

2005 Budget Highlights Tax Commentary

Malaysia

10 September 2004

Executive Summary

- A Taxation System Review Panel is to be established to review the tax system.
- Further measures are to be introduced to ensure tax neutrality of Islamic financial and capital market products with conventional products.
- Further specific tax provisions to be introduced for Real Estate Investment Trusts and Property Trust Funds.
- Interest-in-suspense for financial institutions be deemed as specific provisions for bad debts and allowed full deduction.
- A number of existing incentives and/or capital allowances are to be enhanced for agriculture and food production activities.
- Tax incentives are granted for commercialisation of public sector R&D and relocating manufacturing activities to promoted areas.
- Double deduction and tax incentive in the form of Investment Tax Allowance are introduced to promote the development of *halal* products.
- Increase in tax relief or tax rebates on contribution to approved EPF/takaful/life insurance premiums and purchase of books and computers as well as increased relief for the disabled.
- Import duty and sales tax exemptions for outsourcing manufacturing activities.
- Increase in import and excise duties on cigarettes and liquor and review of duties on selected goods.
- Introduction of Goods and Services Tax on 1 January 2007.

Overview and Commentary

The Prime Minister, YAB Dato' Seri Abdullah Bin Hj. Ahmad Badawi, who is also the Minister of Finance, presented the 2005 Budget on Friday, 10 September 2004.

The 2005 Budget's theme is "Building on Past Achievements Towards Greater Success". The focus is on promoting growth and providing an enabling environment of opportunities in various economic activities for all the rakyat. This is to be achieved using the following strategies:-

- Enhancing the effectiveness of Government financial management, efficiency of the delivery system and competitiveness;
- Accelerating the shift towards a higher value added economy;
- Developing human capital as a catalyst of growth; and
- Ensuring the well-being of the rakyat through improving their quality of life.

The Prime Minister proposed that an amount of RM117.4 billion be allocated for the 2005 Budget. This is forecasted to give rise to a budget deficit of RM18.2 billion for 2005 or equivalent to 3.8% of GDP.

Some of the more notable features of the Budget include:-

- Review of the Taxation System

The setting up of a Taxation System Review Panel comprising representatives from the public and private sectors is a positive move to ensure that the Malaysian taxation system is more efficient, equitable and business friendly. With plans to review the provisions of the Income Tax Act 1967, amongst other legislation, this is a welcomed initiative that will strive to improve clarity and transparency of the tax administration system.

- Goods and Services Tax (GST)

The advanced announcement of the proposed GST to replace the existing Sales and Service Taxes from 1 January 2007 is certainly commendable. With the proposed introduction of the GST, a reduction in the individual and corporate tax rates in the near future can be expected. The interesting issue that is eagerly awaited would be the rate of GST.

- Fund for Tax Refund

Another significant measure announced by the Government is the proposal to establish a Fund for Tax Refund. With this separate Fund in place, taxpayers can expect their tax refunds to be expedited as compared to the current system.

- Tax Reliefs

On the whole, the rakyat will find this Budget particularly friendly in the absence of income tax rises and in the light of increased tax reliefs. These include, amongst others, the increase in EPF as well as Life Insurance Premium relief, from RM5,000 to RM6,000, an increased relief of RM700 for purchase of books and an increased rebate of RM500 for the purchase of personal computers.

This Budget will be greeted as a friendly Budget by the tax paying rakyat and a welcomed Budget by the corporate taxpayers. It is a Budget with a strong social agenda coupled with a committed aim to reducing the Government's budget deficit.

The other key tax changes are outlined in the following pages.

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SUBJECT	BUDGET PROPOSALS
<p>CORPORATE TAX</p> <p><i>Income Tax Refunds</i></p> <p><i>Review of the Taxation System</i></p> <p><i>Review of Tax Treatment for Trade Associations</i></p>	<p>To expedite income tax refunds to companies that have made excess income tax payments since the introduction of the Self Assessment System (SAS) in 2001, the Government proposes the following measures:</p> <ol style="list-style-type: none"> i. Fund for Tax Refund be established to provide for income tax refunds; ii. Excess payments will first be offset against the current year tax liability of the company; and iii. Refunds of excess payments be made from the Fund to companies which do not have any income tax liability in the current year. <p>Reference is made to the Fund being available to companies. However, when the proposed amendment is considered in the light of the existing statutory provisions it appears that the Fund should be available to other taxpayers.</p> <p>The Fund shall come into operation on 1 January 2005.</p> <p>The Government has proposed to establish a Taxation System Review Panel comprising representatives from the public and private sectors. The Panel will review the tax system including the provisions of the Income Tax Act, 1967.</p> <p>In line with the Government's objective of enhancing effectiveness, efficiency and competitiveness it will be the Panel's task to review and propose amendments, as necessary to the current taxing statutes. Clarity and relevance are the main thrusts for the review.</p> <p>To assist and encourage trade associations to increase their funds from sources other than member's subscription fees, it is proposed that the statutory income from member's subscription fees that is exempted be calculated according to the attributable method by taking into consideration actual expenditure incurred.</p> <p>The proposal is effective from YA 2005.</p>

SUBJECT	BUDGET PROPOSALS
<p><i>Enhancement of Incentives:</i></p> <ul style="list-style-type: none"> <li data-bbox="225 465 467 593">- <i>Extension of Multimedia Super Corridor (MSC) Status</i> <li data-bbox="225 667 467 869">- <i>Accelerated Capital Allowance (ACA) on Equipment to Maintain Quality of Power Supply</i> <li data-bbox="225 943 467 1099">- <i>Accelerated Capital Allowance (ACA) For Agricultural Sector</i> <li data-bbox="225 1211 467 1301">- <i>Extension of Incentive for Food Production</i> 	<p data-bbox="496 465 1385 629">MSC will be strengthened with the roll-out to Bayan Lepas, Pulau Pinang and Kulim High-Technology Park, Kedah. This is to develop new sources of growth particularly in the shared services and outsourcing industry and to create an additional 100,000 high value-added jobs in the ICT sector to the existing 20,000 in MSC.</p> <p data-bbox="496 667 1385 831">To reduce the cost of doing business caused by interruptions in the power supply, it is proposed that companies which incur capital expenditure on equipment to ensure the quality of power supply will be given ACA for a period of 2 years. The equipment eligible for ACA shall be determined by the Minister of Finance.</p> <p data-bbox="496 869 979 904">The proposal is effective from YA 2005.</p> <p data-bbox="496 943 1385 1106">To reduce dependence on labour and to promote mechanisation and automation, machinery and equipment used in the agricultural sector including plantations will be eligible for ACA for a period of 2 years. The machinery and equipment eligible for ACA shall be determined by the Minister of Finance.</p> <p data-bbox="496 1144 979 1180">The proposal is effective from YA 2005.</p> <p data-bbox="496 1211 1385 1346">To enhance the incentives currently available to encourage food production such as cultivation of vegetables, fruits, herbs and spices, aquaculture, rearing of cattle, goats and sheep, deep-sea fishing as well as kenaf, it is proposed that:</p> <ul style="list-style-type: none"> <li data-bbox="496 1384 1385 1480">i. the equity condition (for tax deduction equivalent to the amount of investment made in a subsidiary) be reduced from 100% to at least 70% effective from 11 September 2004; and <li data-bbox="496 1518 1385 1615">ii. the incentive period for the existing tax incentives (which includes 100% tax exemption on statutory income for 10 years) be extended for applications received until 31 December 2010.

SUBJECT	BUDGET PROPOSALS
<p>- <i>Tax Incentive For Production of Halal Food</i></p>	<p>To encourage new investments in halal food production for the export market and to increase the use of modern and state of the art machinery and equipment in producing high quality halal food that complies with international standards, companies producing halal food are to be given Investment Tax Allowance of 100% of qualifying capital expenditure incurred within a period of 5 years. The allowance can be set-off against 100% of statutory income in each YA.</p> <p>The above incentive is granted on condition that such companies have already obtained halal certification from Jabatan Kemajuan Islam Malaysia (JAKIM) and other quality certification.</p> <p>The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 11 September 2004.</p>
<p>- <i>Double Deduction To Promote Export Of Services</i></p>	<p>To enhance the competitiveness of export of professional services, a double deduction is proposed for expenses incurred in preparing architectural and engineering models, perspective drawings and 3-D animations for participating in competitions at international level.</p> <p>The proposal is effective from YA 2005.</p>
<p>- <i>Incentives For Commercialisation Of Public Sector R&D</i></p>	<p>To encourage the commercialisation of resource-based R&D findings by public research institutes, the following incentive package is proposed:</p> <ol style="list-style-type: none"> i. A company that invests in its subsidiary company engaged in the commercialisation of R&D findings is to be given a tax deduction equivalent to the amount of investment made in the subsidiary company; and ii. The subsidiary company that undertakes the commercialisation of the R&D findings is to be given Pioneer Status with 100% tax exemption on statutory income for 10 years. <p>The incentive package is given on the following conditions:</p> <ol style="list-style-type: none"> i. At least 70% of the company is owned by Malaysians; ii. The company which invests should own at least 70% of the equity of the company that commercialises the R&D findings; iii. Only resource-based R&D findings are eligible; and iv. The commercialisation of the R&D findings should be implemented within one year from the date of approval of the incentive.

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<p>- <i>Computation of Industrial Building Allowance ("IBA")</i></p> <p>- <i>Zakat paid by companies</i></p> <p>- <i>Merger of private institutions of higher learning ("IPTS")</i></p> <p>- <i>Relocation of manufacturing activities to promoted areas</i></p>	<p>Applications for this incentive should be made to MIDA.</p> <p>The proposal is effective for applications received from 11 September 2004.</p> <p>In order to simplify claims for IBA as well as to enhance the efficiency of tax administration, it is proposed that the basis of computation of IBA on the purchase of used buildings be amended from residual value to current purchase price.</p> <p>The proposal is effective from YA 2005.</p> <p>In order to reduce the cost of doing business, it is proposed that Zakat on business income paid by companies to the respective Islamic religious authorities be allowed as deduction for the computation of income tax. However, the deduction shall not exceed 2.5% of the aggregate income of the company.</p> <p>The proposal is effective from YA 2005.</p> <p>In order to encourage smart partnerships and merger of IPTS to create strong and leading educational entities at par with renowned universities in developed countries, it is proposed that stamp duty and real property gains tax exemptions be given to IPTS that merge.</p> <p>These exemptions will be given for mergers approved by the Ministry of Higher Education and undertaken not later than 31 December 2006.</p> <p>In order to encourage investments in promoted areas, it is proposed that existing companies which relocate their manufacturing activities to the promoted areas be given a second round of the following incentives:</p> <ol style="list-style-type: none"> i. Pioneer Status with tax exemption of 100% of statutory income for a period of 5 years; or ii. Investment Tax Allowance of 100% of the qualifying capital expenditure incurred within a period of 5 years. This allowance can be used to set-off up to 100% of statutory income in each YA. <p>The proposal is effective for applications received by MIDA from 11 September 2004.</p>

SUBJECT	BUDGET PROPOSALS
<p>- <i>Renewable energy production</i></p> <p>- <i>Double Deduction on Expenses for Halal Certification and Quality Systems and Standards Certification</i></p>	<p>To further promote the use of energy generated from renewable and environment friendly resources, it is proposed that equipment used by companies to generate such energy for its own consumption be granted ACA. The annual allowance is to be increased to 80%.</p> <p>The equipment eligible for ACA shall be determined by the Minister of Finance.</p> <p>The proposal is effective from YA 2005.</p> <p>To enhance competitiveness of local products in the global market particularly halal products, double deduction will be given to:</p> <ol style="list-style-type: none"> i. A company which incurs expenses (not being capital expenditure) in obtaining quality systems and standards certification as well as halal certification from JAKIM; and ii. A company which incurs expenses (not being capital expenditure) in obtaining international quality systems and standards certification. <p>Of the above, (i) is addressed in the Finance Bill as an amendment to the Income Tax Act 1967, however, the Bill is silent in relation to (ii).</p> <p>The deduction will be given in the basis period in which the certificate is issued.</p> <p>The proposal is effective from YA 2005.</p>
<p>Capital Markets:</p> <p>- <i>Tax Treatment of Interest-in-Suspense</i></p>	<p>As a measure to further strengthen the cash flow of ‘banks’, it is proposed that interest-in-suspense be deemed as a specific provision for bad debts and allowed a full deduction in the computation of income tax. This will apply to all interest in respect of a loan or credit facility accrued from the date that such loan or facility is classified as a non-performing loan in accordance with the relevant guidelines issued by the Central Bank of Malaysia. Income tax will be imposed when the interest has been received.</p>

SUBJECT	BUDGET PROPOSALS
<p>- <i>Tax Exemption On Interest Income From Bonds Received By Non-Resident Companies</i></p> <p>- <i>Tax Treatment Of Islamic Financial and Capital Market Products</i></p>	<p>‘Bank’ is defined to mean a bank or a finance company or a banking and finance company licensed or deemed to be licensed under the Banking and Financial Institutions Act 1989 or Islamic Banking Act 1983, or any institutions prescribed under the Development Financial Institutions Act 2002.</p> <p>The proposal is effective from YA 2001.</p> <p>Tax exemption will be given on interest income derived by non-resident companies from:</p> <ol style="list-style-type: none"> i. Islamic securities or debentures issued in Ringgit Malaysia, other than convertible loan stock, approved by the Securities Commission; and ii. Securities issued by the Government of Malaysia. <p>The proposal is effective from 11 September 2004.</p> <p>To further develop Islamic Financial and Capital Market Products, the following changes have been proposed:</p> <p><i>Income Tax Act 1967 and Real Property Gains Tax Act 1976</i></p> <p>Assets disposals (required under Islamic financing) which will not be treated as a sale for the purpose of income tax and which will not be subject to real property gains tax shall be those which are:-</p> <p>“... pursuant to a scheme of financing approved by the Central Bank or the Securities Commission, as a scheme which is in accordance with the principles of Syariah, where such disposal is strictly required for the purpose of complying with those principles but which will not be required in any other schemes of financing.”</p> <p>Islamic financial products are to be approved by the Syariah Advisory Council of Bank Negara Malaysia whereas Islamic capital market products are to be approved by the Syariah Advisory Council of the Securities Commission.</p> <p><i>Stamp Act 1949</i></p> <p>An instrument executed pursuant to the above where such instrument is an additional instrument strictly required for complying with the Syariah principles, shall be exempted from stamp duty.</p>

SUBJECT	BUDGET PROPOSALS
<p>- <i>Tax Treatment for Real Estate Investment Trust</i></p>	<p>To further promote the development of property projects via Real Estate Investment Trusts (“REIT”) or Property Trust Funds (“PTF”), the following income tax treatment has been proposed:-</p> <p><i>REIT/PTF</i></p> <ul style="list-style-type: none"> • Income of a REIT or PTF which is distributed to the unit holders in the basis period for that year of assessment shall be exempt from income tax; • Undistributed income of a REIT or PTF shall be taxed at 28%; <p>The purpose behind this appears to be to make REITs/PTFs more attractive as the proposal accords a favourable tax treatment for onward distribution by REITs/PTFs to the investors.</p> <ul style="list-style-type: none"> • Income of a REIT or PTF from the letting of real property shall be treated as gross income from a business source. Expenses are accorded deductions. Any excess expenses shall be disregarded. Similarly excess capital allowances will be disregarded. However, based on a literal reading of the Bill, it appears that where any of the sources consisting of rental properties are non-income producing, all expenses may be at risk of being disregarded. Further clarification would need to be sought on the rules for claiming deductions and capital allowances where the REIT or PTF has properties which do not produce rental income. <p><i>Unit holders</i></p> <ul style="list-style-type: none"> • Income distributed to unit holders be taxed at their respective tax rates; • For a non-resident unit holder, tax payable is at 28% and shall be withheld by the REIT or PTF; and • The accumulated income that has been taxed and subsequently distributed is eligible for tax credit in the hands of the unit holders.

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<p data-bbox="225 360 448 389">INDIRECT TAX</p> <p data-bbox="225 432 469 524"><i>Introduction of Goods and Services Tax</i></p> <p data-bbox="225 936 456 1032"><i>Review of Duty on Cigarettes and Liquor</i></p>	<p data-bbox="496 432 1385 595">To improve efficiency of the taxation system, the present sales tax and service tax will be replaced by a single consumption tax based on the value-added concept known as the Goods and Services Tax (GST). The new system will be more comprehensive, efficient, transparent and effective than the current system of sales tax and service tax.</p> <p data-bbox="496 633 1385 898">The introduction of the GST system is part of the Government's effort to review the present tax system. The Government proposes to implement the new tax on 1 January 2007. The introduction of GST will provide the Government with the opportunity to reduce corporate and individual income tax rates. The Government will also ensure that the low income group will not be burdened by the implementation of GST. In this regard, goods and services considered as basic needs will either be zero rated or exempted. In addition, small businesses will also be exempted from GST.</p> <p data-bbox="496 936 1385 1032">To promote a healthy lifestyle and to curb social ills resulting from addiction to smoking and drinking, it is proposed that duties on cigarettes and liquor be revised as follows:</p> <table border="1" data-bbox="496 1070 1385 1559"> <thead> <tr> <th rowspan="2"></th> <th colspan="2">Import Duty (RM)</th> <th colspan="2">Excise Duty (RM)</th> </tr> <tr> <th><i>Current</i></th> <th><i>Proposed</i></th> <th><i>Current</i></th> <th><i>Proposed</i></th> </tr> </thead> <tbody> <tr> <td>Cigars, cheroots and cigarillos</td> <td>200/kg</td> <td>200/kg</td> <td>58/kg</td> <td>81/kg</td> </tr> <tr> <td>Cigarettes</td> <td>200/kg</td> <td>0.20/stick</td> <td>58/kg</td> <td>0.081/stick</td> </tr> <tr> <td>Beer</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>- <5.8% vol</td> <td>50.50/dal</td> <td>5/litre</td> <td>47.50/dal.</td> <td>6/litre</td> </tr> <tr> <td>- Other</td> <td>49.20/dal</td> <td>5/litre</td> <td>48.80/dal.</td> <td>6/litre</td> </tr> <tr> <td>Wine</td> <td>66/dal</td> <td>7/litre</td> <td>66/dal</td> <td>8/litre</td> </tr> <tr> <td>Brandy</td> <td>575/dal</td> <td>58/litre</td> <td>71/dal</td> <td>8/litre</td> </tr> <tr> <td>Whiskies</td> <td>560/dal</td> <td>58/litre</td> <td>60/dal</td> <td>8/litre</td> </tr> <tr> <td>Vodka</td> <td>535.50/dal</td> <td>55/litre</td> <td>72.50/dal</td> <td>8/litre</td> </tr> </tbody> </table> <p data-bbox="496 1603 1225 1635">This proposal is effective from 4 p.m. on 10 September 2004.</p>		Import Duty (RM)		Excise Duty (RM)		<i>Current</i>	<i>Proposed</i>	<i>Current</i>	<i>Proposed</i>	Cigars, cheroots and cigarillos	200/kg	200/kg	58/kg	81/kg	Cigarettes	200/kg	0.20/stick	58/kg	0.081/stick	Beer					- <5.8% vol	50.50/dal	5/litre	47.50/dal.	6/litre	- Other	49.20/dal	5/litre	48.80/dal.	6/litre	Wine	66/dal	7/litre	66/dal	8/litre	Brandy	575/dal	58/litre	71/dal	8/litre	Whiskies	560/dal	58/litre	60/dal	8/litre	Vodka	535.50/dal	55/litre	72.50/dal	8/litre
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<p><i>Review of Import Duty on Selected Goods</i></p>	<p>To reduce the cost of doing business and tariff protection in stages, the Government proposes to:</p> <ul style="list-style-type: none"> i. abolish import duty on selected goods such as surgical gloves, carpet, glassware and semi-finished components for the wood-based industry; and ii. reduce import duty on selected raw materials for the apparel industry and herbicides. <p>The proposal is effective from 4 p.m. on 10 September 2004.</p>
<p><i>Outsourcing Manufacturing Activities</i></p>	<p>In order to reduce cost of doing business and enhance competitiveness, it is proposed that owners of Malaysian brands who outsource manufacturing activities be given import duty and sales tax exemptions on raw materials which are not manufactured locally and semi-finished goods imported from contract manufacturers abroad.</p> <p>This is effective for applications received by MIDA from 11 September 2004.</p>
<p><i>Exemption of Entertainment Duty on Arts and Cultural Performances</i></p>	<p>To promote Kuala Lumpur as an international centre for arts and culture, it is proposed that arts and cultural performances by local artistes held in Federal Territory of Kuala Lumpur, Labuan and Putrajaya be given full exemption on entertainment duty provided that such performances are approved by the Ministry of Arts, Culture and Heritage.</p> <p>The proposal is effective from 11 September 2004.</p>
<p><i>Import Duty Exemption on Imported Medical Devices for Purposes of Kitting</i></p>	<p>To encourage local manufacturers of medical devices to kit their products to add value as well as to enhance competitiveness, it is proposed that full import duty exemption be given on medical devices that are imported for the purposes of kitting or producing complete procedural sets, provided these medical devices are not manufactured locally.</p> <p>The proposal is effective for applications received by MIDA from 11 September 2004.</p>

SUBJECT	BUDGET PROPOSALS
<p>PERSONAL TAX</p> <p><i>Filing of Returns For Taxpayers Other Than Companies</i></p> <p><i>Tax Rebate and Relief Review</i></p> <p><i>Merdeka Bonds Extension</i></p> <p><i>Income Tax Relief on Contributions to Approved Provident Fund (EPF) or Takaful or Life Insurance Premiums</i></p> <p><i>Income Tax Exemption on Retirement Benefits</i></p>	<p>The deadline to file income tax returns by sole proprietors, partnerships, clubs, associations and Hindu joint families is to be extended from 30 April to 30 June to provide sufficient time for them to prepare their accounts and to ascertain the tax payable.</p> <p>The above deadline is also applicable to an individual who elects to aggregate his/her income with his/her spouse who has business income.</p> <p>The extended deadline does not apply to a person who does not have business income.</p> <p>The proposal is effective from YA 2004.</p> <p>To further encourage every household to benefit from ICT, it is proposed that the tax rebate for purchase of computer be increased from RM400 to RM500. The rebate is claimable once every five years.</p> <p>To inculcate and nurture reading habits, it is proposed that the tax relief for purchase of books be increased from RM500 to RM700.</p> <p>These proposals are effective from YA 2005.</p> <p>Due to the overwhelming response, an additional RM1.75 billion of Merdeka Bonds will be issued up to end of 2005.</p> <p>Merdeka Bonds are issued by the Central Bank of Malaysia for pensioners aged 55 years and above and also for uniformed personnel who have gone on mandatory retirement.</p> <p>It is proposed that individual income tax relief on contributions to an approved fund (i.e. EPF) or takaful as well as payments for life insurance premium be increased from RM5,000 to RM6,000.</p> <p>The proposal is effective from YA 2005.</p> <p>To relieve the tax burden of employees who have to retire on a mandatory basis at the age between 50 to 55, it is proposed that tax exemption be given on retirement benefits of up to RM6,000 for each year of service.</p> <p>The proposal is effective from YA 2003.</p>

SUBJECT	BUDGET PROPOSALS
<p><i>Tax Relief for Disabled Person</i></p>	<p>To assist the disabled, it is proposed that the additional relief for a disabled individual be increased from RM5,000 to RM6,000. For a disabled spouse, the additional relief be increased from RM2,500 to RM3,500.</p> <p>The proposal is effective from YA 2005.</p>
<p><i>Relaxation of Annual Spending Requirement for Charitable Organisations</i></p>	<p>To assist charitable organisations to maintain their approved status, the annual minimum expenditure condition has been reduced from 70% to 50% of their income.</p> <p>The proposal is effective from YA 2005.</p>