FREE ZONE IN MALAYSIA

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Since the country gained independence in 1957, Malaysia's economic activities have shifted from primary commodities such as rubber and wood to industrialisation over the years. To cater for the increasing needs of the business communities in respect of manufacturing and trade facilities and to attract more foreign direct investment, the Malaysian Government has enacted the Free Zones Act 1990 which was gazetted on 10th May 1990. The activities in free zones are governed by the Free Zones Regulations 1991.

As stated in section 3(1) of the Free Zones Act 1990, the Minister of Finance may declare an area to be a free zone. A free zone refers to a secured and designated area where commercial and industrial activities are conducted with minimal customs control and deemed to be a place outside of Malaysia that is not subject to the applications of the Customs Act 1967, Excise Act 1976, Sales Tax Act 2018 and Service Tax Act 2018, except in cases where imports and exports are prohibited under Section 31 of the Customs Act 1967. However, the movement of people and goods into and from the free zone are strictly controlled.

The Minister of Finance may appoint any statutory body constituted under the law of Malaysian federal government or state government, or any company as authority, known as Free Zone Authority, to administer, maintain and operate any free zone. A company (can be 100% owned by foreign investors) that intends to operate in the free zone is required to obtain prior approval from the Free Zone Authority.

Currently, the main activities in the free zone are the electronics and electrical industry, petrochemicals, food products, plastics, medical equipment, general assembly industries, services, logistics, warehousing, e-commerce, etc.

There are two types of the free zone, that is i) **Free Industrial Zone** for companies carrying on manufacturing activities, and ii) **Free Commercial Zone** for companies carrying on commercial activities.

Free Industrial Zone (FIZ)

To qualify for operation in a FIZ, a company has to export at least 80% of its output and its raw materials/components are mainly imported. If a company in FIZ has obtained approval from the Ministry of International Trade and Industry (MITI) to reduce its export condition to 60%, it can also apply to the Customs for the permission to export 60% of its output instead of 80%.

Companies operating in FIZ can enjoy **duty-free imports** of raw materials, including packaging materials and machinery and equipment used directly to produce the approved products as stated in their manufacturing license (unless these manufacturers are exempted from applying for manufacturing license). The companies in FIZ are also **exempted from the payment of excise duty, sales tax, and service tax**. However, raw materials or components which are not directly used in the manufacturing process will not enjoy the said duty/tax exemption such as fuel, office furniture and equipment including food and drinks, air conditioners, vehicles and spare parts, construction materials, forklifts, firefighting equipment, and pollution control equipment and wearing apparel for employees.

As FIZ is deemed to be outside of Malaysia, any goods taken out of the FIZ into the Principal Customs Area[1] (PCA) of Malaysia are deemed to be imported into the country and will be subjected to the payment of the prevailing customs duty, excise duty, and sales tax. As companies in FIZ will export at least 80% of their output, they are allowed to sell a maximum of 20% of their output into PCA. The goods manufactured in the FIZ and brought into the PCA are deemed to be imports, hence the goods must be declared for importation in Customs Form No 1. Likewise, any goods brought into the FIZ from the PCA are deemed to be exports and shall be declared in Customs Form No 2.

Companies operating in FIZ are permitted to send the semi-finished goods and raw materials to another factory located in another FIZ, Licensed Manufacturing Warehouse (LMW) or in the PCA, for specific processes and subsequently return to the company in FIZ provided that the prior approval has been obtained from the State Director of Customs.

Companies operating in FIZ are responsible for keeping proper records of all activities at their premises, including goods received at the premise and taken out to the PCA, waste stock, and method of disposal with the written approval of the Free Zone Authority after consultation with the Customs Department. Meanwhile, Customs Department is entrusted to control the movement of goods at the entry/exit points and with the authority to search premises/vehicles/persons and has the power to arrest and seize goods.

There are currently 21 FCZ in Malaysia, which are mainly in the State of Johor, Melaka, Pulau Pinang, Selangor, Perak, and Sarawak.

1 Principal Customs Area means the territory of Malaysia excluding Labuan, Langkawi, and Tioman under the Customs Act 1967

Free Commercial Zone (FCZ)

The Malaysian government established the FCZ to promote commercial and trading activities in Malaysia, including entrepot trade[2], in conjunction with the promotion of the services sector. Due to the nature of the activities, which can include bulk breaking, repackaging of products that are either imported or sourced from companies in FIZ or LMW or from the PCA, FCZ is normally located near the country's ports. For all imports that will be subsequently re-exported together with other products or as components of another product being repackaged in the FCZ, companies operating in the FCZ are **exempted from paying import duties, excise duty, sales tax, and service tax**, similar to FIZ.

The companies in FCZ are not allowed to carry out retail trade with the exception of FCZ in Rantau Panjang Free Zone in Kelantan, Bukit Kayu Hitam Free Zone in Kedah, and Stulang Laut Free Zone in Johor.

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Disadvantages of Free Zones

Even though there are many benefits, particularly in respect of exemption of duty/tax upon the importation of materials, goods, or equipment can be enjoyed by the companies operating in the free zone, however there are some drawbacks or disadvantages. These include 1) compliance with comprehensive rules and regulations where the Customs Department has rights to conduct regulatory audits; 2) high paid-up capital requirement depending on business activities; 3) specific permits or licenses required; and 4) must maintain an office in the free zone which may increase the operating cost.

Conclusion

The establishment of free zone in Malaysia has helped to establish a more conducive and competitive business environment for companies operating in Malaysia and help the country to attract more foreign direct investment. Apart from that, Malaysia has benefitted from the free zone in terms of technology transfer, skill training, development of local supporting industries, and development of capital and technology intensive industries among others.

[2] Entrepot trade means importing goods from a foreign country with the purpose/motive of exporting them to another country at a higher price.