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Malaysian developments

Guidelines and procedures for the application of special investment tax allowance (ITA) for the Electrical and Electronics (E&E) sector

In Budget 2020, to further promote high value-added activities in the Electrical and Electronics (E&E) sector and to help the sector transition to Industry 4.0 and a 5G digital economy, it was proposed that companies in the E&E sector, whose reinvestment allowance (RA) period has expired, be eligible to apply for a special investment tax allowance (ITA) (see *Take 5: Budget 2020 Malaysia* and *Special Tax Alert: Highlights of Budget 2020*). Applications for the incentive must be received by the Malaysian Investment Development Authority (MIDA) between 1 January 2020 and 31 December 2021.

Following the above proposal, MIDA has recently published on its website, the “Guidelines and procedures for the application of special investment tax allowance for the E&E sector” (E&E Guidelines) dated 26 March 2021.

The E&E Guidelines stipulate that eligible companies will be able to apply for a special ITA of 50% on qualifying capital expenditure for a period of five years, to be set off against 50% of statutory income, commencing from the date of the approval letter. This incentive will be legislated by way of an exemption order which will be issued in due course.

To qualify for the incentive, the company must:

- Be a Malaysian-resident company which is incorporated under the Companies Act 1965 or 2016
- Possess a valid business license from the relevant local authority
- Possess a manufacturing license (ML) from the Minister of International Trade & Industry (MITI), or a confirmation letter from MIDA providing an exemption from ML requirements
- Be engaged in manufacturing activities in the E&E sector and intends to reinvest for the purpose of expansion, automation, diversification and modernization
- Have fully exhausted its 15-year RA claim period by 31 December 2019 and is not currently enjoying any other tax incentives approved by the Government
- Have an investment of at least RM1.5 million in capital expenditure in the proposed project, within the five-year period
- Have incurred the minimum amount of annual operating expenditure and hired the minimum number of Malaysian full-time employees, as proposed by the company

The company must also participate in one of the following programmes:

(a) Vendor Development Programme
Develop at least two new local vendor companies in one of the following subsectors:
- Electronics components
- Electronics consumer
- Electronics industrial
- Electrical

(b) Human Capital Development Programme
(i) Participate in internship programmes with local universities and/or polytechnics or industrial training placements by Technical and Vocational Education and Training (TVET) institutions for at least five Malaysian interns per year, with a minimum training period of three months throughout the incentive period
(ii) Collaborate with local universities on curriculum enhancement in E&E-related syllabus, or
(iii) Undertake up-skilling and/or re-skilling programmes with local universities, polytechnics or technical institutions

The E&E Guidelines also explain the application process, the documents which are to be furnished in support of the application and the procedures for the application.

Further details are available on the MIDA website [Forms & Guidelines - MIDA | Malaysian Investment Development Authority → Manufacturing sector → Application for incentive and/or expatriate posts → Special investment tax allowance for E&E sector]

Guidelines on income tax exemption for religious institutions or organizations pursuant to Income Tax (Exemption) Order 2020 [P.U.(A) 139/2020]

The Income Tax (Exemption) Order 2020 [P.U.(A) 139] was gazetted on 4 May 2020 to provide 100% income tax exemption on all sources of income of a religious institution or organization registered as a company limited by guarantee and incorporated under the Companies Act 2016 (see *Tax Alert No. 7/2020*). The Order took effect from the year of assessment (YA) 2020.

Following the above, the Inland Revenue Board (IRB) has published on its website technical guidelines dated 25 March 2021, in Bahasa Malaysia, titled "Garis Panduan Berhubung Permohonan Pengecualian Cukai Pendapatan Kepada Institusi Atau Organisasi Keagamaan Yang Layak Di Bawah Perintah Cukai Pendapatan (Pengecualian) 2020 [P.U.(A) 139/2020]".

The guidelines were released to explain the meaning of a religious institution or organization within the context of the Exemption Order, as well as the application procedure for the above-mentioned income tax exemption. The guidelines contain the following paragraphs:

1.0 Introduction
2.0 Objective
3.0 Eligible religious institutions or organizations
4.0 The criteria and conditions to be eligible
5.0 The application procedure
6.0 Consequences of a breach of conditions
7.0 The approval period and application for extension
8.0 Conditions to be adhered to during the approval period
9.0 Non-application

Some details are outlined below.

Eligible religious institutions or organizations

The guidelines reiterate that the "religious institution or organization" must be a company limited by guarantee and incorporated under the Companies Act 2016, established exclusively for the purpose of religious worship or the advancement of religion. The institution or organization operating the place of worship must also be verified by the relevant associations or authorities (e.g. Majlis Agama Islam Negeri, Malaysian Buddhist Association, Christian Federation of Malaysia etc.).

The criteria and conditions to be eligible

The guidelines stipulate that all income and property obtained must be used for the purpose of religious worship or advancement of religion as outlined in the constitution or under any written law. In addition, notification to and approval from the IRB must be obtained prior to the acquisition or disposal of assets and/or properties.

The guidelines also reiterate that the exemption does not absolve the religious institution or organization from any requirement to submit any return, statement of accounts or any information required under the Income Tax Act 1967. As such, the annual income tax return forms, audited financial statements and Form E etc. must be submitted by the stipulated deadlines, where applicable.

The application procedure

The guidelines stipulate that the application for approval is to be submitted by the board of directors or committee members to the IRB. The documentation required for the application is outlined in the guidelines.

Consequences of a breach of conditions

The guidelines stipulate that in the event any of the approval conditions stated in the guidelines or the Exemption Order are breached, the IRB has the discretion to revoke the approval for the tax exemption.

The application procedure

The guidelines provide that the approval period is five years. Any application for an extension of the approval period must be submitted within six months before the end of the approval period. The application for an extension of the approval period will only be reviewed if the relevant approval conditions have been met.

Overseas developments

Japan enacts 2021 tax reform bill

On 26 March 2021, Japan's 2021 tax reform bill (the Bill) was enacted following passage of the Bill by the Japanese Diet. The Bill generally follows the tax reform outline announced by Japan's coalition leading parties in December 2020. The amendments generally apply to taxable years beginning on or after 1 April 2021 unless otherwise specified.

The key provisions relevant to multinational corporate taxpayers are summarized below.

Detailed discussion

Digital transformation investment incentives

A digital transformation-related investment of up to JPY30 billion (US$300 million) under a certified business adaptation plan made by 31 March 2023 will be eligible for 30% special depreciation or a 3% to 5% tax credit (capped at 20% of corporate income tax, payable together with the carbon-neutral investment incentives). Digital transformation-related investment includes software, machinery and equipment that contribute to improved productivity and marketing development.

Research and development (R&D) tax credit

- Under the existing law, qualified R&D expenditures are eligible for a 6% to 14% tax credit. The 2021 reform will amend the creditable ratio to 2% to 14% (generally capped at 25% of corporate income tax payable).
- If gross sales in a year between 1 April 2021 and 31 March 2023 decreases by 2% or more as compared to the latest year ended before 1 February 2020, and qualified R&D expenditures for the year are greater than the amount spent in that latest year, an additional creditable amount of 5% will be provided.
- The additional credit measures available under the current law, if qualified R&D expenditures exceed 10% of the average gross sales, will be extended for two years.
- The existing measures for certain small and medium-sized enterprises (SMEs) and for special R&D expenditures will be refined.

Increased employee compensation credit

The existing increased employee compensation credit will be refined to encourage businesses to hire new employees such that if compensation paid to newly hired employees in the current year increases by 2% or more as compared to compensation paid to newly hired employees in the previous year, the compensation paid to newly hired employees in the current year is eligible for a 15% to 20% tax credit, subject to certain conditions (capped at 20% of corporate income tax payable).

Increased limit for deductions of net operating losses (NOLs)

Under the existing law, net operating losses (NOLs) carried forward can only shelter up to 50% of the current year's taxable income (except for certain SMEs). Under the 2021 reform, an increased NOL limit will be provided for eligible NOLs, which is up to the "outstanding amount of accumulated qualified investment" for the applicable fiscal years. This measure is intended to stimulate new investment associated with digital transformation, carbon neutrality and business restructuring.

- Eligible NOLs are NOLs incurred in fiscal years that include any date between 1 April 2020 and 1 April 2021 (in certain circumstances, a fiscal year ended between 1 February 2020 and 31 March 2020 and the following fiscal year).
- The "outstanding amount of accumulated qualified investment" is the amount of investment made under a business adaptation plan, certified within a year of the enactment of the revised *Act on Strengthening Industrial Competitiveness*, reduced by the amount of such investment that was already eligible for this regime.
- The applicable fiscal years are fiscal years that meet all the following:
  - Fiscal years beginning within five years of the first day of the "basis year". The "basis year" is the earliest profitable fiscal year after the fiscal year during which the eligible NOLs are incurred.
  - Fiscal years that include the business adaptation plan period
  - Fiscal years beginning before 1 April 2026

Tax treatment of share-for-share acquisitions

Certain share-for-share acquisitions will qualify for tax neutral (i.e., tax deferred) treatment for existing shareholders, subject to certain conditions, including that 80% or more of the acquisition consideration must be the acquirer's shares.

Incentives to attract foreign financial services companies and fund managers

- Profit-linked directors' compensation (that is usually generally non-deductible except for certain public companies) paid by specified investment management companies will be deductible, subject to certain conditions including approval by investors and certain public disclosure.
- Carried interest (excess distributions from investment partnerships) earned by fund managers will be taxed as capital gain, which is subject to a flat tax rate of approximately 20%, and not as income that is subject to progressive tax rates.
- No inheritance tax or gift tax will be imposed on property outside of Japan acquired by certain non-Japanese nationals.

Carbon neutral investment incentives

Carbon neutral-related investments of up to JPY50 billion (US$500 million) under a certified environment adaptation plan made by 31 March 2024 will be eligible for 50% special depreciation or a 5% to 10% tax credit (capped at 20% of corporate income tax, payable together with the digital transformation investment incentives). Carbon neutral-related investments include equipment that contributes to reduced greenhouse gas emissions.

Digitalization of tax compliance

- The majority of tax-related documentation (including tax returns) will no longer need to be physically stamped.
- The electronic data and documentation retention regime will be refined, including abolishing the tax authorities' pre-approval for electronic retention.
- Certain tax compliance for cross-border transactions (including applications for exemption of qualified bond interest withholding tax and forms for tax treaty benefits) will be accepted via electronic filing, subject to certain conditions.

Philippines enacts law reducing corporate income tax rates and rationalizing fiscal incentives

The Philippine President signed into law the proposed *Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act* on 26 March 2021, but vetoed several provisions. The law amends the Philippines' corporate income tax and incentives system in a bid to attract increased foreign investment and help the economy recover from the COVID-19 pandemic.

The law is set to take effect on 11 April 2021, that is 15 days after its complete publication, unless specifically provided in the law.

The key amendments of the CREATE Act and the provisions vetoed by the President relevant to multinational corporations are summarized below.

Amendments to corporate income tax and other taxes

- Effective 1 July 2020, the corporate income tax (CIT) rate is reduced from 30% to:
    - 20% for domestic corporations with net taxable income not exceeding PHP5 million (US$100,000) and with total assets (excluding land where the business entity's office, plant and equipment are situated) not exceeding PHP100 million (US$2 million)
    - 25% for all other domestic corporations and resident foreign corporations (e.g., branches)
- Effective 1 January 2021, the CIT rate is reduced from 30% to 25% for non-resident foreign corporations.
- Effective 1 July 2020 until 30 June 2023, the minimum CIT rate is reduced from 2% to 1%. The minimum CIT is applicable to domestic and resident foreign corporations and applies if the calculated minimum CIT is higher than the regular CIT amount.
- Effective 1 January 2022, the CIT rate applicable to regional operating headquarters (ROHQs) is increased from 10% to 25%.
- Capital gains derived by foreign corporations from the sale of shares of stock not traded on the Philippines' stock exchange are subject to a flat tax rate of 15% (previously 5% on the first US$2,000 and 10% in excess thereof).
- Increase of the final income tax rate for interest income derived under the expanded foreign currency deposit system by resident foreign corporations from 7.5% to 15%
- Allowance of 150% deduction for labor training expenses incurred for skills development of enterprise-based trainees, subject to certain conditions
- Income tax exemption for foreign-sourced dividends received by domestic corporations which are reinvested in the Philippines, subject to certain conditions
- Removal of 1) tax exemption for income derived by offshore banking units (OBUs) from foreign currency transactions with non-residents; and 2) 10% final tax on interest income derived by OBUs from foreign currency loans granted to residents. Such income will be subject to the 25% CIT rate.
- Definition of "reorganization" for purposes of non-recognition of gain or loss on exchanges of property solely for stock is expanded to include: (i) a merger or consolidation; (ii) an acquisition resulting in gain of control or further control; (iii) an acquisition of all or substantially all properties of another corporation; (iv) a recapitalization; and (v) a reincorporation. Prior Bureau of Internal Revenue (BIR) confirmations or tax rulings are no longer required to avail of the tax exemption on the exchange.

Amendments to indirect tax and incentives related to COVID-19 prevention, control and treatment

- Value-added tax (VAT) exemption on the sale or importation of the following goods:
    - Drugs, vaccines, medical devices, capital equipment, spare parts and raw materials for

- the prevention, control and treatment of COVID-19, subject to conditions, beginning 1 January 2021 to 31 December 2023; and
- Prescription drugs and medicines for cancer, mental illness, tuberculosis and kidney diseases, beginning 1 January 2021 (previously 1 January 2023)

- The importation of COVID-19 vaccines will be exempt from import duties, taxes and other fees, subject to the approval or licenses issued by the Department of Health or the Food and Drug Administration.

Revised fiscal incentives for registered projects and activities

- Qualified export enterprises may be eligible for a four to seven-year income tax holiday (ITH), to be followed by a 10-year 5% special corporate income tax (SCIT) on gross income earned or a 10-year enhanced deductions (ED).
- Qualified domestic market enterprises may be eligible for a four- to seven-year ITH, to be followed by a five-year ED.
- Customs duty exemption for the importation of capital equipment, raw materials, spare parts or accessories directly and exclusively used in the registered project or activity of registered enterprises
- VAT exemption for importation and VAT zero-rating for local purchases of goods and services directly and exclusively used in the registered project or activity, regardless of the registered enterprise's location (i.e., ecozone or free port zone)
- Higher incentives for registered enterprises located outside of metropolitan areas:
  - Additional two years ITH for enterprises located in areas recovering from armed conflict or a major disaster
  - Additional three years ITH for enterprises completely relocating to outside of the National Capital Region
- Transition provisions for existing registered activities:
  - Existing registered activities granted an ITH only will be permitted to continue with their remaining ITH period.
  - Existing registered activities granted an ITH and 5% gross income earned tax (GIT) after the ITH period, or are currently receiving the 5% GIT, will be permitted to continue the 5% GIT for 10 years, regardless of the number of years they have been receiving the incentive.
  - After the expiration of the transition period, existing registered export enterprises may reapply and receive the SCIT for 10 years, subject to certain conditions and performance reviews.

The President of the Philippines may approve a modified set of incentives or financial support package aimed at attracting highly desirable projects or specific industrial activities for projects with a comprehensive sustainable development plan and with a minimum investment capital of PHP50 billion (US$1 billion) or minimum local employment generation of at least 10,000 personnel within three years, among other conditions. The grant of an ITH should not exceed eight years and thereafter, a 5% SCIT may be granted, provided the total period of incentive does not exceed 40 years.

Vetoed provisions of the CREATE Act

- Increasing the VAT-exempt threshold for the sale of real property
- 90-day period for the processing of general tax refunds
- Definition of investment capital to exclude land and working capital
- Redundant incentives (i.e., SCIT) for domestic market enterprises (DMEs) and further classifications of DMEs (e.g., engaged in activities classified as "critical" and with minimum investment capital of PHP500 million (US$10 million))

- Allowing existing registered activities to apply for further extension of new incentives for the same activity
- Limitations on the power of the Fiscal Incentive Review Board (FIRB)
- Specific industries mentioned under activity tiers
- Provision granting the President the power to exempt any investment promotion agency from the reform
- Automatic approval of applications for incentives if not acted upon

Implications

By reducing the CIT rate and rationalizing fiscal incentives, the CREATE Act intends to make the Philippines' corporate tax system responsive, globally competitive and attractive to foreign investors, and at the same time, assist Philippine businesses recover from the economic impact of the COVID-19 pandemic. Multinational corporations looking to restructure their organization should also consider these amendments to achieve tax efficiency in their planning and future operations.

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Important dates

30 April 2021	6th month revision of tax estimates for companies with October year-end
30 April 2021	9th month revision of tax estimates for companies with July year-end
30 April 2021	Statutory deadline for filing of 2020 tax returns for companies with September year-end
15 May 2021	Due date for monthly instalments
31 May 2021	6th month revision of tax estimates for companies with November year-end
31 May 2021	9th month revision of tax estimates for companies with August year-end
31 May 2021	Statutory deadline for filing of 2020 tax returns for companies with October year-end

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