Budget 2020 Tax Incentives: More to be Granted?

KPMG in Malaysia

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Overview and Commentary

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Our Prime Minister, Tun Dr Mahathir Mohamed was pivotal in making Malaysia an industrialised nation in late 1990s. Over two decades later, he once again leads the nation on the path to making Malaysia a high-income nation. Entitled "*Driving Growth and Equitable Outcomes Towards Shared Prosperity*", Budget 2020 unveiled by YB Lim Guan Eng announced strategies proposed to turn the vision into a reality.

With the present global economic uncertainty, this will definitely serve as a challenge. Having said that, Malaysia should seize the opportunity to attract more foreign direct investments (FDI) into the country. Despite the protracted trade war, Malaysia's approved FDI has increased by 47% year by year to 2018, then a 97% increase of approved FDI in the first half of 2019 as compared to the same period last year. A significant inflow of foreign funds would no doubt greatly aid our economy. With that in mind, the Government is actively relooking at the tax regime framework to make Malaysia a more attractive investment nation than our neighbouring counterparts.

The Government is prepared to offer customised packaged investment incentives to attract targeted Fortune 500 companies and global unicorns in high technology, manufacturing, creative and new economic sectors. One of the conditions set in order to qualify for the incentives is that these investors must invest a minimum of RM5 billion. The investment is expected to generate additional activities to support our Small and Medium Enterprises ("SMEs"). Existingly, the SMEs make up to 98.5% of businesses in Malaysia. Hence, it is fair to expect that the Government continues to support the growth for SMEs to boost the Malaysian economy. However, with the current economic environment, it raises the question as to whether the RM5 billion investment from each of these global companies is attainable?

By 1 January 2021, the Government is expecting to issue a new framework of incentives after a thorough review and revamp on the existing one. Hence, in the Budget 2020 announcements, the proposals of tax incentives were generally mere extension of tax incentive periods as well as incentives for industries eager for growth such as green energy, technology, and tourism.

a. Green Energy

As part of the green energy initiatives, a new incentive was proposed for an income tax exemption of 70% of Statutory Income for a period of 10 years for solar leasing companies. Apart from that, the existing green technology incentive options are:

Key Highlights

1	2	3
Green energy initiatives – new exemption for solar leasing companies in addition to a 3-year extension to the existing GITA and GITE	Technology initiatives - Special investment incentive for the E&E sector and R&D to encourage continuous investment in Malaysia	Arts and Tourism – incentives for equipment, investments in theme park / recreational centres and promoting cultural events

- Green Investment Tax Allowance (GITA) - 100% Investment Tax Allowance on capital expenditure on qualifying green assets to set-off against 70% of Statutory Income for a period of 5 years, restricted to year 2020; and
- Green Income Tax Exemption (GITE) - Income tax exemption of 100% of Statutory Income for qualifying green activities for a period of 5 years, restricted to year 2020.

In 2018, the Government had significantly expanded the list of qualifying green assets under GITA and with the Budget announcements, it was proposed that these incentives be extended for a period of 3 years to 2023. With the rising need of green initiatives, Malaysia is steadily making its mark in green technology. These extensions shall address the capital cost, being an indisputable barrier to any renewable energy project. Another point to note, however, is the inherent new technology demands for renewables. Research and development (R&D) plays a major role in the development of technology and this area has been specifically acknowledged by the Government as it goes hand in hand with the process of technological advancement and digitalisation.

b. Technology

In line with global technological advances, Budget 2020 had also addressed Research and Development (R&D) as well as Electrical and Electronics (E&E). To encourage R&D activities in Malaysia, the Government is offering incentives in the form of tax deductions and income tax exemptions, including for the development of Intellectual Property (IP). In order to benefit from these incentives, companies need to perform substantial R&D activities in Malaysia, as per the requirements of the Organisation for Economic Cooperation and Development (OECD).

In light of Industry 4.0 (I4.0), measures need to be put in place to showcase efforts in aligning the nation to the global industrial reform. In line with the embarkation into the I4.0 concept, the Government is encouraging continuous investment especially in the E&E industry to transition into 5G, digital economy. Some of the special incentives for the E&E sector are:

- income tax exemption up to 10 years to E&E companies investing in selected knowledge-based services; and
- special Investment Tax Allowance for E&E companies that have exhausted the 15-year Reinvestment Allowance (RA)

Over the years, the Government has provided several extensions to the RA perhaps in its effort to encourage further investments into Malaysia. Notwithstanding that, these incentives need to be defined well such as providing clarification as to what constitutes "*knowledge-based services*". At the end of the day, these investments should be fruitful not only to the investors but contributing returns to the Government who had provided these companies with incentives to begin with.

c. Tourism

The Arts and Tourism industry on the other hand, is a large contributor to the state's economy. In conjunction with Visit Malaysia Year 2020 (VMY2020), the Government is proposing income tax exemptions, increased tax deductions, and accelerated capital allowances. By bringing the sector up to par with incentives for updated equipment, investments in state-of-the-art theme park / recreational centres and promoting local art and cultural events, this will enhance Malaysia's position as a destination for tourism and spur the nation's economic growth further.

Standing predominantly alongside VMY2020 is Malaysia Year of Healthcare Travel 2020 for its subsector, medical tourism. With the attractiveness of this subsector which has expanded rapidly at the rate of 17% annually since 2015, Malaysia definitely has appeal in becoming the tourism destination spot in the region. In the hopes for solid growth in this sector, these incentives will not only strengthen the industry ecosystem but also creating job opportunities for Malaysians, all in all boosting the nation's economy.

The three aforementioned sectors are among the identified key drivers for Malaysian growth within and beyond the ASEAN region. Regional growth has been one of the key considerations by the Government since the first budget announcements under Pakatan Harapan in 2018.

In addition to the typical incentives mentioned above, what was apparent in the Budget 2020 announcements is the Government's measures to incentivise companies by providing grants. Yet it remains industry-centric similar to the earlier mentioned e.g. green energy, technology, and tourism. Certainly, these are the catalysts to one of the thrusts anchoring this year's budget "*driving economic growth in the new economy and digital era*".

The anticipation of the new revamped framework comes with expectation that the Government considers the new emerging e-commerce industry players including online marketplace and gig economy. In essence, this industry provides flexibility to Rakyat be it as end user, employee or as part of the supply chain ecosystem. By accommodating this sector with incentives, it can appeal to homegrown companies to remain agile and Malaysia as a competitive nation for e-commerce.

For the framework, the Government should also look at the mechanism for incentive granting on top of the underlying concept of these incentives so the effort would not be counterproductive. Examples are:

i. well-timed extension of the promoted list products and activities that recognises the ever-changing business environment;

ii. ease of application processes that are more business-friendly and less process-driven.

Conclusively, these incentives are the enablers for the achievement of our growth, indirectly contribute to the nation's value-add such as quality job creations, technology and knowledge transfer to the local industry to create positive spillover effects to the Malaysian economy. Above all, putting Malaysia well on its way to "*Driving growth and equitable outcomes towards shared prosperity*".

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