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PN No. 1/2022 – Explanation in Relation to the Definition of Factory for the Purpose of Reinvestment Allowance Claim under Schedule 7A, Income Tax Act 1967

The Inland Revenue Board has recently issued the *Practice Note* ["PN"] 1/2022 – *Explanation in Relation to the Definition of Factory for the Purpose of Reinvestment Allowance Claim under Schedule 7A, Income Tax Act 1967* ["ITA 1967"] dated 17th January 2022 to explain the meaning of "factory" stated in paragraph 9, Schedule 7A of the ITA 1967.

- Moore Malaysia
- Moore Global
- Inland Revenue Board

Factory means “portion of the floor areas of a building or an extension of a building used for the purposes of a qualifying project to place or install plant or machinery or to store any raw materials, or goods or materials manufactured prior to sale; provided that in respect of portion of the building or extension of the building used for the storage of raw materials, or goods or materials, or both, it shall not be more than one-tenth (1/10) of the total floor areas of the building or the extension to that building”

In other words, the use of space for the purpose of storage of raw materials or other goods or both which exceeds one-tenth (1/10) of the total floor areas of the factory shall not be taken into account in calculating reinvestment allowance [“RA”] claim under Schedule 7A of the ITA 1967.

The PN provides examples on the determination of floor area / space eligible for RA claim under various scenarios.

Double Deduction for Expenditure in Relation to Vendor Development Programme

Following the Budget 2022 announcement, the *Income Tax (Deduction for Expenditure in Relation to Vendor Development Programme [“VDP”]) Rules 2022* has been gazetted to allow for double deduction of expenditure incurred by an anchor company to carry out the following activities relating to the VDP in ascertaining its adjusted income from business in the basis period for a year of assessment-

- i. activities in relation to product development namely product quality development, product innovation or research and development [“R&D”];
- ii. activities in relation to capability improvement namely certification programme, assessment programme or business process re-engineering; or
- iii. activities in relation to human capital namely hard skill training, lean management, financial management system or capacity building.

The amount of expenditure incurred has to be verified by the Minister of Entrepreneur Development and Cooperatives [“MEDAC”] and the total amount of the expenditure is restricted to RM500,000 for each year of assessment. The deduction is given for a period of 3 consecutive years of assessment commencing from the year of assessment in which the first expenditure is incurred.

VDP is an approved programme by MEDAC to be implemented by an anchor company in developing a new vendor company or strengthening the development of existing vendor company.

To qualify for the double deduction under the above Rules:-

- i. The anchor company and vendor company must be incorporated or deemed to be registered under the Companies Act 2016;
- ii. The anchor company and vendor company must be a resident in Malaysia;
- iii. The anchor company has to participate in the VDP and the vendor company must be a manufacturer or supplier of components, or service provider of the anchor company under the VDP; and
- iv. The vendor company must sign a memorandum of understanding with MEDAC under the VDP for the period from 1st January 2021 until 31st December 2025.

The above Rules shall have effect from the year of assessment [“YA”] 2021.

Note: For further information on the previous *Income Tax (Deduction for Expenditure in Relation to VDP) Rules 2014* and *Income Tax (Deduction for Expenditure in Relation to VDP) (Amendment) Rules 2017*, kindly refer to our *Tax Flash – July 2014* and *Tax Flash – April 2017* issues respectively.

Tax Incentive for Project of Commercialisation of R&D Findings

Following the Budget 2021 announcement, the *Income Tax (Deduction for Investment in a Project of Commercialisation of R&D Findings) Rules 2022* has been gazetted to allow a deduction in the basis period for a year of assessment of an amount equivalent to the value of investment made in a related company to finance a project on commercialisation of R&D findings in the basis period for that year of assessment.

The value of investment eligible to be claimed as a deduction:-

- i. shall be equivalent to the expenditure incurred by the related company in the basis period for the same year of assessment for the operation of its commercialisation activity and asset used for that activity; and
- ii. shall not be disposed of within 5 years from the date of the last investment made if such investment is in the form of holding of paid-up share capital in respect of ordinary shares.

Where a company that has made the above claim for deduction in respect of the investment made in a related company receives an amount as consideration for the disposal of its shares in the related company, the amount received shall be included as part of the company's adjusted income (restricted to the total deductions allowed in relation to the investment) for the year of assessment in a basis period in which that amount is received.

A company must satisfy the following conditions to qualify for the abovementioned deduction:-

- i. the application for approval for the project of commercialisation shall be submitted to the Malaysian Investment Development Authority ["MIDA"] from 7th November 2020 to 31st December 2025;
- ii. the company is a company incorporated in Malaysia under the Companies Act 2016; and
- iii. the project of commercialisation shall commence within one year from the date of approval issued by MIDA.

For the purpose of the above Rules:-

"R&D findings" mean R&D findings in the non-resource based activity or product listed in the Schedule to the Rules and wholly owned by a public research institute or public or private institute of higher learning in Malaysia.

"investment" means an investment in the form of cash in a related company for which the related company has no obligation to repay, or the holding of paid-up share capital in cash in respect of ordinary shares in a related company.

"commercialisation" means a process of transforming R&D findings into a product or process that has an industrial application or that is marketable.

"related company" means a company incorporated under the Companies Act 2016 where at least 70% of its paid-up share capital in respect of ordinary shares are directly owned by a company that has made an investment in a commercialisation project.

Tax Incentives for Manufacturer of Pharmaceutical Products Including Vaccines

In the 2021 Budget announcement, it was proposed that the following incentives be given to encourage manufacturers of pharmaceutical products (including vaccines) to invest in Malaysia:-

- Income tax rate of 0% to 10% for a period of 10 years; and
- Income tax rate of 10% for the subsequent period of 10 years.

Following the above, MIDA has recently uploaded on its website the Guidelines on Incentive for Manufacturers of Pharmaceutical Products Including Vaccines under the 2021 Budget [“the Guidelines”].

The *Income Tax (The Incentive for Manufactures of Pharmaceutical Products Scheme) Rules 2022* has now been gazetted to legislate the above proposals. These Rules shall apply to a manufacturer of pharmaceutical products whose application for the Manufacturers of Pharmaceutical Products Incentive Scheme has been approved by the Minister [hereinafter referred to as the “qualifying company”]. The qualifying company must comply with all the conditions as specified in the Guidelines or as revised by MIDA.

Among others, the conditions for Incentive for Manufacturers of Pharmaceutical Products Scheme Rules which must be observed are as below:-

- i. The qualifying company shall incur the first qualifying capital expenditure (excluding land) within 1 year from the date of issuance of the approval letter; and
- ii. The qualifying company shall incur the full amount of the qualifying capital expenditure as specified in the approval letter within 5 years from the date the first qualifying expenditure is incurred.

Other conditions are as specified in the Schedule to the above Rules.

For the purpose of the above Rules:-

“The Incentive for Manufacturers of Pharmaceutical Products Scheme” means an incentive scheme for the qualifying company which carries on business in respect of a qualifying activity and approved by the Minister.

“manufacturer of pharmaceutical products” means a company:-

- a. incorporated under the Companies Act 2016 and resident in Malaysia;
- b. possess a manufacturing license under the Industrial Co-ordination Act 1975 from Ministry of International Trade and Industry or a confirmation letter of exemption from manufacturing license from MIDA;
- c. undertakes manufacturing of pharmaceutical products including formulation in Malaysia but excluding fill and finish activity.

“fill and finish activity” means the process of filling vials with vaccine and finishing the process of packaging the medicine for distribution.

The above Order shall have effect from the YA 2021.

Note : For further details relating to the Guidelines on Incentive for Manufactures of Pharmaceutical Products Including Vaccines under the 2021 Budget, kindly refer to our [Tax Flash – December 2021 issue](#).

Amendments to Earning Stripping Rules

The *Income Tax (Restriction on Deductibility of Interest) (Amendment) Rules 2022* [“amendment Rules”] has been gazetted to provide some amendments to the Income Tax (Restriction on Deductibility of Interest) Rules 2019 [“principal Rules”] in relation to the restriction of interest deduction from the gross income of a person for any financial assistance in a controlled transaction in respect of his business income for a basis period for a year of assessment.

Salient amendments made to the principal Rules are as follows:-

i. Ascertainment of Tax-EBITDA

- The principal Rules provide that the maximum amount of interest allowable under Section 140C of the ITA 1967 shall be an amount equal to 20% of “tax-EBITDA” which is ascertained in accordance with the formula as below:-

$$A + B + C$$

where,

A is the amount of the adjusted income of the person from his sources consisting of a business for the basis period for a year of assessment before any restriction on deductibility of interest under Section 140C of the ITA 1967 is made;

B is the total amount of qualifying deductions allowed in ascertaining the amount of the adjusted income in A;

C is the total amount of interest expense incurred in relation to the gross income of the person for any financial assistance in a controlled transaction from his sources consisting of a business for the basis period for a year of assessment.

- “**Qualifying Deduction**” (in “B” above) has been redefined as:-
 - where there is business expenditure incurred in the profit and loss account [“P&L”] is allowed as deduction under the ITA 1967 and the amount of the deduction allowed exceeds the amount of the business expenditure incurred, an amount equal to the difference between the amount of the deduction allowed and the amount of the business expenditure incurred in the P&L account; or
 - where there is no business expenditure incurred in the P&L account, the amount of deduction allowable under the ITA 1967.

ii. Carry Forward of Excess Interest Expense

- The principal Rules stipulate that where a company has interest expense which is in excess of the maximum amount of interest allowed, the excess can be carried forward and deducted against the adjusted income of the company for the subsequent years of assessment (subject to the maximum amount of interest for the relevant year), until the whole amount of that excess has been fully utilised.
- The amendment Rules now provide that the above would apply to a “person” (instead of being restricted to only a company).
- The amendment Rules reaffirms that in the case of a company, the excess of the maximum amount of interest expenses allowable for deduction in a basis period for a year of assessment and the unutilised interest expenses brought from the preceding year is eligible to be carried forward provided that the shareholders of the company on the first day and the last day of the basis period for the following year of assessment are substantially the same.

The amendment Rules shall have effect from 1st February 2022.

Note : For further information relating to the above, kindly refer to our [Tax Flash - July 2019 issue](#).

Extension of Accelerated Capital Allowance for the Purchase of New Locally Assembled Excursion Bus

Pursuant to the Income Tax (Accelerated Capital Allowance ["ACA"]) (Excursion Bus) Rules 2021, a licensed tour operator is eligible to claim ACA, (i.e. at initial allowance and annual allowance rates of 20% and 40% respectively) in respect of the capital expenditure incurred on the purchase of excursion bus for the YA 2020 and YA 2021.

Following the Budget 2022 announcement, the *Income Tax (ACA) (Excursion Bus) (Amendment) Rules 2022* has been gazetted to provide for extension of the claim for ACA for another 3 years i.e. until YA 2024.

To be eligible for the above ACA claim, the licensed tour operator must:-

- i. be a resident in Malaysia and holder of the tourism licence issued under the Land Public Transport Act 2010 or the Tourism Vehicles Licensing Act 1999; and
- ii. incur capital expenditure for the purchase of an excursion bus as the first registered owner in the basis period for a year of assessment from a source consisting of his business in relation to the tour operations.

Besides, the excursion bus purchased by the licensed bus operator must be:-

- i. used exclusively for the conveyance of tourists pursuant to the Land Public Transport Act 2010 or the Tourism Vehicles Licensing Act 1999;
- ii. assembled or constructed in Malaysia pursuant to Motor Vehicles (Registration and Licensing) Rules 1959 [L. N. 173/1959]; and
- iii. acquired within the period of the YA 2020 until YA 2024.

The above amendment Rules shall have effect from YA 2022.

Stamp Duty Exemption for Instruments in Relation to Merger or Acquisition Executed by SME

Following the 2022 Budget announcement, the *Stamp Duty (Exemption) (No. 18) Order 2021* has been gazetted to provide exemption from stamp duty for the following instruments in relation to a merger or acquisition executed by Small and Medium Enterprises ["SME"]:-

- contract or agreement for the sale or leasing of property (land, building, machinery and equipment);
- instrument of transfer and memorandum of understanding;
- loan or financing agreement; and
- first leasing agreement.

For the purpose of the above Order, "**SME**" has the same meaning assigned to it under Section 2 of the Small and Medium Industries Development Corporation Act 1995.

To be eligible for the exemption, the application for merger or acquisition shall be received by MEDAC from 1st July 2021 to 30th June 2022.

The above exemption applies to the instruments executed by SME between 1st July 2021 to 31st December 2022.

Service Tax Policy No. 3/2021 (Amendment No. 1)

Further to our firm's submission of technical feedback to the Royal Malaysian Customs Department ["RMCD"] with regard to the Service Tax Policy No. 3/2021, RMCD has published [Service Tax Policy No. 3/2021 \(Amendment No. 1\)](#) (currently only made available in *Bahasa Malaysia*) to take into our comments therein.

With this, it is clear that any brokerage service provider is still required to comply with the relevant compliance requirements as a registered person for service tax (including to submit its service tax return) despite the fact that the brokerage services related to trading of shares listed in Bursa Malaysia are exempted from payment of service tax.

Note : For further details, kindly refer to our [Tax Flash – January 2022 issue](#).

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