

CONSTITUTIONAL AND LEGAL FRAMEWORK FOR SARAWAK, MALAYSIA: WHAT FOREIGN INVESTORS NEED TO KNOW?

I. Background

Sarawak or better known as the 'The Land of the Hornbills' is one of the jewels of Southeast Asia, known for its beautiful cities, multicultural ethnic population and its vast rainforests which makes it a popular tourist destination in Malaysia. From a foreign investors' perspective, Sarawak is a goldmine brimming with economical potential.[1] Sarawak was announced the number one hub for foreign direct investment ("FDI") in Malaysia having received **RM15.8 billion** in foreign direct investment in 2020.[2] Consequently, it would attract more foreign investors to invest heavily in the various economic sectors in Sarawak. However, these investors may not be aware that the constitutional and legal framework in Sarawak differ from the framework in Peninsular Malaysia. Hence, this paper aims to discuss on the constitutional and legal framework of Sarawak, Malaysia.

II. Constitutional Framework of Sarawak

To fully comprehend the underlying legal processes and the policies from which they derive, it is necessary to understand the basics of the overarching legal system of Malaysia. Malaysia practices the concept of constitutional supremacy, where the Federal Constitution ("FC") of Malaysia is the supreme law of the land[3], setting out, inter alia, the relationships between federation and its constituent states and between the judiciary (the courts), legislature (the Parliament) and the executive (the Federal Government).

Cemented in the FC, Sarawak has a special position and enjoys certain privileges. This special position and privileges were guaranteed in the Malaysia Agreement signed in 1963 as a condition for Sarawak to join the Federation of Malaya to form Malaysia.[4] The reasoning behind this condition was that Sarawak is home to an ethnically, culturally, and linguistically diverse group of people. In addition, Sarawak is rich in natural resources such as forests, rivers, and petroleum. The people of Sarawak wanted to maintain greater independence and control over the matters and resources in their state and safeguard their

way of life both culturally and religiously.[5] There are **special privileges given to natives of Sarawak and additional protection for Sarawak under Part XXIIA (Additional Protections for States of Sabah and Sarawak) of the FC**. In this regard, it is pertinent for foreign investors to know the relevant matters under the FC before investing in Sarawak.

First, the term '**Bumiputera**' is a term used to refer to Malays and natives of Sabah and Sarawak.[6] In Sarawak, a Bumiputera would be that of a Sarawakian Malay,[7] and a Sarawakian native,[8] as defined under the FC. As recent as February of this year, amendments to four articles of the FC which came into effect and restored the status of Sabah and Sarawak according to the original content of Malaysia Agreement, also amended the FC's definition of who is a "native" of Sarawak by amending Article 161A(6) and repealing Article 161A(7). As a consequence, Sarawak is rightly allowed to specify by state law who should be regarded as indigenous people of Sarawak. Emeritus Prof Dr Shad Faruqi explained that the definition in the FC was problematic as it excluded people of mixed marriages and provided a list of natives that contained many errors.[9] Another academician, Dr Jaclyn Neo highlighted that the constitutional amendment which allows Sarawak to define who is a "native", could have significant economic and political consequences and that these amendments are "first steps towards greater devolution, more equitable wealth distribution, and democratic empowerment of the peoples of [Sabah and] Sarawak".[10] The amendments were also in line with the Federal Government's transformation agenda to restore the confidence of the public as well as foreign investors in the ability of the ruling government to ensure political stability and smooth implementation of the country's policies toward sustainable socio-economic development.[11]

Bumiputeras of Sarawak enjoy special interests such as reservation of quotas in respect of employment in the public service and business permits or licenses.[12] This can also be seen in the governments' imposition of a Bumiputera requirement policy and certain sectors require Bumiputera/local equity participation and/or impose foreign equity restrictions (collectively referred to as Equity Conditions).[13] This will be discussed in further detail in Part III of the Legal Framework.

Moreover, **Sarawak has its own laws in relation to land, agriculture, forestry, local government and immigration**. [14] These matters are exclusive for the state of Sarawak to regulate, and Parliament does not have the power to legislate on these matters in Sarawak. For instance, the new stricter requirements and regulations of the MM2H (Malaysia My Second Home) programme which came into effect in October last year, is not applicable to the Sarawak MM2H.[15] MM2H is a programme promoted by the Federal Government of Malaysia to allow foreigners who fulfill certain criteria, to stay in Malaysia for as long as possible on a multiple-entry social visit pass. Section 64 and 65 of the Immigration Act 1959/1963 allow Sarawak (and Sabah) to manage immigration matters on the entry of foreigners and the period of stay of foreigners. In view that the conditions under the Sarawak MM2H Programme are appreciably less stringent than those imposed under the new MM2H Programme requirements and regulations, Malaysia may see an increase in applicants to Sarawak.

Sarawak can also **impose import and excise duty on petroleum products, export duty on timber and other forest produce, royalty on minerals, and State Sales Tax.**[16] The right to impose such dues is constitutional as held in March 2020, when Petronas applied for judicial review questioning Sarawak's constitutional right in imposing a state sales tax on the sale of petroleum under Article 95B(3) of the FC and the State Sales Tax Ordinance 1998. The High Court dismissed the application and ruled in favour of Sarawak, stating that Sarawak has the inherent right to impose a State Sales Tax under Article 95B(3) of the FC. The Article was added as one of the conditions of Sarawak joining Malaysia in 1963 and hence the right should not be removed.[17]

III. Legal Framework

Malaysia does not possess a single, unified piece of legislation that governs foreign investment in the country. Instead, foreign investing laws and procedures are usually sector-specific and handled by the appropriate government agency or sectoral regulator.[18]

a. Equity Policy

Prior to 2012, foreign investments had been governed by the Foreign Investment Committee (FIC) Guidelines. These regulations addressed the government's aim to encourage "Bumiputera" involvement.[19] This policy slowly went through a liberalization between 2009 and 2012, but still did not extinguish fully the Bumiputera participation requirement in certain sectors.[20]

FDI constraints are mostly mandated by sector-specific regulations, but regulators may apply supplementary ad hoc restrictions. This is the case, for example, with Equity Conditions. Such requirement may be imposed by legislation where, for example, a piece of legislation specifies a minimum level of Bumiputera/local equity or a foreign equity limitation. In absence of a prescribed Equity Condition, it can be imposed on certain sectors by written guidelines, circulars or practices by the relevant regulator. The relevant regulator can still impose different Equity Conditions on a case-by-case basis.[21]

Non-compliance with Equity Conditions set under discretionary advice is rarely met with legal consequences. However, administrative actions can be used to enforce it, for instance, rejection or non-issuance of operation licenses, permits and project approvals.[22]

b. Sarawak Equity Policies in Specific Sectors

Imposition of Equity Conditions can be seen in matters relating to supply of work and services to the state government of Sarawak. All contractors planning to participate in supply and work tender to Sarawak government are required to register with Unit Pendaftaran Kontraktor dan Jururunding (UPKJ).[23]

A company intending to register with UPKJ for provisions of **supplies & services, mechanical works and electrical works sectors** shall ensure that[24]:

- its foreign equity holding does not exceed 49% of its issued and paid up capital;
- majority of its board of directors, management and employees are Malaysian citizen; and
- at least 30% of its issued and paid capital is held by Bumiputera.

A company can apply for Bumiputera status where its[25]:

- shareholders;
- board of directors;
- management team;
- employees;

is held by a majority or more than 51% Sarawak Bumiputera and the financial management of the company is controlled by Sarawak Bumiputera.

As for other sectors such as **manufacturing**, since June 2003, equity interests in all manufacturing ventures have been fully liberalized. Foreign investors could hold 100% of the shares in all investments in new projects, as well as investments in expansion/diversification projects by existing companies, irrespective of the level of exports and without excluding any product or activity. The equity policy also applies to: (i) companies previously exempted from obtaining a manufacturing licence but whose shareholders' funds have now reached RM2.5 million or have now engaged 75 or more full-time employees and are thus required to be licensed; and (ii) existing licensed companies previously exempted from complying with equity conditions, but are now required to comply due to their shareholders' funds having reached RM2.5 million.

In Sarawak, for example construction projects that are valued for RM200,000 and below (known as Class F projects), would be reserved for Bumiputera status companies.[26] For bigger projects, state government may award the projects through bidding process. The recognition of a Bumiputera status company is not a right in being entitled to attain bigger projects, but merely an advantage for consideration.[27] Hence, it would aid foreign investors to consider whether the industry or company they wish to invest fulfils or is able to fulfil the Bumiputera status as a leverage to secure more projects.

c. Tax Incentives

Malaysia provides both direct and indirect tax incentives via its Promotion of Investments Act 1986, Income Tax Act 1967, Customs Act 1967, Excise Act 1976 and Free Zones Act 1990.

The direct tax incentives grant partial or total relief from income tax payment for a specified period, while indirect tax incentives are in the form of exemptions from import duty and excise duty.

These tax incentives cover:

- manufacturing sector;
- agricultural sector;
- biotechnology industry;
- environmental management;
- research and development;
- training;
- approved service projects;
- shipping and transportation industry;
- information and communication technology; and
- less developed areas, etc.[28]

In addition to the Federal Government's incentives, Sarawak also offers a number of special investment incentives for manufacturing projects, such as:

- companies eligible for pioneer status in Sarawak will be granted tax exemption of 100% (normally 70%) of their statutory income;
- companies eligible for Investment Tax Allowance, rate of allowance will be increased to a maximum 100% (normally 75%) of the statutory income;
- second round of pioneer status for existing and new companies;
- selected industries located in Sarawak can be granted incentives (pioneer status or investment tax allowance), which are no longer offered for products manufactured in other parts of Malaysia;
- infrastructure allowance of 100% of qualifying expenditure;
- manufacturing projects in Sarawak catering for domestic market are also entitled to full import duty exemption on any raw material, components or parts which are not available in Sarawak;
- eligibility for double deduction on freight charges incurred in the export of rattan and wood-based products (except plywood, sawn timber and veneer);
- inexpensive industrial land;
- minimal down payment for the purchase of industrial land; and
- flexible terms of payment for the purchase of industrial land (subject to change).[29]

Manufacturers who ship their goods from Sabah or Sarawak to any port in Peninsular Malaysia qualify for double deduction on freight charges.[30]

The World Bank's Doing Business Report 2019 which sets out the changes made to ease business facilitation by the Federal Government led to a significant improvement of Malaysia's ranking from 24 to 15 in one year and in the 2020 report ranks Malaysia 12th amongst 190 global economies, and 2nd in South East Asia.

1. Mainly due to her abundant natural resources, lucrative oil and gas fields, oil palm plantations, diverse Borneo rainforests and strategic location for cross-border trade.

2. Bong, K. (2020, December 15). Sarawak tops M'sia for FDI, attracts RM15.8 billion in first nine months of 2020. DayakDaily. Retrieved from <https://dayakdaily.com/sarawak-top-msian-state-for-fdi-attracts-rm15-8-billion-in-first-nine-months-of-2020/>.
3. Article 4 (Supreme Law of the Federation) of the Federal Constitution.
4. "The Rakyat Guide – 7. Sabah & Sarawak". Retrieved from http://www.malaysianbar.org.my/index.php?option=com_docman&task=doc_download&gid=2849.
5. Ibid.
6. Leong, T. (2017, August 3). Who are Malaysia's Bumiputera? The Straits Times. Retrieved from <https://www.straitstimes.com/asia/se-asia/who-are-malaysias-bumiputera>.
7. Article 160 (Interpretation) of the Federal Constitution.
8. Article 161A (Special position of natives of States of Sabah and Sarawak); Article 161A(6) of the Federal Constitution (amended) and Article 161(A)(7) of the Federal Constitution (repealed).
9. Faruqi, S.S. (2021, Dec 16). A good step towards redemption. The Star. Retrieved from <https://www.thestar.com.my/opinion/columnists/reflecting-on-the-law/2021/12/16/a-good-step-towards-redemption>.
10. Neo, J.L. (2021, Nov 19). Restoring Constitutional Equality to Sabah and Sarawak: Do the Proposed Amendments to the Malaysian Federal Constitution Go Far Enough? Retrieved from <https://constitutionnet.org/news/restoring-constitutional-equality-sabah-and-sarawak-do-proposed-amendments-malaysian-federal>.
11. Yunus, A. (2021, Dec 14). Constitution amendments to empower Sabah, Sarawak tabled. New Straits Times. Retrieved from <https://www.nst.com.my/news/nation/2021/12/754196/constitution-amendments-empower-sabah-sarawak-tabled>.
12. Article 153 (Reservation of quotas in respect of services, permits, etc., for Malays and natives of any of the States of Sabah and Sarawak) of the Federal Constitution.
13. 2021 Investment Climate Statements: Malaysia. (n.d.). U.S. Department of State. Retrieved from <https://www.state.gov/reports/2021-investment-climate-statements/malaysia/>.
14. See footnote 4.
15. Louis, N.A. (2021, Aug 24). Sarawak welcomes foreigners who find federal second home requirements too demanding. DayakDaily. Retrieved from <https://dayakdaily.com/sarawak-welcomes-foreigners-who-find-federals-second-home-requirements-too-demanding/>.
16. Article 112C (Special grants and assignments of revenue to States of Sabah and Sarawak) & Tenth Schedule (Grants and Sources of Revenue Assigned to States), Part V (Additional Sources of Revenue Assigned to States of Sabah and Sarawak) of the Federal Constitution. Sarawak can also impose thirty per cent customs revenue on medicine and health products, state ports and harbours, state water supplies, and revenue from licenses connected with water supply.
17. Edward, C. (2020, March 13). Victory for Sarawak as Court dismisses Petronas application for Judicial Review on SS. Borneo Post Online. <https://www.theborneopost.com/2020/03/13/victory-for-sarawak-as-court-dismisses-petronas-application-for-judicial-review-on-ss/>.
18. 2019 Invest Policy and Regulatory Review-Malaysia (2019), 7-8. World Bank Group. Retrieved from <https://openknowledge.worldbank.org/bitstream/handle/10986/33597/Malaysia-2019-Investment-Policy-and-Regulatory-Review.pdf?sequence=1&isAllowed=y>.
19. Influenced by the Malaysia's National Development Policy of 1990 and National Vision Policy of 2001 aimed to attain at least 30% Bumiputera involvement in all industries by 2010.
20. Autonomous Liberalisation. The 30 % Bumiputera equity criterion was eliminated for no fewer than 44 service sub-sectors between 2009 and 2012. Retrieved from <https://www.miti.gov.my/index.php/pages/view/4236>. Also see footnote 13.
21. See footnote 18.
22. See footnote 21.
23. Taklimat Panduan Pendaftaran Kontraktor & Pembekal UPKJ. Retrieved from <http://www2.sesco.com.my/noticeDoc/UPKJ%20Briefing%20to%20SEB%20Miri.pdf>.
24. Ibid.
25. Ibid.
26. Borneo Post. (2020, July 2). Limbang Class F Contractors Hit Hard by Policy Allowing JKKK to Implement Projects. <https://www.theborneopost.com/2020/07/02/limbang-class-f-contractors-hit-hard-by-policy-allowing-jkkk-to-implement-projects/>.

27. On April 5th 2010, a circular was released that instructed a policy of allocating 10% of cost of contract of large projects that is worth RM10 million to Class F. Furthermore, the guidelines provides to limit the scope of work of RM200K for each of Class F contractor. See Mohd Hanif, M. I. (n.d.). Problems and Dilemmas of Class F Contractors Participation in Large Projects. <https://engineering.utm.my/civil/ethesis/wp-content/uploads/sites/47/MASTERS/DSM/S11/Problems-And-Dilemmas-Of-Class-F-Contractors%E2%80%99-Participation-In-Large-Projects-%E2%80%93-Mohd-Ikhmil-Faevwasz-Bin-Mohd-Hanif.pdf>.
28. MIDA, Chapter 2 – Incentives for New Investments. Retrieved from <https://www.mida.gov.my/wp-content/uploads/2020/07/Chapter-2-Incentives-for-New-Investments.pdf>.
29. Investment Incentives (n.d.). The Official Portal of Sarawak Government. Retrieved from https://sarawak.gov.my/web/home/article_view/214/229/.
30. See footnote 28.

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