What's The Deal With JS-SEZ?

Key Tax Considerations For Singapore Companies

12 February 2025, Wednesday

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KEY TAKEAWAYS

- Companies operating in qualifying sectors can apply to the Malaysian Investment Development Authority for the various tax incentive schemes under the JS-SEZ Tax Incentives Package.
- Due to the proximity of the JS-SEZ, there may be a tendency for a Singapore company to send its employees to oversee the setting up of the Malaysian entity within the JS-SEZ. This could potentially lead to permanent establishment exposure for the Singapore company.
- Under the JS-SEZ incentives package, knowledge workers are eligible for a 15% flat tax rate on chargeable employment income for a period of 10 years.

A landmark initiative designed to strengthen cross-border cooperation with the establishment of a one-stop centre to facilitate investments and businesses, the Johor-Singapore Special Economic Zone (JS-SEZ) aims to create 20,000 skilled jobs and facilitate the expansion of 50 projects in the first five years, and 100 projects within the first decade. Spanning over 3,500 square kilometres, JS-SEZ is approximately four times the size of Singapore and comprises nine flagship zones, each focused on specific key sectors.

To keep tax professionals abreast of this significant development, the Singapore Chartered Tax Professionals hosted a webinar featuring four distinguished tax advisors from both sides of the Causeway. Together, the panel shared valuable insights into key tax considerations for companies and provided attendees with much to think about.

"To capitalise on the opportunities arising from JS-SEZ, it is critical for Singapore companies to think through the various tax considerations from the outset: What are the tax incentives available and their qualifying conditions? How can the company optimise the supply chain taking into account transfer pricing considerations? What would employment in JS-SEZ mean to Singaporean employees from an individual tax perspective? These are just a few of the many tax considerations for Singapore companies embarking on their JS-SEZ journey," they highlighted.

JS-SEZ Tax Incentives Package

From 1 January 2025 to 31 December 2034, companies operating in qualifying sectors can apply to the Malaysian Investment Development Authority (MIDA) for the various tax incentive schemes under the JS-SEZ Tax Incentives Package.

Generally, the focus is on high-value manufacturing activities, business services, integrated tourism projects and smart logistics.

Different tax incentive schemes apply for different designated flagship zones. For example, a company must be located within flagship zone A (Johor Bahru Waterfront) or B (Iskandar Puteri) to qualify for the Global Services Hub Scheme, which provides a 5% tax rate for up to 15 years to qualifying companies.

However, if the company is considering the Manufacturing Business Incentive Scheme for the manufacturing of medical devices, which provides a 5% tax rate for 10 or 15 years depending on the level of capital investment, then it must be located within flagship zone F (Kulai-Sedenak).

Tax Issues to Bear in Mind for Singapore Companies

SINGAPORE HEADQUARTERS AND INCENTIVES

Given Singapore's position as a leading global and regional headquarters location, one possible strategy for businesses is to maintain their headquarters in Singapore where strategic management and high-value activities (such as R&D and IP management) continue to be performed in Singapore, while establishing qualifying manufacturing activities and regional high-value back-office functions within JS-SEZ to leverage the new tax incentives and benefit from lower labour and land costs in Malaysia.

Despite the allure of the new tax incentives offered by JS-SEZ, one must not forget that Singapore has its own comprehensive suite of attractive tax incentives. For example, businesses can leverage the Enterprise Innovation Scheme (EIS) to benefit from a 400% enhanced deduction on qualifying R&D activities, or the IP Development Incentive (IDI) for a reduced tax rate of 5%, 10% or 15% on a percentage of qualifying income derived from the commercialisation of certain IP.

By evaluating their specific circumstances and strategically structuring their operations, businesses can potentially leverage the tax incentives offered in both countries and enjoy the best of both worlds.

CORPORATE INCOME TAX CONSIDERATIONS

When investing into JS-SEZ, one common corporate tax issue to consider is the impact of equity funding versus debt funding.

If a Singapore holding company uses equity to fund its subsidiary in JS-SEZ, the foreign dividends that it receives from the Malaysian subsidiary will generally not be subject to Malaysian withholding tax or Singapore income tax under Section 13(8) of the Income Tax Act 1947, subject to meeting relevant conditions.

On the other hand, if the Singapore holding company uses debt to fund its subsidiary in JS-SEZ, the interest expense, while deductible for Malaysian income tax purposes, may not be as valuable if the Malaysian entity qualifies for a lower tax rate under the JS-SEZ tax incentives. In addition, the interest payment will also be subject to Malaysian withholding tax, increasing the financing costs for the group as a whole.

Due to the proximity of the JS-SEZ, there may also be a tendency for the Singapore company to send its employees to oversee the setting up of the Malaysian entity within the JS-SEZ. This could potentially lead to permanent establishment exposure for the Singapore company.

BEPS PILLAR TWO CONSIDERATIONS

Some people may ask whether the reduced tax rates under the JS-SEZ Tax Incentives Package are still relevant, given that the world is moving towards a global minimum tax rate of 15% under the BEPS Pillar Two initiative.

The short answer is yes, it is relevant. The BEPS Pillar Two initiative only applies to a small group of very large MNE groups with consolidated revenue exceeding €750 million. As such, the reduced tax rates under the JS-SEZ are still attractive to companies not subject to BEPS Pillar Two.

All is not lost for these MNE groups subject to BEPS Pillar Two either. Depending on their specific circumstances, they, too, may be able to benefit from the JS-SEZ tax incentives with the help of certain mechanisms available in the Pillar Two rules. For example, the Pillar Two rules apply a jurisdictional blending approach when determining the GloBE effective tax rate for a jurisdiction. This means that the income taxed at lower rate (for example, income taxed at 5% due to the JS-SEZ tax incentives) will be blended with other income taxed at higher rates (for example, income of other Malaysian group entities taxed at a corporate tax rate of 24%). As long as the overall GloBE effective tax rate for Malaysia exceeds 15%, top-up tax will not apply.

TRANSFER PRICING CONSIDERATIONS

Transactions between a Singapore company and its related party located within the JS-SEZ must comply with the arm's length principle in both countries. It also goes without saying that the Malaysian entity located within the JS-SEZ will be subject to the transfer pricing (TP) documentation regime in Malaysia with its nuanced differences from Singapore's own regime.

From a TP perspective, the JS-SEZ provides a unique planning opportunity for businesses looking to operate on both sides of the Causeway. While there are many attractive tax incentives offered by both Singapore and JS-SEZ, it ultimately comes down to whether businesses will be able to allocate sufficient economic substance to each entity to meet the qualifying conditions for the respective incentives, while ensuring that the overall business structure makes commercial sense.

INDIVIDUAL TAX CONSIDERATIONS

Under the JS-SEZ incentives package, knowledge workers are eligible for a 15% flat tax rate on chargeable employment income for a period of 10 years. To qualify, individuals must hold a degree or higher qualification in a professional or technical field recognised by the Malaysian government and possess substantial work experience. Additionally, they must not have earned employment income in Malaysia for at least 24 months prior to their application and must have a monthly salary of at least RM20,000.

As of 12 February 2025, there are no specific guidelines regarding whether knowledge workers must be Malaysian tax residents to benefit from the 15% flat tax rate. However, it is noted that the Knowledge Worker Incentive in Iskandar Malaysia requires individuals to be Malaysian tax residents to enjoy the preferential tax rate. As such, a similar residency requirement may apply under the new JS-SEZ Incentives Package.

Other considerations for Singapore companies setting up presence in the JS-SEZ include whether remote working or dual employment arrangements may be implemented. Clear policies and guardrails should be established to ensure compliance with both Singaporean and Malaysian tax regulations.

Employees commuting across the border, especially when there is no formal cross-border commuting policy or active monitoring in place, may lead to complications to their tax residency statuses and affect individual tax compliance as well as lead to further considerations from a corporate tax perspective.

Conclusion

The JS-SEZ offers a transformative platform for businesses to harness the synergies between Singapore and Malaysia, driving innovation and growth. As we await further guidance on the JS-SEZ Tax Incentives Package, it is crucial for businesses to stay informed and integrate comprehensive tax considerations into their decision-making processes, enabling them to capitalise on the opportunities presented by the JS-SEZ while positioning themselves for long-term success.

Note: Information on the JS-SEZ Tax Incentives Package found in this article is accurate as of 12 February 2025.

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