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Tax Exemption for Intellectual Property Development (MIDA Guideline)

Recently, the Malaysian Investment Development Authority (**MIDA**) published a [Guideline on Incentive for Intellectual Property \(IP\) Development \(Guideline\)](#). The Guideline states that 100% income tax exemption is given on qualifying IP income for up to 10 years.



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This exemption is subject to the guidelines on Modified Nexus Approach (**MNA**) to ensure that only income derived from IP developed in Malaysia is eligible for the incentive, where a formula adopted by the Forum on Harmful Tax Practices (FHTP) would be used to calculate qualifying income based on actual research and development (R&D) expenditure incurred by companies.

Modified Nexus Approach

The nexus approach under BEPS Action 5 is based on a substantial activity requirement. Essentially, there must be a direct nexus between the income receiving benefits and the activity contributing to that income. This means that tax benefits can only apply to income arising from IP where the actual R&D activity is undertaken by the business itself.



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Capital contribution or expenditure on substantial R&D activity by someone other than the business will mean that income arising from that activity will not qualify for benefits. The MNA recognises that companies which choose to outsource R&D activity to other group companies are unlikely to be able to enjoy tax benefits (income tax exemption based on the Guideline) on the resulting income, so the MNA will allow related party outsource expenditure (and any IP acquisition costs) to be taken into account. However, the guidelines on MNA and formula to calculate the qualifying IP income are still not available.

The crux of the Guideline is as follows:

(a) Objective of the incentive

- To encourage enterprises to invest in R&D creation to exploit IP through the licensing of patented knowledge.
- To attract companies to conduct R&D activities in Malaysia and facilitate the commercialisation of IP.
- To anchor more post-R&D economic activities, thereby creating jobs and new products/services for the economy.

(b) Eligible applicants

- New/existing companies that own the rights of the qualifying IPs and are receiving income from the qualifying IP activities related to the promoted activities/list prescribed under the Promotion of Investments Act 1986 (PIA) and the Income Tax Act 1967 (ITA).

(c) Qualifying IP asset types

- Patent or utility innovation
- Copyrighted software
- Family of qualifying IPs

(d) Qualifying IP income types

- Royalty
- Licensing fees

(e) Eligibility criteria

- R&D activities must be conducted in Malaysia, where such activities lead to the development, improvement, modification or creation of the Qualifying Asset.
- Adequate amount of operating expenditure incurred annually to support the company in conducting its business operation in Malaysia.
- The company must have at least 30% science and technical staff having a degree or diploma with a minimum five years' experience from related fields.

(f) Qualifying R&D expenditure

- Eligible R&D expenditure for MNA calculation will be in line with the types of eligible expenditure under s 34A of the ITA.
- Includes expenditure under cost-sharing agreements, provided that the cost of payable R&D is clearly stated in the agreement.
- Qualifying expenditure can be backdated up to three years from the date the IP is registered/filed.

(g) Effective date of incentive/exemption period

- The exemption period starts from the date of the first IP filed at the Intellectual Property Corporation of Malaysia (MyIPO) or any equivalent body outside of Malaysia.
- The exemption period for subsequent filing of IPs will be granted within the period approved for the first IP.

(h) Effective date of application

- Applications received by MIDA from 1 January 2020 until 31 December 2022.

(i) Non-application

- The incentive is not applicable to companies currently enjoying tax incentives under s 34A (“*Special deduction for research and development expenditure*”) or s 34B (“*Special deduction for contribution to an approved research institute or payment for use of services of an approved research institute or company*”) of the ITA.
- Not applicable to IP filed and first invoice issued before 1 July 2018.

Our views

Taxpayers who are interested in applying for the incentive should look out for the issuance of the subsidiary legislation and the guideline on MNA. Meanwhile, interested taxpayers should prepare to comply with the requirements as stated in the Guideline. For example, taxpayers should ensure they have at least 30% science and technical staff who possess a degree/diploma with minimum five years’ experience.

The Guideline also provides that qualifying expenditure can be backdated up to three years from the date the IP is registered/filed. Interested taxpayers should keep track and ensure that there are supporting documents for the qualifying R&D expenditure incurred in anticipation of the registration of the IP.

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