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PART 1 - OVERVIEW

1. Introduction

- 1.1 Under the Malaysia International Islamic Finance Centre (MIFC) initiative announced in August 2006, several incentives include a tax holiday on income generated from international currency business until 2016. This incentive was announced during Budget 2007 and is available to qualifying persons effective from the date they are approved, licensed or registered, as the case may be. The Income Tax Exemption Order gave effect to the announced incentive.

2. Definition

- 2.1 "Income Tax Exemption Order" refers to the Income Tax (Exemption) Order No. 12, 2007 (P.U.(A)154/2007).
- 2.2 "international currency business" refers to approved business conducted under ICBU, IIB licence or ITO registration in currencies other than ringgit and the currency of the State of Israel.
- 2.3 "qualifying expenditure" is expenses identifiable as directly attributable to the international currency business of the qualifying person that shall be deducted from qualifying income or qualifying ringgit income.
- 2.4 "qualifying income" is income derived from international currency business that is booked under the International Currency Business Account.
- 2.5 a "qualifying person" is either:-
- (a) International Currency Business Unit (ICBU) of an Islamic bank licensed under Islamic Banking Act 1983 (IBA) or of an institution licensed under Banking and Financial Institutions Act 1989, approved by Bank Negara Malaysia;

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(b) International Currency Business Unit (ICBU) of takaful operators registered under the Takaful Act 1984 (TA), approved by Bank Negara Malaysia;

(c) International Islamic Banks (IIB) licensed under the IBA; or

(d) International Takaful Operators (ITO) registered under TA.

2.6 “qualifying Ringgit income” is income derived from investments made in ringgit that is related or incidental to the carrying on of international currency business by the qualifying person.

3. Applicability

3.1 This guideline is applicable to the qualifying persons listed above and shall be read in conjunction with the Income Tax Act 1967, Income Tax Exemption Order, the relevant Acts’, guidelines, circulars and foreign administration rulings relevant to the conduct of international currency business under MIFC.

4. Objective

4.1 The objective of this guideline is to provide guidance on the application of the Income Tax Exemption Order and the related tax administrative requirements on income and expenses derived from international currency business of qualifying persons.

PART II - TAX ADMINISTRATIVE REQUIREMENTS

5. Maintenance of Separate Accounts

5.1 For the purpose of the Income Tax Exemption Order, all qualifying persons are required to maintain the following separate accounts, namely:-

- (a) **International Currency Business Account** – a separate account to book income and expenses from international currency *business activities* including investments made in currencies other than ringgit which is related or incidental to the international currency *business activity* conducted by the qualifying person concerned; and
- (b) **Qualifying Ringgit Account** – a separate account to book income and expenses from *investment activities* made in ringgit which is related or incidental to the international currency *business activity* conducted by the qualifying person concerned.

6. International Currency Business Account

6.1 *Qualifying Income*

6.1.1 The International Currency Business Account is established to separate income derived from conducting international currency *business activity and investment activity* that qualifies for income tax exemption. Income from international currency *business activity* of the qualifying persons that are offered under the ICBU, IIB and ITO, as the case may be, in currencies other than ringgit shall be booked under this account. As a general rule, in the context of international currency *business activities*, only business income from transactions in international currencies are considered as qualifying income that can be booked under the International Currency Business Account.

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6.1.2 Income and expenses from *investment activities* carried on in currencies other than ringgit for the purpose of or incidental to the international currency business of the qualifying person may also be booked under the International Currency Business Account.

6.1.3 *Business activities* involving ringgit or are conducted/ denominated in ringgit (except for qualifying ringgit income and expenses) cannot be placed under the International Currency Business Account or Qualifying Ringgit Account notwithstanding that it is conducted as part of international currency Islamic banking or takaful businesses as the objective is to generate new international currency Islamic finance business¹ other than the existing international currency business. Income from such *business activities* conducted by qualifying persons shall be taxable.

6.2 **Qualifying Expenses**

6.2.1 Expenditure that can be identified as directly attributable² to the international currency Islamic *business activity* is eligible to be deducted from income. Qualifying persons are required to determine *direct* expenses specifically for the purpose of computing qualifying income.

7. **Qualifying Ringgit Account**

7.1 **Qualifying Ringgit Income**

7.1.1 The income derived from *any investment activities* made in ringgit that is related or incidental to the international currency business of a qualifying person shall be booked under the Qualifying Ringgit Account.

¹ Refer to Appendix 1 for a list of examples of international currency business activities and Appendix 2 for examples of income that may be booked under the International Currency Business Account and Qualifying Ringgit Account.

² Refer to Appendix 3 for a list of examples of expenditures that are directly attributable to the international currency Islamic *business activities* and *investment activities*

7.1.2 For the purpose of the Income Tax Exemption Order, ICBUs, IIBs and ITOs are permitted to invest in ringgit provided the activity is directly related or incidental to the conduct of international currency *business activities*.

7.2 Qualifying Ringgit Expenses

7.2.1 Any expenses directly identifiable as attributable³ and incurred in making such *investment activities* shall be booked under the Qualifying Ringgit Account and deducted from the qualifying ringgit income. Similar to the International Currency Business Account, for the purpose of computing income that is exempted from tax, qualifying persons are required to deduct direct expenses from the qualifying income.

8. Specific issues on ICBUs: Unidentifiable Expenditure - Common Expenses Item, Common Funding Cost & Capital Allowances

8.1 Common Expenses

8.1.1 As the MIFC is an initiative to promote new business area within the international Islamic finance industry, the tax incentive is implemented with minimal administrative burden to qualifying persons. Accordingly, ICBUs are not required to allocate common expenses, direct or indirect. Only expenses that are directly identified as attributable to the international currency business whether in carrying on the activity or making investments related or incidental to such activity shall be deducted from the qualifying income or qualifying ringgit income of the qualifying person respectively.

8.2 Capital Allowance

8.2.1 At this juncture, ICBUs are also not required to allocate capital allowances.

³ Refer to Appendix 3

8.3 Common Funding Cost

8.3.1 Where the cost of funds of the ICBU is common, the qualifying person shall adopt the same overall basis for allocating the cost used throughout the group or the entity concerned. The acceptable bases are time spent, financing base, income contribution or such other basis as approved by Bank Negara Malaysia from time to time. Once selected and approved, the qualifying person is not allowed to change the basis without the prior written approval of Bank Negara Malaysia.

PART III - INCOME THAT IS NOT SUBJECT TO TAX

9. Income of Qualifying Person

9.1 Income of a qualifying person that is entitled to exemption from tax under the Income Tax Exemption Order is the aggregate income booked under the International Currency Business Account and Qualifying Ringgit Account, after respectively deducting the expenses as provided in this guideline.

PART IV - COMPLIANCE AND FURTHER INFORMATION

10. Compliance

10.1 The principal officer of the qualifying person responsible for taxation matters shall ensure adherence to the Income Tax Exemption Order as clarified by this guideline and any further clarification guideline issued by Bank Negara Malaysia or Income Tax Ruling that may be issued by the Inland Revenue Board concerning this tax incentive.

11. Further information

- 11.1 Qualifying persons may seek an advanced tax ruling from the Inland Revenue Board or seek clarification through the Bank Negara Malaysia Working Committee on Tax Neutrality for Islamic Banking & Finance.

PART V - IMPLEMENTATION DATE

12. This guideline shall be effective on ICBU, IIB and ITO upon date of approval to establish ICBU from Bank Negara Malaysia, date of licence and date of registration respectively.

PART VI - APPENDICES**Income Tax Act – Income Tax Exemption Order**

P.U. (A) 154.

1944

INCOME TAX ACT 1967

INCOME TAX (EXEMPTION) (No. 12) ORDER 2007

IN exercise of the powers conferred by paragraph 127(3)(b) of the Income Tax Act 1967 [Act 53], the Minister makes the following order:

Citation and commencement

1. (1) This order may be cited as the **Income Tax (Exemption) (No. 12) Order 2007**.

(2) This Order comes into operation from the year of assessment 2007 until 2016.

Interpretation

2. In this Order, unless the context otherwise requires—

“Central Bank of Malaysia” means the Central Bank of Malaysia established under the Central Bank of Malaysia Act 1958 [Act 519];

“International Currency Business Unit” means a unit within—

- (a) an Islamic bank licensed under the Islamic Banking Act 1983 [Act 276] which carries on Islamic banking business in any currencies other than Ringgit Malaysia;
- (b) a licensed institution under the Banking and Financial Institutions Act 1989 [Act 372] and approved to carry on Islamic banking business in any currencies other than Ringgit Malaysia under the section 124 of the same Act; or
- (c) a takaful operator registered under the Takaful Act 1984 [Act 312] which carries on takaful business in any currencies other than Ringgit Malaysia;

“International Islamic Bank” means an Islamic bank licensed under the Islamic Banking Act 1983 which carries on an Islamic banking business in any currencies other than Ringgit Malaysia;

“International Takaful Operator” means a takaful operator registered under the Takaful Act 1984 which carries on a takaful business in any currencies other than Ringgit Malaysia;

“qualifying Ringgit account” means an account of investment made in Ringgit Malaysia which is related and incidental to the business of a qualifying person and approved by the Central Bank of Malaysia;

“qualifying person” means an—

- (a) International Islamic Bank;

- (b) International Takaful Operator; or
- (c) International Currency Business Unit,

approved by the Central Bank of Malaysia.

Exemption

3. (1) The Minister exempts a qualifying person in the basis period for a year of assessment from the payment of income tax in respect of statutory income derived from its business and qualifying Ringgit account.

(2) Nothing in subparagraph (1) shall absolve or deemed to have absolved the qualifying person from complying with any requirement to submit any return or statement of accounts or the furnish of any other information under the provisions of the Act.

Separate account

4. The qualifying person shall maintain a separate account for the income derived from its business and qualifying Ringgit account referred to in subparagraph 3(1), and other sources of income in the basis period for that relevant year of assessment.

Application of paragraphs 5 and 6 of Schedule 7A

5. Paragraphs 5 and 6 of Schedule 7A to the Act shall apply, *mutatis mutandis*, to the amount of statutory income exempted referred to under subparagraph 3(1).

Made 12 March 2007

[Perb. CR(8.09)294/6/4-9 (SJ.9) (SK.12); LHDN. 01/35/(S)/42/51/231-17.8; PN(PU³)80/L]

TAN SRI NOR MD. BIN YAKCOP
Second Minister of Finance

[To be laid before the Dewan Rakyat pursuant to subsection 127(4) of the
Income Tax Act 1967]

Appendix 1

Below is a list of examples of international currency business activities. While the list is not exhaustive, it is indicative of the type of business activities that are eligible for preferential tax treatment.

Islamic banking & finance**I. Deposits, Financing & Related Activities**

- (a) Bilateral or syndicated financing products in currencies other than ringgit
- (b) Foreign currency deposit products
- (c) Non-ringgit funds placement, Islamic bankers acceptance on bills, bills and Islamic negotiable instruments
- (d) Opening, advising, confirming non-ringgit denominated trade-related letters of credit (LCs)
- (e) Non-ringgit trade financing and refinancing with/without LCs
- (f) Provision of non-ringgit guarantees, performance bonds and services relating to remittances
- (g) Credit or charge card services⁴ to where billing is in non-ringgit

II. Treasury

- (a) Proprietary and non-proprietary transactions that is related or incidental to the conduct of international currency *business activity* :-

⁴ Only for ICBUs

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- i. Foreign currency treasury transactions which does not involve ringgit
 - ii. Arranging, acting as intermediary or derivative intermediary, or trading of swaps which does not involve or that is not based on ringgit
 - iii. Islamic hedging transactions which does not involve or that is not based on ringgit
- (b) Financial, economic, analysis and investment research services on non-Malaysian business, industries and markets, and non-ringgit investments or instruments

III. Islamic Capital Markets (Both Equity & Non-Equity)

- (a) Trading in non-ringgit Islamic securities
- (b) Arrange, manage, underwrite, syndicate, sell or invest in non-ringgit Shariah compliant investments
- (c) Non-ringgit Islamic securities transactions, investments and services (including brokerage, nominee and custodian)
- (d) Corporate advisory services

IV. Fund Management & Advisory Services

- (a) Management of non-ringgit funds for customers
- (b) Investment advisory on non-ringgit instruments and transactions
- (c) Services or transactions on non-ringgit investments to customers
- (d) Trustee/custodian/depository services on behalf of foreign investors for non-ringgit instruments

V. Islamic Banking Services to Overseas Affiliates

Provision of the following services to Approved Affiliates⁵ that carries on all or any part of Islamic banking business –

- (a) General administration and management, business planning & coordination, procurement of raw materials & components for use in approved offices, technical support services, marketing control and sales promotion planning, training and personnel management
- (b) Corporate advisory services
- (c) Research and analysis (economic or investment)
- (d) Credit control and administration
- (e) Islamic finance products research and development carried out in Malaysia for Approved Affiliates or customers
- (f) Arrange financing facilities or Islamic securities issuance in non-ringgit in Malaysia
- (g) Management of funds of Approved Affiliates

VI. Takaful

- (a) Provision of takaful protection whether by direct takaful, co-takaful or re-takaful in currencies other than ringgit
- (b) Investment-linked takaful in currencies other than ringgit
- (c) Distribution of third party's takaful and re-takaful products
- (d) Distribution of takaful products and services by non-resident third parties and Approved Affiliates⁶
- (e) Consultancy services relating to takaful products or business
- (f) Provision of takaful expertise to Approved Affiliates

⁵ the qualifying person's own overseas branch office, overseas headquarters or overseas subsidiary and overseas associate companies

⁶ own overseas branch office, overseas subsidiary or overseas associate companies located outside that carries on all or any part of takaful or re-takaful business or is under a bancatakaful arrangement

Appendix 2**Examples of Income that may be booked under the International Currency Business Account & Qualifying Ringgit Account****I. Islamic banking ICBU or IIB**

- (i) Profit, rental, dividend or any other forms of gains (in lieu of interest, by whatever name called) income from the following:-
 - a. Financing activities
 - b. Trading/dealing activities
 - c. Investment activities
 - d. Due from other financial institutions
 - e. Discount on Islamic securities held
 - f. Profit/rental (in lieu of interest)-in-suspense recovered
 - g. Gains on realisation, disposal or sale of investments or properties
 - h. Foreign exchange gains
 - i. Foreign sourced profits, dividend or gains by whatever name called in lieu of interest from investments.
- (ii) The following fee-based income:-
 - a. Processing fees
 - b. Syndication fees
 - c. Commitment fees
 - d. Guarantee fees

- e. Underwriting fees
- f. Corporate advisory fees
- g. Portfolio management fees
- h. Acceptance commissions
- i. Charges and fees for money transmission services
- j. Custodian fee
- k. Trust administration fee
- l. Management fee

Qualifying persons may book income and expenses from Shariah compliant investments in the International Currency Business Account (for non-ringgit denominations) and Qualifying Ringgit Account (for ringgit denominations) provided the income and expenses are made in connection with or related to the conduct of international currency *business activities*.

Below are some examples of such investment:-

- (a) MIFC Islamic securities originated in Malaysia approved by the Securities Commission
- (b) Deposits with ICBUs and IIBs
- (c) Islamic securities of corporations
- (d) Islamic securities, notes, Islamic negotiable instruments, bills
- (e) Islamic negotiable instruments, notes, Islamic securities and other investment instruments issued by ICBUs, IIBs and ITOs in Malaysia
- (f) Positions in Shariah-compliant derivative contracts
- (g) Immovable asset situated outside Malaysia

- (h) Islamic deposits with ICBUs (in any currency) and IIBs (in non-ringgit) in Malaysia
- (i) Shariah compliant deposits with financial institutions outside Malaysia
- (j) Malaysian government securities
- (k) Foreign exchange transactions
- (l) Profit rate/currency/index forwards, options and swaps
- (m) Units in any unit trusts or collective investment schemes
- (n) Commodity murabahah

II. Takaful Operator ICBU or ITO

- (i) Contribution from business underwritten through the ICBU or ITO
- (ii) Wakalah fee (for those under wakalah model) including
 - (a) Management expenses recovered from international currency business takaful fund
 - (b) Commission expenses from international currency takaful including those earned from re-takaful ceded
- (iii) Surplus transferred from takaful fund of international currency business takaful fund
- (iv) Gains, discount or income from trading, sale of securities, sale/ disposal/ redemption or realisation of investments, securities or properties held for the purpose of the international currency takaful business.
- (v) Foreign exchange gains
- (vi) Profit sharing or performance from investments of takaful fund assets

Qualifying persons may book income and expenses from Shariah compliant investments in the International Currency Business Account (for non-ringgit denominations) and Qualifying Ringgit Account (for ringgit denominations) provided the income and expenses are made in connection with or related to the conduct of international currency *business activities*.

Below are examples of such investment:-

- (a) MIFC Islamic securities originated in Malaysia approved by the Securities Commission
- (b) Deposits with Islamic banks' ICBUs and IIBs in any currency
- (c) Islamic securities of corporations
- (d) Islamic securities, notes, Islamic negotiable instruments and bills
- (e) Islamic negotiable instruments, notes, Islamic certificates and other investment instruments issued by ICBUs, IIBs and ITOs in Malaysia
- (f) Positions in Shariah-compliant derivative contracts
- (g) Immovable asset situated outside Malaysia
- (h) Islamic deposits with ICBUs (in any currency) and IIBs (in non-ringgit) in Malaysia
- (i) Shariah compliant deposits with financial institutions outside Malaysia
- (j) Malaysian government securities
- (k) Profit rate/currency/index forwards, options and swaps
- (l) Units in any unit trusts or collective investment schemes
- (m) Commodity murabahah

Appendix 3**Examples of expenditures that are directly attributable to the International
Currency Islamic *Business Activities* and *Investment Activities****Business Activities:-*

- (a) Personnel and office related expenditures for the ICBU
- (b) Salaries-related expenditures for expatriates working directly under the ICBU
- (c) Traveling-related expenditures incurred by staff and expatriates that are directly attributable to the ICBU

Investment Activities directly attributable to the ICBU:-

- (a) Intermediary, custodian and other fees related to acquiring, disposing and holding of investments
- (b) Cost incurred in managing risk associated with investment (e.g. hedging cost)
- (c) Cost of undertaking research in relation to the investment activities