

# DOING BUSINESS IN MALAYSIA

Prepared by: **SKRINE**

Skrine Unit No. 50-8-1,  
8th Floor, Wisma UOA Damansara  
50 Jalan Dungun, Damansara Heights  
50490 Kuala Lumpur, Malaysia  
Tel: +603 – 2094 8111  
Fax: +603 – 2094 3211  
Email: [skrine@skrine.co](mailto:skrine@skrine.co)

# DOING BUSINESS IN MALAYSIA

## I. Forms of Business Organisations

In Malaysia any business enterprise must take one of the following three forms:-

- a sole proprietorship;
- a partnership;
- a locally incorporated company, or branch of a foreign company.

### A) Sole Proprietorship and Partnership

A sole proprietor, as well as a partner of a business, is personally liable for the debts of the business. Partners of a business may draw up partnership agreements or be governed by the *Partnership Act 1961*. All sole proprietorships and partnerships must be registered with the Companies Commission of Malaysia ("CCM") under the *Registration of Businesses Act 1956*. Prior to the establishment of the CCM in April 2002, the functions relating to registration of businesses was undertaken by the Registrar of Businesses. No foreign individuals or companies (whether locally incorporated or foreign) can be registered as a sole proprietor with the CCM. The CCM as a matter of practice, does not permit companies (whether locally incorporated or foreign) or foreign individuals to be registered as partners in a partnership. The present laws of Malaysia do not permit partnerships with limited liability to be established, except for offshore limited partnerships in Labuan, under the *Labuan Offshore Limited Partnerships Act 1997*.

### B) Incorporated Company

Any two or more persons may incorporate a company. Although there are three types of companies that may be formed, the most popular is a company limited by shares where the personal liability of members is limited to the amount if any, unpaid on their shares. A company may be either a private or a public company.

A private company is one whose articles of association restrict the right of its members to transfer their shares, restrict membership to 50 and prohibits any invitation to the public to subscribe for its shares or debentures or to deposit money with it. A public company however, is generally one that desires to raise capital from the public. Such companies typically go on to seek listing of their shares on the Bursa Malaysia Securities Berhad ("BMSB"), the Malaysian stock exchange.

### C) Branch of a Foreign Company

Instead of forming a local company, a foreign company may choose to operate a branch in Malaysia.

The Malaysian *Guidelines on Foreign Participation in Wholesale and Retail Trade* provides that with effect from 1 November 1995, a foreign company is not allowed to establish a branch to carry on business in wholesale and retail trade in Malaysia. Instead, all foreign involvement is required to be through a company incorporated in Malaysia under the *Companies Act 1965*.

### D) Typical Foreign Business Ventures

In practical terms, foreigners desiring to carry on a business in Malaysia have the following options:-

- (a) register a branch office if the investor is a foreign company;
- (b) incorporate a separate Malaysian company as its subsidiary;
- (c) acquire all or a majority of the shares of an existing Malaysian company; or
- (d) enter into joint venture with a Malaysian company or individual typically through holding shares in a newly-incorporated joint venture company.

## **II. The Investment Regulatory Framework**

In Malaysia, a two-pronged approach is used to regulate investment i.e. (i) policy; and (ii) legislation.

### **A) New Economic Policy**

At the heart of the government's policy on investment was the New Economic Policy popularly known as the "NEP". Formulated in 1970, the objectives of the NEP were to eradicate poverty and to correct racial economic imbalance so as to lead to a capital ownership structure which consists of Bumiputeras, non-Bumiputeras and foreign interests in the proportion of 30%, 40% and 30% respectively.

The Foreign Investment Committee ("FIC") was established as a part of the Prime Minister's Department in Malaysia to regulate, *inter alia*, the acquisition of assets, mergers and takeovers in accordance with the guidelines and policies as laid down by the Government.

Based on the objectives of the NEP, the FIC issued its *Guidelines for the Regulation of Acquisition of Assets, Mergers and Take-overs of Companies and Businesses* ("FIC Guidelines") and formed the FIC under the wings of the Economic Planning Unit in 1974.

### **B) New Development Policy**

Following the expiry of the NEP in 1990, the Government introduced the New Development Policy (NDP) in 1991 as the framework for economic policy between 1991 and 2000. While still holding the NEP's twin objectives of poverty eradication and ethnic redistribution of wealth, NDP places greater emphasis on redistribution through rapid growth.

### **C) The Government Stimulus Package announced on 21 May 2003**

The measures announced in the Government Stimulus Package pertaining to the FIC Guidelines are effective and applicable as of 21 May 2003. Some of the measures have been incorporated into the new guidelines issued by the FIC on 1 August 2004 and include the following:-

- (i) Acquisitions by Malaysian and foreign interests, in the case of companies that do not have any Bumiputera equity or having less than 30% Bumiputera equity, the equity condition imposed will be Bumiputera (indigenous Malay) equity of at least 30%. In the case of acquisitions by foreign interest, the remaining equity can be held either by foreign interests or jointly by foreign and Malaysian interests.

However, in the case of acquisitions of companies with Bumiputera equity shareholding of 51% or more, the companies will be required to maintain at least 51% Bumiputera equity at all times.

- (ii) The requirement of at least 30% Bumiputera equity participation will be applied by all ministries except where exemptions have been granted by the Government.

- (iii) The threshold level for acquisitions by foreign and Malaysian interests which are exempted from FIC's approval will be raised from RM 5 million to RM 10 million. The existing percentage of share acquisition/voting rights of Malaysian and foreign interests which trigger the requirement for FIC's approval will remain.
- (iv) Processing of approvals on acquisitions by licensed manufacturing companies will be centralized at the Ministry of International Trade and Industry ("MITI"), and corporate proposals pursuant to sec. 32 of the *Securities Commission Act 1993* at the Securities Commission ("SC"). These proposals will no longer require FIC's consideration.
- (v) The equity conditions that will be imposed on companies seeking listing on the BMSB are as follows: -
  - a. Bumiputera equity participation of at least 30% upon listing, subject to sub-paragraph (b).
  - b. For listing of companies having major foreign based operations as defined in SC's Policies And Guidelines On Issue/Offer of Securities, the 30% Bumiputera equity shareholding requirement need not be complied with.
- (vi) The compliance period for the equity conditions has been relaxed as follows: -
  - a. Equity conditions imposed, if any, must be complied within two (2) years from the date of the FIC approval letter;
  - b. the compliance period may be extended by one (1) year based on the merits of the case.
- (vii) Foreign interest is allowed to acquire landed properties exceeding RM 150,000 per unit.

D) Regulatory Bodies

- (a) MIDA

With the aim of reducing red tape, the Government set up an investment centre called the Malaysian Industrial Development Authority ("MIDA"). Its role is to receive, process and convey decisions on manufacturing projects, including tax and investment incentives, exemptions from import and customs duty, expatriate posts and other matters affecting investors. Senior officers from the Ministries of Finance and Labour, and the Immigration, Customs and Environmental Departments are stationed at MIDA to help answer queries from investors.

- (b) MITI

MITI spearheads the development of industrial activities to further enhance Malaysia's economic growth.

E) Manufacturing

- (a) The Industrial Co-ordination Act 1975

The Industrial Co-ordination Act 1975 ("ICA") requires persons involved in any manufacturing activity to obtain a licence from MITI if: -

- i) the manufacturing company's shareholders' funds exceed RM 2.5 million; or
- ii) it employs 75 or more full time employees; or
- iii) the manufacturing activities are in relation to optical discs.

If the manufacturing company does not come within the requirements of the ICA, it is exempted from the requirement of applying for a manufacturing licence. However, if the manufacturing company does exceed RM 2.5 million in shareholders funds or employs 75 or more full time employees at any time in the future, it would then be required to submit an application in the prescribed form for a manufacturing licence to MIDA, which is the government's principal agency for the promotion and co-ordination of industrial development in Malaysia.

(b) Equity Policy for New, Expansion or Diversification Projects

The level of exports had been used to determine foreign equity participation in manufacturing projects. However, since 31 July 1998, the Malaysian government has relaxed the equity policy guidelines for all applications for investments in new as well as expansion/diversification projects in the manufacturing sector. Under this relaxation, foreign investors could hold 100% of the equity irrespective of the level of exports.

However, this relaxation only applied to applications that were received by 31 December 2003. In addition, it did not apply to specific activities and products where Malaysian companies had the capabilities and expertise. These activities and products were paper packaging, plastic packaging (bottles, films, sheets and bags), plastic injection moulded components, metal stamping and metal fabrication, wire harness, printing and steel service centres. In these cases, specific equity guidelines prevailed.

To further enhance Malaysia's investment climate, equity holdings in all manufacturing projects were fully liberalised effective from 17 June 2003. Foreign investors can now hold 100% of the equity 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 any product/activity being excluded.

The new 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.
- 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.

(c) Equity Policy Applicable to Existing Companies

Equity and export conditions imposed on companies prior to 17 June 2003 will be maintained.

However, companies can request for these conditions to be removed. The government will be flexible in considering such requests and approval will be given based on the merits of each case. Companies with export conditions can apply for approval from MIDA to sell in the domestic market based on the following guidelines:

- Up to 100% of their output for those products with nil duty or those not produced locally
- Up to 80% of their output if the domestic supply is inadequate or there has been an increase in imports from ASEAN for products with Common Effective Preferential Tariff (CEPT) duties of 5% and below.

F) Petroleum Industry

(a) The Petroleum Development Act 1974

MITI is also the licensing authority for any proposed business of manufacturing, processing or refining of petroleum or petrochemical products. However the Ministry of Domestic Trade and Consumer Affairs is the licensing authority for any proposed business of marketing or distribution of petroleum or petrochemical products.

Any proposed upstream petroleum activity comes under the purview of a corporation set up by the government and under the direction and control of the Prime Minister. This corporation called 'Petroleum Nasional Berhad' ("Petronas") has been vested with the entire ownership, rights and privileges of exploring petroleum resources on land and off-shore.

G) Multimedia Super Corridor ("MSC") and Multimedia Development Corporation ("MDC")

For investors keen on developing or using multimedia technologies to provide value, the Government offers several incentives to those who intend to set up companies that qualify for MSC status.

Companies which have been granted the MSC status by the MDC will enjoy the following incentives that are backed by the Government's Bill of Guarantees:-

(a) Financial Incentives

- i) Pioneer status – Malaysian income tax exemption of 100% of the MSC-status company's statutory income commencing from the date when it starts generating revenue. This incentive is granted for a period of five years renewable for up to 10 years, or.
- ii) 100% investment tax allowance on qualifying expenditure for five years from the date on which it is first incurred.
- iii) Eligibility for R&D grants for local small and medium-sized companies in the MSC with at least 51% Malaysian ownership.
- iv) Duty-free importation of multimedia products.

(b) Non-financial Incentives

- i) Unrestricted employment of local and foreign knowledge workers.
- ii) Freedom of ownership (exemption from local ownership requirements, e.g. bumiputera shareholding requirement).
- iii) Freedom to source capital globally for MSC Infrastructure and the right to borrow funds globally.
- iv) Other incentives:-
  - Intellectual property protection and a pioneering and comprehensive framework of cyber laws can be enjoyed by MSC-status companies irrespective of location.
  - No censorship of the Internet.
  - Support available from the one-stop client centre of the MDC on matters such as expedition of the issuance of visas, application of other licences and permits and compliance of reporting requirements.
  - World class physical and IT infrastructure if companies are located within the MSC.

- Globally competitive telecommunication tariffs and services guaranteed if MSC-status companies are located within the MSC.
- High quality, planned urban developments if MSC-status companies locate within the MSC.
- Excellent R&D facilities, including the region's first Multimedia University if companies are located within the MSC.
- Green environment protected by strict zoning if located within the MSC.

Companies operating in the MSC which are incorporated as separate legal entities are given exemption from exchange control regulations upon the companies being awarded MSC status by the MDC. The exemption granted is solely for transactions undertaken on its own account. However, prior approval should be obtained to deal with Specified Persons as defined by the Central Bank of Malaysia in its exchange control notices (made in its capacity as Controller of Foreign Exchange) and in the restricted currencies of Israel, Serbia and Montenegro. In addition, MSC companies are also required to submit the necessary statistical forms/reports/statements for monitoring purposes.

To qualify for MSC status, the company making the application must fulfill the following criteria: -

- Be a provider or heavy user of multimedia products and services.
- Employ a substantial number of knowledge workers.
- Provide technology transfer and/or knowledge to Malaysia, or otherwise contribute towards the development of the MSC or support Malaysia's k-economy initiatives.

A company that qualifies for MSC status will further be expected to operate according to the following conditions in order to maintain this preferential designation:-

- Establish a separate legal entity for the MSC qualifying activities.
- Locate itself in a MSC designated cyber city.
- Comply with environmental guidelines.

For existing companies, the tax incentives above will apply to the "value added" of the companies i.e. the companies' additional statutory income above the average income for the past three years, or as the value of new investment made in the MSC.

With effect from year of assessment 1998, institutions of higher education with faculties offering an internationally recognised standard of higher education in multimedia, information technology, engineering, the sciences and other related fields that will contribute to the development of human resources for the MSC.

#### H) Foreign Investment Committee

If the proposed investment does not involve petroleum or licensed manufacturing activities or multimedia technologies, the investor may have to obtain the approval from the FIC for the following:-

- any proposed acquisition by foreign interests of any substantial fixed assets in Malaysia;
- any proposed acquisition of assets or any interests, mergers and take-overs of companies and businesses in Malaysia by any means, which will result in ownership or control passing to foreign interests;
- any proposed acquisition of 15% or more of the voting power by any one foreign interest or associated group or by foreign interest in the aggregate of 30% or more of the voting power of a Malaysian company and business;

- control of Malaysian companies and businesses through any form of joint-venture agreement, management agreement and technical assistance or other arrangements;
- any mergers and take-over of any company and business in Malaysia whether by Malaysian or foreign interests;
- any other proposed acquisition of assets or interests exceeding RM10 million in value whether by Malaysian or foreign interests (the threshold was revised to RM 10 million with effect from 21 May 2003); and
- any acquisition by Malaysian interests of shares in Malaysian incorporated companies which constitutes more than 50% of the voting power of the company i.e. where it gains statutory control.

Specific projects approved by the Government are exempted from the requirements of FIC's prior approval.

#### I) Securities Commission

The Securities Commission ("SC") is a statutory body established pursuant to the *Securities Commission Act 1993* ("SCA"). In the exercise of its powers under sec. 33A(1) of the SCA, it has prescribed a code on take-overs and mergers known as the *Malaysian Code on Take-overs and Mergers 1998* ("Take-over Code").

Any person who makes a take-over offer, or acquires more than 33% of the voting shares of a public company (whether or not listed on any stock exchange) or obtains control in a company must comply with the provisions of the Take-over Code. Likewise, any acquisition of more than 33% of a private company which has either shareholders' funds or a paid-up capital of RM 10 million or more based on the latest audited accounts (on a consolidated basis, if applicable) and a purchase consideration exceeding RM 20 million must also comply with the Take-over Code.

#### J) Guidelines on Foreign Participation in Wholesale and Retail Trade

Under the *Guidelines on Foreign Participation in Wholesale and Retail Trade* ("WRT Guidelines"), with effect from 1 November 1995, all proposals for foreign involvement in wholesale and retail trade within the meaning of the WRT Guidelines must obtain the prior approval of the Committee on Wholesale and Retail Trade. This includes the opening of new branches or the relocation of existing businesses with foreign involvement.

Wholesale trade is defined as *"the re-sale (sale without transformation) of new and used goods to retailers, to industrial, commercial, institutional or professional users or to wholesalers, or acting as agents in buying merchandise for, or selling merchandise to such persons or companies"*. Retail trade is defined as *"the re-sale (sale without transformation) of new and used goods to the general public, for personal or household/ consumption or utilisation, by shops, department stores, mail order houses, retail motor vehicle dealers, consumer co-operatives, auction houses, etc"*.

Under the WRT Guidelines, any foreign involvement in wholesale and retail trade would require the incorporation of the business locally under the *Companies Act 1965*. With effect from 1 November 1995, a foreign branch is not allowed to establish a place of business or carry on business in wholesale and retail trade in Malaysia.

#### K) International Procurement Centre Scheme

The International Procurement Centre ("IPC") scheme allows locally incorporated companies, whether locally or foreign owned, which carry on business in Malaysia to undertake the procurement and sales of

raw materials, components, and finished products for its group of related and unrelated companies in Malaysia and abroad. This would include the procurement and sales from local sources or from any source.

(a) Incentives and facilities for IPC status companies

A company granted IPC status will enjoy the following:-

Tax Incentives

- (i) Malaysian income tax exemption of 100% of the IPC's statutory income for 10 years.
- (ii) Dividends paid from the exempt income will be exempted from income tax in the hands of the shareholders.

To qualify for the above tax incentives, an IPC status company must satisfy the following criteria:-

- Total annual turnover of the company should not be less than RM100 million.
- Annual sales to the domestic market are limited to 20% of its annual sales turnover. If the annual sales to the domestic market exceed 20%, the additional sales will not be given tax exemption.
- Sales to Free Zones and licensed manufacturing warehouses (LMWs) are considered as domestic sales.
- The company must serve as a collection and consolidation centre for finished goods, components and spare parts from overseas or within the country to be distributed to dealers, importers or its subsidiaries or associated companies within or outside Malaysia.

Facilities

- (i) Expatriate post approved based on requirements of IPC.
- (ii) Open one or more foreign currency accounts with any licensed commercial bank to retain their export proceeds for the IPC activities only without any limit imposed.
- (iii) Enter into foreign exchange forward contracts with any licensed commercial bank to sell forward export proceeds based on projected volume of export.
- (iv) Allowed 100% equity holding by the promoter.
- (v) Allowed to bring in raw materials or finished products without customs duties exemption into Free Industrial Zones or Licensed Manufacturing Warehouses for repackaging, cargo consolidation and integration before distribution to the final consumers.

(b) Criteria for IPC status

The applicant should have: -

- (i) A locally incorporated company under the *Companies Act 1965* with a minimum paid up capital of RM 500,000.
- (ii) A minimum total business spending (operating expenditure) of RM1.5 million per annum.
- (iii) Incremental usage of Malaysian ports and airports.
- (iv) A minimum annual sales turnover of RM50 million by the third year of operation.

In general, sales by an IPC status company to the domestic market are limited to not more than 20% of its annual sales value.

Applications of IPC status are to be submitted to MIDA.

### III. Immigration and Expatriate Posts

The Government's policy is to encourage employment of Malaysians. However the Government allows foreign personnel to be brought in where there is a shortage of suitably trained Malaysians. In addition the Government also allows companies with foreign investors to bring in expatriates to fill 'key posts' to protect their interests.

The government has, with effect from 17 June 2003, issued new guidelines on the employment of expatriate personnel as follows:-

- (a) For manufacturing companies with a foreign paid up capital of US\$ 2 million and above:
  - (i) an automatic approval will be given for up to 10 expatriate posts, including five key posts;
  - (ii) expatriates can be employed for up to a maximum of 10 years for executive posts, and five years for non-executive posts.
- (b) For manufacturing companies with a foreign paid-up capital of more than US\$200,000 but less than US\$2 million:
  - (i) an automatic approval will be given for up to five expatriate posts, including at least one key post;
  - (ii) expatriates can be employed for up to a maximum 10 years for executive posts, and five years for non-executive posts.
- (c) Manufacturing companies with a foreign paid-up capital of less than US\$200,000 will be considered for both key posts and time posts based on the current guidelines as follows:
  - (i) Key posts can be considered where the foreign paid-up capital is at least RM500,000. This amount, however, is only a guideline and the number of key posts allowed depends on the merits of each case;
  - (ii) Time posts can be considered for up to 10 years for executive posts that require professional qualifications and practical experience, and five years for non-executive posts that require technical skills and experience. For these posts, Malaysians must be trained to eventually take over the posts.
  - (iii) The number of key posts and time posts allowed depends on the merits of each case.
- (d) For Malaysian-owned manufacturing companies, automatic approval for the employment of expatriates for technical posts, including R & D posts, will be given as requested.

An expatriate personnel who is transferred from one post to another within the same company will be required to obtain a new employment pass. His original employment pass will be amended to reflect the change in post. A new expatriate personnel replacing another must also obtain a fresh employment pass.

All employment passes are valid for the period approved for the post. However, for key post holders, employment passes will be issued on a five-year renewable basis except in circumstances where:

- the validity of the expatriate's passport is less than five years,
- the expatriate's employment contract is less than five years, or

- the employer requires the services of the expatriate for less than five years.

Holders of employment passes will be issued with multiple entry visas valid for the duration of the employment pass

There are several types of passes issued by the Immigration Authorities: -

(i) Visit Pass (Temporary Employment)

This is issued to persons who enter the country to take up employment for less than 24 months or earn a monthly income of less than RM2,500.

(ii) Employment Pass

This is issued to foreigners who enter the country to take up employment for a minimum period of two years and earn a monthly income of not less than RM2,500.

(iii) Visit Pass (Professional)

This is issued to foreigners who wish to enter the country for the purpose of engaging in a short-term contract with any agency.

The categories of foreigners who are eligible are as follows:

- artistes
- those entering for filming
- researchers recognised by the Government of Malaysia
- members of an International Organisation
- volunteers
- invited lecturers/speakers
- those entering for religious purposes
- experts in the installation or maintenance of machines/computers.

The validity of the pass varies but it does not exceed 12 months at any one time.

(iv) Dependant's Pass

This is issued to wives and children of foreigners who have been issued with an employment pass. This pass may be applied for together with the application for an employment pass or after the employment pass is approved. Wives and children of foreigners who enter the country on a visit pass (temporary employment or professional) will be issued a visit pass (social).

(v) Student's Pass

This is issued to foreigners who enroll as students in any approved educational institution.

(vi) Visit Pass (social or/and business)

- Owners and company representatives entering Malaysia to attend a company meeting or seminar, inspect the company's accounts, or to ensure the smooth running of the company

- Investors or businessmen entering to explore business opportunities and investment potential
- Foreign representatives of companies entering to introduce goods for manufacture in Malaysia, but not to engage in direct selling or distribution
- Property owners entering to negotiate, sell or lease properties
- Foreign reporters from mass media agencies entering to cover any event in Malaysia
- Participants in sporting events

These passes cannot be used for employment or for supervising the installation of new machinery or the construction of a factory.

#### **IV. Finance and Exchange Control**

##### **A) Bank Negara Malaysia**

The central bank of Malaysia, known as Bank Negara Malaysia is the monetary authority in Malaysia. It has wide powers to supervise and control the activities of commercial banks and all other financial institutions and also to regulate the financial industry. Bank Negara Malaysia is also the Controller of Foreign Exchange (“Controller”), the exchange control authority.

##### **B) Exchange Control Act and Exchange Control Notices of Malaysia**

The *Exchange Control Act 1953* prohibits all dealings and transactions which come within the purview of the Act, unless the permission of the Controller is obtained. Pursuant to the powers given to the Controller under the Act, the Controller has granted certain permissions by way of exchange control notices (“ECM Notices”).

###### **(a) Repatriation of profit, capital, dividends and interests**

Due to the volatile conditions of the Asian economies in 1997 and 1998, the Malaysian government imposed on 1 September 1998 a levy on repatriation out of Malaysia of foreign funds (except for foreign direct investments).

Foreign direct investments, being an investment made by non-resident in a company, where the non-resident is entitled to exercise or control the exercise of not more than 10% of the votes attached to the voting shares of the company, or where the directors of the company are under an obligation to act in accordance or with the wishes of the non-resident, were allowed to repatriate their investments, including capital, profits, dividends and interest without being subject to any levy even after 1 September 1998. Likewise, dividends, interest and rental earned were not subject to the said levy.

However, the government over the course of time gradually relaxed the levy and with effect from 2 May 2001, the remaining exit levy, being the 10% exit levy imposed on profits of portfolio investments repatriated within 12 months from the month profits are realized, was abolished.

###### **(b) Non-resident controlled companies (“NRCC”)**

In certain circumstances, the prior permission of the Controller is required before an NRCC can obtain domestic banking facilities.

Under ECM 8 issued by the Controller, an NRCC is defined as a company in Malaysia where: -

- i) More than 50% of its shareholding is held by non-residents and/or NRCC's;
- ii) It is a branch of a company which is incorporated outside Malaysia;
- iii) The majority shareholding is held by residents, but the ultimate right of control is held by non-residents and/or NRCCs; or
- iv) Although the ultimate right of control is held by residents, the majority shareholding is held by non-residents and/or NRCCs.

Notwithstanding the above, the Controller may, if it deems fit, direct that a particular company be designated as an NRCC. An NRCC would include the NRCC group comprising the holding companies and subsidiaries in Malaysia.

A resident would require the prior approval of the Controller to extend credit facilities to an NRCC unless the credit facilities come within the following exceptions:-

- i) Any amount, in Ringgit or foreign currency for short term trade financing (which includes facilities to guarantee payment for purchase of goods) where the tenure of credit does not exceed 12 months; and
- ii) Up to the aggregate limit of RM 50 million (prior to 21 April 2003, the aggregate limit was RM 10 million) in Ringgit or foreign currency for any other credit facility (excluding short term trade financing);

and also provided that the credit facilities in foreign currency are extended by a licensed bank or licensed merchant bank in compliance with provisions of ECM 10.

There is no restriction on the amount of credit facilities to be extended by foreign-owned banking institutions in Malaysia to an NRCC, provided the aggregate amount of credit facilities obtained by the NRCC from all residents does not exceed RM 50 million. Prior to 21 April 2003, at least 50% of short term trade financing and 50% of other types of credit facilities, must be extended by Malaysian-owned banking institutions pursuant to ECM 8.

A banking institution which is an NRCC is exempted from the requirements of ECM 8.

## **V. Labour and Social Security**

Malaysia's labour laws are set out in a number of statutes based mainly on English and Australian statutes.

### **A) Employment Act 1955**

This Act applies to all employees whose earnings do not exceed RM1500 per month and any person who (irrespective of salary) is employed:

- i) as a manual labourer;
- ii) as a supervisor of manual labourers to operate or maintain any mechanically propelled vehicle for the purpose of transporting passengers or goods or reward or commercial purposes (e.g. lorries, trailers, buses, mini vans, forklifts, chauffeur driven cars, etc.)

- iii) as a domestic servant;
- iv) in certain positions in sea-going vessels.

The Act sets out, amongst others, minimum terms of employment, for example, on annual, sick and maternity leave, overtime payments and termination notice periods. There are various regulations made under this Act such as the *Employment (Termination and Lay-Off Benefits) Regulations 1980* and the *Employment (Limitation of Overtime Work) Regulations 1980*.

B) Industrial Relations Act 1971

This Act regulates the relations between employers and workmen and their trade unions and seeks to prevent and settle differences and disputes arising between them. Some of the main features of this Act are:-

- the protection afforded to workmen to form and/or join a trade union and to participate in union activities
- the provisions relating to trade union recognition and collective bargaining
- the law and process involved in the settlement of trade disputes
- the protection afforded to workmen against unjust dismissals
- proceedings in the Industrial Court.

C) Trade Unions Act 1959

This Act provides for the registration, constitution and administration of trade unions and regulates their activities in matters relating to union disputes and usage of funds. The Act does not permit the formation of an omnibus or a federation of different types of trade unions and only allows these to be formed on an industrial, trade and occupational basis. While the Government's policy is to encourage the growth of democratic and responsible trade unionism within the context of public and rational interests, it has sought to provide sufficient safeguards in the Act against militancy or unlawful activities of trade unions.

D) Employees Provident Fund Act 1951

This Act provides for compulsory contribution by employers and employees at the rates of 11% and 12% respectively, to a provident fund which may be withdrawn by an employee in certain circumstances such as upon attaining the age of 55 years, for medical expenses, children's education and the purchase of a home. Expatriates and domestic servants are exempted from compulsory contribution.

E) Employees' Social Security Act 1969

All industries with one or more employees are required to insure their employees whose wages do not exceed RM2,000 a month. Employees who have become liable to contribute continue to be entitled to be insured even if their salaries exceed RM2,000 per month. The two schemes under the Act are:-

- (i) the Employment Injury Scheme providing coverage for disablement or death due to employment injury. The contribution is solely by the employer and is about 1% of the employees' wages;
- (ii) the Invalidity Pension Scheme providing a coverage to employees against invalidity and death from any cause before the age of 55 years. The contribution of about 2% to 2.5% of the

employee's wages is shared by the employer and employee with the employer taking the larger share.

## VI. Intellectual Property

The scope of intellectual property rights protection in Malaysia is wide-ranging and currently comprises trademarks, patents, copyright, industrial designs, geographical indications and layout designs of integrated circuits. Malaysia is also a member of the World Intellectual Property Organisation (WIPO) and a signatory to a number of international treaties which govern intellectual property rights, including the Berne Convention for the Protection of Literary and Artistic Works 1886, the Paris Convention and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

### A) Trademarks

In general, the nature of protection that may be accorded to a trademark will be determined by whether or not the trademark is registered. Registered trademarks and service marks are governed by the *Trade Marks Act 1976* and the *Trade Marks Regulations 1997*. Upon registration, no one other than the registered proprietor or registered user is allowed to use the trademark. In the event of any unauthorised use or infringement of a trademark, the proprietor may take civil action against the purported infringing party. With regards to trademarks that are either unregistered or pending registration, an aggrieved party may have recourse to a remedy under the law of passing off. However in order for a passing off action to succeed, the aggrieved party must prove that he has suffered damage or loss to his goodwill or reputation as a result of some misrepresentation by another party. Furthermore, by virtue of the fact that the *Trade Descriptions Act 1972* requires goods sold in Malaysia to carry correct and true trade description, an aggrieved party could also apply to the Malaysian courts for an order to declare that an infringing trademark or an act of passing off is a false trade description. Notably, in conformance with TRIPs, the *Trade Marks Act 1976* also prohibits the registration of well-known trademarks by unauthorised persons, and the importing of counterfeit trademarks into Malaysia.

### B) Patents

With regards to inventions, the *Patents Act 1983* and *Patent Regulations 1996* govern the protection of the same in Malaysia. An invention is patentable if it is universally novel, involves a non-obvious step and is capable of industrial application. Once granted protection, a patent owner will be entitled to fully exploit the patent, which includes the power to deal with, transmit or assign the patent.

### C) Copyright

Unlike trademarks and patents, the protection afforded by copyright is not dependent on registration. Copyright law in Malaysia is governed by the *Copyright Act 1987* as well as the various subsidiary legislation. The *Copyright Act 1987* confers copyright on three broad categories of work: (i) original works i.e. literary, musical and artistic works; (ii) sound recordings, films and broadcasts; and (iii) typographical arrangements or published editions. As Malaysia is a member of the Berne Convention, literary, musical, artistic works and films of foreign authorship are also entitled to the same rights and protection in Malaysia. This is provided that such works were first published in a country that is a member of the Berne Convention, or where it is first published elsewhere, it is then published in a country that is a member of the Berne Convention within 30 days of such publication elsewhere. Additionally, pursuant to the recent amendments in the *Copyright (Application to Other Countries) Regulations 1990*, sound recordings, broadcasts and published editions, which were made, first published or transmitted from a World Trade Organisation member country is also protected pursuant to the said *Copyright Act 1987*.

In line with its obligations under the TRIPs Agreement, Malaysia has also recognised a performer's right in his live performance. Pursuant to the *Copyright (Amendment) Act 2000*, performers' rights are now incorporated as part of the *Copyright Act 1987*. Thus, a performer may now control the way his live performance will be communicated to the public as well as the fixation (i.e. recording) of his live performance as a sound recording or on film. Additionally a performer may also control the reproduction, distribution, rental or sale of a fixation of his live performance.

D) Industrial Designs

Malaysia also provides for the protection of industrial designs by virtue of the *Industrial Designs Act 1996* and *Industrial Designs Regulations 1999*. A design can only be registered if it is new, and does not merely involve a method of construction nor is it dictated solely by function. It is to be noted that an artistic work incorporating a design may also be registrable under the *Industrial Designs Act 1996*, the effect of which is to enable a design to be protected either under copyright or industrial design law or both. Nevertheless, from 1st September 1999, the *Copyright Act 1987* denies copyright protection for designs which are capable of being registered but which have not been registered, where there is an application of that design to an article and that article has been reproduced more than 50 times by an industrial process.

Another recent addition to the intellectual property rights framework in Malaysia is the *Layout Designs of Integrated Circuits Act 2000*. In order to qualify for protection, the layout design of an integrated circuit has to be original, to the extent that the layout design must result from the creator's own intellectual effort and be freely created. Similar to copyright, registration is not a pre-requisite to the granting of protection for layout designs of integrated circuits.

E) Geographical Indications

The *Geographical Indications Act 2000* is also a fairly new piece of legislation in Malaysia, which basically accords protection to goods which are named after the region or locality in which the goods are produced. Akin to trademarks, there is a requirement for registration for geographical indications. However, geographical indications which are contrary to public order and morality are not registrable. In the case of any infringement of geographical indications, the actions and remedies available to an aggrieved party are also similar to those of trademark infringement.

F) Confidential Information and Trade Secrets

Apart from the intellectual property rights protected by statute, confidential information and trade secrets are also entitled to protection under the principles of common law and equity. An action for breach of confidence requires that the information be confidential in nature, that it was imparted in circumstances importing an obligation of confidence and that the use of the information was unauthorised.

G) Administration of IP Matters

Finally, a statutory body known as the Intellectual Property Corporation of Malaysia was recently set up to take over the functions of the Intellectual Property Division of the Ministry of Domestic Trade and Consumer Affairs. Pursuant to the *Intellectual Property Corporation Act of Malaysia 2002*, the new body has been given jurisdiction over all issues relating to intellectual property, such as registration as well as advising on the review and updating of all the intellectual property legislation in Malaysia.

## VII. Tax Structure

The basic taxation system in Malaysia is territorial in nature. All income of companies and individuals accrued in, derived from or received in Malaysia from outside Malaysia, are liable to income tax. However, foreign sourced income received in Malaysia from outside Malaysia by resident companies (except those involved in the banking, insurance, air and sea transportation business), non-resident companies and non-resident individuals are exempted from income tax in Malaysia.

The Malaysian taxation system comprises of direct and indirect imposition of taxes. The forms of direct taxes are income tax, real property gains tax and petroleum income tax. Indirect taxes come in the form of excise duty, customs duties, sales tax, service tax, stamp duty and quit rent and assessments on realty. There is no capital gains tax in Malaysia apart from real property gains tax.

### A) Income Tax

#### (a) Sources of taxable income

The *Income Tax Act 1967* governs the taxation of income tax in Malaysia. Under the *Income Tax Act 1967* the classes of income chargeable to income tax are as follow:-

- gains or profits from an employment (salaries, remunerations, etc.);
- gains and profits from a business which includes profession, vocation and trade and every manufacture, adventure or concern in the nature of trade;
- dividends, interests or discounts;
- rents, royalties or premiums;
- pensions, annuities or other periodic payments; and
- other gains or profits of an income nature not falling under any of the above.

#### (b) Personal Income Tax

A resident individual in Malaysia is chargeable to income tax on income accruing in or derived from Malaysia or received in Malaysia from outside Malaysia. A non-resident individual is chargeable on the income accruing in or derived from Malaysia. The rate of tax depends on the individual's resident status, which is determined by the duration of his stay in the country as stipulated under sec. 7 of the *Income Tax Act 1967*. Generally, an individual residing in Malaysia for more than 182 days in a year has tax resident status.

Effective from the year of assessment 2004, income remitted to Malaysia by a resident individual is exempted from income tax. A resident individual is taxed on his chargeable income at a graduated rate from 0% to 28% after deducting tax reliefs. A non-resident individual is not eligible for any personal tax relief and is subject to 28% tax on the chargeable income accruing in or derived from Malaysia unless there are double tax treaties. Other sources of income received by a non-resident individual are subject to withholding tax as discussed below. Non-resident public entertainers are taxed at 15% of the gross income.

#### (i) Personal Reliefs

The chargeable income of a resident individual is arrived at after making several deductions. These include the personal reliefs for self (a further deduction will be given if the taxpayer is a disabled person), spouse and unmarried children below 18 years of age; parents' medical expenses; medical expenses on serious diseases including medical examinations for individual, spouse or child; expenditure for purchase of basic support equipment for the individual, spouse, child or parent who is disabled; and

contributions to the Employees Provident Fund (EPF), life insurance premiums, and insurance premiums for education or medical benefits, etc.

An amount limited to a maximum of RM5,000 on fees expended by the individual for any course of study up to tertiary level for the purpose of acquiring scientific, technical, vocational, industrial, and information and communications technology (ICT) skills at the local institutions of higher learning in Malaysia recognized by the Government is also allowed as a deduction.

(ii) Tax Rebate

The tax liability of a resident individual is reduced by way of the following rebates:

- An individual with a chargeable income not exceeding RM35,000 enjoys a rebate of RM350. Where the wife is not working or the wife's income is jointly assessed, she also enjoys a further rebate of RM350. Similarly, a wife who is assessed separately will also enjoy a RM350 rebate, provided her chargeable income does not exceed RM35,000.
- RM400 towards the purchase of a personal computer once every five years per family. Under Budget 2005, with effect from year of assessment 2005, this rebate has been increased to RM500.
- Any fee paid to the government for the issue of an employment pass, visit pass or work permit.

A non-resident individual on the other hand, is liable to tax at the rate of 28% without any tax rebate. However, he can claim rebates in respect of levy paid to the government for the issuance of an employment work permit.

B) Company Tax

A company, whether resident or not, is assessable on income accrued in or derived from Malaysia. With effect from year of assessment 2004, income derived from sources outside Malaysia and remitted by a resident company is exempted from tax, except in the case of the banking and insurance business, and sea and air transport undertakings. A company is considered a resident in Malaysia if the control and management of its affairs are exercised in Malaysia.

A tax rate of 28% applies to both resident and non-resident companies. A company carrying on petroleum upstream operations is subject to a petroleum income tax of 38%.

C) Real Property Gains Tax

Capital gains are generally not subject to tax in Malaysia. Real property gains tax is chargeable on capital gains arising from the disposal of real property and on the disposal of shares in a real property company ("RPC"). Under the *Real Property Gains Tax Act 1976*, "real property" is defined as any land situated in Malaysia and includes any interest, option, or other right in or over such land. A "RPC" is defined as a controlled company which owns real property or shares in a RPC or both, the defined value of which is not less than 75% of the value of its total tangible assets. A controlled company means a company having not more than 50 members and controlled by 5 persons at the most. The rates of real property gains tax for Malaysian citizens, permanent residents and resident companies are as follows:-

On disposal within 2 years	30%
Disposal in the third year	20%
Disposal in the fourth year	15%
Disposal in the fifth year	5%

Disposal in the sixth year  
and thereafter

Nil (Individual)  
5% (Company)

Citizens and permanent residents also enjoy an exemption of RM5000 or an exemption on 10% of the gains (whichever is greater), besides a one-time tax exemption on the gains, arising from the disposal of one private residence.

However in respect of non-citizens, non-permanent residents and non-resident companies, gains from the disposal of real property within five years are taxed at a rate of 30%, and 5% in respect of a disposal in the sixth year or thereafter.

D) Withholding Tax

Under the *Income Tax Act 1967*, withholding tax is to be withheld and remitted to the Malaysian Inland Revenue Board ("IRB") by the resident payer within thirty days after payment or crediting such payment to a non-resident person (includes individual and company).

Withholding taxes in Malaysia are limited to certain categories of income under the *Income Tax Act 1967* as follows:-

- 10% on the following special classes of income derived in Malaysia in respect of:-
  - amount paid in consideration of services rendered in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;
  - amount paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;
  - rent or other payment made under any agreement or arrangement for the use of any moveable property.

Effective from 21 September 2003, payments to non-residents for services performed outside Malaysia will not be subject to withholding tax.

- 10% on royalties
- 15% on interest
- 15% on the services of a public entertainer
- 13% on contract payment in respect of services rendered under a contract and 3% on contract payment to the employees of that non-resident company. (As opposed to the other categories, this is not a final tax but an advance payment to the IRB until the final tax of the non-resident is computed).

The withholding tax rates are subject to reduction in the double taxation treaties, if any.

Under Budget 2005, with effect from 11<sup>th</sup> September 2004, tax exemption will be given on interest income derived by non-resident companies from:-

- Islamic Securities or debentures issued in Ringgit Malaysia, other than convertible loan stock, approved by SC; and
- Securities issued by the Government.

An employee on a short term visit to Malaysia enjoys tax exemption in respect of his income from an employment exercised in Malaysia when his presence does not exceed 60 days in a calendar year. However, the income of a non-resident individual who performs independent services such as consultancy services is not exempted from tax.

#### E) Indirect Taxes

Sales tax is a one stage ad valorem tax levied on taxable goods imported for local consumption and on taxable goods manufactured and sold locally except petroleum products where the rates are specific. Sales tax does not apply to Joint Development Area, Labuan, Langkawi, Tioman, Free Zones and LMW. Manufacturers of taxable goods are required to be licensed under the *Sales Tax Act 1972*. However, manufacturers whose annual sales turnover does not exceed RM100,000 in the preceding year and is not expected to exceed RM100,000 during the next 12 months may apply for a certificate of exemption from licensing. Sales tax is generally at 10% but certain non-essential foodstuffs and building materials are taxed at 5%, cigarettes and tobacco products at 25% and liquor and alcoholic drinks at 20%.

Service tax applies to taxable goods and services, including food and drinks; provision of rooms for lodging and premises for meetings; health services and the provision of accommodation and food by private hospitals, certain professional and consultancy services, provided by taxable persons. Service tax does not apply to Free Zones, Langkawi, Labuan, Tioman and Joint Development Area. Any taxable person carrying on taxable services must apply for a licence under the *Service Tax Act 1975*. As of 1 January 2003, certain professional services provided by a company to companies within the same group was exempted from the current service tax of 5%. Generally, the imposition of service tax is subject to a specific threshold based on an annual turnover ranging from RM150,000 to RM300,000.

Customs duties (include import duty and export duty) are imposed under the *Customs Act 1967*. The rates of customs duties vary based on the types of goods. The rates and exemption of customs duties are prescribed in subsidiary legislation made under the *Customs Act 1967*.

The rate of stamp duty chargeable depends on the nature of the instrument involved and varies from a fixed charge, ad valorem or a certain percentage of the value of the subject matter of the transaction. Stamp duty is imposed under Stamp Act 1949.

Excise duties are levied on selected products manufactured in Malaysia (e.g. cigarettes and liquors) for local consumption and selected imported goods. In order to encourage the export of locally manufactured goods, companies with LMW status that manufacture goods subject to excise duty are exempted from being licensed under the *Excise Duty Act 1976*.

Local rates such as assessment and quit rent are imposed by state governments and local authorities on real property located within the jurisdiction of such authorities.

#### F) Double Taxation Agreement

Malaysia has entered into approximately 60 bilateral double taxation agreements. Generally under the double taxation agreements, income such as business profits, dividends, interests and royalties derived from Malaysia by non-residents are not subject to Malaysian income tax unless the non-resident carries on activities within Malaysia through a permanent establishment, that is, a fixed place in Malaysia where a trade or business is carried on.

## VIII. Tax Incentives

Tax incentives, both direct and indirect, are provided for mainly in the *Promotion of Investments Act 1986*, *Income Tax Act 1967*, *Customs Act 1967*, *Sales Tax Act 1972*, *Excise Act 1976* and *Free Zones Act 1990*. The incentives are applicable to investments in the manufacturing, agriculture, tourism and approved services sectors as well as R&D, training and environmental protection activities.

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

### A) Pioneer Status

The major tax incentives for companies investing in the manufacturing sector are the pioneer status or an investment tax allowance. Eligibility for pioneer status or an investment tax allowance is based on certain priorities, including the levels of value-added, local content, technology used and industrial linkages. Such eligible projects are termed as “promoted activities” or “promoted products”.

A company that has been granted Pioneer Status will enjoy a five to ten-years tax exemption on part or all its statutory business income depending on the promoted activities or promoted products. To encourage investment in the promoted areas i.e. the States of Sabah and Sarawak and the designated Eastern Corridor of Peninsular Malaysia, applications received from 13 September 2003 from companies located in these areas will enjoy a 100% tax exemption on their statutory income. Companies which have been granted approval for this incentive but have not commenced commercial production, or applications under consideration, are also eligible for the incentive.

### B) Investment Tax Allowance

As an alternative to Pioneer Status, a company may apply for Investment Tax Allowance (ITA). A company granted ITA gets an allowance of up to 100% on qualifying capital expenditure incurred for the purposes of the promoted activities or products within five years from the date on which the first qualifying capital expenditure was incurred.

The company can offset this allowance against 70% of its statutory income for each year of assessment. Any unutilized allowance can be carried forward to subsequent years until fully utilized. The remaining 30% of its statutory income will be taxed at the prevailing company tax rate.

To encourage investment in the promoted areas i.e. the States of Sabah and Sarawak and the designated “Eastern Corridor” of Peninsular Malaysia, applications received from 13 September 2003 from companies located in these areas will enjoy an allowance of 100% on the qualifying capital expenditure incurred within a period of five years. The allowance can be utilised to offset against 100% of the statutory income for each year of assessment. Companies which have been granted approval for this incentive but have not commenced commercial production, or applications under consideration, are also eligible for the incentive.

### C) Reinvestment Allowance

All Malaysian resident companies that have been in operation for at least 12 months and incur qualifying capital expenditure within five years from the date the expenditure was first incurred to expand production capacity, modernize and upgrade production facilities, diversify into related products, and automate its production facilities can obtain a reinvestment allowance (RA).

The RA is 60% on qualifying capital expenditure incurred by the company which can be offset against 70% of its statutory income for the year of assessment. Any unutilized allowances can be carried

forward to subsequent years until fully utilized. A RA is given in addition to the normal capital allowances.

A company can offset the RA against 100% of its statutory income for the year of assessment if:

- The company undertakes reinvestment projects in Sabah, Sarawak and the designated “Eastern Corridor” of Peninsular Malaysia;
- The company attains a productivity level exceeding the level determined by the Ministry of Finance.

The RA will be given for a period of 15 consecutive years beginning from the year the first claim of RA was made. Companies can only claim upon completion of the qualifying project, i.e. after the building is completed or when the plant/machinery is put to operational use. Assets acquired for the reinvestment cannot be disposed of during the two years from the time of reinvestment. If the assets included in the qualifying capital expenditure are disposed within two years from the date of acquisition, RA given in respect of that asset is deemed to have not been given.

Effective from 21 September 2002, a company that intends to reinvest before the expiry of its pioneer status incentive can surrender its pioneer status for cancellation and be eligible for RA.

#### D) Industrial Building Allowance

An industrial building allowance (IBA) is granted to companies incurring capital expenditure on the construction or purchase of a building that is used for specific purposes, including manufacturing, agriculture, mining, infrastructure facilities, research, approved services projects and hotels that are registered with the Ministry of Culture, Arts and Tourism. Such companies are eligible for an initial allowance of 10% and an annual allowance of 3% from the residual value of the assets. As such, the expenditure can be written off in 30 years. Under Budget 2005, with effect from year of assessment 2005, IBA will be computed based on the purchase price of the assets.

#### E) Deduction for Promotion of Exports

Certain expenses incurred by resident companies for the purpose of seeking opportunities to export Malaysian manufactured and agricultural products and services qualify for deduction.

Some of the eligible expenses that qualify for single deduction are the registration of patents, trade marks and product licensing overseas and hotel accommodation for a maximum of three nights in providing hospitality to potential importers invited to Malaysia.

Some of the eligible expenses that qualify for double deduction include overseas advertising, publicity and public relations work, supplying samples abroad, including accommodation expenses up to RM200 per day and sustenance expenses up to RM100 per day for company representatives who travel overseas for business and maintaining sales offices and warehouses overseas to promote exports. Under Budget 2005, with effect from year of assessment 2005, double deduction will be given to expenses incurred in preparing architectural and engineering models, perspective drawings and 3D animations for participating in competitions at international level.

#### F) Operational Headquarters

An approved operational headquarters (OHQ) refers to a locally incorporated company, whether Malaysian-owned or foreign-owned, which carries on a business in Malaysia of providing qualifying services to its offices or its related companies outside Malaysia.

Prior to the announcement of Budget 2003, the chargeable income of an approved OHQ in relation to its source consisting of the provision of qualifying services was subject to tax at the concessionaire rate of 10% under Part VII of Schedule 1 to the *Income Tax Act 1967*.

It was announced in Budget 2003 that an approved OHQ will be exempted from income tax for a period of 10 years for the following sources of income:

- Business Income - Income arising from services rendered by an OHQ to its offices or related companies outside Malaysia.
- Interest - Income derived from interest on foreign currency loans extended by an OHQ to its offices or related companies outside Malaysia.
- Royalties - Royalties received from research and development work carried out in Malaysia by an OHQ on behalf of its offices or related companies outside Malaysia.

Dividends paid from the exempt income will be exempted in the hands of shareholders. The above exemption is to be made by way of a statutory order under sec 127 of the *Income Tax Act 1967* and will be effective for applications received by MIDA from 21<sup>st</sup> September 2002.

Effective from the year of assessment 2003, income from qualifying services provided by an OHQ to its related companies in Malaysia during its tax exempt period is exempted from tax provided such income does not exceed 20% of the OHQ income from qualifying services.

To qualify for these incentives, the paid-up capital of the company should be a minimum of RM0.5 million and the total business spending should be at least RM1.5 million per annum. The company should also perform a minimum of three of the following qualifying services for its offices or related companies outside Malaysia:

- (i) general management and administration;
- (ii) business planning and coordination;
- (iii) procurement of raw materials, components and finished products;
- (iv) technical support and maintenance;
- (v) marketing control and sales promotion planning;
- (vi) data/information management and processing;
- (vii) treasury and fund management services;
- (viii) corporate financial advisory services;
- (ix) research and development work; and
- (x) training and personnel management.

Further, effective from year of assessment 2003, expatriates working in OHQs will be taxed only on the portion of their chargeable income attributable to the number of days they are in Malaysia.

An approved OHQ enjoys non-financial incentives including freedom to maintain foreign currency accounts and obtain credit facilities in foreign currency to fund their treasury and fund management operations for their related companies outside Malaysia.

#### G) Regional Distribution Centres

A Regional Distribution Centre (RDC) is a collection and consolidation centre for finished goods, components and spare parts from overseas or within the country to be distributed to dealers and

importers or its subsidiaries or associated companies within or outside the country. Among the activities involved are bulk breaking, repackaging and labeling.

RDCs are eligible for the following incentives:

- Full income tax exemption on statutory income for 10 years
- Dividends paid from the exempt income are exempted from income tax in the hands of the shareholder
- Exemption on import duty and sales tax on goods for distribution
- Approval will be given to expatriate positions according to the requirements

However, to qualify for the above incentives, an approved RDC status company must also fulfil the following additional criteria :

- It must be incorporated in Malaysia under the *Companies Act 1965*
- It must have an annual sales turnover of at least RM100 million
- It must be located in the free zones (free industrial zone or free commercial zone) or licensed warehouse (public and private) or LMW
- Sales to the domestic market are limited to 20% of its sales turnover. If sales to the domestic market exceed 20%, the additional sales will not be tax exempt.

The incentives are applicable for applications received by the Ministry of Finance through MITI from 21<sup>st</sup> September 2002.

## **IX. Non-Tax Incentives**

### **A) Exemption from Import Duty on Raw Materials / Components**

Full exemption from import duty can be considered for raw materials/components, regardless of whether the finished products are meant for the export or domestic market. With regard to products for the export market, full exemption from import duty on raw materials/components is normally granted, provided the raw materials/components are not produced locally or, where they are produced locally, are not of acceptable quality and price. As for products for the domestic market, full exemption from import duty on raw materials/components that are not produced locally can be considered. Full exemption can also be considered if the finished product made from dutiable raw materials/components is not subject to any import duty. Most machinery and equipment not locally produced are not liable for import duty. However, machinery and equipment imposed with import duty can be considered for exemption subject to certain conditions.

### **B) Drawback of Import Duty, Sales Tax and Excise Duty**

Under the *Customs Act 1967*, *Sales Tax Act 1972* and *Excise Act 1976*, a drawback on import duty, sales tax and excise duty that have been paid may be claimed by a manufacturer if the parts, raw materials or packaging materials are used in the manufacture of goods for export within a year.

### **C) Sales Tax Exemption**

Under the *Sales Tax Act 1972*, the Minister of Finance may, by way of statutory orders, grant full or partial exemptions (with or without conditions) on taxable goods or taxable persons from sales tax. Manufacturers of taxable goods with an annual sales turnover of less than RM100,000 in the preceding year and is not expected to exceed RM100,000 in the next 12 months or persons whose manufacturing

operations consist of certain prescribed activities may apply for a certificate of exemption from licensing and are thus exempted from charging sales tax. However, these manufacturers can opt to be licensed so as to obtain facilities provided to the licensed manufacturers including acquisition of taxable goods free of sales tax.

## **X. Federal Territory of Labuan**

Labuan, an island of the coast of East Malaysia, is an integrated international financial offshore centre offering a wide range of financial products and services. There are various legislation enacted for the creation of the Labuan Offshore Financial Centre including the establishment of offshore companies which enjoy protection against public scrutiny of their existence and records.

Offshore companies are allowed to carrying on offshore business activities in Labuan. Under the *Labuan Offshore Business Activity Tax Act 1990*, subject to certain provisos, "offshore business activity" means an offshore trading or an offshore non-trading activity carried on in or from Labuan in a currency other than the Malaysian currency by an offshore company with non-residents or with another offshore company, but excluding shipping operations other than charter of ships on a bareboat basis.

Offshore trading activities include banking, insurance, trading, management, licensing or any other activity which is not an offshore non-trading activity. Offshore non-trading activities refer to activities relating to the holding of investments in securities, stocks, shares, loans, deposits and immovable properties by an offshore company on its own behalf. Where an offshore company carries on both an offshore trading activity and an offshore non-trading activity, it shall be deemed to be carrying on an offshore trading activity.

The *Labuan Offshore Business Activity Tax Act 1990* provides for the reduction or complete exemption of income tax in respect of offshore business activities carried on by offshore companies in Labuan.

An offshore company carrying on an offshore trading activity can choose to pay tax each year at the rate of 3% of its net audited profits or a fixed sum of RM20,000 a year. An offshore company carrying on an offshore non-trading activity for the basis period for a year of assessment is not subject to tax for that year of assessment. An offshore company, which has no basis period for a year of assessment is taxed a fixed rate of RM20,000 for that year of assessment. Capital gains are reflected as part of the net profits of an offshore company carrying on an offshore trading activity and hence it will be subject to 3% tax or RM20,000. Capital gains from the sale of shares in an offshore company are not taxable if the shareholders disposing such shares do not have a business presence in Malaysia and are not investment dealers.

Labuan trust companies rendering qualifying professional services to offshore companies in Labuan is exempted from income tax up to 65% of the statutory income from that source until year of assessment 2004. The qualifying professional services include legal, accounting, financial and secretarial services, and those provided by a trust company as defined in the *Labuan Trust Companies Act 1990*.

Non-citizens employed in a managerial capacity in an offshore company in Labuan enjoy income tax exemption up to 50% of gross income until year of assessment 2004.

The *Income Tax Act 1967* applies to any activity other than offshore business activity carried on by an offshore company or an offshore insurance business carried on by a Malaysian offshore insurer as defined under the Offshore Insurance Act 1990, which is a branch of a Malaysian insurer. The following exemptions are available under the *Income Tax Act 1967*:

- (a) For dividends received by an offshore company are tax exempted, no refund or set-off applies to tax deducted for such dividends.

- (b) Dividends paid by an offshore company out of income derived from an offshore business activity or out of exempt income is not subject to income tax in the hands of the recipient. Such dividends will be paid gross without any tax deducted at source.
- (c) The distribution made by an offshore trust is not subject to income tax in the hands of the beneficiary.
- (d) The royalty paid by an offshore company to a non-resident person or another offshore company is exempted from withholding tax.
- (e) Interest paid by an offshore company to a non-resident person (other than interest accruing to a business carried on by a non-resident person in Malaysia carrying on a banking, finance company or insurance business) or another offshore company is exempted from withholding tax.
- (f) Interest paid by an offshore company to a resident person, other than a person carrying on a banking, finance company or insurance business in Malaysia, is exempted from tax.
- (g) Technical or management fees paid by an offshore company to a non-resident or another offshore company are exempted from tax.
- (h) Lease rental paid to non-resident persons in respect of income arising from the use of a moveable property by an offshore company licensed to carry leasing business in Labuan is exempted from tax.

Some of the other tax incentives for offshore companies in Labuan are as follows:

- Offshore business transactions by an offshore company (including M&A of an offshore company and transfer of shares in an offshore company) are exempted from stamp duty.
- Operators and investors could stand to benefit from double tax agreements (DTA) between Malaysia and well over 50 countries.
- Malaysia has signed investment guarantee agreements (IGA) with more than 60 countries, providing additional protection against nationalization of investment undertaken in Labuan.
- Labuan is a duty free island where goods are brought in free of import duties, making it a shopping haven for tourist and business travellers.

## **XI. Arbitration in Malaysia**

Arbitration has become the principal avenue in Malaysia for dispute resolution, as an alternative to using the court system in commercial and business disputes, especially at the international level. Besides the court, arbitration is currently the only legally binding and enforceable alternative. Arbitration offers advantages in that it is confidential, neutral and flexible. In light of the backlog of cases pending, litigation at the courts can be time consuming and costly.

Arbitrations, whether domestic or international, may be either ad hoc or institutional arbitrations. Ad hoc arbitrations are those agreed to by the parties without the involvement of an arbitration institution. The proceedings will follow the procedural laws of the place selected by the parties as the place of arbitration, which in Malaysia allows the arbitrator to act with freedom so long as both parties are given a reasonable opportunity to be heard. Institutional arbitrations, on the other hand, are governed by the rules of institutions which provide arbitration services.

#### A) Arbitration Act 1952

The *Arbitration Act 1952* relates to the conduct of arbitrations and substantially follows the English *Arbitration Act 1950*. This Act is supplemented by Order 69 of the *Rules of the High Court 1980* which governs the procedure for cases related to arbitration brought before the Court.

The Act creates two legal regimes for arbitration in Malaysia. The first is arbitrations conducted under the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965* or under the *United Nations Commission on International Trade Law Arbitration Rules 1976* and the *Rules of the Regional Centre for Arbitration at Kuala Lumpur* (Convention and Centre arbitrations). In respect of these arbitrations, except for the provisions of law relating to the enforcement of arbitral awards, the Act and all other Malaysian written law do not apply.

The second are those other arbitrations, apart from Convention and Centre arbitrations, to which the provisions of the Act apply. Most arbitrations conducted pursuant to arbitration agreements are governed by the Act. The Act is a code incorporating provisions in respect of the powers of the arbitrator, constitution of the arbitral tribunal, enforcement of awards and control by the courts. Parties to an arbitration agreement may exclude or vary many of these provisions, with the exception of the jurisdiction of the court to intervene when there is impropriety in the arbitral proceedings.

#### B) Benefits of Arbitration

The benefits of arbitration vis-à-vis court litigation are:

- Arbitration hearings are confidential unlike court hearings and judgments which are public. However, if the court's limited jurisdiction is sought, the matter could then become public.
- Arbitral rules are flexible in terms of procedure, hearing, time frame, and place of hearing whereas courts are bound by their rules of procedure.
- Depending on the willingness of the parties involved, arbitration can be much faster than litigation.
- Arbitral awards may be challenged in the courts only on limited grounds. The awards for international arbitration are enforceable internationally since Malaysia is a signatory of the *New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards*.
- Arbitration allows the parties to select the language, procedural rules, nationality of arbitrators, legal representation and place of arbitration.
- In arbitration, the parties are able to select arbitrators who are highly specialized in the areas of dispute.

#### C) Process of Arbitration

Under the principles of the Act, arbitration commences when one party to the arbitration agreement serves notice on the other party, to appoint an arbitrator, or to submit the dispute specified to the designated arbitrator. If the arbitration is referred to the Kuala Lumpur Regional Centre for Arbitration ("KLRCA"), the claimant has to file a copy of the notice served on the respondent to the Director of the KLRCA, together with a copy of any other notice on the arbitral proceedings. The Director must also be informed if there shall be an appointing authority other than the KLRCA and the name of such authority. Upon request, the Director shall make available the necessary facilities and assistance for the conduct of the proceedings.

If the arbitrator accepts the appointment, he will convene a preliminary hearing with the parties and their legal advisers. They will discuss and decide interlocutory applications on the delivery of pleadings, discovery of documents, nature of the evidence to be adduced and other procedural matters.

The arbitral proceedings can be similar to a court trial. For arbitrations under the Act, arbitration agreements shall be deemed to include an undertaking that the parties claiming under it shall submit to be examined by the arbitrator and shall upon request produce all documents in their possession or power. The arbitration tribunal is empowered to examine the parties and their witnesses on oath or affirmation and to order that documents be produced. In this regard, any party may take out a summons in the High Court for the giving of evidence or production of documents.

The parties can set out their own rules in the arbitration agreement with respect to all aspects of the arbitration proceedings but the court has jurisdiction to intervene on the ground of impropriety in the proceedings for an arbitration governed by the Act.

The Act will apply where there are gaps in the arbitration agreement. The Act provides for the High Court to intervene on application by either party in the appointment and removal of arbitrators, extension of time for commencing arbitration proceedings, in ordering production of evidence and documents and appearance of persons for examination, in the enforcement, remittance and setting aside of arbitral awards and deciding on costs. Such intervention however is excluded for Convention and Centre arbitrations.

The award reached by the arbitrator must comply with any directions contained in the submission to be valid and should decide the matters submitted. If the arbitration is supervised by the KLRCA, the arbitral tribunal shall submit a signed copy of the award after the parties are notified and the Director shall assist in the filing and registration of the award if required by the law of the country where the award is made.

An arbitrator may decide on the costs of the arbitration including his own fees unless stated otherwise in the arbitration agreement. If the arbitration is submitted to the KLRCA, the Director shall after consultation with the arbitrators and the parties, settle the basis of computation of fees and expenses before the arbitrators assume their duties. The costs of arbitration will comprise the remuneration and expenses of the arbitrator, all expenses properly incurred by the parties in the course of inquiry before the arbitrator and any expenses incurred in connection with the arbitration by the parties or by the arbitrator with the consent of the parties. Parties are to decide in the agreement as to who shall pay the costs. The general practice is that the losing party bears the costs.

*Skrine*

*6 October 2004*

*Skrine*

*Unit No. 50-8-1, 8<sup>th</sup> Floor, Wisma UOA Damansara,  
50 Jalan Dungun, Damansara Heights,  
50490 Kuala Lumpur,  
Malaysia.*

*Tel: +603 – 2094 8111*

*Fax: +603 – 2094 3211*

*Email: skrine@skrine.com*

*Skrine is one of the oldest and largest law firms in Malaysia providing a wide range of legal services. Its main areas of practice include corporate, capital markets, litigation and intellectual property.*

*Contributed by Janet Looi Lai Heng, N. Pathmavathy, Selvamalar Alagaratnam, Melanie Ann Selvalingam, Elaine Lee Pei Sze, Jeannette Tan Lii Shyan and Adriani Wahjanto.*