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In this Issue

- [Special Deductions in Respect of a Qualifying R&D Activity](#)
- [Updated Operational Guidelines on Imposition of Penalty under Section 112\(3\) of the ITA 1967, Section 51\(3\) of the PITA 1967 and Section 29\(3\) of the RPGT Act 1976](#)
- [Special Tax Treatment to Financial Institution](#)
- [Updated FAQ on International Tax Issues Due to COVID-19 Travel Restrictions](#)
- [Guidelines on Stamp Duty on Share Transfer Instruments for Shares of Companies That Are Not Listed on Bursa Malaysia](#)
- [Service Tax Policies](#)
- [Guide on Goods and Services Tax](#)

Special Deductions in Respect of a Qualifying R&D Activity

The Inland Revenue Board ["IRB"] has recently published the *Public Ruling ["PR"] No. 5/2020 – Tax Treatment of Research & Development ["R&D"] Expenditure Part I – Qualifying R&D Activity* and *PR No. 6/2020 – Tax Treatment of R&D Expenditure Part II – Special Deductions* as well as the *Guidelines on The Application Procedure for a Special Deduction in Respect of a Qualifying R&D Activity* to provide updates and guidance on the claim for special deductions in respect of a qualifying R&D activity subsequent to the introduction of the new definition of R&D which was in force from 28th December 2018 onwards.

Salient points of the abovementioned PR and Guidelines are as follows:-

- [Moore Malaysia](#)
- [Moore Global](#)
- [Inland Revenue Board](#)

- i. The special deductions available for R&D expenditure are:-
- Double deduction in respect of expenditure (not capital in nature) incurred on in-house R&D approved by the IRB (delegated by the Minister of Finance) [Section 34A of the Income Tax Act 1967 (“ITA 1967”)]
 - “In-house R&D” means R&D activity carried out in Malaysia by an entity within its business for the purpose of using the results of the R&D activity for furthering its own business
 - A pioneer company may elect to claim single deduction in respect of the qualifying R&D expenditure incurred during its tax relief period in the first basis period for a year of assessment in respect of its post-pioneer business
 - For year of assessment [“YA”] 2016, YA 2017 and YA 2018, automatic claim (i.e. without obtaining prior approval from the IRB) for this double deduction in respect of qualifying expenditure not exceeding RM50,000 each year is allowed for companies:-
 - incorporated under the Companies Act 2016 and resident in Malaysia; and
 - having paid-up capital of not more than RM2.5 million under Paragraph 2A, Schedule 1 of the Act (i.e. a SME)
- Note: For more information on the automatic claim for double deduction of R&D expenditure, please refer to our [Tax Flash - October 2016](#) issue.*
- Double deduction in respect of (not being capital expenditure) [Section 34B of the ITA 1967]:-
 - contribution in cash to a research institute approved by the Minister of Finance;
 - payment for the use of the services of a research institute/company approved by the Minister of Finance; or
 - payment for the use of the services of:-
 - a R&D company approved by Malaysia Investment Development Authority [“MIDA”] which provides R&D services in Malaysia to its related companies or to any other company
 - not applicable to a company incurring payment to a R&D company which is a related company and has been granted Investment Tax Allowance and the incentive period has not ended; or
 - a contract R&D company approved by MIDA which provides R&D services in Malaysia only to a company other than its related company
 - Single deduction in respect of expenditure (not capital in nature) incurred on R&D related to the business and directly undertaken by the entity or on its behalf (where no claim is made under Section 34A or 34B of the ITA 1967) [Section 34(7) of the ITA 1967]
- ii. For the purposes of the claim for special deductions, “R&D” is defined as 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, but 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 modifications or changes to materials, devices, products, processes or production methods;
 - cosmetic modifications or stylistic changes to materials, devices, products, processes or production methods
- iii. To be eligible for the claim for special deductions, the entity must:-
- be a tax resident in Malaysia;
 - be carrying on a business in Malaysia;
 - undertake an R&D activity in relation to its business in Malaysia

iv. Qualifying R&D Activities / Level

- The eligibility for the claim of special deductions shall be ascertained at R&D activity level. In the event an entity is undertaking a R&D project which consists of a set of R&D activities, the eligibility assessment has to be done for each R&D activity carried out. In which case, only expenditure incurred for qualifying R&D activities within the R&D project qualifies for special deductions
- An R&D activity:-
 - can be described as the sum of actions deliberately undertaken (planned and budgeted) by R&D performers, in order to generate new knowledge based on original concepts and their interpretation or hypothesis, to achieve an advancement in a field of science or technology;
 - is uncertain about its final outcome (or at least about the quantity of time and resources needed to achieve it);
 - should serve to resolve scientific or technological uncertainties and challenges associated with achieving an advance in overall knowledge or capability in a field of science or technology; and
 - should achieve an advancement in scientific or technological knowledge and capability as a whole in a field of science or technology. Where an activity is conducted using existing science or technology solely to advance a person's existing knowledge and capability alone, this is not an R&D activity
- For further guidance on fulfilment of the definition of R&D in determining whether a R&D activity qualify for special deductions, detailed discussion and examples are provided in the PR No. 5/2020 based on the three (3) criteria as listed below:-
 - Have an objective to:-
 - acquire new knowledge;
 - create new products or processes; or
 - improvement of existing products or processes.
 - Involved in something new (novelty) or technical risk; and
 - Is a systematic, investigative and experimental (SIE) study in a field of science or technology
- Documentary evidence in support of the qualification of a R&D activity (especially to support the presence of a SIE approach) i.e. systematic records of the processes and outcome of each activity which show relevance to the R&D activity or the R&D project as a whole shall be maintained
- The excluded activities under the definition of R&D represent:-
 - Activities that do not fulfill the criteria of resolving a scientific or technological uncertainty for the advancement of science or technology, even though they may involve tests or systematic processes; or
 - Activities within an R&D project occurred before the scientific or technological uncertainty is identified or after it has been resolved which are related to commercial or administrative objectives (including legal and administrative work in connection with patent applications, records and litigation and the sale or licensing of patents)
- The activities listed below are regarded as not in the nature of R&D:-
 - General education and training;
 - Scientific and technical information services;
 - Fabrication or modification of machinery / equipment;
 - General commercial activities including:-
 - the range of commercial and financial steps necessary for innovation and development and marketing of a new product, process or service such as a business plan, cost benefit analysis, management or policy studies;
 - the production and distribution of goods and services;
 - administrative and other supporting services (such as secretarial, clerical, book keeping or security);
 - general support services (such as transportation, storage, upkeep, cleaning, repair and maintenance); and
 - Activities including design and construction engineering, related to construction, relocation, rearrangement, or startup of facilities or equipment, other than facilities or equipment used solely for a particular research project

v. For in-house qualifying R&D activities, the claim for special deductions shall be made in respect of expenditure incurred during the period between the commencement and completion of the R&D activity. For this purpose, the completion of an R&D activity refers to a date when the testing of a prototype product is completed or the principles of a new production process is established

vi. Qualifying R&D Expenditure

- The types of expenditure incurred for a R&D activity which would be eligible for special deductions include raw materials, manpower (with restrictions), technical services, travelling cost, transportation cost, maintenance cost, rental and other revenue expenditure used/incurred directly for R&D activities
- Effective 28th December 2018, expenditure incurred for technical services undertaken outside Malaysia is only allowed for double deduction if the payment for such services is not more than 30% (previously 70%) of the total allowable R&D expenditure. However, consideration may be given for single deduction under Section 34(7) of the ITA 1967 in respect of the said expenditure amounting to more than the said threshold

vii. Standard Claiming Procedure

- Double Deduction under Section 34A
 - Obtain prior approval from IRB on the R&D activity via submission of *Borang 1* and *Lampiran 1* together with supporting documents:-
 - not less than 6 months before the end of the accounting period, if the R&D activity of a new project commenced in the first half of the accounting period
 - not later than 1 month after the end of the accounting period, if the R&D activity of a new project commenced in the second half of the accounting period
 - not less than 6 months before the end of the accounting period, if it is for the extension of project
 - Complete *Borang 2*, keep the original form for own records and submit a copy of the form to the Tax Policy Department of the IRB on the date of submission of the income tax return for the relevant year of assessment or not later than 3 months from the date of issuance of the certificate of approval by the IRB
 - If a qualifying R&D activity that has been granted an approval is postponed, abandoned or terminated within the approval period, official notification must be submitted to the IRB and the approval granted would be deemed withdrawn effective from the date of termination or abandonment of the R&D activity
 - Written appeals in respect of rejected applications for approval of R&D activity must be made within 30 days from the date of the letter of rejection
- Double Deduction under Section 34B
 - Ensure that the R&D activities conducted by the approved R&D company or approved contract R&D company fulfill the definition of R&D and its qualifying criteria
 - Complete *Borang 3* (previously *Borang DD2/1995*), keep the form together with supporting documents for records. The same shall be furnished to the IRB during tax audit
- Single Deduction under Section 34(7)
 - Ensure that the R&D activities undertaken (whether in-house or outsourced) fulfill the definition of R&D and its qualifying criteria
 - Complete *Borang 4*, keep the original form for own records and submit a copy of the form to the Tax Policy Department of the IRB within 30 days after the due date for submission of the income tax return for the relevant year of assessment

viii. Industrial Building Allowance ["IBA"] and Capital Allowance ["CA"]

- A building that is used for the purpose of R&D activities shall be regarded as an industrial building and qualifies for the claim for IBA. Qualifying building expenditure eligible for the said claim refers to capital expenditure incurred on the construction or purchase of a building which is used for the purpose of R&D activities and shall include capital expenditure incurred on the alteration or renovation of rented premises to carry out R&D activities
- The new definition of "R&D" applies to expenditure incurred on new buildings which are constructed or purchased commencing from 28th December 2018

- Capital expenditure incurred in respect of plant and machinery used for the purpose of R&D activities approved under Section 34A of the ITA 1967 is allowed for the claim of CA

Updated Operational Guidelines on Imposition of Penalty under Section 112(3) of the ITA 1967, Section 51(3) of the PITA 1967 and Section 29(3) of the RPGT Act 1976

The IRB has recently issued the *Operational Guidelines No. 3/2020 - Imposition of Penalty under Section 112(3) of the ITA 1967, Section 51(3) of the Petroleum Income Tax Act 1967 [“PITA 1967”] and Section 29(3) of the Real Property Gains Tax Act 1976 [“RPGT Act 1976”]* (in *Bahasa Malaysia*) dated 13th August 2020 (updated). This updated Operational Guidelines No. 3/2020 is broadly similar to the earlier Operational Guidelines No. 5/2019 on the same subject matter issued on 16th October 2019 except that besides the penalty for late submission of the relevant returns, it has provided for the imposition of additional penalty on the difference in the amount of chargeable income reported compared with that raised under a provisional assessment.

It is noteworthy that where a person has failed to submit his tax return for a year of assessment by the stipulated deadline and the chargeable income reported is more than the chargeable income under a raised assessment (i.e. Form J), additional penalty in respect of the difference in the amount of chargeable income can be imposed.

The penalty provisions for failure to submit the tax returns and the rates of additional penalty are as follows:-

Related Act	Section Involved for Best Judgement Assessment	Section for Imposition of Penalty	Section for Imposition of Additional Penalty	Penalty Rate
ITA 1967	Section 90(3)	Section 112(3)	Section 112(4)	45%
PITA 1967	Section 51(3)	Section 51(3)	Section 51(4)	45%
RPGT Act	Section 29(3)	Section 29(3)	Section 29(5)	25%

Note: For further information on the Operation Guidelines No. 5/2019, please refer to our *Tax Flash – October 2019*.

Special Tax Treatment to Financial Institution

Following the issuance of the Frequently Asked Questions [“FAQ”] with regards to the Special Tax Treatment to Financial Institutions in Relation to Moratorium Granted to Customer under the *Prihatin Rakyat* Economic Stimulus Package (*PRIHATIN*), the *Income Tax (Special Treatment for Interest on Loan) Regulations 2020* has been gazetted to provide guidance to a bank or financial institution on the special tax treatments of interest income on loans received from 1st April 2020 to 30th September 2020 or becomes receivable on or after 1st October 2020 and impairment of a loan.

The above Regulations shall have effect from year of assessment 2020 and thereafter.

Note: For more information relating to the FAQ on Special Tax Treatment to Financial Institutions in relation to Moratorium Granted to Customers, please refer to our *tax updates via email of 27th May 2020*.

Updated FAQ on International Tax Issues Due to COVID-19 Travel Restrictions

The IRB has updated the *FAQ on International Tax Issues Due to COVID-19 Travel Restrictions* to provide guidance on tax issues affecting individual/company in relation to tax residence status, permanent establishment and cross border employment income due to travel restrictions imposed under the COVID-19 pandemic situation.

Among others, it is noteworthy of the following that may affect the tax residence status of an individual:-

- i. For an individual who is temporarily absent from Malaysia because of COVID-19 travel restrictions, the period of temporary absence from Malaysia due to the travel restrictions can be taken to form part of his/her period or periods in Malaysia for the purpose of tax residence. To prove such temporary absence in Malaysia, the individual concerned must keep relevant documents / records and information as evidence, such as travel documents, local and foreign authority travel restrictions, etc.
- ii. On the other hand, for a non-resident individual who is temporarily present in Malaysia because of the travel restrictions, such period of temporary presence in Malaysia shall not be taken to form part of that individual's period or periods in Malaysia for tax purposes. In relation to this, the IRB has clarified that "temporary presence in Malaysia because of COVID-19 travel restrictions" refers to the movement control order period in Malaysia from 18th March 2020 until 31st August 2020.

Note: For more information relating to the previous FAQ on International Tax Issues Due to COVID-19 Travel Restrictions, please refer to our [tax updates via email of 13th May 2020](#).

Guidelines on Stamp Duty on Share Transfer Instruments for Shares of Companies That Are Not Listed on Bursa Malaysia

The IRB has recently uploaded the [Guidelines on Stamp Duty on Share Transfer Instruments for Shares of Companies That Are Not Listed on Bursa Malaysia 2019](#) ["Guidelines 2019"] (in *Bahasa Malaysia*) to provide guidance in determining the value of shares of companies that are not listed on Bursa Malaysia for the purpose of computing stamp duty payable on the share transfer instrument.

Commencing from 1st June 2019, the Guidelines 2019 replaces the guidelines on the same subject matter issued in year 2001.

The method of determination of value of shares of companies that are not listed on Bursa Malaysia is summarised below:-

Categories	Before 1st June 2019	From 1st June 2019 Onwards
Sale of shares of companies that requires approval of Securities Commission ["SC"]	Price or value approved by SC	Price or value approved by SC
Loss-making companies	<ol style="list-style-type: none"> i. Par/nominal value; or ii. Net Tangible Asset ["NTA"]; or iii. Consideration; whichever is higher. 	<ol style="list-style-type: none"> i. NTA; or ii. Consideration; whichever is higher.
Profit-making companies	<ol style="list-style-type: none"> i. NTA; or ii. Price Earning Ratio; or iii. Consideration; whichever is higher. 	<ol style="list-style-type: none"> i. NTA; or ii. Consideration; whichever is higher.
Newly incorporated companies		Consideration
Dormant companies		<ol style="list-style-type: none"> i. NTA; or ii. Consideration; whichever is higher.

Service Tax Policies

The Royal Malaysian Customs Department [“RMCD”] has published the following service tax policies on 13th August 2020:-

- i. [Service Tax Policy No. 1/2020 \(Amendment No. 1\)](#) – Expansion of Scope of Taxable Service;
- ii. [Service Tax Policy No. 3/2020 \(Amendment No. 1\)](#) – Service Tax Policy on Claiming a Refund by Offsetting Method on Service Tax on Imported Digital Service Provided by Foreign Registered Person;
- iii. [Service Tax Policy No. 4/2020 \(Amendment No. 1\)](#) – Service Tax on Online Distance Learning Services;
- iv. [Service Tax Policy No. 5/2020 \(Amendment No. 1\)](#) – Service Tax on Online Newspaper, Online Journals and Periodicals; and
- v. [Service Tax Policy No. 8/2020 \(Amendment No. 1\)](#) – Group Relief Facility on Provision of Taxable Services to Company within the Same Group of Companies.

Please note that the Service Tax Policy No. 8/2020 (Amendment No. 1) is made as a result of the enactment of the Service Tax (Digital Service) (Amendment) Regulations 2020. For more information, please refer to our Tax Flash – May 2020.

Note: Kindly refer to our [Tax Flash – March 2020](#) and [Tax Flash – May 2020](#) for further details.

Guide on Goods and Services Tax

The RMCD has published the Goods and Services Tax [“GST”] [Guide on Declaration and Adjustment after 1st September 2018](#) dated 18th August 2020 [“the GST Guide”]. The GST Guide is to replace the GST on Declaration and Adjustment after 1st September 2018 dated on 8th May 2019 [“the Former GST Guide”].

RMCD has removed paragraph 19 from the Former GST Guide and that implies that taxpayers are now allowed to amend their GST returns or / after 1st September 2020.

Note: Kindly refer to our [Tax Flash – May 2019](#) for further details.

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