

Dividends paid out of tax-exempt income to shareholders will also be exempted. Any unutilised allowance can be carried to the subsequent years until it is fully utilised.

(ii) **Export Incentives**

Companies engaged in the manufacturing, agricultural and services sectors are given tax exemption as follows:

(a) exemption of statutory income equivalent to 10% of the value of increased exports is given to manufacturers provided that the goods exported attain at least 30% value added;

(b) exemption of statutory income equivalent to 15% of the value of increased exports is given to manufacturers provided that the goods exported attain at least 50% value added;

(c) exemption of statutory income equivalent to 10% of the value of increased exports is given to companies which export fruits and cut flowers;

(d) exemption of statutory income equivalent to 10% of the value of increased exports is given to companies in selected services sector as follows:

(i) legal;

(ii) accounting;

(iii) engineering consultancy;

(iv) architecture;

(v) marketing;

(vi) business consultancy;

(vii) office services;

(viii) construction management;

(ix) building management;

(x) plantation management;

(xi) health; and

(xii) education.

Expenses incurred pertaining to the promotion of export of services are eligible for double deduction. This incentive is available to the entire services sector. For ASP the deductions are allowed to be accumulated and offset against post exemption income. The expenses allowed are as follows:

(a) export market research;

(b) preparation of tenders for supply of services;

(c) supply of technical of information;

(d) fares in respect of travel overseas by employees of companies for business;

(e) accommodation and sustenance expenses incurred by Malaysian businessmen going overseas for business, subject to RM200 per day for lodging and RM100 per day for food; and

(f) cost of maintaining offices overseas for purposes of promotion of services.

Double deduction is also given to hotels and tour operators on expenditure incurred on promotional activities overaseas. The qualifying expenditure are:

(a) expenditure on publicity and advertisements in any mass media outside Malaysia;

(b) expenditure on the publication of brochures, magazines and guide books, including delivery costs that are not charged to the overseas customers;

(c) expenditure on market research into new markets overseas, subject to the prior approval of the Minister of Culture, Arts and Tourism;

(d) expenditure that includes fares to any country outside Malaysia for purposes of negotiating or securing a contract for advertising or participating in trade fairs, conferences or fora approved by the Minister of Culture, Arts and Tourism. Such expenses are subject to a maximum of RM200 per day for lodging and RM100 per day for food for the duration of the stay overseas;

(e) expenditure on organising trade fairs, conferences or fora approved by the Minister of Culture, Arts and Tourism; and

(f) maintenance of a sales offices overseas, for purposes of promoting tourism to Malaysia.

(iii) **Shipping Industry**

The income of a shipping company derived or deemed to be derived from the operations of Malaysian ships is exempted from tax. This incentive is granted to residents only. "Malaysian Ship" means a sea going ship registered as such under the Merchant Shipping Ordinance 1952 (Amended) other than a ferry, barge, tugboat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessels.

Dividends distributed from the income of a shipping enterprise to shareholders will also be exempted from tax.

Presently, there is no import duty on ships weighing more than 26 gross tonnages. However, a 30% import duty is imposed on ships weighing not more than 26 gross tonnages.

(iv) **Incentives For Operational Headquarters Company**

'Approved Operational Headquarters Company' (OHQ) refers to a locally incorporated company that carries on a business in Malaysia of providing qualifying services to its offices or its related companies outside Malaysia.

The qualifying services of an Approved OHQ are as follows:

(a) management and administrative services to its offices or related companies outside Malaysia in respect of:

(i) general management and administration;

(ii) business planning and coordination;

(iii) procurement of raw materials, components and finished products;

(iv) technical support and maintenance;

(v) marketing control and sales promotion planning; and

(vi) data/information management and processing.

(b) treasury and fund management services to its offices or related companies outside Malaysia;

(c) corporate financial advisory services to its offices or related companies outside Malaysia;

(d) research and development work carried out in Malaysia on behalf of its offices or related companies outside Malaysia; and

(e) training and personnel management to its offices or related companies outside Malaysia.

An Approved OHQ is prohibited from providing treasury and fund management services and corporate financial advisory services to non-related companies in Malaysia. Further, an Approved OHQ set up by a financial institution is prohibited from providing treasury and fund management services even to its related companies in Malaysia unless the related companies are institutions licensed under the Banking and Financial Institutions Act (BAFIA) 1989.

Companies granted an Approved OHQ status will enjoy the following fiscal incentives:

(a) **Business Income**

Income arising from services rendered by an OHQ company to its offices or related companies outside Malaysia will be subject to tax at the concessionary rate of 10%.

(b) **Interest**

Income derived from interest on foreign currency loans extended by an OHQ to its offices or related companies outside Malaysia will be subject to tax at the concessionary rate of 10%.

(c) **Royalties**

Royalties received from research and development work carried out in Malaysia by an OHQ on behalf of its offices or related companies outside Malaysia will be subject to tax at the concessionary rate of 10%.

The tenure of the incentives mentioned above are for 5 years from the date of approval of the OHQ status. A further extension of 5 years may be granted subject to the fulfilment of such conditions as specified at the time of approval.

Approved OHQ also enjoy the non-fiscal incentives as follows:

(*a*) expatriate posts will be approved based on expertise, skill requirements and needs of the company. Duration of a work permit will be between 3 and 5 years and the duration of multiple entry visas issued will be equivalent to the length of service of the expatriate in the country;

(*b*) credit facilities in foreign currency without the approval of the Central Bank from any licensed commercial banks and merchant banks in Malaysia, including the licensed offshore banks in Labuan and any non-residents to fund their treasury and fund management operations for their related companies outside Malaysia. The OHQ is not allowed to lend or raise funds in any currency on behalf of any resident;

(*c*) borrowings in Ringgit up to RM10 million without approval from domestic sources for use in Malaysia. Borrowings more than RM10 million require prior approval from the Central Bank;

(*d*) invest freely in foreign securities and lend to related companies outside Malaysia as long as the domestic borrowing in Ringgit is within the RM10 million limit and the remittances are made in foreign currency equivalent;

(*e*) open one foreign currency account or one multi-currency account with any of the Designated Banks to retain export proceeds in foreign currency subject to a limit and conditions specified from time to time by the Central Bank;

(*f*) open one or more foreign currency accounts with the Designated Banks in Malaysia, the licensed offshore banks in Labuan or overseas banks for crediting foreign currency receivables other than export proceeds with no limit on the overnight balances; and

(*g*) use of professional services of a foreign firm if such services are not available locally.

Qualifying Criteria

Companies that have a sizeable network of companies outside Malaysia that is well established and sizeable in terms of assets and employees with a substantial number of qualified professionals, technical and other supporting personnel can apply for an Approved OHQ status. An Approved OHQ to be eligible for the incentives under this scheme should fulfil the following criteria:

(*a*) the paid-up capital of the company should be a minimum of RM0.5 million;

(*b*) the total business spending should be at least RM1.5 million per annum;

(*c*) the company should carry out a minimum of 3 of the qualifying services as listed above;

(*d*) the company should appoint at least 3 senior professional/management personnel;

(*e*) the company should serve at least 3 related companies outside Malaysia; and

(*f*) the company contributes to the Malaysian economy by way of employment opportunities, inflow of foreign funds, utilization of local professional services, etc.

(v) **Incentives For International Procurement Centre (IPC)**

In order to encourage the establishment of IPCs and to make Malaysia a marketing and distribution centre, the following incentives are provided to an approved IPC:

(*a*) the number of expatriate posts approved would be based on the requirement of the IPC;

(*b*) IPC is allowed to open one or more foreign currency accounts with any licensed commercial bank to retain their export proceeds without any limit imposed;

(*c*) IPC is allowed to enter into foreign exchange forward contracts with any licensed commercial bank to sell forward export proceeds based on projected sales;

(d) IPC is exempted from the requirements of the Ministry of Domestic Trade and Consumer Affairs Guidelines on foreign equity ownership on wholesale and retail trade; and

(e) IPC is allowed to bring in raw materials, components in finished products without payment of custom duties into Free Zones or Licensed Manufacturing Warehouse for repacking, cargo consolidation and integration before distribution to the final consumers.

The IPC status is open to both foreign and local companies. An IPC company is allowed to procure and sell raw materials, companents and finished products sourced locally or abroad to either its affiliated or non-affiliated companies. However the company must satisfy the following criteria:

(a) locally incorporated under the Company's Act 1965 with a minimum paid-up capital of RM0.5 million;

(b) a minimum total business spending of RM1.5 million per year; and

(c) a minimum annual business turnover of RM50 million.

The Ministry of International Trade and Industry will act as a "one-stop agency" to process and approve all applications for IPC status.

(vi) In-house Research and Development (Double Deduction)

Apart from ITA of 50% under the Promotion of Investments Act 1986, companies undertaking in-house R&D activities are given incentives under the Income Tax Act 1967 as follows:

(a) Double deduction on revenue expenditure incurred on research approved by the Minister of Finance.

(b) Double deduction on payment for use of services of:

(i) approved research institutions;

(ii) approved research company;

(iii) contract R&D company; and

(iv) R&D company but services sought by related companies do not qualify.

To encourage R&D activities generally, the following incentives are also given:

(a) Double deduction on cash contributions made to approved research institutions;

(b) The tax treatment relating to gifts of used machinery or equipment, by a donor to an approved research institute, will deem the disposal value of such machinery or equipment as zero. Any unutilised capital allowance (residual expenditure) with respect to that item will be given full deduction in the year of assessment in which the donation was made; and

(c) Industrial Building Allowance for buildings used to carry out approved research projects or used by approved research companies for purposes of carrying out research.

B2. Reinvestment Allowance

Income Tax Act 1967 provides Reinvestment Allowance (RA) to encourage existing companies to reinvest. The allowance is granted to companies in the manufacturing and agricultural sector that incur qualifying capital expenditure for the following purposes:

(i) expansion of production capacity; or

(ii) modernisation and upgrading of production facilities; or

(iii) diversification into related products; or

(iv) automation of production facilities.

RA of 60% could be used to set off against 70% of statutory income. However, from year of assessment 1998, if the reinvestment made results in a significant increase in productivity than the RA of 60% could be utilised to set off against 100% of statutory income. This incentive is similar to the RA given to companies in the 'Eastern Corridor' of Peninsular Malaysia, Sabah and Sarawak.

The granting of RA is subject to the following conditions:-

(a) the reinvestment must result in an increase in productivity;

(*b*) the company must be in operation for at least 12 months;

(*c*) RA is given for a period of 5 years beginning from the year the first reinvestment is made; and

(*d*) Assets acquired from RA cannot be disposed within 2 years of reinvestments.

The basis to claim RA has also been adjusted to be in line with the claim for capital allowance that is, RA is to be claimed when the building or machinery is ready for operation.

For the agricultural sector, RA is only made available to encourage production of essential food as follows:

(*a*) rice;

(*b*) maize;

(*c*) vegetables;

(*d*) fruits;

(*e*) tubers;

(*f*) livestock farming;

(*g*) production of aquatic products; and

(*h*) any other activities approved by the Minister.

B3. Other Promoted Activities

Income Tax Act 1967 also provides incentives for other activities that are additional to those provided under the Promotion of Investments Act 1986. The nature and objectives of the incentives are briefly described in the following paragraphs:

(i) **The Use of Computers**

Effective from the year of assessment 1996, computer and information technology assets will be entitled to an initial allowance of 20% and an annual allowance of 40% to enable the full amount to be written off within a period of 2 years.

(ii) **Protection of Environment**

Effective from the year of assessment 1996, environmental protection equipment will be entitled to an initial allowance of 40% and an annual allowance of 20% to enable the full amount to be written off within a period of 3 years.

(iii) **Industrial Building Allowance for Approved Buildings**

Industrial Building Allowance (IBA) is granted to industrial buildings and buildings used for purposes of warehouse bulk storage of goods for export, approved research projects and approved research companies, hotel businesses and approved service projects. The IBA has an initial allowance of 10% and an annual allowance of 2%.

(iv) **Special Building Allowance for Education**

To encourage private sector involvement in providing education, qualifying expenditure on the purchase or construction of building for use as a school or an educational institution and technical or vocational training institutes will qualify for special building allowance of one-tenth of that expenditure annually for a period of 10 years.

(v) **Special Building Allowance for Accommodation for Employees**

To assist employers to retain their labour force and as a benefit to employees, qualifying expenditure on the purchase or construction of buildings for accommodation of employees in manufacturing businesses will be given a special building allowance of one-tenth of that expenditure annually for a period of 10 years. Effectives from year of assessement 1997, the special building allowance is extended to approved services sector including tourism.

(vi) **Special Building Allowance for Child Care Facilities for Employees**

To encourage employers to establish child care facilities for their employees, thereby retaining the female workforce, qualifying expenditure on the construction or purchase of a building for such purposes will be given a special building allowance of one-tenth of that expenditure annually for a period of 10 years.

(vii) **Industrial Building Allowance For Warehousing Facilities**

Warehouse buildings which are used for export and re-export are given a special allowance which is one-tenth of the expenditure incurred on construction or purchase of the building.

(viii) **Capital Allowance For Heavy Machinery**

Heavy machinery used in the building, construction and primary industry (mining, logging and forestry) are eligible for capital allowance as follows:

(a) local heavy machinery is eligible for initial allowance of 20% and annual allowance of 20%, 16% or 12%; and

(b) imported heavy machinery is eligible for initial and annual allowance of 10%.

(ix) **Double Deduction for Training**

Double deduction is given for expenses incurred on an approved training programme undertaken by manufacturing and non-manufacturing companies. This incentive, however, is available only to those companies that are not yet required by law to contribute to the Human Resource Development Fund (HRDF). For the manufacturing sector, the programme could be undertaken either as an in-house training or at approved training institutions. However, for the non-manufacturing sector, the training should be undertaken at approved training institutions only.

(x) **Gifts of Used Machinery & Cash Contributions**

The tax treatment relating to gifts of used machinery or equipment, by a donor to a technical or vocational training institute established and maintained by the Government or statutory body or technical or vocational training institute approved by the Minister of Finance, will deem the disposal value of such machinery or equipment as zero. Any unutilised capital allowance (residual expenditure) with respect to item will be given full deduction in the year of assessment in which the donation was made.

Single deduction is given for contribution in cash to a technical or vocational training institution established and maintained by a statutory body.

(xi) **Pre Employment Training**

Training expenses prior to commencement of business incurred by companies, besides small and medium scale manufacturing companies are eligible for single deduction. Companies are required to provide evidence that the trainees will be employed as its employees.

(xii) **Deduction for Capital Expenditure on Approved Agricultural Projects**

Schedule 4A of the Income Tax Act 1967 allows a person carrying on an approved agricultural project to elect so that the qualifying capital expenditure incurred by him with respect to that project is deducted from his aggregate income, including income from other sources. Where there is insufficient aggregate income, the unabsorbed expenditure will be carried forward to subsequent years of assessment. Where he so elects, the project will not be entitled to any capital allowance or agricultural allowance on that same capital expenditure.

The qualifying capital expenditure eligible for deduction for purposes of this incentive is as follows:

(a) the clearing and preparation of land;

(b) planting of a new crop related to an approved agricultural project (replanting is deductible under section 34(6)(d));

(c) the construction of roads or bridges in estate areas;

(*d*) the construction of buildings in estate areas under approved agricultural projects or the construction of buildings on estate areas for the welfare and housing of the relevant workers; and

(*e*) the construction of a pond or the installation of an irrigation or drainage system used for the purposes of an approved agricultural project.

An approved agricultural project means an agricultural project approved by the Minister of Finance. Only qualifying capital expenditure incurred within a specific period and with respect to a farm having a specified minimum acreage for each approved project as stipulated by the Minister of Finance will qualify.

(xiii) **Double Deduction of Export Credit Insurance Premiums**

To encourage exporters to penetrate into non-traditional markets, premium payments on export credit insurance are eligible for double deduction with effect from the year of assessment 1986.

(xiv) **Special Incentives for Rattan and Wood-Based Products**

Manufacturers in Sabah and Sarawak who export rattan and wood-based products (excluding sawn timber and veneer) will be eligible for double deduction on freight charges incurred by them. Besides, they also enjoy full exemption of import duty on raw materials or components used in the manufacture of all rattan and wood-based products.

(xv) **Industrial Adjustment**

Companies in operation before 31 December 1990 in the wood-based, textile, machinery and engineering industries 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 industry in the manufacturing sector to restructure by way of reorganisation, reconstruction or amalgamation within that particular sector to strengthen the basis for industrial self-sufficiency, improving industrial technology, increasing productivity, enhancing the efficient use of natural resources and the efficient management of manpower.

The companies participating in approved industrial adjustment programmes are eligible for existing double deduction incentive schemes for approved training and approved R&D and the Industrial Building Allowance for buildings used for approved industrial training and R&D.

Companies undertaking approved industrial adjustment programmes are also eligible for the Industrial Adjustment Allowance (IAA). The IAA provides for an allowance of up to 100% on qualifying capital expenditure incurred by a manufacturing company in its efforts at undertaking 'industrial adjustment'. The salient features of the IAA are:

(*a*) The 'industrial adjustment' programme has to be approved by the Minister of International Trade and Industry and the Minister of Finance.

(*b*) The IAA is given for qualifying capital expenditure incurred within five years from the date of approval of the incentive.

(*c*) Companies enjoying ITA shall only be eligible to apply for IAA on capital expenditure on which ITA has not been granted.

(*d*) Companies granted IAA will not be eligible for Reinvestment Allowance in respect of the same expenditure.

Besides the above, an Industrial Adjustment Fund has been set up for companies undertaking the restructuring programmes. The Industrial Adjustment Fund provides loans to qualifying companies at concessionary rates.

(xvi) **Tax Exemption for Tour Operators and Convention Organisers**

Tour operators who bring in at least 500 foreign tourists a year through group inclusive tours that enter and exit the country either by air, sea or land, will be exempted from tax in respect of income derived from the business of operating such tours. This incentive is effective until the year of assessment 2000. It will be given to travel operators who are registered and approved by the Ministry of Culture, Arts and Tourism.

Effective from the year of assessment 1997, local companies which promote international conferences in Malaysia will be eligible for income tax exemption on income earned from bringing at least 500 foreign participants into the country.

(xvii) **Overseas Investments**

Resident companies that invest overseas and remit their income derived from overseas to Malaysia will be given tax exemption. However, this exemption does not apply to income from banking, insurance and sea and air transport businesses.

Besides this, an approved overseas investment project is also allowed to deduct pre-operating expenses, such as expenses for market research.

(xviii) **Proprietary Rights**

Effective from year of assessment 1997, expenditure incurred on acquiring patents, designs, models, plans, trade marks or brand names is allowed as capital allowance deduction in the computation of income tax. The expenditure allowed should be relevant to the acquisition and related expenses such as stamp duty and legal fees.

(xix) **Companies in the Programme to Strengthen Industrial Linkages**

Effective from the year of assessment 1997, expenditure incurred by large companies including MNCs to assist SMIs as suppliers of components under the approved scheme to strengthen industrial linkages is allowed as a deduction in the computation of income tax. The expenditure allowed includes expenditure incurred for the training of employees, product development and testing and factory auditing to ensure the quality of vendors' products.

(xx) **Incentives To Encourage The Use Of Natural Gas For Vehicles (NGV)**

The following incentives are provided to encourage the use of NGV:

(a) Initial capital allowance of 40% and an annual allowance of 20% to be fully written off within a period of 3 years will be given to transport companies operating buses that only use natural gas; and

(b) Initial capital allowance of 40% and an annual allowance of 20% to be fully written off within a period of 3 years on equipment needed to provide NGV facilities at petrol stations as follows:

- (i) gas compressor units;
- (ii) ground storage cascade;
- (iii) dispenser units;
- (iv) control panels;
- (v) electric control panels; and
- (vi) others such as compressor bays, electric cables and high pressure pipes.

(xxi) **Incentives To Promote Malaysian Brand Names**

Starting from 1 January 1997, expenditure incurred on advertising of local brand products locally, for example advertisement on a billboard at a strategic location, is given double deduction for income tax purposes. To be eligible, the local brands must satisfy the following criteria:

(a) the company is at least 70% Malaysian owned;

(b) the brand is owned by the company and is registered in Malaysia; and

(c) the product must achieve export quality standards.

C. Customs Act 1967, Sales Tax Act 1972, Service Tax Act 1975 and Excise Act 1976

Besides direct tax incentives which are provided under the Income Tax Act 1967 and the Promotion of Investments Act 1986, the Government also provides a number of indirect tax incentives under a number of Acts such as the Customs Act 1967, Sales Tax Act 1972, Service Tax Act 1975 and Excise Act 1976. These indirect tax incentives are as follows:

(i) **Tax exemptions on machinery/equipment**

Companies in eligible sectors are given full import duty and sales tax exemption on machinery and equipment which are directly used in the promoted activity but are not manufactured locally. Companies are eligible for sales tax and excise duty exemptions if the machinery is purchased from local manufacturers. Eligible sectors are as follows:

(a) manufacturing including production and post-production of film and video;

(b) agriculture;

(c) tourism project operators including convention centres;

(d) hotels (for specified equipment only);

(e) companies given the Multimedia Super Corridor status for multimedia equipment;

(f) companies given the Approved Service Project status;

(g) companies specialising in R & D; and

(h) companies carrying out technical or vocational training and which have been approved of ITA incentive, and training institutes approved by the Minister of Finance.

For companies under (g) and (h) above, machinery and equipment that are imported are also eligible for import duty and sales tax exemption even though they may be available locally.

For approved companies in the manufacturing and service sectors, apart from those used directly in production/activities, machinery and equipment used for the following purposes is also eligible for sales tax and import duty exemption:

(a) control of environmental pollution;

(b) in-house research; and

(c) in-house training.

In the 1997 Budget, exemption of import duties on spares and consumables used in manufacturing activities by companies operating in Principal Customs Areas (PCA) was withdrawn. However, spares and consumables obtained under the following circumstances are still eligible for exemptions:

(a) spares and consumables sourced locally;

(b) replacement parts required for research and development and for approved training;

(c) spares and consumables which are imported together with equipment/machinery required to start a new business (only if the quantity imported is within the norms of the industry);

(d) spares and consumables used by non-manufacturing industries such as the film and agriculture industries, and companies operating in LMW/FIZ which are not produced in the PCA;

(e) spares and consumables imported for expansion and modernisation projects including upgrading are given tax exemptions as in the case for new operations. For this purpose modernisation and upgrading must result in the improvement in quality or increased capacity or in compliance of legal requirements such environmental laws;

is only applicable to distinctly assembly-based industries, such as the automotive, the electronic and electrical industries.

Nevertheless exemption of import duty on components for assembly-based industry may still be considered for the following:

(*a*) companies operating in the 'Eastern Corridor' of Peninsular Malaysia, Sabah and Sarawak. However, the companies will not be given exemption if the component is produced locally;

(*b*) the finished products are not subject to import duties;

(*c*) SMI companies that are participating in the Entrepreneur Development Programme under the Ministry of Finance, the ILP Programme under MITI and the Vendor Development Programme under the Ministry of Entrepreneur Development even if the goods can be obtained from local producers;

(*d*) indirect exports where the company sells to local manufacturers who export their finished products. However, the company will not be given exemption if the relevant component is produced locally; and

(*e*) components not manufactured in Principal Customs Area and which are purchased from companies operating in LMW/FIZ.

(iii) **Abolition or Exemption of Indirect Tax for the Tourism Sector**

(*a*) Abolition of import duty and sales tax for tourist items such as pewterware, cameras, watches, lighters, fountain pens, transistor radios, perfumes and cosmetic products;

(*b*) Service tax exemption is given to budget class hotels that have less than 25 rooms;

(*c*) Service tax is abolished in Labuan and Langkawi;

(*d*) Import duty and excise duty on completely-knocked-down (CKD) components for locally assembled tourist buses are abolished; and

(*e*) Import duties and sales tax exemption on machinery and equipment produced locally or imported (specified items) for use by hotels and other related accommodation as well as approved tourism related projects. However, effective from Budget Day 1997, tax exemption on certain imposed hotel equipment is withdrawn. Equipment such as those which are essential for security and those required for the hygienic preparation of food will continue to be eligible for import duty and sales tax exemption if there are not produced locally. The equipment are as follows:

(i) electronic security system;

(ii) generator sets;

(iii) high/medium speed lifts;

(iv) boilers;

(v) laundry equipment;

(vi) dish washing machines;

(vii) centralised air conditi system equipment; and

(viii) freezers and cold ro equipment.

Sales tax and excise duties exemp will be given on the following it if they are sourced locally:

(i) marble, tiles, sandsto granite (lobby only);

(ii) sanitary ware and fittin

(iii) locks;

(*f*) spares and consumables used by SMIs that are participating in the Entrepreneur Development Programme under the Ministry of Finance, the ILP under MITI and the Vendor Development Programme under the Ministry of Entrepreneur Development.

(*g*) spares and consumables that attract import duty more than 5% and have no potential to be produced locally. The exemption is from 18 April 1998 till 31 October 1999;

(*h*) export oriented companies which export at least 80% of their products. The exemption is from 18 April 1998 till 31 October 1999; and

(*i*) spares and consumables which have too small and limited domestic demand. The exemption is from 18 April 1998 till 31 October 1999.

Replacement parts and consumables include the following goods/material:

(*a*) replacement parts for machinery/ equipment used directly in the production process such as screws and bolts, filters, valves, gaskets and refractory bricks; and

(*b*) organic and inorganic consumables used directly or indirectly in the process but not embodied in the finished product such as grinding stones, sandpaper and catalysts.

Moulds and dies are not considered as spare parts and consumables, as such they are still eligible for tax exemption.

(ii) **Tax Exemption on Raw Materials/ Components**

Companies in the manufacturing sector are eligible for import duty exemption on imports of raw materials/components which are directly used in the production process and are not produced locally. Nevertheless, for the export market, tax exemption may still be considered if the locally produced material is not competitive in terms of its quality or price.

The level of import duty exemption on raw materials/components depends on the market for the respective product. For the export market full exemption will be given. For the domestic market, full exemption will only be given under the following conditions:

(*a*) the finished products (made from the dutiable raw materials/components) are not subject to import duties;

(*b*) the company concerned has complied fully the Government's policy guidelines in relation to the ownership of shares, management and employment structure in all categories;

(*c*) companies located in the 'Eastern Corridor' of Peninsular Malaysia, Sabah and Sarawak. For projects in Sabah and Sarawak, exemption will also be given if the raw materials/ components are not produced in the respective states; and

(*d*) SMI companies participating in the Entrepreneur Development Programme under the Ministry of Finance, the ILP Programme under MITI and the Vendor Development Programme under the Ministry of Entrepreneur Development even if the goods can be sourced locally.

Under other circumstances, raw material/ components used in production for the domestic market will only be given partial exemption where the company is normally required to pay 2% or 3% of import duty. Where the raw material/components are subjected to 3% import duty or less, no tax exemption will be considered.

Effective from 26 October 1996, the level of import tax exemption on components for the assembly-based industries geared for the domestic market will be gradually reduced. Initially, for imported components with a 5% a.v. duty and above the company will have to pay at least 5% a.v. imported duty. For imported components with an import duty of less than 5% a.v. the company will continue to pay duty according to prevailing rates. At present the policy

(iv) laundry equipment;

(v) generator sets;

(vi) audio visual equipment;

(vii) restaurant and kitchen equipment;

(viii) air conditioning equipment;

(ix) telephone and PABX systems;

(x) boilers;

(xi) safes;

(xii) refrigerators (for rooms);

(xiii) carpets (lobby only);

(xiv) linen;

(xv) lifts; and

(xvi) chandeliers.

(iv) **Tax Exemption To Encourage The Use Of Natural Gas For Vehicles (NGV)**

To encourage the use of natural gas for vehicles (NGV) the following indirect tax incentives are given:

(a) the retail price of NGV has been fixed at half the retail price of petrol, determined through the automatic price mechanism for petroleum products;

(b) import duty exemption on equipment for the conversion of petrol/diesel vehicles to NGV;

(c) import duty and sales tax exemption for the conversion of vehicles to use natural gas. This exemption is given to local vehicle assemblers/ manufacturers;

(d) a 50% reduction in road tax from the prevailing rates for monogas vehicles (solely powered by gas);

(e) a 25% reduction in road tax from the prevailing rates for bi-fuel vehicles (petrol vehicles modified to use NGV); and

(f) a 25% reduction of road tax from the prevailing rates for dual-fuel vehicles (diesel vehicles modified to use NGV).

(v) **Exemption of Service Tax**

Effective from 1 January 1997, service tax exemption is given to:

(a) export of professional services;

(b) services rendered by approved research and development companies;

(c) services rendered by private hospitals except in the provision of accommodation and food; and

(d) services rendered in Federal Territory of Labuan and Langkawi.

D. Non-Tax Incentives

A number of other non-tax incentives are also provided to spur the private sector to take advantage of investment opportunities that will assist the development of the Malaysian economy. These incentives include:

1. Export Credit Refinancing Facilities;
2. Export Credit Insurance and Guarantee Schemes; and
3. Industrial Technical Assistance Fund.

D1. Export Credit Refinancing Facilities

Under the Export Credit Refinancing (ECR) Scheme which is currently administered by the Export-Import Bank of Malaysia Berhad (EXIM Bank) effective from 1 January 1998 (previously the Scheme had been administered by the Central Bank of Malaysia), direct and indirect exporters of eligible manufactured goods, agricultural products and selected primary commodities can obtain short-term financing for purposes of exports under the pre-shipment and post-shipment ECR from the commercial banks (ECR banks) at competitive rates of interest.

(i) **Post-shipment Facility**

Exporters of eligible products, who export on usance or credit terms of a minimum of 30 days, may obtain post-shipment ECR upon shipment of their goods. The period of financing is by the period of credit extended by the exporter to the foreign buyer, but subject to a minimum of seven days and a maximum of six months. The maximum amount of refinancing is 100% of the value of the export, subject to a maximum limit of RM50 million loans outstanding at any one time, while the minimum amount eligible for refinancing is RM10,000. The post-shipment ECR loans must be liquidated on or before their maturity date or upon receipt of the export proceeds, whichever is earlier.

(ii) **Pre-shipment Facility**

Exporters of eligible products and their domestic suppliers of input materials can obtain pre-shipment ECR to finance their working capital for production of goods for export. For trading companies, they can obtain pre-shipment ECR to finance their purchase of domestic intermediate/final products from local suppliers for export. The period of financing is between the receipt of an export order and the time of export, subject to a maximum period of four months. The maximum amount of refinancing under this facility is 80% of the export order value, subject to a maximum limit of RM50 million loans outstanding at any one time. Direct exporters possessing the following characteristics are eligible to utilise the order-based method:

(a) new exporters, whose tenor of their export business is less than 12 months; or

(b) exporters whose maximum exports of eligible goods for the last financial year and the preceding 12 months is less than RM1 million; or

(c) seasonal exporters.

Domestic input suppliers may have access to the pre-shipment ECR facility through the issuance of an ECR Domestic Letter of Credit (DLC) or the ECR Domestic Purchase Order (DPO) issued by the exporters in their favour. The maximum amount of refinancing for the domestic input suppliers are 80% of the ECR DLC or the ECR DPO value, subject to a maximum limit of RM50 million loans outstanding at any one time.

As an alternative, direct exporters may have access to the pre-shipment ECR facility through the Certificate of Performance (CP) method. To utilise the CP-based method, direct exporters must have exported a minimum of RM1 million of eligible products during the last financial year and the preceding 12 months. Application for a CP shall be made to EXIM Bank, through an ECR bank. The validity period of a CP is 12 months, while the maximum eligible amount is 70% of the export value during the preceding 12 months. The eligible amount is segregated into three periods of four months each, subject to a maximum refinancing amount of RM50 million per period.

The pre-shipment ECR loans must be liquidated, on or before their maturity date or upon receipt of the export proceeds and post-shipment proceeds, whichever is earlier. For loans extended to the domestic suppliers on the ECR DLC/DPO basis, the loans are to be liquidated upon receipt of payment from the buyer's bank or upon maturity of the loan, whichever is earlier.

Goods not specified in the Negative List of the ECR Scheme (Appendix 2 of the ECR Guidelines) would be eligible for financing, subject to fulfilling the criteria of having a minimum local content of 30% and a minimum value added of 20%. Exporters, whose products do not meet these criteria, may apply to EXIM Bank for special consideration on a case-by-case basis. Exemption from the local content and value added criteria are, however, extended to agricultural products, selected primary commodities, wood articles, base metals and textiles (refer to Appendix 3 of the ECR Guidelines). Further details on the ECR Scheme are available in the "Guidelines on Export Credit Refinancing Facilities" issued by EXIM Bank.

D2. Export Credit Insurance and Guarantee Schemes

Malaysia Export Credit Insurance Berhad (MECIB), incorporated in 1977 is the only national export credit agency in Malaysia, and is a who owned subsidiary of Bank Industri Malaysia Berhad, a Government development financial institution.

MECIB's objective is to support and strengthen the export promotion drive in Malaysia by providing a range of export credit insurance and guarantee services. The most tangible is the protection provided by MECIB under its contracts of insurance whereby it undertakes to indemnify its policyholders of their losses arising from any of the following causes:

Risks Covered

(i) **Commercial Risks - 90% of their losses:**

(a) Buyer's insolvency;

(b) Buyer's default; and

(c) Buyer's repudiation of contracts.

(ii) **Country Risks or Non-Commercial Risk - 95% of their losses:**

(a) Blockage or delay in the transfer of payments to Malaysia;

(b) War, revolution and other annoyances, including war between buyer's and exporter's country;

(c) The imposition of import restrictions and Import licence cancellation;

(d) Cancellation of export licences; and

(e) The default of a foreign Government buyer.

Facilities Offered

(a) **Insurance Policies**

(i) **Comprehensive Policy (Shipments)**

This policy covers non-payment resulting from commercial/ country risks in respect of goods and commodities exported on credit terms of not more than 180 days. Where the products involved require longer credit, then credit up to 270 days can also be insured. The cover commences from the date of shipment. Percentage of cover is up to 95% of the amount of loss.

(ii) **Comprehensive Policy (Contracts)**

This policy covers goods specifically produced under a contract of sale for overseas buyers especially where loss can be sustained in the event of the contract being frustrated in the pre-shipment period. Hence, cover commences from the date of the contract. Percentage of cover is up to 95% of the amount of loss.

(iii) **Specific Policy (Tailor Made)**

This policy covers export of capital or semi-capital goods and/or services with lengthy manufacturing and/or payment periods and high contract values. It is tailored to the needs and features of each project or manufacturer in Malaysia. The credit terms must be for a minimum of two years and the policy is issued on a one-off project basis. Cover is effective from the date the contract is signed. Percentage of cover is up to 95% of the amount of loss.

(iv) **Banker's Comprehensive Policy (Shipments)**

This policy is issued to the bank in order to improve post-shipment financing access by the non-payment by the buyer on the export bills discounted in favour of the exporter. Percentage of cover is up to 95% on the amount of loss sustained by the bank.

(v) **Domestic Credit Insurance**

This policy indemnifies up to 85% on the loss arising from the buyer's bankruptcy and the buyer's protracted default.

(b) **Short Term Bank Guarantees**

(i) **Banker's Export Finance Insurance Policy (BEFIP)**

BEFIP facilitates short-term pre-export working capital financing through commercial banks especially for Small