Part 1: Pioneer Status

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Pioneer Status – Who Qualify?

- **Company or person**
- **Desirous of establishing or participating in a promoted activity or of producing a promoted product**
- **existing company desire to engage in a new promoted activity or producing a new promoted product,**
- **Given by product / activity**
- **Mutually exclusive with ITA / RA/other tax incentives (other than 2x)**

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Mechanism of Incentives

- Separate accounts for each activity granted PS/ITA.
- Abated 70% @ SI = Exempt
  = Tax exempt account
  = 2 tier tax exemption
- Tax relief period: Production day – 5 years / 10 years
  (Stated in Pioneer Certificate)

Pioneer Status – Tax treatment

	After 31.10.91	
Pioneer income(#)	70%/100% Statutory income	BA
Tax exempt account	Pioneer income Non-pioneer loss S44(2) Pioneer loss S43/44 (#)	BA (BB) (BC) BD Disregard loss i.e. cannot used to set off other income
30% of statutory income	Deemed total income ≠ unabsorbed pioneer loss ≠ non-pioneer loss ≠ tax exempt donation	
Pioneer loss	Set-off against Pioneer Income	

(#)wef 1.1.2019,royalty income/any income derived fr commercial exploitation of intellectual property rights would not be treated as pioneer income. Taxed under ITA

Pioneer Status – Tax treatment (Cont'd)

	After 31.10.91
Unabsorbed CA/losses c/f to post-on pioneer period	Yes for pioneer period expired 1.10.2005(up to 7 consecutive years)
Non pioneer loss	To set off: 1st : Pioneer income 2nd : Balance = normal rules
Pre-pioneer loss	c/f to pioneer or post pioneer period
Pre-pioneer CA	utilised in pioneer period
Pre-pioneer TWDV c/f	c/f to pioneer (deemed incurred in pioneer)

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Pioneer Status – Tax treatment (Cont'd)

Note :

- Eligible to accumulate and c/f the following claims to post pioneer period :

a. DD on promotion of exports,

b. DD on packaging design and

c. DD on research and development

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Summary of Tax Incentives

		Pioneer Status	
		Exemption Period (Years)	Restricted to % of statutory income
Project of national and strategic importance / MSC		10	100
~~Projects in Promoted Areas~~		~~5~~	~~100~~
High Technology Company / medical devices testing lab company		5	100
Contract R&D Company		5	100 (must approve by MITI as R & D status)
R&D Company		-	-
In-House R&D		-	-
Technical or Vocational Training Company		-	-
Other Companies		5	70

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Part 2:
Investment Tax Allowance

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Investment Tax Allowance – Who Qualify?

- **Company or person**
- **Producing promoted product / engaged in promoted activity**
- **Product or activity granted Pioneer Status ≠ qualify unless Pioneer Status surrendered**
- Retrospective approval (Section 27L, proviso (ii)) commencement of the promoted activity is permitted provided not more than 3 years from the date the application is received
- **Given by products or activities ➔ can enjoy ITA or PS for separate products / activities within the company**

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Investment Tax Allowance - Mechanism of Incentives

- **5 years from date first QE is incurred**
- **60% on QCE**
- **Restricted to 70% @ SI (including unutilised ITA b/f)**
- **Unutilised ITA can be c/f**
- **Unabsorbed CA and losses can be c/f**
- **Two tier tax exemption = ITA utilised**

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Qualifying Capital Expenditure

	Manufacturing	Agriculture	Hotels	Tourist Projects
Factory	√			
Plant and machinery (excl. replacement items)	√	√	√	√
Clearing & preparing of land		√		√
Planting of crops		√		√ trees & plants
Provision of irrigation & drainage system		√		
Construction of access roads incl. bridges		√		√ roads & other infrastructure facilities
Buildings constructed or purchased - welfare or persons - living accommodation - Structural (improvements on land / structures)		 √ √ √		 √ √ √
Birds, animals & other exhibits				√
Construction of hotel building of an approved std (Alteration, extension, renovation)			√	

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Summary of Tax Incentives

	Investment Tax Allowances		
	Period (years)	Rate (% of qualifying CE)	Restricted to % of statutory
Project of national and strategic importance / MSC	5	100	100
~~Projects in Promoted Areas~~	~~5~~	~~100~~	~~100~~
High Technology Company / medical devices company	5	60	100
Contract R&D Company(*)	10	100	70
R&D Company(*)	10	100	70
In-House R&D	10	50	70
Technical or Vocational Training Company	10	100	70
Other Companies	5	60	70

* ***Must be approved by MITI wef 1.1.2022***

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Distinction between In-house Research, R&D Company and Contract R&D

	In-house research (S 29F, 26E)	R&D Company (S 29F, 26E)	Contract R&D
Definition	R&D carried on in M'sia within a company for the purpose of its own biz	Company which provides R&D services in M'sia to its related companies or any other company	Company which provides R&D services in M'sia only to a company other than its related comp.
ITA (qualifying capital expenditure)	50%	100%	100%
Period	10 years	10 years	10 years
Amount of ITA to be utilised for each YA	Restricted to 70% of S.I.	Restricted to 70% of S.I.	Restricted to 70% of S.I.

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Distinction between In-house Research, R&D Company and Contract R&D (Cont'd)

	In-house research (S 29F, 26E)	R&D Company (S 29F, 26E)	Contract R&D
Profits abated will be exempt from tax and to be distributed as 2-tier dividend	Yes	Yes	Yes
Any unutilised ITA to be carried forward to future YA	Yes	Yes	Yes
Remarks	S29F(3) of the PIA 1986 seems to imply that in-house R&D is a biz distinct from its manuf'ing activities. Thus, ITA for in house R&D could not be set-off against the profits from its manuf'ing biz. As research is a cost centre it would be a dis-incentive for comp. to carry out in-house R&D	Related companies which use the service of the R&D company would not be given a DD incentive (s 34B(2) – principal Act)	

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Definition of Research & Development (s 2)

R&D has been defined to mean
any systematic, investigative and experimental study that involves novelty or technical risk carried out in the field of science or technology with the object of acquiring new knowledge or using the results of the study for the production or improvement of materials, devices, products, produce, or processes, but **does not include**—
(a) quality control or routine testing of materials, devices or products;
(b) research in the social sciences or the humanities;
(c) routine data collections;
(d) efficiency surveys or management studies;
(e) market research or sales promotion;
(f) routine modifications or changes to materials, devices, products, processes or production methods; or
(g) cosmetic modifications or stylistic changes to materials, devices, products, processes or production methods.

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ITA

- **Dec 2020 Q1(d)**

3. BP will use the remaining RM5 million for R&D services to be provided by BR&D for innovation and improveme of its products over the years of assessment (YAs) 2024, 2025 and 2026.

9. BR&D will utilise RM6 million from its share capital to acquire and install research equipment. Initially it w only provide R&D services to BP.

(d) Preferred company to claim for R&D incentive

(i) Explain why BR&D is potentially eligible for the status of R&D company, and compute the tax savings for BP and BR&D if BR&D obtains approval for investment tax allowance (ITA) under the Promotion of Investments Act.

(ii) Assuming BR&D qualifies as an R&D company, assess BP's eligibility for the double deduction incentive in respect of the R&D fees it incurs over the three years of assessment, and compute the tax savings.

(iii) Based on the computation of tax savings, recommend which company should claim the R&D incentive. Attach your computations as an appendix to the report.

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(d) Claim for R&D incentive

(i) BR&D – potential eligibility as an R&D company, and associated tax savings

BR&D is potentially eligible for the status of R&D company because it provides R&D services to its related company. Product innovation and improvement, *prima facie*, constitutes R&D as defined. Upon approval for investment tax allowance (ITA), BR&D will be eligible for the 100% ITA to be set off against 70% of statutory income each YA.

[**Tutorial note:** *R&D is defined in the Income Tax Act [s.2] to mean any systematic, investigative and experimental study which involves novelty or technical risk carried out in the field of science or technology with the object of acquiring new knowledge or using the results of the study for the production or improvement of materials, devices, products, produce, or processes, but does not include quality control, routine testing, research in social sciences, management studies, market research, routine modification of products or cosmetic modifications to products.*]

Tax savings
Refer to the attached Appendix for the tax savings.

Refer new definition

(ii) BP's eligibility for double deduction, and associated tax savings

The RM5 million to be spent on R&D services to be rendered by BR&D will qualify for double deduction under the Income Tax Act [s.34B], provided that the related R&D company has not availed itself of ITA under the Promotion of Investments Act.

Tax savings
Refer to the Appendix for the computation of tax savings.

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ITA

(iii) Our recommendation

As seen in the comparative tax savings in the attached Appendix, the tax savings are:

RM1,440,000 if BR&D claims ITA as an R&D company; and
RM2,400,000 if BP claims the double deduction.

However, BP cannot claim the double deduction if BR&D has claimed ITA under the Promotion of Investments Act. Nevertheless, BP can claim a single deduction [under s.34(7), Income Tax Act 1967]. With the combined tax savings of RM2·64 million (RM1·2 million by BP + RM1·44 million by BR&D), it appears that BR&D should apply for the status of R&D company and obtain the ITA incentive.

– End of report –

Appendix

Computation of tax savings under R&D incentives

	BR&D (RM)	BP) (RM)
Double deduction of R&D expenditure to R&D company		5,000,000 x 2 = 10,000,000
Tax exempt income based on investment tax allowance	6,000,000 at 100% = 6,000,000	
Tax savings at 24% over three YAs	1,440,000	2,400,000

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Choosing The Right Incentive

	PIONEER STATUS	ITA
Projected profit for the 5 year period	Fairly accurate	Not affected if wrongly forecasted
Losses, suffered during the 5 yr period	Affect the tax exempt income.	≠ tax exempt income.
Capital intensive	X	√
Long Gestation Period	NOT suitable	Not affected
QCE disposed off ≤ 5 years	N/A	ITA clawed back
Tax exempt acct	Depend on the pioneer income of the 5 year period	Depend on the amt of QCE incurred & utilized.. Unutilised ITA claims c/f until fully utilised

Eg 23.8, pg 312

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7 June 2022

1. Hippie Sdn Bhd (HSB) is a company incorporated and resident in Malaysia. It commenced business on 1 May 2022, carrying out a promoted activity. HSB will close its accounts to 31 December 2022, and thereafter annually to 31 December.
2. HSB has a paid-up ordinary share capital of RM50 million. It has been approved with normal investment tax allowance (ITA), effective from 1 July 2022. Ahmad anticipates that HSB will incur qualifying capital expenditure of RM7 million in the year ending 31 December 2022, and another RM31 million in the year ending 31 December 2023.
3. HSB forecasts that it will break even in the first eight months, but thereafter expects profits of RM7·5 million for YA 2023, and RM19·7 million for YA 2024.

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ITA

- **June 2022 Q2**

Please carry out the following work:

(a) Investment tax allowance (ITA)

Explain to Ahmad how ITA works. In this regard, provide a tax computation of Hippie Sdn Bhd (HSB) for the years of assessment (YAs) 2022, 2023 and 2024 to illustrate the quantification and set-off of ITA so that Ahmad understands the mechanism.

For this purpose, assume that the forecast figures from HSB approximate its statutory income for each YA after fully setting off capital allowances.

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2 Hippie Sdn Bhd (HSB)

(a) Investment tax allowance (ITA)

How ITA works

ITA is an additional deduction from the business statutory income (SI), i.e. after capital allowances. It is quantified at 60% of the qualifying capital expenditure. Each year of assessment (YA), the amount of ITA which may be utilised or set off is restricted to 70% of the SI. Any amount thus absorbed is credited to an exempt account, out of which exempt dividend may be distributed. Any amount unabsorbed may be carried forward indefinitely to be set off against income from the same business source.

Computation of SI from HSB's business:

	RM'000	YA 2022 RM'000	YA 2023 RM'000	YA 2024 RM'000
SI		0	7,500	19,700
YA 2022				
Qualifying capital expenditure (QCE)	7,000			
60% of QCE	4,200			
ITA utilised	0	0		
ITA c/f	4,200			
SI for YA 2022		0		
YA 2023				
QCE	31,000			
60% of QCE	18,600			
Add: ITA b/f	4,200			
	22,800			
Less: 70% of SI	(5,250)		(5,250)	
Unabsorbed ITA c/f	17,550			
SI for YA 2023			2,250	
YA 2024				
QCE	0			
60% of QCE	0			

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PYQ Sept/Dec Q1/2016

1 You, a senior associate, and your tax director attended a meeting with Mr David Cooper, the Vice President Finance of Smart Incorporated (SI), at the office of Tax Firm on 5 December 2016. Below are the notes of that meeting prepared by you.

Extracts from notes of meeting

SI is a multinational group of companies based in the USA. SI plans to set up a manufacturing facility in Malaysia to produce smart watches. Towards this end, SI has incorporated a company in Malaysia, Very Smart Malaysia Sdn Bhd (VSM), with a paid-up ordinary share capital of RM500,000. VSM will commence the construction of its factory in January 2017 and expects to commence production from 1 January 2018.

The financial projections for the new project in Malaysia provided by Mr David were as follows:

Financial year ending 31 December	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Profit/(loss) before tax	(500)	(300)	3,000	7,000	8,000	9,000
Depreciation		1,000	1,000	1,000	1,000	1,000
Qualifying capital expenditure	10,000	5,000	nil	nil	nil	500

VSM expects to receive the first invoice for the factory construction on 1 January 2017.

SI understands from the Malaysian Investment Development Authority (MIDA) that the proposed project is eligible for a tax incentive with enhanced features as 'smart watch' is listed as a promoted product under the 'high technology' category.

Please draft a letter to Mr David which addresses the following issues:

(i) **Tax incentives available**
Identify and explain the incentives available to VSM and the mechanism by which the incentives are given.

PYQ Sept/Dec Q12016

(ii) **Choice of tax incentive**
Provide an explanation of the attributes of the project which would influence the choice of incentive, together with comparative calculations of VSM's tax liability for the years of assessment 2018 to 2022. State our recommendation on the choice of the tax incentive based on your calculations.

For the purposes of these calculations, the capital allowances available will be as follows:

Year of assessment	RM'000
2018	4,350
2019	1,650
2020	1,650
2021	1,650
2022	1,820

Your comparative calculations should ignore any costs of financing.

PYQ Sept/Dec Q1/2016

Further to our meeting on 5 December 2016, we would like to set out the tax issues and implications in relation to your proposed investment in a manufacturing facility in Malaysia. We have also included in the letter some suggestions on how the tax efficiency of the project can be improved based on the information provided during our above mentioned meeting.

(i) Tax incentive available

As Very Smart Malaysia Sdn Bhd (VSM) intends to establish a factory to manufacture a promoted high technology product (the smart watch), it qualifies for enhanced benefits as compared to the standard incentive package offered by the Government. The company can choose either the pioneer status or the investment tax allowance (ITA) incentive. These two incentives are mutually exclusive and the tax incentive application must indicate the incentive applied for.

Pioneer status

If VSM applies for pioneer company status, it will be accorded a full (100%) income tax exemption of the statutory income of the 'smart watch' manufacturing project for its first five years of production (the pioneer period). Statutory income basically refers to the income of the company after deducting tax allowable expenses and capital allowances.

The income exempted can be credited into a tax exempt income account from which tax exempt dividends can be distributed.

ITA

Alternatively, if claimed, the ITA is based on the capital expenditure incurred by VSM. Under this incentive, an additional allowance equal to 60% of the qualifying capital expenditure (factory building and plant and machinery) can be claimed for five years. The ITA claimed/absorbed can be used to exempt up to 100% of the statutory income of the proposed project. Any unutilised ITA can be carried forward indefinitely to be utilised against the future taxable income of the project.

Similar to the pioneer status incentive, the income exempted by the ITA is credited into a tax exempt income account from which tax exempt dividends can be distributed.

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PYQ Sept/Dec Q1/2016

(ii) Preferred tax incentive

As both pioneer status and the ITA incentives are mutually exclusive, it is important that VSM chooses the right/optimum tax incentive to maximize its tax advantage. As pioneer status is given based on the profits earned in the first five years, this incentive would generally be preferred for projects which are profitable but with low/moderate capital investment. On the other hand, the ITA would give a better outcome if the project is capital intensive and there is a relatively long gestation period before the project becomes profitable.

Based on the financial projections provided, we attach a simulation of the tax position of VSM during the five-year incentive period. This indicates that pioneer status would give a better outcome as the company would not be in a tax paying position for the first five years of operation whilst under the ITA incentive, the company would have a tax liability of RM2,779,000.

Based on the above, we recommend that VSM apply for pioneer status.

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PYQ Sept/Dec Q1/2016

Appendix

Comparative calculations of tax incentives for the proposed manufacturing project

Option 1: Pioneer status

Year of assessment	2018	2019	2020	2021	2022
	RM'000	RM'000	RM'000	RM'000	RM'000
Profit before tax	(300)	3,000	7,000	8,000	9,000
Depreciation	1,000	1,000	1,000	1,000	1,000
Adjusted income	700	4,000	8,000	9,000	10,000
Less: Capital allowance	(700)	(4,000)	(2,950)	(1,650)	(1,820)
Statutory income	Nil	Nil	5,050	7,350	8,180
Pioneer exemption – 100%	Nil	Nil	(5,050)	(7,350)	(8,180)
Chargeable income	Nil	Nil	Nil	Nil	Nil
Tax liability at 24%	Nil	Nil	Nil	Nil	Nil
Unabsorbed CA carried forward					
(RM4,350,000 – RM700,000)	3,650				
(RM3,650,000 + RM1,650,000 – RM4,000,000)		1,300			
(RM1,300,000 + RM1,650,000 – RM2,950,000)			Nil	Nil	Nil

Total tax liability: Nil

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PYQ Sept/Dec Q1/2016

Option 2: Investment tax allowance (ITA)

Year of assessment	2018	2019	2020	2021	2022
	RM'000	RM'000	RM'000	RM'000	RM'000
Statutory income (per above)	Nil	Nil	5,050	7,350	8,180
ITA (up to 100%) (working)	Nil	Nil	(5,050)	(3,950)	Nil
Chargeable income	Nil	Nil	Nil	3,400	8,180
Tax liability at 24%	Nil	Nil	Nil	816	1,963

Total tax liability: RM2,779,000

Working: ITA claim

Year of assessment	2018	2019	2020	2021	2022
	RM'000	RM'000	RM'000	RM'000	RM'000
Total qualifying expenditure					
(RM 10,000,000 + RM5,000,000)	15,000				Nil*
ITA at 60%	9,000	Nil	Nil	Nil	Nil
Amount brought forward	Nil	9,000	9,000	3,950	Nil
Amount utilised	Nil	Nil	(5,050)	(3,950)	Nil
Amount available for carry forward	9,000	9,000	3,950	Nil	Nil

* As the first qualifying expenditure was incurred on 1 January 2017, the tax relief period for ITA would be from 1 January 2017 to 31 December 2021. Therefore, the capital expenditure incurred in the year of assessment 2022 is not eligible for an ITA claim.

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