TaXavvy

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Malaysia Digital tax incentives

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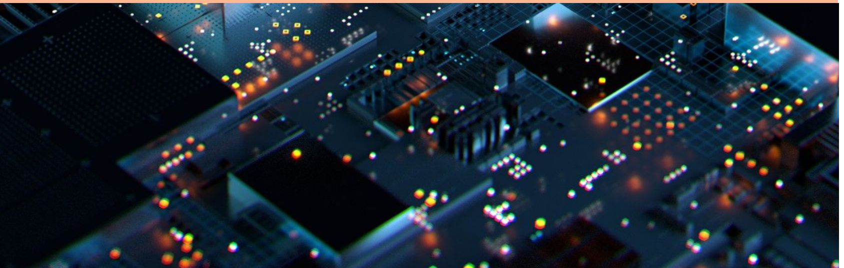
On 31 May 2024, Malaysia Digital Economy Corporation Sdn Bhd (MDEC) unveiled its outcome-based Malaysia Digital (MD) tax incentives for MD companies proposing to undertake qualifying activities by leveraging any of the following promoted tech enablers:

- Artificial Intelligence (AI) and / or Big Data Analytics (BDA)
- Internet of Things (IoT)
- Cybersecurity
- Cloud
- Blockchain
- Drone Technology
- Creative Media Technology including Extended Reality (XR) and / or Mixed Reality (MR)
- Integrated Circuit (IC) Design with Embedded Software
- Robotics and / or Automation
- Advanced Network Connectivity and / or Telecommunication Technology



Broad overview of the MD tax incentives

The incentives are offered for new investments and expansion as follows:

	New investments incentive		***Expansion incentive[1]***	
Options (mutually exclusive)	*Reduced tax rate*	*Investment Tax Allowance (ITA)*	*Reduced tax rate*	*Investment Tax Allowance (ITA)*
Tax incentive	• 0% tax rate on qualifying intellectual property (IP) income[2] • 10% tax rate on qualifying non-IP income, or	ITA of 60% of qualifying capital expenditure (QCE) set-off against 100% statutory income (SI), or	15% on statutory income for qualifying IP income[2] and non-IP income	ITA of 30% of QCE set-off against 100% SI, or
Upon meeting additional conditions[3]	• 5% tax rate on qualifying non-IP income	ITA of 100% of QCE set-off against 100% SI		ITA of 60% of QCE set-off against 100% SI
Incentive period	10 years	5 years	5 years	5 years
Application period	Applications received by 31 December 2027 for companies awarded MD Status starting 1 July 2022		Applications received during the period from 1 January 2024 to 31 December 2027	

1 - For companies which have completed initial incentive or have not been granted any incentive on existing activities.
2 - The reduced tax rate shall apply on a percentage of qualifying IP income derived from qualifying IP right (patent, computer programme, etc. as prescribed) to be determined in accordance with the modified nexus approach formula (to be specified in subsidiary legislation). IP income are royalty and / or licensing fees.
3 - Additional minimum 3 conditions relating to sustainable economic development.

The details of the eligibility criteria and conditions are provided in the following pages.

Key eligibility criteria	*New investments incentive*	*Expansion incentive*
Incorporation and resident status	A company incorporated or deemed to be registered under the Companies Act 2016 and resident in Malaysia	
Paid up capital	Minimum of MYR50,000	Minimum of MYR250,000
Period in operation	N/A	At least 36 months
MD Status	Has made an application for the award of MD Status	Is an MD or MSC Malaysia Status company
Qualifying activity (i.e. the tech enablers)	In relation to the qualifying activity, the applicant: ● is proposing to undertake the activity in Malaysia ● has not been granted any tax incentive by the Government In relation to sales invoice for the qualifying activity, the applicant: ● has not issued any sales invoice prior to making the application, or ● has not issued any sales invoice more than 12 months prior to making the application where there is 60% of direct / indirect Malaysian equity ownership in the applicant	In relation to the qualifying activity, the applicant: ● is proposing to undertake the activity in Malaysia ● has not been granted any tax incentive by the Government ● has not issued any sales invoice for the qualifying activity in Malaysia prior to making the application
Existing activity	N/A	Has met all conditions of the tax incentive under the MD or MSC Malaysia Status financial incentive schemes (if granted), or has surrendered the tax incentive.
Related company	The applicant will not be eligible for the incentive for the qualifying activity if a related company: ● has been granted tax incentive in respect of the qualifying activity ● has issued any sales invoice for the qualifying activity prior to the applicant making the application for the tax incentive	

Key conditions for New investment incentive

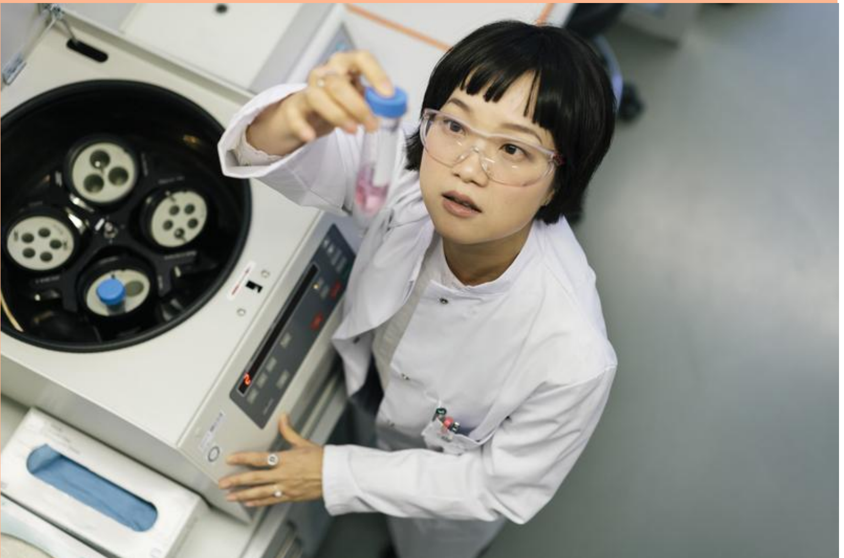
	Reduced tax rate		*Investment Tax Allowance*	
	Non-IP income	*IP income*	*ITA of 60% QCE*	*ITA of 100% QCE*
General conditions	● Employ adequate number of full-time employees in Malaysia throughout the year of assessment (YA) which comprise adequate number of knowledge workers with a minimum monthly basic salary of MYR5,000 ● To incur adequate amount of annual operating expenditure in Malaysia by the end of each YA ● The qualifying activity is carried out in Malaysia throughout the YA ● The MD Status and conditions are maintained and complied with at all times ● An independent auditor-verified self-declaration form on compliance of conditions is to be submitted to MDEC within 7 months of the end of each YA, failing which the company will not be entitled to claim the reduced tax rate for that YA		● To incur adequate amount of QCE ● Employ adequate number of full-time employees in Malaysia ● The qualifying activity is carried out in Malaysia at all times ● The MD Status and conditions are maintained and complied with at all times The above conditions are to be complied with within 3 years from principal approval given.	
Modified Nexus Approach	N/A	To comply with Modified Nexus Approach where details are pending issuance of subsidiary legislation (see page 6 for general information on the Modified Nexus Approach)	N/A	N/A
Additional conditions	For the reduced tax rate of 5%, a minimum of 3 conditions related to **sustainable economic development** (e.g. initiatives in education, social and environment, to be stated in approval letter) to be met at the end of each YA	N/A	N/A	To meet a minimum of 3 conditions related to **sustainable economic development** (e.g. initiatives in education, social and environment, to be stated in approval letter) in year 4 and 5 of the incentive period

Key conditions for Expansion incentive

	Reduced tax rate		***Investment Tax Allowance***	
	Non-IP income	*IP income*	*ITA of 30% QCE*	*ITA of 60% QCE*
General conditions	● Maintain existing and employ adequate number of full-time employees in Malaysia throughout the YA which comprise adequate number of knowledge workers with a minimum monthly basic salary of MYR5,000 ● To incur adequate amount of annual operating expenditure by the end of each YA ● To meet a minimum of 2 conditions related to **sustainable economic development** (e.g. initiatives in education, social and environment) at the end of each YA ● The qualifying activity is carried out in Malaysia throughout the YA ● The MD or MSC Malaysia Status and conditions are maintained and complied with at all times ● An independent auditor-verified self-declaration form on compliance of conditions is to be submitted to MDEC within 7 months of the end of each YA, failing which the company will not be entitled to claim the reduced tax rate for that YA		● To incur adequate amount of QCE ● To maintain existing and employ adequate number of full-time employees in Malaysia ● The qualifying activity is carried out in Malaysia at all times ● The MD or MSC Malaysia Status and conditions are maintained and complied with at all times The above conditions are to be complied with within 3 years from principal approval given.	
Modified Nexus Approach	N/A	To comply with Modified Nexus Approach where details are pending issuance of subsidiary legislation (see page 6 for general information on the Modified Nexus Approach)	N/A	N/A
Additional conditions	N/A	N/A	N/A	To meet a minimum of 3 conditions related to **sustainable economic development** (e.g. initiatives in education, social and environment, to be stated in approval letter) in year 4 and 5 of the incentive period

Modified Nexus Approach - R&D expenditure as a proxy to substance

Based on the substantial activities requirements, the approach takes into account the level of R&D activity in a country and the income arising from that R&D activity which should qualify for tax incentives.



Nexus Approach

The Nexus Approach under BEPS Action 5 requires a direct nexus between the income generated (and hence the tax benefits from the incentive given) and the R&D activities undertaken directly by the taxpayer. This may be measured from the qualifying R&D expenditure (QE) incurred by the taxpayer. Depending on each jurisdiction, the tax benefits may take the form of income exemption, tax deduction / allowance equivalent to the QE incurred, R&D credit / rebate against income tax payable, etc. Under the MDEC Guidelines, the relevant tax incentive which is offered is in the form of reduced tax rate.

Nexus ratio

Under the Nexus Approach, the portion (ratio) of income which qualifies for tax benefit shall be made in proportion to the QE which bears to total QE and non-QE. This concept may be illustrated using the following formula:

$$\frac{QE}{QE + Non\text{-}QE} \times \textit{IP income} = \textit{IP income which qualifies for tax benefits}$$

Modified Nexus Approach

The Nexus Approach only allows a company to benefit from a tax incentive to the extent that the company itself incurred and performed the R&D which gave rise to the IP income. However, concerns were raised for situations where R&D activities are outsourced to group companies. It also disregards cost incurred for IPs which are acquired from other parties for commercial expediency. Taking into account these concerns, the Nexus Approach was subsequently revised and the revised approach is referred to as the Modified Nexus Approach. The key revision is to provide for an allowance of up to a 30% uplift of QE. The uplift works by allowing Non-QE which may include expenditure from IP asset acquisition and R&D outsourced to related parties to be added to QE subject to a maximum of 30% of the underlying QE.

Note: The above is for illustration purposes only. Details of the Modified Nexus Approach which is applicable to the MD tax incentives will be specified in subsidiary legislation that is to be gazetted.

Modified Nexus Approach (cont'd)

Below are two illustrations on the uplift mechanism which allows up to 30% of R&D expenditure which is not directly performed by the company:

	Example 1 (MYR)	**Example 2 (MYR)**
Cost of R&D incurred and performed directly by a company **[A]**	100	100
Cost of IP assets acquired **[B]**	10	5
R&D expenses outsourced to a related company **[C]**	40	20
Maximum uplift amount (30% of A) **[D]**	30	30
Overall qualifying expenses uplift amount **[A + (B+C, capped at D)]**	130 (100 + 30)	125 (100 + 25)
	The uplift amount (MYR10 + MYR40) is subject to maximum of MYR30.	*The uplift amount (MYR5 + MYR20) is below the maximum of MYR30.*

Source: OECD / G20 Base Erosion and Profit Shifting Project - Action 5: Agreement on Modified Nexus Approach for IP Regimes

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Connect with us

Our Offices

Kuala Lumpur
Jagdev Singh
jagdev.singh@pwc.com
+60(3) 2173 1469

Penang & Ipoh
Kang Gaik Hong
gaik.hong.kang@pwc.com
+60(4) 238 9225

Melaka & Johor Bahru
Benedict Francis
benedict.francis@pwc.com
+60(7) 218 6000

Kuching
Lee Yuien Siang
yuien.siang.lee@pwc.com
+60(8) 252 7202

Cynthia Ng
cynthia.hh.ng@pwc.com
+60(3) 2173 1438

Labuan
Jennifer Chang
jennifer.chang@pwc.com
+60(3) 2173 1828

Corporate Tax Compliance & Advisory

Consumer & Industrial Product Services
Margaret Lee
margaret.lee.seet.cheng@pwc.com
+60(3) 2173 1501

Steve Chia
steve.chia.siang.hai@pwc.com
+60(3) 2173 1572

Clifford Yap
clifford.eng.hong.yap@pwc.com
+60(3) 2173 1446

Taariq Murad
taariq.murad@pwc.com
+60(3) 2173 1580

Hee Sien Yian
sien.yian.hee@pwc.com
+60(3) 2173 0222

Cynthia Ng
cynthia.hh.ng@pwc.com
+60(3) 2173 1438

Alvin Woo
alvin.jm.woo@pwc.com
+60(3) 2173 1820

Emerging Markets
Fung Mei Lin
mei.lin.fung@pwc.com
+60(3) 2173 1505

Michelle Chuo
michelle.sy.chuo@pwc.com
+60(3) 2173 1289

Financial Services
Jennifer Chang
jennifer.chang@pwc.com
+60(3) 2173 1828

Lim Phaik Hoon
phaik.hoon.lim@pwc.com
+60(3) 2173 1535

Lorraine Yeoh
lorraine.yeoh@pwc.com
+60(3) 2173 1499

Tan Tien Yee
tien.yee.tan@pwc.com
+60(3) 2173 1584

Energy, Utilities & Mining
Technology, Media & Telecommunications
Heather Khoo
heather.khoo@pwc.com
+60(3) 2173 1636

Lavindran Sandragasu
lavindran.sandragasu@pwc.com
+60(3) 2173 1494

Keegan Ong
keegan.sk.ong@pwc.com
+60(3) 2173 1684

Aurobindo Ponniah
aurobindo.ponniah@pwc.com
+60(3) 2173 3771

Ang Wei Liang
wei.liang.ang@pwc.com
+60(3) 2173 1597

Zarina Othman
zarina.sheikh.othman@pwc.com
+60(3) 2173 1615

Services & Infrastructure
Lim Phaik Hoon
phaik.hoon.lim@pwc.com
+60(3) 2173 1535

Connect with us

Specialist services

Capital Allowance
Richard Baker
richard.baker@pwc.com
+60(3) 2173 0644

China Desk
Lorraine Yeoh
lorraine.yeoh@pwc.com
+60(3) 2173 1499

Corporate Services
Lee Shuk Yee
shuk.yee.x.lee@pwc.com
+60(3) 2173 1626

Dispute Resolution
Tai Weng Hoe
weng.hoe.tai@pwc.com
+60(3) 2173 1600

Chris Tay
christopher.h.tay@pwc.com
+60(3) 2173 1143

Individual Tax
Michelle Chuo
michelle.sy.chuo@pwc.com
+60(3) 2173 1289

Indirect Tax
Raja Kumaran
raja.kumaran@pwc.com
+60(3) 2173 1701

Abd Gani Othman
abdgani.othman@pwc.com
+60(3) 2173 1648

Geeta Balakrishnan
geeta.b.balakrishnan@pwc.com
+60(3) 2173 1652

Annie Thomas
annie.thomas@pwc.com
+60(3) 2173 3539

International Tax Services / Mergers and Acquisition
Gan Pei Tze
pei.tze.gan@pwc.com
+60(3) 2173 3297

Lim Chee Keong
chee.keong.lim@pwc.com
+60(3) 2173 0639

Lee Boon Siew
boon.l.lee@pwc.com
+60(3) 2173 0932

Japanese Business Consulting
Yuichi Sugiyama
yuichi.sugiyama@pwc.com
+60(3) 2173 1191

Clifford Yap
clifford.eng.hong.yap@pwc.com
+60(3) 2173 1446

Korea Desk
Keegan Ong
keegan.sk.ong@pwc.com
+60(3) 2173 1684

Tax Reporting & Strategy
Lavindran Sandragasu
lavindran.sandragasu@pwc.com
+60(3) 2173 1494

Pauline Lum
pauline.ml.lum@pwc.com
+60(3) 2173 1059

Mohd Haizam Abdul Aziz
mohd.haizam.abdul.aziz@pwc.com
+60(3) 2173 5355

Tax Technology
Yap Sau Shiung
sau.shiung.yap@pwc.com
+60(3) 2173 1555

Joey Chong
joey.chong@pwc.com
+60(3) 2173 0092

Workforce Tax
Kartina Abdul Latif
kartina.a.latif@pwc.com
+60(3) 2173 0153

Mohammad Iesa Morshidi
iesa.morshidi@pwc.com
+60(3) 2173 3136

Worldtrade Management Services
Chandrasegaran Perumal
chandrasegaran.perumal@pwc.com
+60(3) 2173 3724

Transfer Pricing
Anushia Soosaipillai
anushia.joan.soosaipillai@pwc.com
+60(3) 2173 1419

Jagdev Singh
jagdev.singh@pwc.com
+60(3) 2173 1469

Desmond Goh
desmond.goh.keng.hong@pwc.com
+60(3) 2173 1439

Lim Ying Tian
ying.tian.lim@pwc.com
+60(3) 2173 0291

Ong Ai Ling
ai.ling.ong@pwc.com
+60 (3) 2173 0711

Lilia Edlina Azmi
lilia.edlina.azmi@pwc.com
+60(3) 2173 1498

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