

## The “Duty-Free” Myth: Compliance And Control In Malaysia’s Free Zones

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For companies operating in Malaysia’s Free Zones, the perception of a “duty-free” environment often obscures a far more complex regulatory reality. While these zones allow goods to move without immediate customs duties, they exist within a tightly monitored legal framework overseen by the Royal Malaysian Customs Department and the Malaysian Border Control and Protection Agency (MCBA).

Enforcement is neither theoretical nor rare. In February 2026, authorities intercepted two shipping containers at West Port in Port Klang containing more than 37 tonnes of illegal electronic waste. Investigators found that the cargo had been falsely declared in the Customs Information System as ABS plastic flakes and industrial machinery, an attempt to circumvent environmental import restrictions.

Such cases illustrate the legal risks facing companies that misuse free zone facilities. Under Section 133 of the Customs Act 1967 (CA 1967), making incorrect declarations or falsifying customs documentation constitutes a criminal offence punishable by a fine of up to RM500,000, imprisonment of up to seven years, or both. Where goods are unlawfully imported or exported, Section 135(1)(a) provides for additional penalties, including fines calculated as multiples of the value of the goods.

For operators within free zones, compliance failures extend beyond financial penalties. Inaccurate inventory records or involvement in document falsification can trigger suspension or revocation of operating privileges, effectively halting business activities and exposing directors to personal liability.

The reason for this strict enforcement lies in the legal structure of the zones themselves. Free zones allow goods to bypass immediate customs duties only because they are legally treated as outside Malaysia’s Principal Customs Area. The privilege therefore depends on exact documentation, traceable inventory flows and full regulatory transparency.

### **Free Commercial Zones vs Free Industrial Zones**

Malaysia’s free zones are established under the Free Zones Act 1990 (FZA 1990). Section 3(1) grants the Minister of Finance the authority to declare any designated area either a Free Commercial Zone (FCZ) or a Free Industrial Zone (FIZ), with each category permitting different activities.

The fundamental fiscal incentive appears in Section 4 of the Act: goods may be brought into, produced or manufactured in a free zone without payment of customs or excise duties, provided they are not specifically prohibited by law.

### **Free Commercial Zones**

Free Commercial Zones function primarily as logistics and trading hubs. Permitted activities include trading (excluding retail), break-bulking, grading, repacking and relabelling. Facilities within the Port Klang Free Zone, for example, typically operate as regional distribution centres supporting international supply chains.

Goods entering FCZs are generally exempt from customs duties, excise duties and Sales and Service Tax provided they are subsequently re-exported. However, when goods are sold into Malaysia’s Principal Customs Area, Section 7 of the FZA 1990 treats them as foreign imports, triggering the full range of domestic tariffs and taxes under the Customs Act 1967.

### **Free Industrial Zones**

Free Industrial Zones serve a different function. They are designed exclusively for manufacturing activities.

The FZA 1990 defines “manufacture” as the conversion of raw materials whether organic or inorganic into a new product through mechanical or manual processes that alter size, shape, composition or quality.

Once manufacturing is complete, Section 8 of the Act tightly regulates the movement of finished goods. Operators must either export the products directly or obtain approval to transfer them to a Free Commercial Zone. Goods cannot be used or consumed within the zone without written permission from a senior customs officer.

The Act also restricts the types of goods that may enter the zone. Section 11 allows duty-free entry only for materials used directly in manufacturing or goods imported specifically for export. Administrative equipment and non-production assets do not automatically qualify for duty exemptions unless the Minister grants a specific exemption.

## **Establishing A Free Zone Operation**

Operating within a free zone requires multiple regulatory steps. Although procedures vary slightly between Free Zone Authorities, the overall framework follows a consistent structure.

### **Step 1: Incorporation And Regulatory Approvals**

Companies must first be incorporated under the Companies Act 2016 before applying to operate within a free zone.

They must also obtain sector-specific approvals required for any Malaysian business. Manufacturing entities typically require manufacturing licences, while fire safety certification must be obtained from the Fire and Rescue Department of Malaysia. Environmental approvals may be required from the Department of Environment, particularly where industrial processes or hazardous materials are involved.

Businesses handling agricultural or biological products must also secure import or export permits from Malaysian Quarantine and Inspection Services.

Local authorities additionally require a Business Premise and Signboard Licence. These external approvals ensure that companies comply with safety, environmental and municipal regulations before a free zone authority grants operational approval.

### **Step 2: Registration With The Free Zone Authority**

Once preliminary approvals are secured, companies must apply to the relevant Free Zone Authority using Form ZB4 or ZB5.

After reviewing the business model and the facility’s security arrangements, the authority may issue a ZB6 approval. This document assigns a warehouse or manufacturing code that authorises operations within the zone. The approval is valid for one year and must be renewed annually.

Operators must then integrate with the Free Zone Information Processing System or SMK Dagang Net platform, which allows electronic customs declarations for all cargo entering or leaving the zone.

### **Step 3: Continuous Operational Compliance**

Day-to-day compliance is critical.

Operators must submit ZB1 declarations for all imports, exports and transshipments, maintain accurate inventory records and operate a physical office within the zone.

Customs authorities conduct periodic audits, often without prior notice. Companies must therefore maintain detailed documentation demonstrating that all goods entering the zone were either processed according to permitted activities or re-exported.

Failure to reconcile inventory records can result in enforcement actions, including suspension of operating licences.

### **The Shift Toward Integrated Border Enforcement**

Malaysia’s regulatory framework is also evolving. The creation of the Malaysian Border Control and Protection Agency marks a shift toward integrated border management.

The agency consolidates functions previously spread across more than 20 departments, including customs, immigration and quarantine authorities. By integrating data systems and risk analysis capabilities, the government aims to improve monitoring of goods movements across ports and land entry points.

For free zone operators, the implications are clear: enforcement is becoming more coordinated and technologically driven.

The “duty-free” label therefore reflects a conditional privilege rather than an exemption from oversight. Goods may move without immediate tax liability only because the legal framework assumes strict documentation and traceability.

### **Compliance As A Strategic Requirement**

Free Commercial Zones and Free Industrial Zones remain powerful tools for companies managing regional supply chains. They offer logistical advantages and deferred tax liabilities that can significantly improve cash flow.

But the benefits come with strict legal responsibilities.

The Free Zones Act 1990 provides the framework that enables duty-free operations. The Customs Act 1967, however, enforces the boundary. Businesses that fail to maintain transparent records or comply with statutory procedures risk severe financial penalties and the loss of the very privileges that make the zones attractive.

In Malaysia’s increasingly integrated enforcement environment, regulatory compliance is not simply a legal formality. It is the essential condition for participating in the country’s free zone economy.

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