Recovering From Covid-19: Tax Measures and Incentives in Malaysia



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In this three-part series, Wong & Partners discuss introduced tax incentives that may be available to multinational enterprises (MNEs) that are contemplating the restructuring or expansion of their operations into Malaysia. Part 1 of this series looks at the recent tax incentives that have been introduced by the Malaysian government in view of the Covid-19 pandemic. Parts 2 and 3 of the series focus on the medical device manufacturing sector and the digital economy sector respectively. Further, Wong & Partners discuss tax incentives-related challenges that may arise during the pandemic.

Faced with the threat of severe national-level economic hardship caused by Covid-19, the Malaysian government has made a concerted effort to support the economy while trying to contain the pandemic. Covid-19 survival and recovery packages have been introduced, which supplement the substantial tax incentives already on offer in Malaysia. As MNEs renew their supply chain models and contemplate the geographic expansion or diversification of their operations, Malaysia's array of tax incentives will be of interest during and beyond the Covid-19 crisis.

Even before Covid-19 hit the world, Malaysia had a focused objective in creating a business-friendly environment to attract foreign direct investment. The corporate income tax rate is currently 24%, and Malaysia has negotiated and entered into double taxation agreements with more than 70 jurisdictions including Australia, Canada, China, France, Germany, Hong Kong, India, Indonesia, Japan, Netherlands, Singapore, South Korea, Switzerland, the U.K., and Vietnam.

While hitting the mark on attributes that are attractive to investors, Malaysia adheres to international standards such as those recommended in the Organization for Economic Co-operation and Development/G-20 base erosion and profit shifting (BEPS) package. As a member of the Inclusive Framework on BEPS, Malaysia has upgraded its laws and policies so that they are consistent with the BEPS minimum standards, including the recommendations in Action 5 on countering harmful tax practices.

Generally, tax incentives in Malaysia are governed by the Promotion of Investments Act 1986 and the Income Tax Act 1967. These Acts cover investments in key areas including manufacturing, agriculture, tourism (including hotels), and certain services sectors. Under the Eleventh Malaysia Plan 2016–2020, the national development strategy of Malaysia is to increase efforts to attract investment in high impact programs and projects in identified niche cluster activities.

In addition, a region-centric approach within Malaysia has been encouraged among the states in Malaysia to complement and leverage the strengths and resources available for economic growth. For example, the Northern Region, which includes Penang, Kedah, Perak, and Perlis, has focused on promoting manufacturing activities in the medical device, bio-industries, machinery and equipment, electrical and electronics, and aerospace sectors. Key manufacturing facilities of

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global industrial leaders in these sectors are located in the region's industrial parks.

When Covid-19 Hit Malaysia: Government Support Measures

Much like the rest of the world, Malaysia was hit abruptly by Covid-19. The Malaysian government responded swiftly and aggressively in the early stage of the pandemic by committing about 280 billion Malaysian ringgit (approximately $68 billion) by way of three economic stimulus packages on February 27, March 27, and April 6, 2020, which mitigated the hardships faced by businesses and individuals in Malaysia. The latest stimulus package amounting to 40 billion Malaysian ringgit was announced on May 31, 2021, amid the implementation of another full movement control order as Malaysia battled a fourth wave of new Covid-19 cases.

These packages included various tax measures. For example, companies could claim tax deductions on expenses incurred to provide employees with disposable personal protective equipment (PPE), and capital allowances for non-disposable PPE expense.

On June 5, 2020, the Malaysian government went further to unveil the National Economic Recovery Plan (*Pelan Jana Semula Ekonomi Negara*, or PENJANA). The Recovery phase is the fourth of a six-stage approach—Resolve, Resilience, Restart, Recovery, Revitalize, and Reform—to counter the economic fallout from the Covid-19 pandemic. PENJANA involves 40 initiatives worth approximately 35 billion ringgit, of which 10 billion ringgit is in the form of direct fiscal injection by the government.

PENJANA includes a number of tax incentives which may be relevant to MNEs with business operations in Malaysia as well as potential investors. Subsequently, an economic stimulus package involving 10 billion ringgit was announced in September 2020 to boost economic recovery, and the Strategic Programme to Empower the People and Economy (PEMERKASA) worth 20 billion ringgit, which focuses on targeted assistance to the people and sectors that are still affected by Covid-19, was launched in March 2021.

Tax Incentives

To attract foreign companies to relocate their businesses to Malaysia, the following tax incentives, among other measures, were announced under PENJANA. These tax incentives will be of interest to MNEs in key industries such as the chemicals, electrical and electronics, machinery and equipment, aerospace, and medical device industries. Applications for these incentives can be made to the Malaysian Investment Development Authority (MIDA) between July 1, 2020 and December 31, 2022 (the Malaysian government has proposed to extend the application deadline from December 31, 2021 under Budget 2021).

Full income tax exemption (i.e., 0% tax rate) for new investment in manufacturing sectors

The number of years in which the full income tax exemption is available to a manufacturing company is dependent on the value of capital investment of the company:

- 10 years' tax exemption where the company makes capital investments of between 300 million ringgit to 500 million ringgit within three years from the approval of the incentive;

- 15 years' tax exemption where the company makes capital investments of more than 500 million ringgit within three years from the approval of the incentive.

The company must incur the first capital expenditure within one year from the date of approval of the incentive.

100% investment tax allowance

Existing companies in Malaysia that relocate their overseas facilities into Malaysia will be able to apply for a 100% investment tax allowance for five years.

Further, under Budget 2021, the Malaysian government has proposed to extend the availability of these incentives to companies in selected services sectors, including companies adopting Industrial Revolution 4.0 and digitalization technology with investments that contribute to a significant multiplier effect in:

- the provision or development of technology solutions, based on substantial scientific or engineering challenges;

- the provision of infrastructure and technology for cloud computing;

- research and development or design and development activities;

- medical devices testing laboratory and clinical trials; and

- any other services as determined by the Minister of Finance.

The tax incentives for the services sector will take the form of a preferential income tax rate of between 0% to 10% for up to 10 years (for new companies) and a preferential income tax rate of 10% for up to 10 years (for existing companies with new service activities).

Additionally, a reinvestment allowance incentive was announced under PENJANA to encourage the reinvestment activities of existing companies.

Fulfillment of Tax Incentive Conditions During the Pandemic

Another point we wish to address is an issue that may arise as a result of the economic and other effects of the Covid-19 pandemic. Incentives awarded by the Malaysian government often include conditions for the achievement of certain targets or milestones in respect of capital and operational expenditure. However, businesses in many industries have experienced production slowdowns, supply chain disruptions, and reduced demand. Consequently, they may face difficulties meeting tax incentive conditions such as expenditure targets.

Typically, tax incentive conditions do not account for extraordinary events such as the Covid-19 pandemic. Companies that have been awarded incentives by the Malaysian government will need to review the conditions (for example, if there is any stipulation regarding expenditure for the year 2020 and beyond) to determine whether there may be difficulties meeting them as a result of the pandemic.

If the conditions are not met, there may be significant tax consequences—the tax authority may revoke the incentive on a retrospective basis and claw back unpaid taxes over the period of the incentive. Companies with existing tax incentives that find themselves unable to fulfill certain conditions as a result of the pandemic should consider reaching out to the Malaysian government to discuss potential options.

As for companies that are applying for new incentives, this is an opportune time to highlight to MIDA the challenges they may realistically face in the next few years as the world recovers from Covid-19, and negotiate for conditions that take into account these challenges.

Planning Points

We are hopeful that national policymakers will think through the Covid-19-related challenges that businesses will realistically face in the coming months, and push for the introduction of more targeted measures, incentives, and policies. In the meantime, the substantial PENJANA tax incentives and array of tax incentives already on offer in Malaysia will be a useful starting point for MNEs as they re-imagine strategies and consider diversifying their operations into new geographical locations.

MNEs which have already been planning expansion into this region or are considering expansion can seriously consider Malaysia as a potential destination to locate their operations, given the attractive tax incentives as well as other non-fiscal benefits that Malaysia offers. Such non-fiscal benefits include a good and affordable talent pool, relatively low operating costs, good infrastructure and transportation linkage, the wide usage of the English language, and a business-friendly environment.

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