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After MSC, what's next for Malaysia?

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THE recent launch of the BioValley project heralded Malaysia's initiative to spearhead the country into the forefront of the biotechnology industry.

This project was another bold initiative by the Malaysian Government to catalyse Malaysia's economic growth by harnessing the enormous potential of this rapidly-growing industry.

Biotechnology is the application of the principles of engineering and technology for biological advancements. It involves specific techniques using living organisms to create, modify or enhance a product. Its applications are seemingly endless but currently encompass mainly the fields of medicine, pharmaceutical, agriculture and food production.

BioValley, which was launched by Prime Minister Datuk Seri Dr Mahathir Mohamad on May 20 2003, will be located at a 200ha site neighbouring Cyberjaya and Putrajaya, right in the heart of the Multimedia Super Corridor (MSC). It, therefore, forms another artery of the MSC.

The BioValley is to be the nucleus for research and development (R and D) in biotechnology and a centre for scientists to interact and exchange ideas on their research.

As the tabling of the Malaysian National Budget approaches, it is timely to consider the type of tax incentives which will attract biotech companies to set up their base in Malaysia's BioValley.

The Government's target is to attract 150 biotech companies with investments worth of RM40 billion over the next decade. Initial response has been excellent with three biotech companies already committing investments in excess of RM100 million. In addition, there is another RM100 million investment in the pipeline by a Chinese biotech investor.

The Government has committed RM100 million for the establishment of three institutes in agro-biotechnology, pharmaceutical and nutraceutical, and molecular biology fields. These institutes will form the R and D core of all Malaysia's biotechnology initiatives.

Tax incentives currently available

In deciding on the appropriate tax incentives for a biotech project, the investor is faced with the whole array of manufacturing and R and D tax incentives. These tax incentives are primarily in the form of pioneer status tax holidays, investment tax allowance (ITA) on qualifying capital expenditure and double deduction for qualifying expenses. Where the project justifies, a tailored request for tax incentives can be made under the recently-introduced pre-packaged incentive schemes.

In addition, the recent Economic Stimulus Package announced the following incentives for the biotech industry:

- \* group tax relief incentive has been extended to biotechnology;
- \* approved R and D expenditure incurred during the pioneer status will be given another deduction after the pioneer status period; and
- \* R and D companies will be given either a second round five-year Pioneer Status or ITA for a further period of 10 years.

A specially-designed biotech incentive package would certainly be a boost to the BioValley project. A closer examination of the activities and requirements of biotech companies reveal the need for targeted tax incentives to facilitate the growth of the BioValley.

It is conceivable that biotech companies' activities would involve the provision of R and D services and the exploitation of developed patents and technology. To enhance attractiveness to biotech investors, the tax incentives, whether in the form of pioneer status or ITA, should cover both these activities. Following from the example of MSC companies, biotech companies could be requested to submit their business plans and all qualifying activities will be eligible for tax incentives.

The commercial success of most biotech projects would generally be preceded by a significant investment in time and R and D funding. The gestation period for biotech projects is significantly longer than other industries. As such, the real benefit of a pioneer status incentive would not be enjoyed without an extension of the tax holiday period from the normal five years to say, 10-15 years.

The commencement date of the pioneer status incentive should also be considered. Generally, under the existing pioneer status incentive, commencement date is when a company first produces marketable quantities even though the company may be operating with losses. Due to the nature of biotech projects, an effective solution would be for the pioneer status to take effect commencing in the year when a company starts to generate profit, as made available to approved food production projects.

#### Upfront tax deduction for initial investment

To encourage Malaysian conglomerates to invest in BioValley, an effective incentive would be to grant an upfront tax deduction for the initial investment by the investor company in setting up the BioValley company.

#### Withholding tax exemption

An important lesson we learn from the MSC project is the need to acquire foreign technical know-how and expertise especially in the initial years of set-up. We foresee that similarly for Malaysian biotech companies, to leapfrog technological developments in the biotech field, there will be a need to acquire generic technology or patents for their own research and development projects.

Payments for patents, technological know-how and expertise to non-residents attract withholding tax which while legally is the cost of the non-residents, are generally in practice passed back to the Malaysian payers. The cost of acquiring technology, know-how and technical expertise which are essential for the Malaysian biotech companies would be reduced if the withholding tax can be waived.

#### Personal tax exemptions/Double deductions

The success of the BioValley as with any K-economy initiative is dependent on the availability of talent. An innovative tax package to draw these experts, whether Malaysians or expatriates to Malaysia, is needed. Among other measures for consideration would be, say a 50 per cent income tax exemption for a specified period of time. This measure was granted to expatriates during the initial promotion of Labuan as an international Offshore Financial Centre.

Malaysia is not alone in this biotech initiative. There are noted biotech hubs such as that in Flanders, Belgium and the Australian Technology Park in Sydney, Australia, that are advocating similar objectives with more countries jumping on the bandwagon. An attractive package will seek to enhance Malaysia's BioValley's ability to attract the much sought after investment funds.

Of course, the long-term success of Malaysia's BioValley and the biotechnology industry would depend on a more holistic approach. Due consideration has to be given to a wide spectrum of factors other than tax policies, including access to funding, human capital and talents, adequate intellectual property protection laws etc.

In its present conceptual form, the strengths of Malaysia's BioValley lie in its potential to exploit the biodiversity of Malaysia's natural resources and the level of infrastructure and support that is to be provided. And increasingly so, a major pull factor for any foreign investor to Malaysia would be the overall stability of the Malaysian Government and their underlying commitment to ensuring the success of this latest and arguably, ambitious initiative.

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