



**INLAND REVENUE BOARD OF MALAYSIA**

**VENTURE CAPITAL  
TAX INCENTIVES**

**PUBLIC RULING NO. 2/2016**

*Translation from the original Bahasa Malaysia text*

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### **DIRECTOR GENERAL'S PUBLIC RULING**

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

**Director General of Inland Revenue,  
Inland Revenue Board of Malaysia.**

**1. Objective**

The objective of this Public Ruling (PR) is to explain the tax incentives in relation to the venture capital industry in Malaysia.

**2. Related Provisions of The Law**

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are sections 2, 7 and 8.

2.3 Relevant subsidiary laws referred to in this PR are as follows:

(a) Income Tax (Exemption) (No.11) Order 2005 [P.U.(A) 75/2005] as amended by the Income Tax (Exemption) (Amendment) (No.2) Order 2006 [P.U.(A) 420/2006] and Income Tax (Exemption) (Amendment) Order 2009 [P.U.(A) 159/2009];

(b) Income Tax (Deduction for Investment in a Venture Company) Rules 2005 [P.U. (A) 76/2005]; and

(c) Income Tax (Exemption) (No.12) Order 2005 [P.U.(A) 77/2005].

**3. Interpretation**

The words used in this PR have the following meanings:

3.1 "Individual" means a natural person.

3.2 "Resident" means resident in Malaysia for the basis year for a year of assessment by virtue of section 7 or 8 of the ITA.

3.3 "Statutory income" in relation to a person, a source and a year of assessment, means statutory income ascertained in accordance with the ITA.

3.4 "Adjusted income" in relation to a source and a basis period, means the adjusted income ascertained in accordance with the ITA.

3.5 "Securities Commission" means the Securities Commission established under section 3 of the Securities Commission Act 1993 [Act 498].

3.6 "Company" means a body corporate and includes any body of persons established with a separate legal entity by or under the laws of a territory outside Malaysia and a business trust.

3.7 “Basis year” has the meaning assigned by section 20 of the ITA.

3.8 “Year of assessment” means calendar year.

#### 4. Venture Capital Industry in Malaysia

4.1 Venture capital is financial capital provided by individuals, companies or venture capital companies (VCC) to high potential and high risk growth start-up companies at early stage. Investors (individuals and companies, including VCC) referred to as venture capitalists take very high risks when investing in a start-up venture company (VC). In most cases, a VC provides the investors with profit sharing in the form of share equity in the VC.

4.2 A VCC is a company incorporated under the Companies Act 1965 [Act 125] to obtain funds from investors (equity capital) or loan capital, which are invested in the VC in the form of seed capital, start-up or early stage financing. On the other hand, a venture capital management corporation (VCMC) manages on behalf of a VCC the investments in securities of a VC in different business stages, i.e. seed capital, start-up or early stage financing.

4.3 A VC is a company incorporated under the Companies Act 1965, which is –

- (a) resident in Malaysia for the basis year for a year of assessment; and
- (b) involved in utilising the seed capital financing, start-up financing or early stage financing for –
  - (i) products or activities promoted under the Promotion of Investment Act 1986 [Act 327] where a VC has been granted tax incentives such as pioneer status or investment tax allowance;
  - (ii) technology-based activities listed in Appendix A of the Venture Capital Tax Incentives Guidelines issued by the Securities Commission (SC);
  - (iii) products or activities which have been developed under the Industrial Research and Development Grant Scheme, granted by the Ministry of Science, Technology and Innovation; or
  - (iv) products or activities which have been developed under the MSC Research and Development Grant Scheme granted by Multimedia Development Corporation.

#### Note

The definition of a VC has been updated in accordance with the Venture Capital Tax Incentives Guidelines issued by the SC. However, the definition

is still in accordance with the relevant Income Tax (Exemption) Orders and Income Tax Rules (as mentioned in paragraph 2.3 of this PR).

- 4.4 The terms seed capital financing, start-up financing and early stage financing mentioned above have the following meanings:

“Seed capital financing” means financing provided by an individual or a company to a VC for the purposes of research, assessment and development of an initial concept or prototype, where the VC’s organisational structure has not been formalised.

“Start-up financing” means financing provided by an individual or a company to a VC for product development and initial marketing, where the VC is in the process of formalising its organisational structure, or if its organisational structure has been formalised, the VC has not sold its products commercially.

“Early stage financing” means financing provided by an individual or a company to a VC as–

- (a) capital expenditure or working capital to initiate commercialization of a technology or product;
- (b) additional capital expenditure or additional working capital to increase production capacity, or for marketing or product development; or
- (c) an interim financing for the purpose of being listed on the official list of a stock exchange.

## 5. Regulatory Framework for the Venture Capital Industry

The SC has been entrusted to assess and certify applications for tax incentives for the venture capital industry pursuant to the relevant income tax rules and exemption orders. SC has issued the Guidelines for the Registration of VCC and VCMC, and the Venture Capital Tax Incentives Guidelines (revised on 18.4.2014), which are available from SC’s website at [www.sc.com.my](http://www.sc.com.my).

## 6. Tax Exemption Incentive for a Venture Capital Company Investing in a Venture Company

A VCC may apply for a tax exemption under the relevant Income Tax Exemption Orders as stated in paragraph 2.3 of this PR.

### 6.1 Tax exemption

A VCC is exempted from the payment of tax in respect of the statutory income –

- (a) from all sources of income excluding interest income arising from savings or fixed deposits and profits from syariah-based deposits; and
- (b) for a period of ten years of assessment or the life of the fund established for the purpose of investing in a VC whichever is the lesser.

## 6.2 Conditions to qualify for the tax exemption

In order to qualify for the exemption as stated in paragraph 6.1 of this PR, the VCC shall for each year of assessment for the period of exemption, obtain a certification from the SC confirming that –

- (a) the VCC has invested at least 70% of its invested funds in a VC or where the investment is in the form of seed capital at least 50% of its invested funds;
- (b) the VCC has not invested in a VC which is its related company at the point of the first investment; and
- (c) the VCC has provided an early stage financing to a VC which is involved in activities which are not listed as technology-based business activities<sup>1</sup>, from seed capital or start up stage, where such early stage financing is provided as –
  - (i) additional capital expenditure or additional working capital to increase production capacity, marketing or product development; or
  - (ii) an interim financing for the purpose of being listed on the official list of a stock exchange.

In other words, if a VCC provides early-stage financing to a VC, which is involved in an activity not listed as a technology-based business activity for purposes stated in paragraphs 6.2(c)(i) and 6.2(c)(ii), the VCC would qualify for a tax exemption if it had also provided financing to the VC from the seed capital or start-up stage.

<sup>1</sup>Currently the list of technology-based business activities are as follows:

- a. Advanced electronics and information technology;
- b. Telecommunications;
- c. Equipment/instrumentation, automation and flexible manufacturing systems;
- d. Biotechnology, bioconversion and genetic engineering;

- e. Healthcare;
- f. Electro-optics, non-linear optics and optoelectronics;
- g. Advanced materials;
- h. Energy;
- i. Aerospace;
- j. Transportation;
- k. Value-added services; and
- l. Emerging technologies.

<sup>1</sup>Refer to the Venture Capital Tax Incentives Guidelines for details of the technology-based business activities.

The term related company mentioned above has the following meaning:

“Related company” in relation to a company, means a company –

- (a) the operations of which are or can be controlled either directly or indirectly, by the first mentioned company;
- (b) which controls or can control, either directly or indirectly, the operations of the first mentioned company; or
- (c) the operations of which are or can be controlled, either directly or indirectly, by a person who control or can control, either directly or indirectly, the operations of the first mentioned company:

Provided that a company shall be deemed to be a related company of another company if –

- (i) at least 20% of its issued share capital is beneficially owned, either directly or indirectly, by that other company; or
- (ii) at least 20% of its issued share capital of that other company is beneficially owned, either directly or indirectly, by the first mentioned company.

### Example 1

A VCC was established in 2013. In 2015 the VCC made its first investment and invested 80% of its invested funds in a start-up VC. The VC is involved in genetic engineering which is listed as a technology-based business activity. Both the VCC and the VC are not related companies. The financial accounting period of the VCC ends on 31 December each year. The VCC

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obtained a certification from the SC confirming that it had invested at least 70% of its invested funds in the VC for the year ending 31.12.2015.

As the VCC had obtained a certification from the SC that it had invested at least 70% of its invested funds in the VC for the year of assessment 2015, it would qualify for a tax exemption in respect of its statutory income from all sources of income excluding interest income arising from savings or fixed deposits and profits from syariah-based deposits. The tax exemption is for a period of ten years of assessment beginning from the year of assessment 2015 or for the life of the fund established for the purpose of investing in a VC, whichever is lesser provided that an annual certification is obtained from the SC.

### **Example 2**

A VCC was established on 16.11.2012. In 2013 the company made its first investment in the form of seed capital and invested 60% of its invested funds in a VC. The VC is involved in the cultivation of organic produce, an activity not listed as a technology-based business activity. Both the VCC and VC are not related companies. In the year 2014, additional financing was provided by the VCC for start-up financing. In the year 2015, additional financing was provided as early stage financing. The VCC obtained a certification from the SC confirming that it had invested:

- (a) funds in the form of seed capital in 2013;
- (b) additional start-up financing in 2014; and
- (c) additional working capital in 2015 for early stage financing.

As the VCC had fulfilled the conditions of seed capital financing and additional capital for start-up and early stage financing in an activity not listed as a technology-based business activity as certified by the SC, it would qualify for a tax exemption for the year of assessment 2015. The tax exemption is for a period of ten years of assessment beginning from the year of assessment 2015 or for the life of the fund established for the purpose of investing in a VC, whichever is lesser provided that an annual certification is obtained from the SC.

### **Note**

For the year of assessment 2013 and 2014, the VCC does not qualify for a tax exemption as it only provided seed capital financing and start-up financing to a VC involved in an activity not listed as a technology-based business activity.

6.3 Loss from disposal of shares

Where a VCC incurs a loss from the disposal of shares in a VC in the basis period for any year of assessment within the exempt period, such loss shall be carried forward to the post-exempt period.

6.4 Savings provisions upon revocation of Order

A VCC that has been granted an exemption under the Income Tax (Exemption) (No. 3) Order 2001 [P.U.(A) 211/2001] will continue to enjoy the exemption for the remaining years of assessment of the exempt period of that VCC.

**7. Tax Deduction Incentive for an Individual or a Company Investing in a Venture Company**

The Income Tax (Deduction for Investment in a Venture Company) Rules 2005 [P.U. (A) 76/2005] provides tax deduction for an investor who invests in a VC. The provisions of the Rules are as follows:

7.1 Investors who qualify for a deduction

An individual or a company, including a VCC would be entitled to claim a deduction in ascertaining the adjusted income for a basis period for a year of assessment of an amount equivalent to the value of the investment in shares (cost of investment) in a VC if the individual or company, including a VCC –

- (a) is resident in Malaysia;
- (b) has a business source; and
- (c) invested in a VC at start-up, seed capital and early stage financing for products and activities listed in subparagraph 4.3(b) of this PR.

7.2 Conditions to qualify for the deduction

In order to qualify for the deduction, the company or individual shall obtain certification from the SC confirming that –

- (a) the investment was in the form of the holding of shares which at the time of acquisition are not listed for quotation in the official list of a stock exchange;
- (b) the investment, in relation to a company, was not made in a VC which is its related company at the point of first investment;
- (c) the investment was made for seed capital financing, start-up financing or early stage financing;

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- (d) it had provided early stage financing to a VC which is involved in activities which are not listed as technology-based activities, from the seed capital or start-up stage, where such early stage financing was provided as -
- (i) additional capital expenditure or additional working capital to increase production capacity, marketing or product development; or
  - (ii) interim financing for the purpose of being listed on the official list of a stock exchange; and

In other words, if a company or an individual provides early-stage financing to a VC, which is involved in an activity not listed as a technology-based business activity for purposes stated in paragraphs 7.2(d)(i) and 7.2(d)(ii), the company or individual would qualify for a tax deduction if financing to the VC from the seed capital financing or start-up financing was also provided by them.

- (e) the investment was made at least two years prior to the date of its disposal.

The tax deduction is given at the time the investment is disposed of as certified by the SC, and not at the time the investment is made.

### Example 3

Elyias wanted to invest in a new business venture in robotics. A new company Robot Malaysia Sdn Bhd was incorporated for this business venture. Elyias only provided seed capital and early stage financing for this business venture and was not actively involved in the management of the VC as he has other business interests. Elyias applied for a tax deduction as robotics is a technology-based business activity listed in the guidelines issued by SC for Venture Capital Tax Incentives.

Elyias made the following investments and realisation:

- (a) On 1.3.2013, the initial paid up share capital of Robot Malaysia Sdn Bhd was 10 million shares @ RM 1 per share. Elyias took up 50% of the shares at a cost of RM5 million.

Robot Malaysia Sdn Bhd used the initial paid up share capital raised for -

- (i) research, assessment and development of robotic products; and

- (ii) capital expenditure and working capital to initiate commercialisation of the product.
- (b) On 1.3.2015, Robot Malaysia Sdn Bhd acquired additional funding of 2 million shares (@ RM1 per share) to be utilised as working capital for product development and marketing.

Elyias took up 10% of the additional shares at the cost of RM200,000.

- (c) On 15.12.2015, upon listing of Robot Malaysia Sdn Bhd on the Bursa Malaysia, Elyias disposed of all his 5.2 million shares in the company and realised a profit of RM10 million.

Elyias had the following sources of income for each year ending 31 December:

Sole proprietor - trading business	2013 RM	2014 RM	2015 RM
Adjusted income / (loss)	2,000,000	3,500,000	6,000,000
Capital allowances	100,000	100,000	100,000
Dividends (single-tier)	50,000	50,000	50,000

The investments made by Elyias in Robot Malaysia Sdn Bhd was utilised by the VC for seed capital and early stage financing.

As Elyias had disposed of his shares in the VC in the year of assessment 2015, he is eligible to make a claim for a deduction of RM5 million on the cost of investment in shares in the VC in the year of assessment 2015 as –

- (a) he is a resident in Malaysia and has a business source in Malaysia;
- (b) he had invested at the seed capital and early stage in a VC involved in a technology-based business activity as listed in Appendix A of the Venture Capital Tax Incentives Guidelines;
- (c) he had provided initial working capital to the VC in 2013;
- (d) he had obtained a certification from the SC confirming the relevant details as stated in paragraph 7.2 (a) to (c) and (e) of this PR. The financing provided by Elyias did not fall under paragraph 7.2(d); and

- (e) the investment of RM5 million made in the VC on 1.3.2013 qualifies for a deduction since the shares were held for more than 2 years prior to the date of disposal on 15.12.2015. The additional shares of RM200,000 invested on 1.3.2015 does not qualify for a deduction as the shares were held for less than 2 years prior to the disposal.

Elyias is single and had no other claims of deduction or relief. He obtained a certification from the SC (as mentioned in paragraph 7.2 of this PR) upon disposal of his shares in Robot Malaysia Sdn Bhd and made a claim for a deduction for investment in the VC.

The computation of Elyias chargeable income and income tax payable is as follows:

<b>Year of Assessment</b>	<b>2013 RM</b>	<b>2014 RM</b>	<b>2015 RM</b>
Sole proprietor - trading business Adjusted income	2,000,000	3,500,000	6,000,000
<b>Deduction for investment in VC</b>	-	-	<b>5,000,000</b>
Adjusted income	-	-	1,000,000
Capital allowances	100,000	100,000	100,000
Statutory business income	1,900,000	3,400,000	900,000
Dividend	NIL	NIL	NIL
Aggregate income / Total income	1,900,000	3,400,000	900,000
Personal relief	9,000	9,000	9,000
Chargeable income	1,891,000	3,391,000	891,000
Income tax payable			
First RM100,000 Balance @ 26%	13,850 <u>465,660</u> <u>479,510</u>	13,850 <u>855,660</u> <u>869,510</u>	
First RM400,000 Balance @ 25%			84,650 <u>122,750</u> <u>207,400</u>

## 8. **Mutually Exclusive**

A VCC that has applied for tax exemption under paragraph 6 of this PR and received certification from the SC is not entitled to apply for a tax deduction under paragraph 7 of this PR for the whole of the tax exempt period. This is because both incentives are mutually exclusive.

### **Example 4**

On 1.3.2013, two other investors invested in Robot Malaysia Sdn Bhd (same VC as in Example 3) as follows:

- (a) Rich Bhd, a VCC enjoying a tax exemption under the Income Tax (Exemption) (No. 11) Order 2005 stated in paragraph 2.4 of this PR since the year of assessment 2011 took up 25% of the 10 million shares in Robot Malaysia Sdn Bhd at a cost of RM2.5 million; and
- (b) Super Chemicals Sdn Bhd, a manufacturing company took up 25% of 10 million shares at a cost of RM2.5 million.

Both investors disposed of their shares in the VC on 15.12.2015.

As Rich Bhd, a VCC is enjoying an exemption under the Income Tax (Exemption) (No. 11) Order 2005, the VCC does not qualify for a tax deduction on the amount invested as share investment in the VC.

If Super Chemicals Sdn Bhd satisfies all the criteria in the Income Tax (Deduction for Investment in a Venture Company) Rules 2005 [P.U. (A) 76/2005] as stated in paragraph 7 of this PR, the company would qualify for a deduction on the cost of the investment in shares.

## 9. **Tax Incentive for a Venture Capital Management Corporation**

A VCMC must be registered with the SC pursuant to the Guidelines for the Registration of VCC and VCMC issued by the SC.

Pursuant to the Income Tax (Exemption)(No.12) Order 2005 [P.U.(A) 77/2005], a VCMC that is registered with the SC will be exempted from the payment of income tax in respect of the statutory income from the share of profits received by it from a VCC on any investment made by the VCC as stipulated in the agreement entered into between the VCMC and the VCC. The said VCC must have obtained certification from the SC for tax exemption under the Income Tax (Exemption) (No. 11) Order 2005 or deduction under the Income Tax (Deduction for Investment in a Venture Company) Rules 2005.



**10. Application for Certification of Investment for Tax Exemption and Tax Deduction in a Venture Company**

Applications for annual certification for the purposes of tax exemption and tax deduction must be made to the SC by completing the relevant forms and submitting the relevant documentation as explained in the Venture Capital Tax Incentives Guidelines which can be obtained from the SC's website.

**Director General of Inland Revenue,  
Inland Revenue Board of Malaysia.**