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TOUGH CUTS TO TAX HOLIDAYS FOR EXPANSION AND REINVESTMENT IN 2017 INVESTMENT RULES

The Myanmar regime of investment-related tax incentives has been updated by the new "Investment Rules", officially known as Notification 35/2017 ("Rules 2017"). One of the key issues for investors is the tax exemption for expansion of projects that already received an MIC permit under the Foreign Investment Law 2012 (FIL). Under the Foreign Investment Law 2012, all expansions received import tax exemptions, and there were no conditions or limitations for such an expansion. The Rules 2017 introduce some surprising and restrictive conditions for expansions, including the expansions of projects with an existing MIC Permit. Another unforeseen problem for investors with projects already in place are the new and severe limitations to the income tax exemption for reinvested profit.

The most publicized and eye-catching of the new restrictions, already known since the Myanmar Investment Law 2016 (MIL) was issued, regard the income tax holiday. Previously available to every investor with an MIC Permit regardless of industry sector or location, an income tax holiday under the MIL is only granted if the project's activity features on the "Promoted Sector List", and located in one of the three zones.

Highlights of this note

- Surprising new conditions for project expansion import tax exemption
- New projects: Promoted Sector List and Zones
- Commercial Date of Operation
- Reinvestment income tax incentive becomes strict and risky
- Export-related tax incentive requires 80% export
- Retroactive penalties?

The Rules 2017 also stipulate penalties for those who have benefited from them undeservedly.

The Rules 2017 replace the Investment Rules of Notification 11/2013 under the previous Foreign Investment Law. They were released just before the Myanmar New Year break.

In this note we explain the practical effects of the tax provisions in the Rules 2017 on both existing and new investment projects.

		2012 FIL	2016 IL	Notes
1	Corporate income tax holiday	The MIC had no choice but to give every foreign investor a 5 year tax holiday	The MIC may or may not grant an income tax holiday. The holiday period can be 3, 5 or 7 years depending on location. Myanmar is divided in 3 zones for that purpose.	Myanmar citizen investors may receive more favourable incentives than foreign ones, the 2016 IL states.
2	Reinvestment	Profit which is reinvested within one year is exempt from income tax		Reinvestment of profit is allowed for other similar type of business under 2016 IL whereas reinvestment is allowed only in the same business under 2012 FIL
3	Depreciation	Right to depreciate at a rate set by the state.	Accelerated depreciation equal to 1.5 times of the original depreciation can be allowed. (Accelerated depreciation is allowed to start from the date of commercial operation under 2016 IL)	Clarified
4	Export income tax rate	Reduction of income tax to 50% of rate for export	No such rule	Abolished
5	Equal income tax rate	Right to pay tax at rate for Myanmar citizens.	Law states that income tax on foreigners shall be the same as on citizens.	Clarified, made into a general rule rather than a right.
6	R&D deduction	Right to deduct from assessable income	No change.	
7	Loss carry forward	Up to three consecutive years from the year the loss is sustained in respect of such loss sustained within two years immediately following the exemption	No such rule	The 2012 FIL, following the 1987 FIL on this matter, contained this confusing rule on losses, which actually is less advantageous than the general income tax law rule which applies to everyone
8	Imported machinery, equipment, materials	Exemption from customs duty and Commercial Tax during the construction period of the project.	No change	
9	Raw materials	Exempt from customs duty and Commercial Tax for first three year.	Exempt from customs duty and Commercial Tax if at least 80% of income is expected to be from export. Exemption from customs duty and Commercial Tax is given for "materials used in the business" if imported during construction period.	Incentive restricted. If the raw materials are imported during construction period, exemptions may be available. Semi-finished goods added to scope by 2016 IL
10	Refund of tax and duty in case of export	No such rule	When goods are exported, duty and tax paid on the import of the raw materials materials and semi-finished goods of those goods can be refunded	New incentive
11	Expansion of the project	Exempt from customs duty and Commercial Tax on imported plant and equipment.	No change	
12	Commercial Tax for export	Exemption	No such rule	Deleted. Apart from electricity (CT @ 8%) and crude oil (CT @ 5%), CT is zero rated for other export goods

Surprising new conditions for project expansion import tax exemption

When an investor adds a phase or otherwise enlarges the original project, we call that an expansion. Under 77 (d) MIL, customs duty and Commercial Tax exemptions are available for such an expansion. It is uncontroversial in the region that Governments should at least exempt import duties for capital goods of new investment coming in. Yet, the Rules 2017 add new and perhaps unnecessary conditions limiting the application of this exemption. Rule 104 states, somewhat cryptically, that "where an investor increases the volume of Investment or expands the original investment business subject to 77 (d) MIL, it shall be deemed that the volume of Investment is expanded only after 80% of the originally proposed investment has been made".

What does this mean? It could mean that you cannot receive tax exemptions for an expansion until after you have completed at least 80% of your original project. One wonders why it is necessary to have such limitation. After all, if investors want to expand, why not let them? If they decide they can go into phase 2 even before phase 1 is entirely finished (which must have been unforeseen or else phase 2 would have been part of the original project), all the better.

Alternatively, Rule 104 could mean that any expansion should be at least 80% of the value of the original, which seems like an unreasonable and arbitrary restriction. Either way, we do not see why expansions have to be limited.

Investors who do not complete the construction of their projects on time are already sanctioned by forfeiting their Permit under Rule 144.

Rule 105 adds another problem for expansions, now providing that regardless of how long the expansion might take, the investor has only 2 years to import all materials. The construction period of original projects is not explicitly limited in the Rules, and we wonder why an expansion would be any different.

It is not entirely clear if existing projects with existing Permits are subject to all of the new tax conditions set out in the Rules 2017. The MIL just states that "any Permit under the [FIL, MCIL] shall continue to be effective till the end of such Permit" (s. 93 MIL). The Rules 2017 add that "the Investor shall be entitled to continue carrying out the investment and enjoy the benefits in accord with the terms of the Permit". What does "the terms of the Permit" mean? Does that include the tax rules on expansion, which are not mentioned in the Permit but set out for all Permits in the Rules 2013?

The Rules 2017 also state that "where a Permit is granted under a previous investment law, to the extent that the Investor wishes to benefit from any additional or discretionary incentives under this Law, the Investor shall apply for such incentives in accordance with this Law" (Rule 225). Presumably, based on Rule 225, when an investor applies for an expansion of a project with an existing Permit, the Rules 2017 with their new restrictions in Rules 104 and 105, will indeed apply.

Furthermore, an investment or an expansion must exceed the absolute threshold of US $300,000 in terms of "additional funds or application of further capital", or else no tax exemptions will be granted.

New projects: Promoted Sector List and Zones

Tax incentives are not automatic in Myanmar. They need to be requested and approved. Even under the Foreign Investment Law 2012 only the 5 year income tax incentive was mandatory. It was always quite clear what the

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March 31, 2017, Nay Pyi Taw.

discretionary tax incentives were under the Foreign Investment Law, but it remained largely unorganized exactly how and when these were granted in the previous system. The Rules 2017 now offer more hard and fast criteria in that regard, and an explicit confirmation that a tax incentive can be applied for at the same time as the Endorsement or the Permit.

Although Rule 91 cites other, less tangible conditions as well, the main ones, which are described as being "mandatory", come down to this:

1. The income tax incentive of 3, 5 or 7 year is only available for "Promoted Activity" as listed in Notification 13/2017. So, there is a long list of activities which the MIC will provide tax holidays. Other activities, it seems, will not receive a tax holiday;
2. If the activity is on the Promoted list, the tax holiday period will be determined based on whether the investment will be located in Zone 1, 2 and/or 3, as defined in Notification 10/2017.
3. At least US $300,000 in expenses or additional capital is involved;

In addition, there are conditions set out for specific tax incentives, as discussed below.

Commercial Date of Operation

Under the FIL, an income tax holiday can be triggered by informing the start of the commercial operation date to the MIC during or at the end of the construction period. MIC will issue a letter that states the Commercial Date of Operation ("COD") and this will trigger the start date of the tax holiday period. In other words, this will mean the end of the construction period and customs duty and other tax exemptions during the construction period will also end.

However, under the new MIL, an income tax holiday can be triggered during the construction period as well if the company is generating any assessable income. Alternatively, the COD can be triggered within 90 days from the end of construction period. The income tax holiday will commence from the COD approved by the MIC. The difference is the trigger of the COD during the construction period will not affect tax exemptions granted during the construction period.

Reinvestment income tax incentive becomes strict and risky

Besides the 3, 5 or 7 year income tax holiday, the MIC might agree to exempt your income from tax under 77 (a) MIL. This is the re-investment tax incentive. The idea is that you will be spared the income tax on your profit in the year you earned it, if you reinvest that profit in the Myanmar project. This possibility also existed under the FIL but was in practice hardly used.

The Rules 2017 are not entirely clear whether this re-investment incentive is also subject to the conditions of the Promoted Sector List and zone location. The MIL does not suggest so, but Rule 92 states that subparagraphs (a) to (f) of Rule 91 are "mandatory to "the Tax Incentive" (not defined). The requirement "for income tax exemption, all investments are made in a Promoted Sector" is (c), and "in the case of income tax exemption, the Investment is being made in a place designated …as Zone 1, 2 or 3…" is (f), so within the mandatory requirements, provided we are talking about "income tax exemption". Was this meant to include the income tax exemption for reinvested profit, which is certainly some kind of an income tax exemption? Rule 99, specifically on the re-investment, does not refer to the "mandatory conditions of Rule 91 (a) to (f).

Furthermore, the Rules 2017 now add a few frankly dangerous conditions which arguably void the incentive of its purpose. Most importantly, Rule 99 now provides that the exemption is not permitted unless "all income tax and other taxes due in respect of the assessment year … have been paid". Although this sounds good in theory, in practice there are always differences of view between the taxpayer and the Internal Revenue Department, and adjustments for unpaid taxes are unavoidable. Any such adjustment after a tax audit would jeopardize, retroactively, the entire tax exemption. Another problem is the penalty for missing a reinvestment year. There are many acceptable reasons why a good faith taxpayer may miss the "next year" deadline. Rather than just charging interest, which would have been reasonable, the Rules exact the disproportionate penalty of losing all re-investment tax exemptions for all time.

Export-related tax incentive requires 80% export

Under 77 (b) MIL, the MIC can also grant a permanent customs duty and Commercial Tax exemption for an export

focused project. The MIL does not state when one can be considered to be "export oriented", as in, how much of the revenue should be derived from export. The Rules 2017 provides that missing information, and sets the requirement at 80%. Rule 97 also adds an additional complication, which is hard to imagine being implemented in practice, stating that the exemption may be granted on a pro-rata basis on the percentage of income in excess of this amount.

Retroactive penalties?

Rule 115 in the Rules 2017 provides that the MIC may revoke tax exemptions retroactively if in its reasonable opinion, the project was not carried out substantially in accordance with the application made to the MIC. In case the investor intended to mislead or defraud the MIC, this is wholly warranted. But in reality, there is no project that unfolds entirely as planned, and there can be serious disagreements on what variations can be deemed "substantial" (which could have been connected to a percentage of capital contribution). More importantly, there is no carve-out for projects that were amended based on economic reasons. One cannot fault an investor for a turn in economic climate, or for a change in its own financial circumstances. Is it the intention to claim a refund of all taxes saved if an investor had to cut the size of the project because, despite his good faith and best efforts, he is unable to raise enough resources?

One wonders if this rule is really needed. If an investor with a Permit does not complete the construction of the project by the end of the (extended) construction period, he already loses his Permit. Remarkably, this sanction does not seem to exist for the Endorsement.

Along the same lines, Rule 94, states that the MIC may refuse to grant tax incentives in case the investor has in the previous 3 year "discontinued or significantly reduced a prior investment".

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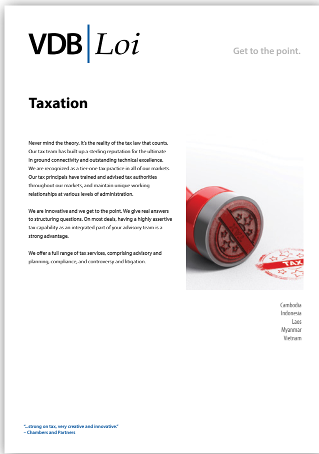

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