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Malaysia - Budget Commentary 2006

The Prime Minister/Minister of Finance, Dato' Seri Abdullah Bin Hj. Ahmad Badawi presented the 2006 Budget Proposal to Parliament on September 30, 2005. We would like to highlight the proposal that might affect the foreign companies doing business in Malaysia.

I. Corporate Tax

1. INTRODUCTION OF GROUP RELIEF AS TAX TREATMENT (Appendix 1)

Present Position

Group relief allows losses of a company to be deducted against the income of another company within the same group. Currently, only companies that invest in approved food production, forest plantation, biotechnology, nanotechnology, optics and photonics are given group relief on losses incurred by their subsidiary companies which undertake such projects. However, other companies are not eligible for group relief.

Proposal

To enhance private sector investment in high-risk projects, it is proposed that group relief be provided to all locally incorporated resident companies under the Income Tax Act 1967. The group relief is limited to 50% of current year unabsorbed losses to be set-off against the income of another company within the same group (including new companies undertaking activities in approved food production, forest plantation, biotechnology, nanotechnology, optics and photonics) subject to the following conditions:

- (1) the claimant and the surrendering companies each has a paid-up capital of ordinary shares exceeding RM2.5 million;
- (2) both the claimant and the surrendering companies must have the same accounting period;
- (3) the shareholding, whether direct or indirect of the claimant and surrendering companies in the group must not be less than 70%;
- (4) the 70% shareholding must be on a continuous basis during the preceding year and the relevant year;

- (5) losses resulting from the acquisition of proprietary rights or a foreign-owned company should be disregarded for the purpose of group relief; and
- (6) companies currently enjoying the following incentives are not eligible for group relief:
 - (a) Pioneer Status;
 - (b) Investment Tax Allowance/Investment Allowance;
 - (c) Reinvestment Allowance;
 - (d) Exemption of shipping profits;
 - (e) Exemption of income tax under Section 127 of the Income Tax Act 1967;
and
 - (f) Incentive Investment company

With the introduction of the above incentive, the existing group relief incentive for approved food production, forest plantation, biotechnology, nanotechnology, optics and photonics will be discontinued. However, companies granted group relief incentive for the above activities shall continue to set off their income against 100% of the losses incurred by their subsidiaries.

The proposal is effective from year of assessment 2006.

2. REVIEW OF TAX TREATMENT ON LOSSES AND UNABSORBED CAPITAL ALLOWANCE (Appendix 3)

Present Position

Currently, companies are allowed to carry forward their accumulated losses and unabsorbed capital allowances to be set-off against their future income. Such tax treatment is accorded for an unlimited period of time. Furthermore, companies that ceased operations for several years may still utilise accumulated losses and unabsorbed capital allowances to be set-off against new business income or by new shareholders with an objective to reduce their taxable income.

Proposal

To discourage companies from taking advantage of loss-making companies, it is proposed that accumulated losses and unabsorbed capital allowances of a company be not allowed

to be carried forward in the event there is a change of more than 50% in its shareholdings.

The proposal is effective from year of assessment 2006.

3. TAX TREATMENT ON INCOME OF INVESTMENT HOLDING COMPANY (Appendix 5)

Present Position

An investment holding company (IHC) is a company engaged wholly (100%) in holding of investment and its income is normally derived from dividends, rental and interests.

Currently, income of an IHC is deemed as passive income. As such, an IHC is allowed deduction only on 25% of permitted expenses.

Proposal

To enhance investments by IHCs, it is proposed that the income of IHCs listed on Bursa Malaysia, be treated as business income and the expenses be given full deduction for the purpose of income tax. An IHC is redefined as a company that derives at least 80% of its gross income from holding of investment. However, losses and unabsorbed capital allowances be not allowed to be carried forward.

The proposal is effective from year of assessment 2006.

4. FLEXIBILITY IN ESTIMATING TAX PAYABLE FOR COMPANIES (Appendix 7)

Present Position

Under the Self Assessment System (SAS), companies are required to provide estimates of tax payable for the current year and these estimates should not be less than the estimates or the revised estimates of the preceding year. Companies are allowed to revise their estimates on the 6th and the 9th month of their financial year. However, the current treatment does not take into account changes in the economic situation that may adversely affect the performance of the company.

Proposal

To render flexibility to companies in providing estimates of tax payable for the current year, it is proposed that such estimates for companies be lowered from not less than 100 percent to not less than 85 percent of the preceding year's estimates or revised estimates.

The proposal is effective from year of assessment 2006.

5. PROVISION TO ALLOW TAX ASSESSMENTS AFTER SIX YEARS (Appendix 37)

Present Position

Currently, the Director General of Inland Revenue is only allowed to make assessments on income tax, petroleum income tax and real property gains tax within a period of six years.

Proposal

To enhance tax administration and to prevent revenue loss, it is proposed that the Director General of Inland Revenue be empowered to make assessment on income tax, petroleum income tax and real property gains tax after a period of six years in cases where the assessment is determined by the court or withdrawal, revocation or cancellation of any exemption, relief, remission or allowance.

The proposal is effective from year of assessment 2006.

II. INCENTIVES

1. STREAMLING TAX TREATMENT FOR PIONEER STATUS COMPANIES (Appendix 2)

Present Position

Currently, Pioneer Status companies are not allowed to carry forward losses and unabsorbed capital allowances incurred during the pioneer period to the post-pioneer period. Such treatment does not benefit loss-making pioneer companies.

Proposal

To further enhance the effectiveness of this incentive, it is proposed that accumulated losses and unabsorbed capital allowances incurred by companies during the pioneer period be allowed to be carried forward and deducted from post-pioneer income of a business relating to the same promoted activity or promoted product.

The proposal is effective for companies whose pioneer period will expire on and after 1

October 2005.

2. EXTENDING THE SCOPE OF INDUSTRIAL BUILDING ALLOWANCE (Appendix 14)

Present Position

Currently, only specific promoted buildings are given Industrial Building Allowance (IBA). Buildings occupied by Multimedia Super Corridor status (MSC status) companies in Cyberjaya are not eligible for IBA.

Proposal

To encourage the construction of more buildings in Cyberjaya for use by MSC status companies, it is proposed that IBA for a period of 10 years be given to owners of new buildings occupied by MSC status companies in Cyberjaya. Such new buildings include completed buildings but are yet to be occupied by MSC status companies.

The proposal is effective from year of assessment 2006.

3. EXTENDING THE SCOPE OF INCENTIVES FOR MULTIMEDIA ACTIVITIES (Appendix 15)

Present Condition

Currently, MSC status multimedia companies operating in Cybercities (Cyberjaya, Kuala Lumpur City Centre, Technology Park Malaysia, Bayan Lepas in Penang and Kulim Hi-Tech Park in Kedah) and multimedia faculties in institutions of higher learning outside the Cybercities, are eligible for the following tax incentives:

- (1) Pioneer Status with 100% tax exemption on statutory income for a period of 10 years; or
- (2) Investment Tax Allowance of 100% of qualifying capital expenditure incurred within a period of 5 years to be set-off against 100% of statutory income for each year of assessment.

Apart from this, multimedia companies involved in the development of computer software outside the Cybercities are eligible for Pioneer Status with 70% tax exemption or Investment Tax Allowance of 60% for 5 years.

Proposal

To further encourage ICT and multimedia activities including Regional Shared Service Centres throughout the nation, it is proposed that selected companies undertaking such activities outside the Cybercities be given the following incentives:

- (1) Pioneer Status with tax exemption of 50% of statutory income for a period of 5 years; or
- (2) Investment Tax Allowance of 50% of qualifying capital expenditure incurred within a period of 5 years to be set-off against 50% of statutory income for each year of assessment.

Selected companies eligible for such incentives require the recommendation of the Multimedia Development Corporation (MDC).

The proposal is effective for applications received by MDC from 1 October 2005.

IV. INDIVIDUAL TAX

1. TAX TREATMENT ON BENEFITS FROM EMPLOYEES' SHARE OPTION SCHEME (Appendix 36)

Present Position

Currently, benefits derived by employees from Employees' Share Option Scheme (ESOS) in the form of shares offered at discounted price are deemed gross income and thus subject to tax. For the purpose of income tax, the value of the benefits from each share is determined based on the difference between the market price of the share on the date of offer and the discounted price for each share. The value of the benefit does not take into consideration the price of the share on the date when the share option is exercised.

The benefit is liable to tax in the year the option is exercised. However, total tax payable is based on the tax computation in the year the offer was made. As such, employees are discouraged from exercising their share option if prices of shares are on a downtrend and requires adjustment of income tax for the year ESOS was offered.

Proposal

To ensure that the benefit derived by employees from ESOS is not reduced if prices of

shares are on a downtrend, it is proposed that the value of the benefit for each share option be determined based on the difference between the market price on the date the share option is exercised or exercisable, whichever is the lower, and the discounted price offered by the employer. The benefit is liable to tax in the year the option is exercised.

The proposal is effective from year of assessment 2006.

V. RPGT (Real Property Gain Tax) and Stamp Duty

1. TAX TREATMENT ON ESTIMATED LOSSES OF LOW COST HOUSING PROJECTS (Appendix 11)

Present Position

Property developers are required by the Government to undertake low cost housing projects. Such projects are often not profitable. In the preparation of estimates of tax payable for the current year, property developers are not allowed to set-off estimated losses of one property development project against estimated profits of another project.

Proposal

To encourage property developers to build more low cost houses, it is proposed that the estimated losses of low cost housing projects be allowed to be set-off against estimated profits of other property development projects in the preparation of estimates of tax payable for the current year.

The proposal is effective from year of assessment 2006.

2. EXTENDING THE SCOPE OF REAL PROPERTY GAINS TAX EXEMPTION ON RESIDENTIAL PROPERTY (Appendix 25)

Present Position

Currently, an individual can claim real property gains tax (RPGT) exemption on one residential property during his/her lifetime. However, for a married couple, the right to elect for such an exemption is given only to the husband even though the property is owned by the wife, on condition that he has not done so before marriage. On the other hand, if the husband has elected for such an exemption before marriage, the wife is not eligible to do so even though she is the sole or joint owner of the property.

In the event the husband has claimed RPGT exemption on the residential property owned by the wife, he is no longer eligible to claim RPGT exemption on his own house later.

Proposal

To accord equal tax treatment without gender bias, it is proposed that the election to claim RPGT exemption on a residential property is given to both husband and wife on one residential property each, once in a lifetime.

The proposal is effective from 1 October 2005.

The other proposals proposed at the same time are as follows;

Proposals at Budget for the Year 2006

- Appendix 4 - Extension Of Application Period For Incentives For Promoted Areas
- Appendix 6 - Extending The Scope Of Allowable Expenses For Companies
- Appendix 8 - Review Of Tax Treatment On Small Value Assets
- Appendix 9 - Review Of Tax Treatment On Interest Expense For Leasing Activity
- Appendix 10 - Tax Treatment On Estimated Losses Of Low Cost Housing Projects
- Appendix 12 - Extending The Scope Of Allowable Expenses For Real Estate Investment Trusts
- Appendix 13 - Review Of Tax Treatment On Bonds
- Appendix 16 - Remission Of Stamp Duty On Loan Instruments For Small And Medium Enterprises
- Appendix 17 - Review Of Child Relief For Tertiary Education
- Appendix 18 - Introduction Of Relief For Disabled Child Pursuing Tertiary Education
- Appendix 19 - Extending The Scope Of Individual Tax Relief For Further Education
- Appendix 20 - Tax Treatment On Expenses Incurred For New Courses By Private Higher Education Institutions -
- Appendix 21 - Extending The Scope Of Incentives For Private Higher Education Institutions
- Appendix 22 - Incentive For Unemployed Graduates Training Scheme
- Appendix 23 - Reduction Of Road Tax On Private Diesel Vehicles
- Appendix 24 - Tax Incentive For Industrialized Building System
- Appendix 26 - Review Of Tax Exemption On Royalty From Artistic Works
- Appendix 27 - Tax Exemption On Equipment For Performing Arts
- Appendix 28 - Review Of Withholding Tax On Technical Fees
- Appendix 29 - Review Of Tax On Beer And Liquor
- Appendix 30 - Review Of Tax On Cigarettes And Tobacco Products
- Appendix 31 - Additional Incentives To Encourage The Use Of Natural Gas For Vehicles
- Appendix 32 - Review Of Tax Incentives For Generation Of Renewable Energy
- Appendix 33 - Review Of Tax Incentives For Conservation Of Energy
- Appendix 34 - Review Of Requirement For Gazette Tax Exemption Order
- Appendix 35 - Review Of Import Duty On Selected Goods

Appendix 38 - Extending The Scope Of Fund For Tax Refund

Appendix 39 - Enhancing The Competency Of Tax Agents

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