

Islamic Venture Capital & Private Equity Conference 2009

Incentives from the Malaysian Government*

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*connectedthinking

PRICEWATERHOUSECOOPERS 

Agenda

- Introduction
- Tax Neutrality for Islamic Finance
- Incentives for Islamic Finance

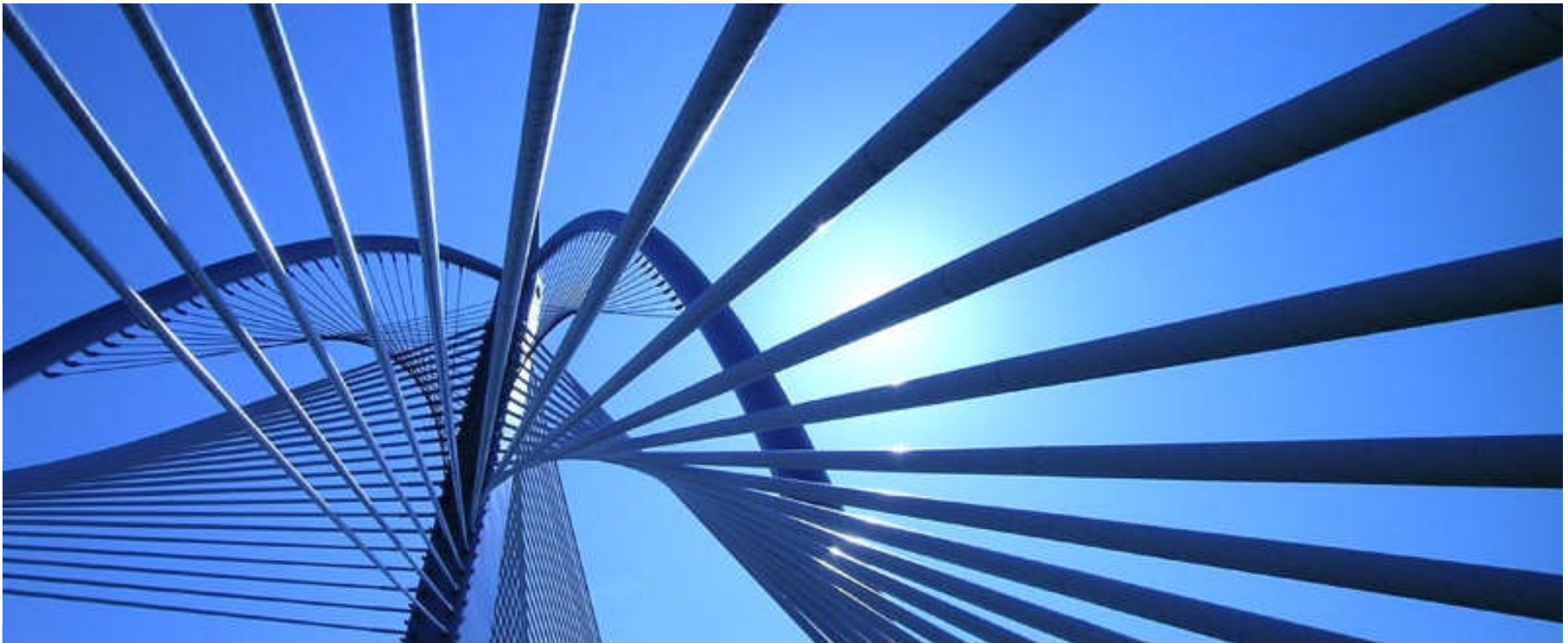
Introduction



Initiatives by Malaysian Government

- Tax is a hidden cost in any funding structure
- Potential tax liability and tax inefficiencies will affect any financing structure
- Malaysian Government has been promoting Islamic Banking and Finance in Malaysia
- Certain tax neutrality and exemptions have been provided and these have been refined over the years
- Further tax incentives have also been provided to Islamic Finance as part of the Government's initiatives for MIFC

Malaysian Tax Legislation – Tax Neutrality

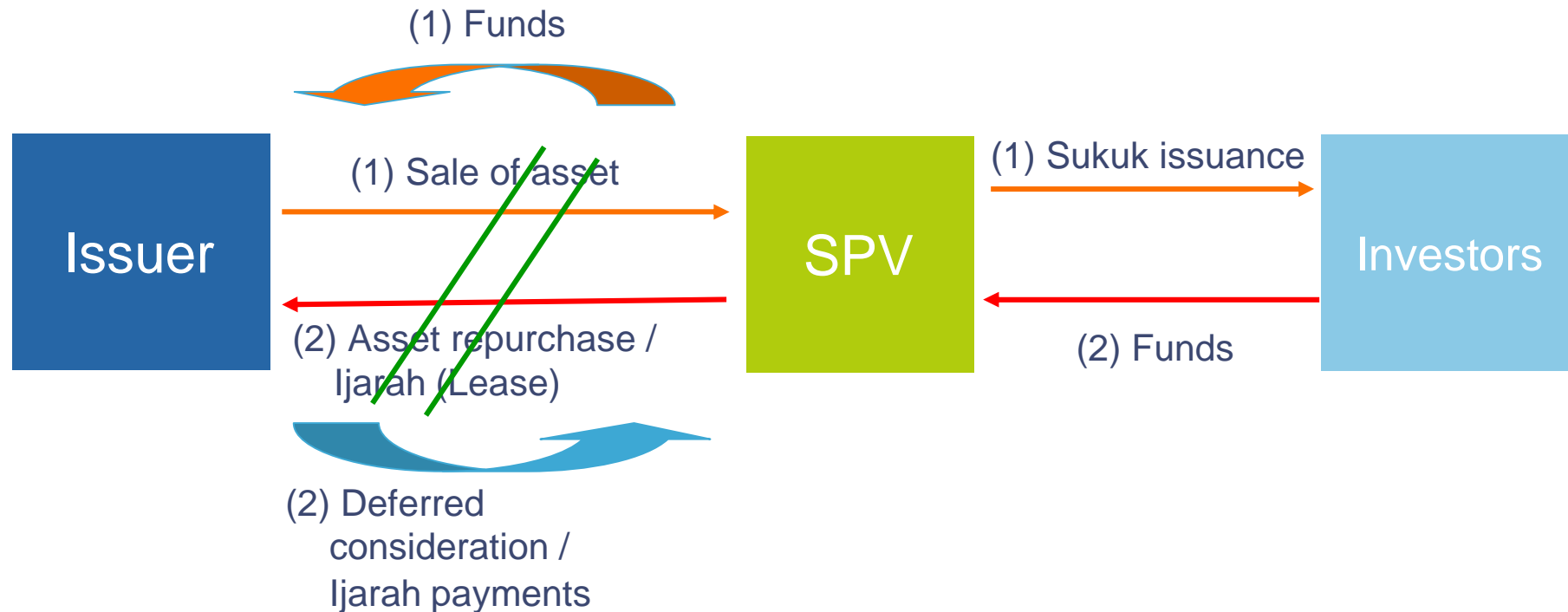


Profit treated similar to interest



- The Malaysian Income Tax Legislation treats “profits” in Islamic transactions to be similar to interest – Sec. 2(7)
- Therefore, all tax rules relating to “interest”, such as interest withholding tax and exemptions will equally apply on the “profit”
- This ensures that Islamic financing is provided with the same treatment as conventional financing

Tax neutrality provisions



- Due to the additional underlying asset transactions required for Syariah financing, Section 2(8) seeks to ignore these for tax purposes
- Section 2(8) allows Islamic financing to continue without any tax issues relating to asset transfer or lease
- Tax neutrality treatment only applicable if transactions have been approved by relevant authorities (i.e. Bank Negara, Securities Commission, LOFSA)

Tax Incentives for Islamic Finance

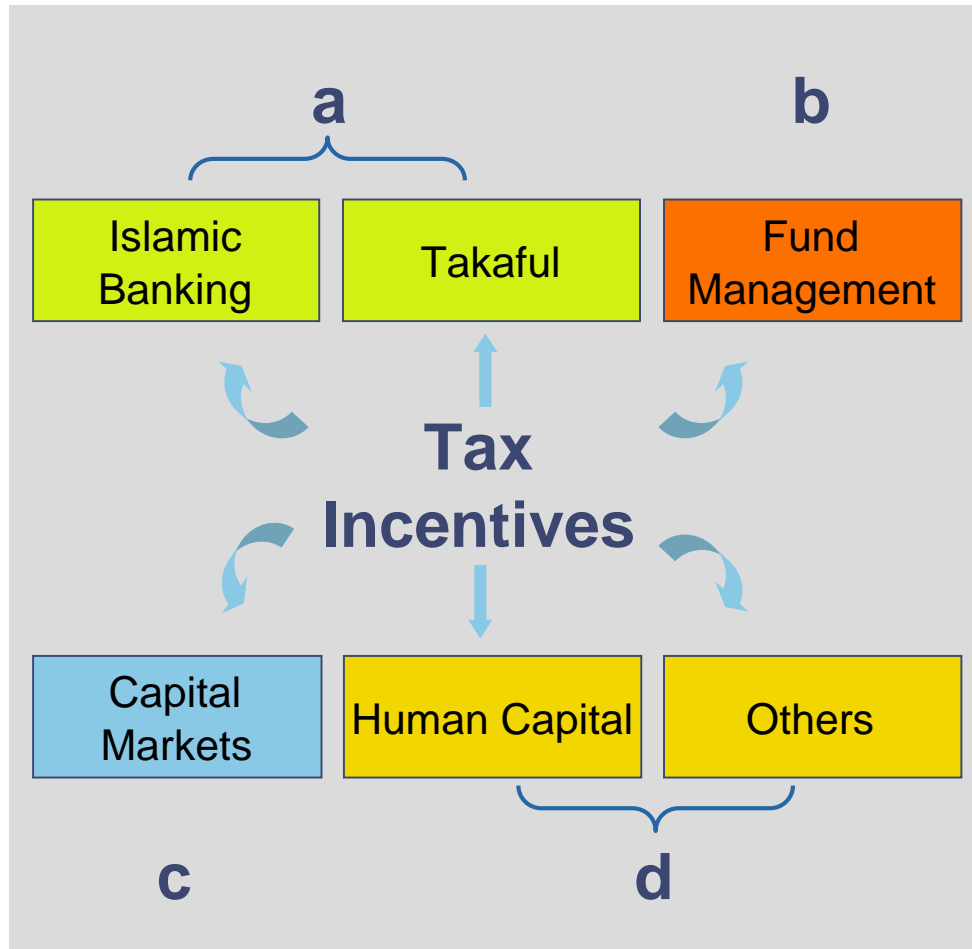


Introduction

Malaysia as International Islamic Financial Centre (MIFC)

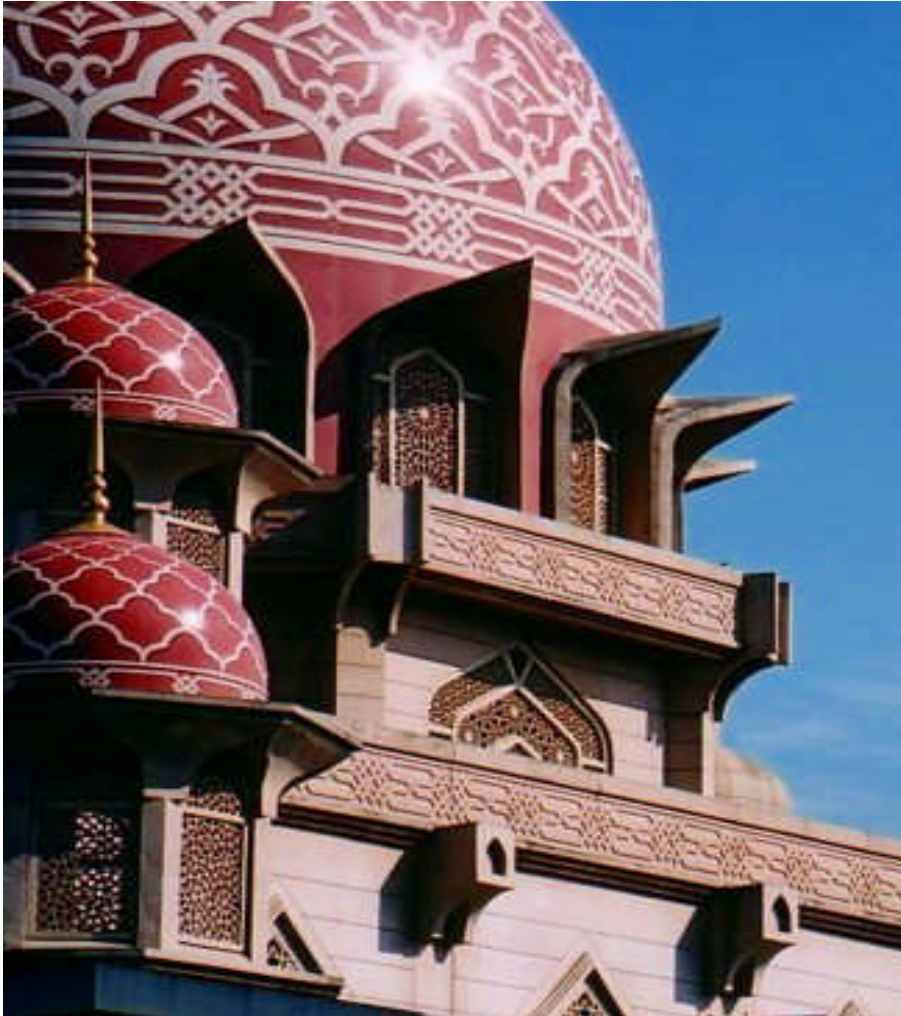
- Prior to the economic downturn, the global market saw an influx of liquidity particularly from the Middle East and investors looking for modes of financing which comply with Islamic religious principles
- As the demand for Islamic financing products globally grew, many countries in the region and globally such as Singapore, UAE and United Kingdom compete to become the Islamic hub of the region
- To position Malaysia further as a leading Islamic financial centre, BNM has come up with the MIFC initiative to kick start the development of Malaysia into an Islamic financial hub in the region and globally
- In the wake of the recent global financial crisis, the viability of Islamic finance is even more prominent than ever

Islamic Finance



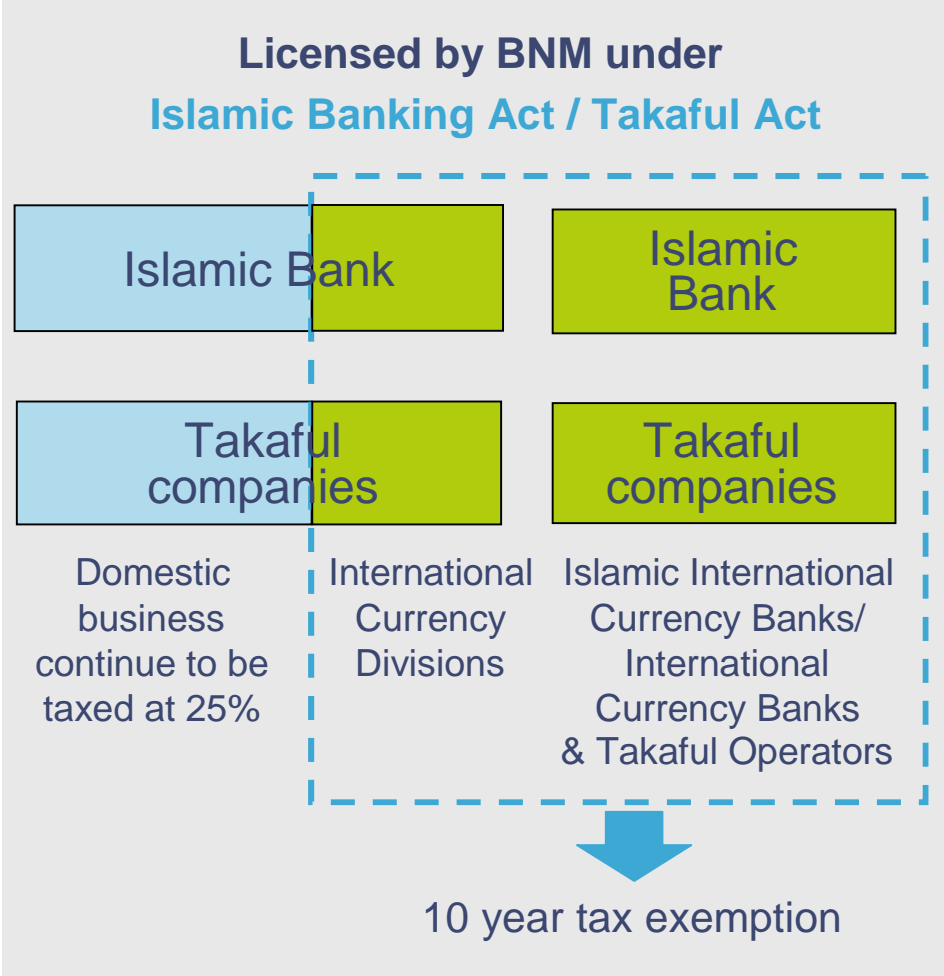
- Substantial tax incentives have been provided to towards the development of Malaysia as an International Islamic Financial Centre
- Tax incentives can be broadly categorised into the following areas:
 - a) Islamic Banking and Takaful
 - b) Fund Management
 - c) Capital markets
 - d) Human capital and others

a) Islamic Banking and Takaful



1. Income tax exemption for Islamic Banking and Takaful business
2. Tax exemption – Profits paid by Islamic Banks to non-residents
3. Tax neutrality of Islamic financing transactions – Musharakah financing not required to file partnership tax returns

1. Income tax exemption for Islamic banking and Takaful business



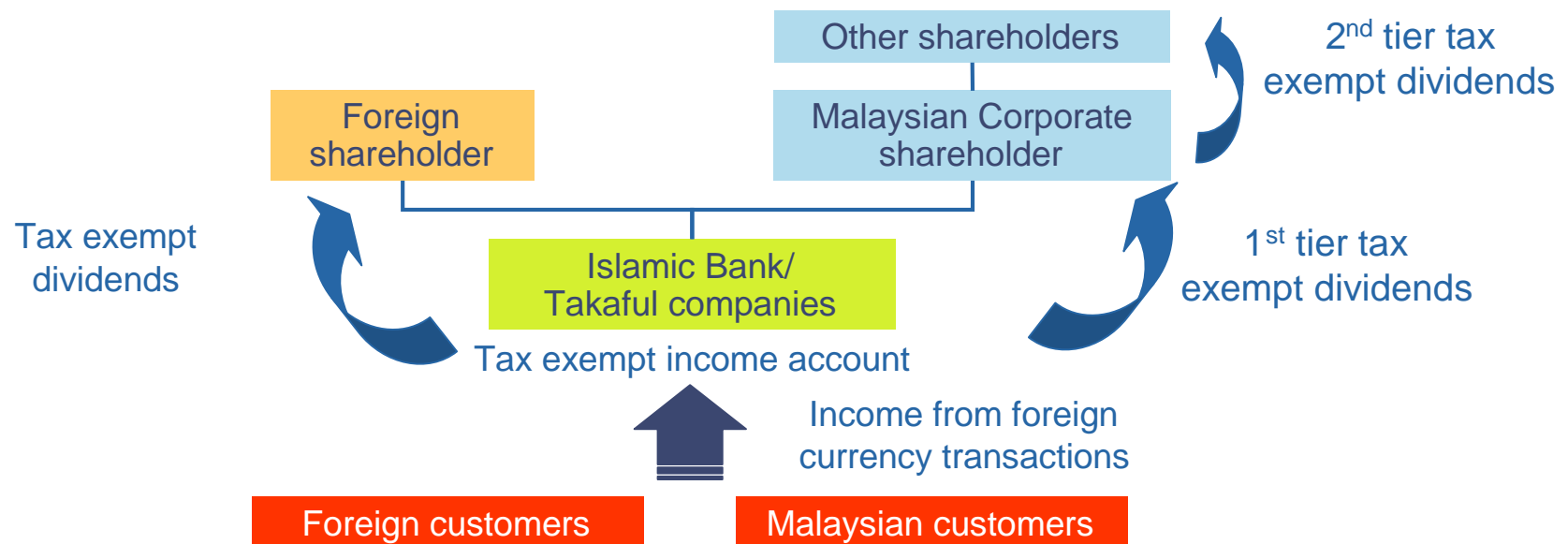
Income tax exemption for 10 years:

- Islamic banks / units licensed under Islamic Banking Act 1983 on income derived from Islamic banking business conducted in international currencies, including transactions with Malaysian residents ⓘ
- Takaful companies/ units licensed under Takaful Act 1984 on income derived from Takaful business conducted in international currencies, including transactions with Malaysian residents

Effective from YA2007 to YA2016

1. Income tax exemption for Islamic banking and Takaful business (cont'd)

- Income from foreign currency transactions will be tax exempted
- The exempt income of the Islamic banking and Takaful operation businesses can be freely repatriated to the shareholders as tax exempt dividends. Malaysia does not impose withholding tax on dividends
- The exempt dividends received by Malaysian corporate shareholders can be further distributed as tax exempt dividends up to 2 tiers



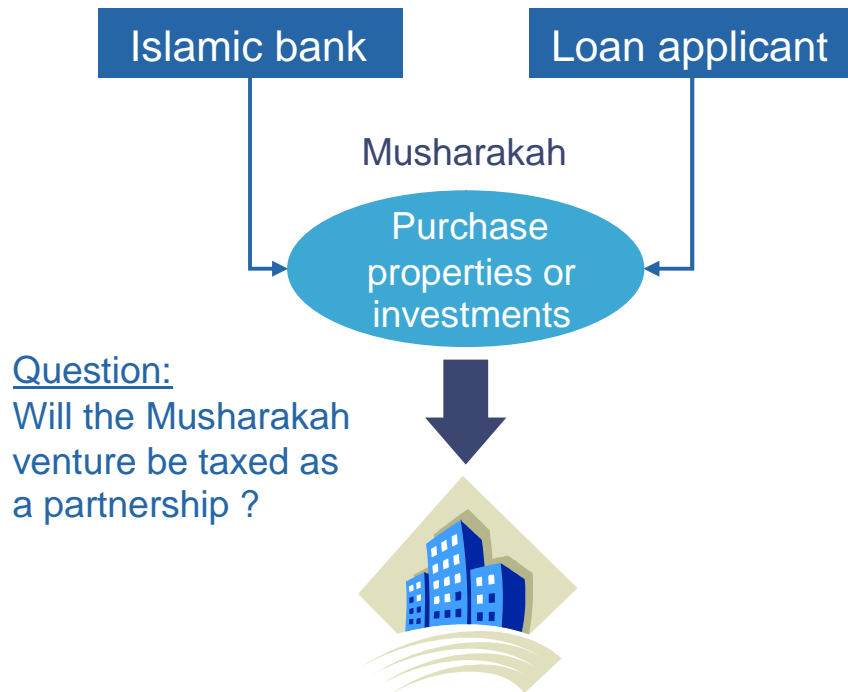
2. Tax exemption – profits paid by Islamic Banks to non-residents



** Paragraph 33 Schedule 6 has been amended to include Islamic Banks licensed under Islamic Banking Act, 1983 and other financial institutions approved by the Ministry of Finance*

- Effective 2 September 2006, “profits” paid by Islamic Banks to non-resident customers will be exempted from tax and withholding tax
- This is to stream line tax treatment on profits and “interest” received from Islamic banks and conventional banks

3. Tax neutrality– Musharakah financing



- Previously, the definition of “partnership” includes all types of partnership (only exception being a Hindu joint family)
- New Amendment: Definition amended to **exclude** “any association which is established pursuant to a scheme of financing in accordance with the principles of Shariah”

- Provide tax neutrality to Islamic financing structures based on the concept of Musharakah
- No separate partnership tax return is required to be submitted

**Effective from YA2007
(Amendment to Section 2)**

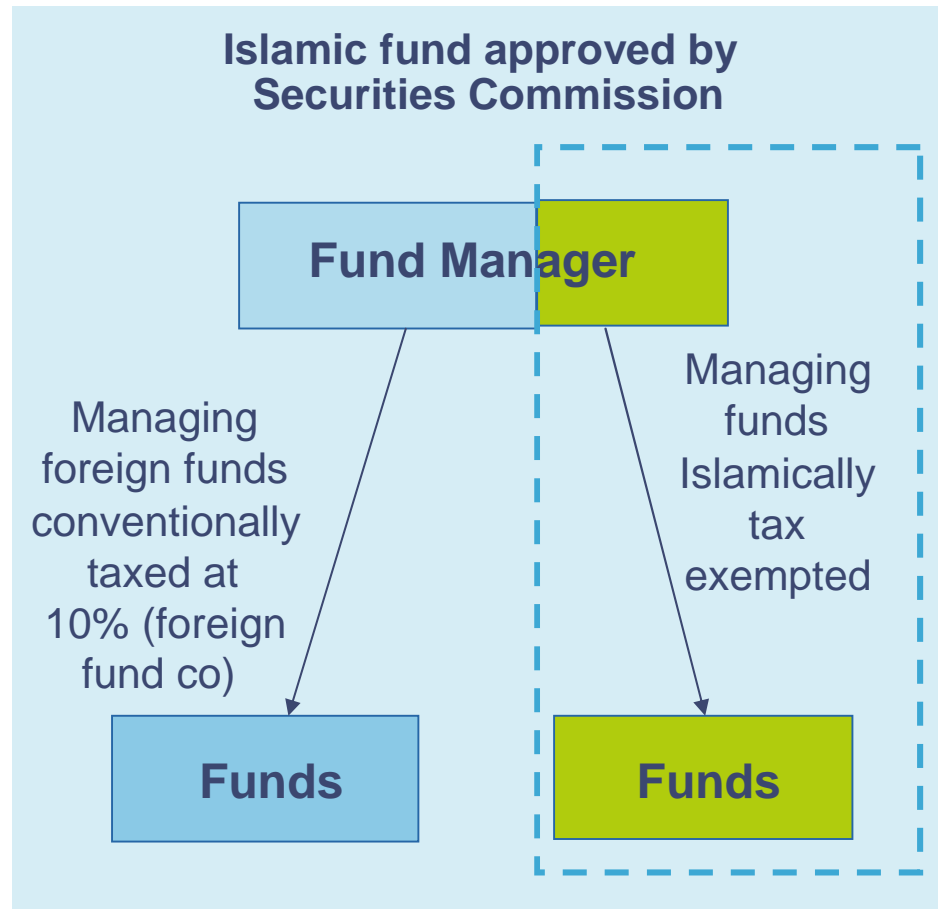
Tax Incentives for Islamic Finance

b) Fund Management



1. Tax exemption for companies managing foreign Islamic funds

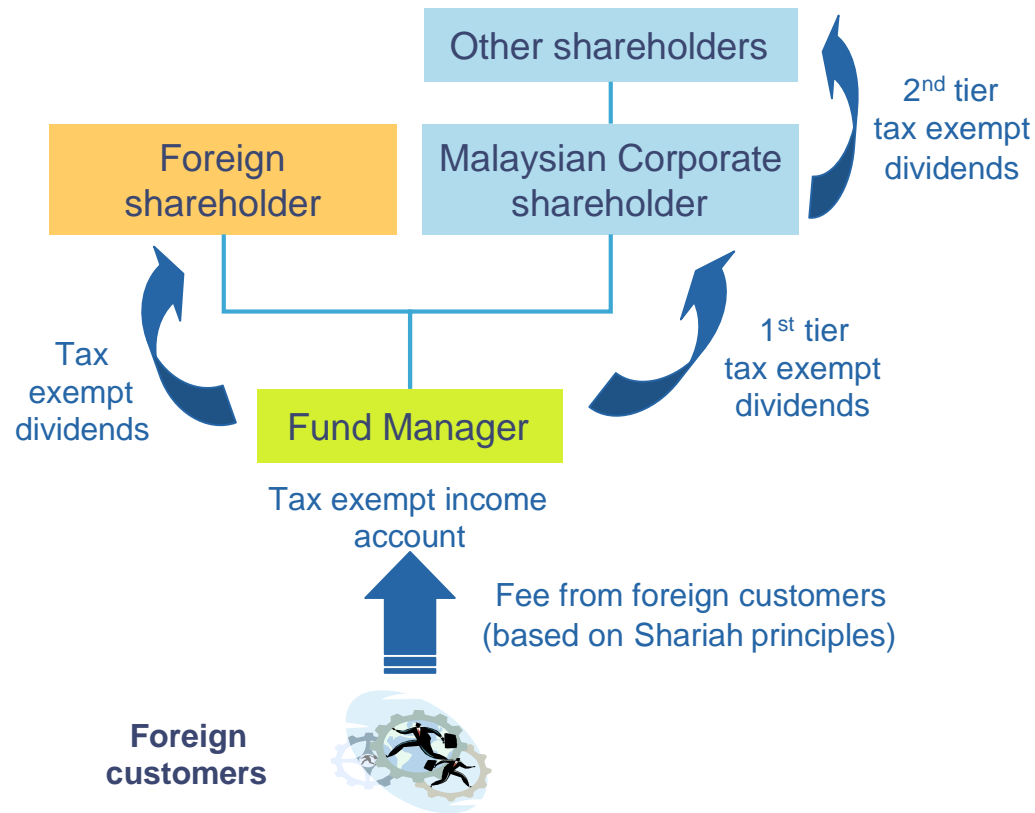
1. Income tax exemption for fund management companies managing Islamic funds



- Local and foreign companies managing Islamic funds established under Shariah principles - full tax exemption on management fees up to YA 2016
- Fund must be approved by SC
- Requirement to maintain separate accounts

Incentive up to YA 2016

1. Income tax exemption for fund management companies managing Islamic funds (cont'd)



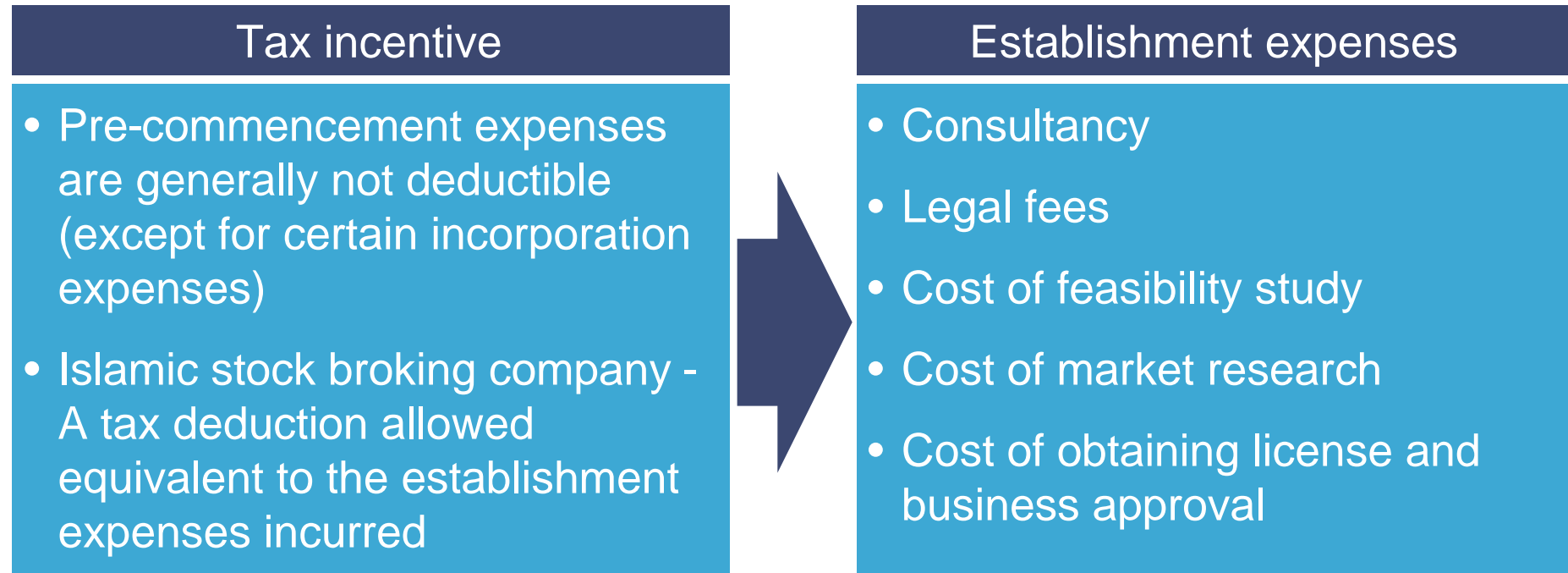
- Income from managing foreign investors funds based on Shariah will be tax exempted
- Exempt income can be declared as tax exempt dividends to shareholders up to 2 tiers

c) Islamic Capital Market



1. Expenses to establish Islamic stock broking companies
2. Tax treatment of SPV for Islamic financing
3. Profits on foreign currency bonds
4. Tax exemption on income derived from dealing and advising on corporate finance relating to the arranging, underwriting and distributing of non-Ringgit sukuk

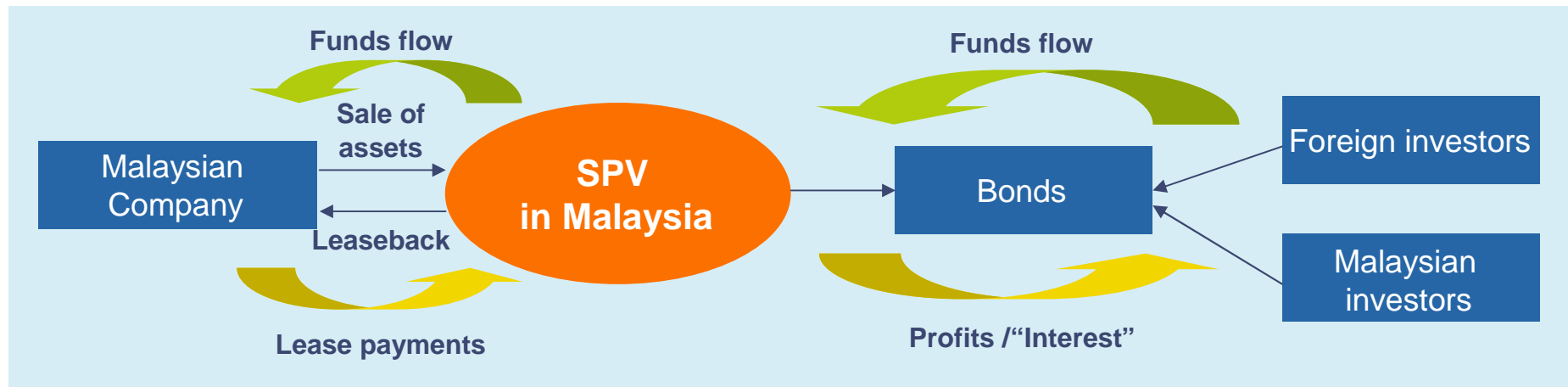
1. Tax deduction on expenses to establish Islamic stock broking companies



- Applications received by SC from 2/9/2006 until 31/12/2009
- Company must commence business within 2 years from date of approval from the SC

2. Tax treatment of Special Purpose Vehicle (“SPV”) for Islamic financing

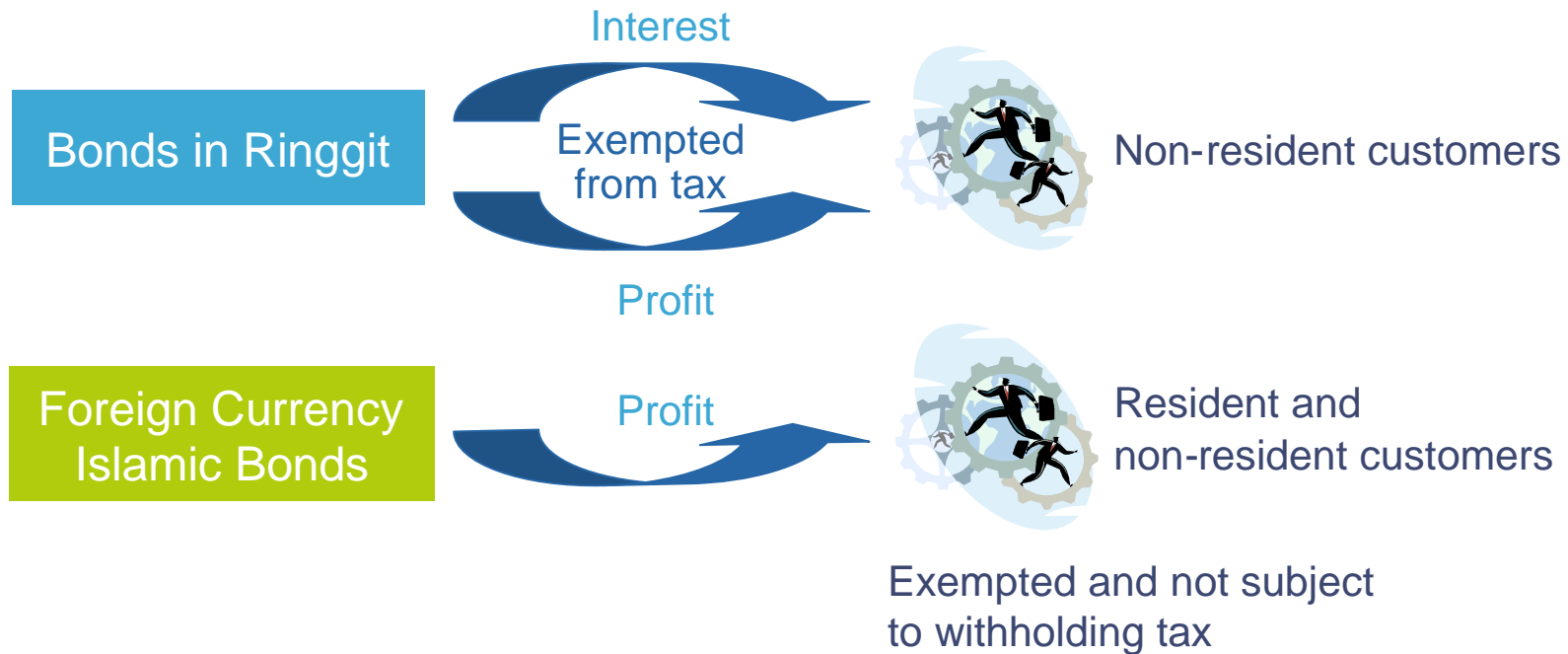
Example of Islamic bond issuance



- Under Islamic financing transactions, SPV is set up purely to channel funds and facilitate issuance of Islamic bonds/ funding
- SPV will not be subject to income tax and not required to comply with tax administrative requirements
- Income and expenses of the SPV accounted for by the company setting up the SPV

Effective from YA2007

3. Tax exemption – profits on foreign currency bonds



- Interest or profits on Ringgit bonds approved by the SC is not subject to withholding tax to non-residents
- Interest on profits on non-Ringgit Islamic bonds approved by SC is not subject to withholding tax to residents and non-residents

4. Tax exemption on dealing and corporate finance advice on non-Ringgit sukuk

Income Tax (Exemption)(No.9) Order 2008

- Income tax exemption for Malaysian residents licensed under the Capital Markets and Services Act 2007 for income derived from dealing in non-Ringgit Sukuk which originates from Malaysia
- Issued by Government of Malaysia or approved by SC

Income Tax (Exemption)(No.10) Order 2008

- Income tax exemption for Malaysian residents licensed under the Capital Markets and Services Act 2007 for income derived from advising on corporate finance relating to the arranging, underwriting and distributing of non-Ringgit Sukuk which originates from Malaysia
- Issued by Government of Malaysia or approved by SC

Effective YA2009 to YA 2011

d) Human capital and others



1. Tax incentives on training in Islamic Finance
2. Tax exemption for non-resident Islamic finance expert
3. Additional 20% stamp duty exemption on Islamic Financial instruments
4. Tax deduction for promoting MIFC

1. Tax incentives on training in Islamic Finance

| Individual | Corporate |
|---|---|
| <ul style="list-style-type: none">• Relief of up to RM5,000 per annum for fees paid for courses in <i>Islamic finance</i> approved by Bank Negara Malaysia or Securities Commission at local institutions of higher education, including at the International Centre for Education in Islamic Finance (“INCEIF”) | <ul style="list-style-type: none">• Double deduction on expenses incurred for training of employees in <i>Islamic finance</i> approved by Bank Negara Malaysia or Securities Commission at local institutions of higher education, including at the International Centre for Education in Islamic Finance (“INCEIF”) |

Effective from YA 2007

2. Tax exemption for non-resident Islamic finance expert

Income Tax (Exemption)(No.3) Order 2008

- Withholding tax exemption on consultancy fees received by non-resident experts on consultancy services in Islamic finance
- Such experts would have to be verified by the MIFC Secretariat.

Effective 8/9/2007 to 31/12/2016

3. Additional 20% stamp duty exemption on Islamic Instruments

Stamp Duty (Remission)(No.2) Order 2007

- Additional 20% stamp duty exemption is given on instruments used in Islamic financing
- Instrument has to be approved by Bank Negara Malaysia Syariah Advisory Council or Securities Commission

Effective 2/9/2006 to 31/12/2009

* **Additional stamp duty exemption**

100% stamp duty exemption for 10 years on foreign currency instruments executed by International Currency Islamic financial institutions and on instruments relating to Ringgit as well as foreign currency Islamic securities.

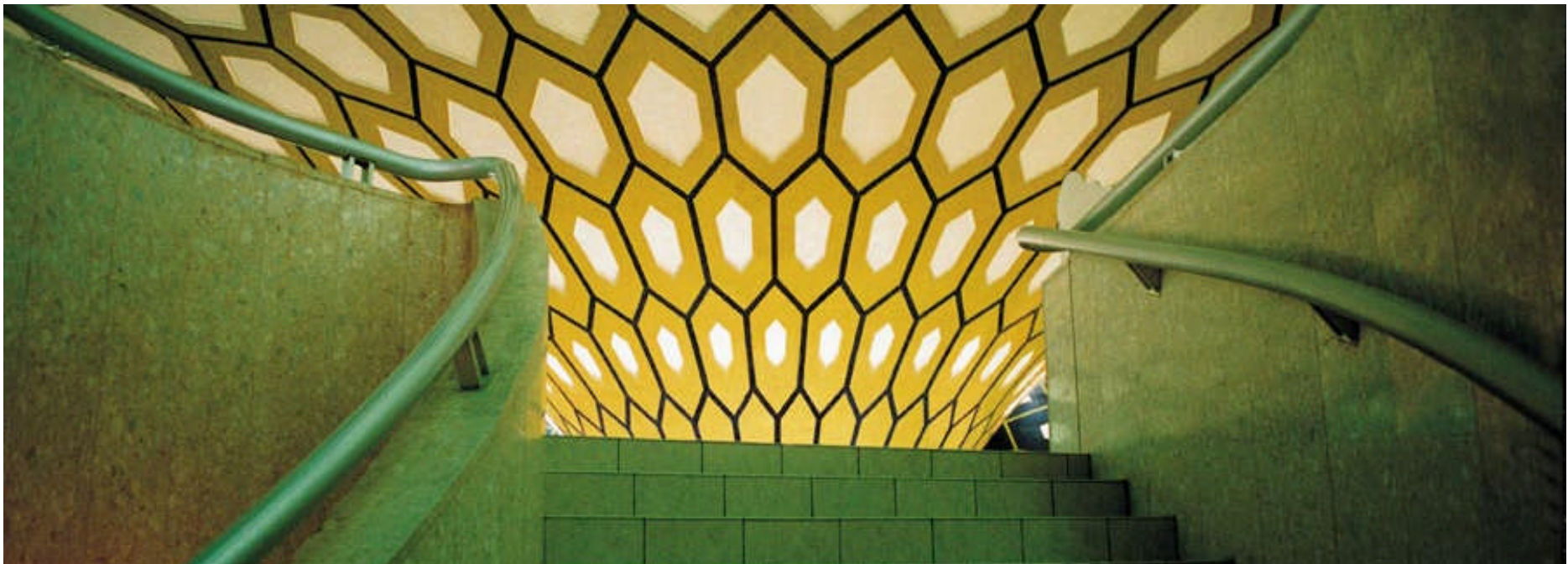
4. Tax deduction for promoting MIFC

Income Tax (Deduction for Promotion of MIFC) Rules 2008

- Certain expenses incurred in promoting Malaysia as an international Islamic finance centre have been allowed for tax deduction
- Expenses include market research, feasibility studies, cost of air fares and participating in events overseas, cost of maintaining sales office overseas approved by MIFC Secretariat, publicity and media advertisement overseas and other expenses verified by MIFC Secretariat

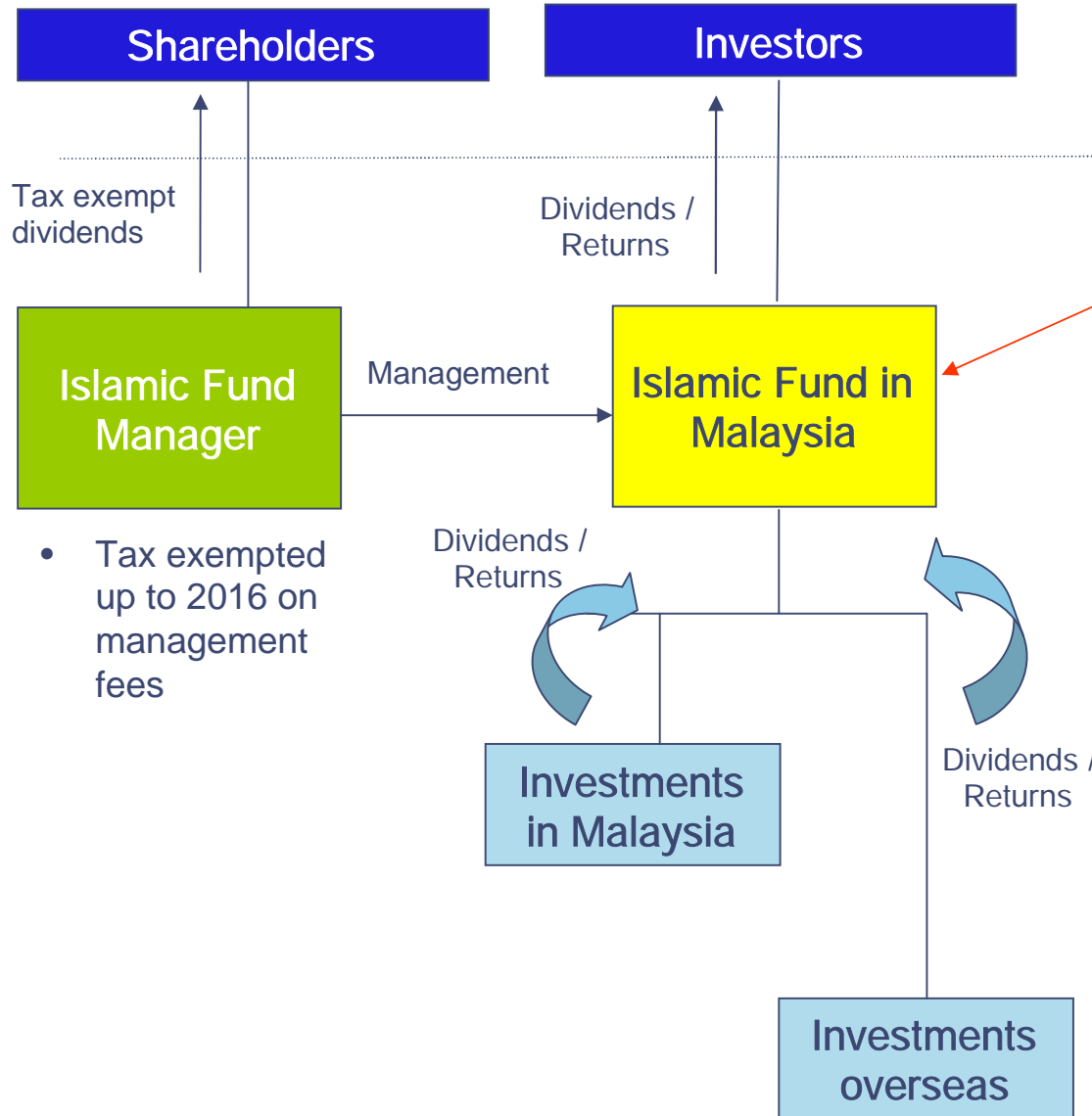
Effective 2/9/2006 to 31/12/2009

Example



Example

Private Funds – Company structure

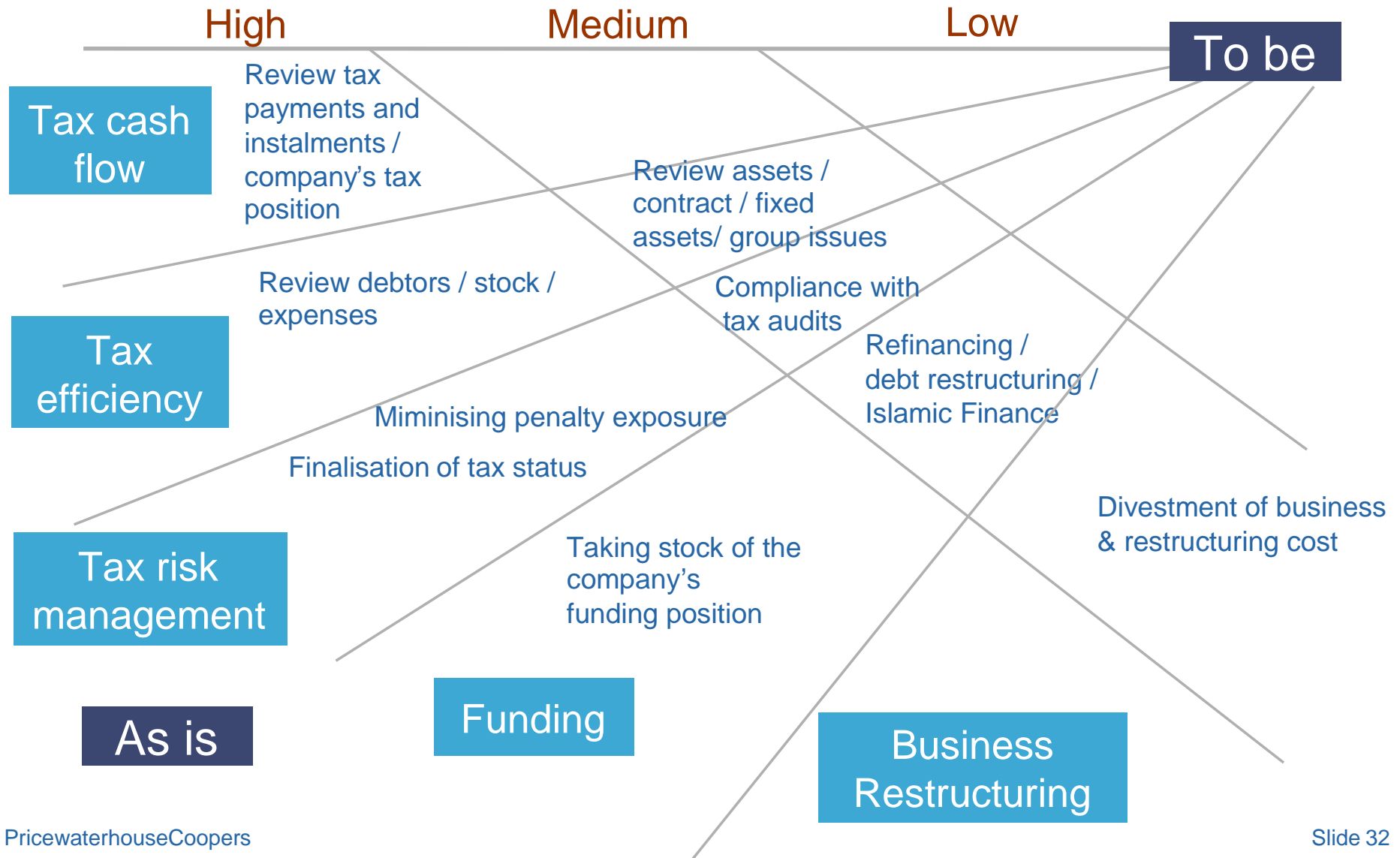


- No further tax or withholding tax on dividends paid by Private Fund to Investors
- Generally, should be treated as investment holding company.
- Foreign income not subject to income tax
- No further tax on Malaysian dividends
- Capital gains not taxed in Malaysia
- Profits from Banks and Sukuks will be taxed (unless foreign currency Sukuk)
- Fund can declare single tier dividends to investors from all income and capital gains received

Managing tax in current economic turbulence



Prioritising Tax Issues



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