Needed: A budget for uncertainties

BY CHERYL POO AND ESTHER LEE

Much rests on Budget 2021, which will be revealed on Nov 6, as it will be the upcoming budget under a new government, under the 12th Malaysia Plan (12MP) and during the unprecedented global health crisis wrought by Covid-19. The year has thus far seen the rollout of four economic stimulus packages — the first on July 13, the Prihatin Stimulus Package on March 27, Perijana on June 5 and Kita Prihatin on Sept 25 — collectively amounting to a massive RM180 billion.

Will the government introduce further stimulus packages to address the immediate problems stemming from Covid-19 or a longer-term plan to spur the country’s economic growth?

It goes without saying that Budget 2021 will be an expansionary one with the aim of addressing immediate and medium-term issues, which will be in line with the finance minister’s earlier indication that the budget would have four broad themes — caring for the people, steering the economy, sustainable living, and enhancing public service delivery.

Most expect to see some of the stimulus measures announced so far this year, especially those that assist the vulnerable income groups and affected businesses, extended in the upcoming budget.

In a report by United Overseas Bank (UOB) Bhd, senior economist Julia Goh foresees earlier stimulus measures — such as wage subsidies, cash aid, automotive sales tax exemption and property-related measures — being extended into 2021, alongside new measures to support consumption, stimulate investments, accelerate digitalisation, improve job creation and wages, and promote environmental sustainability.

Nevertheless, it is pertinent to assess how effective the measures are before extending them.

“In drafting Budget 2021, it is important for the government to take stock of the impact of the various measures announced in Perijana and Prihatin to determine their effectiveness and continue with what works,” says PWMC Malaysia tax leader Jagan Singh.

As much as addressing the nation’s most immediate concerns must take precedence, the budget will also have to prepare for the country’s fiscal sustainability and sustainable growth moving forward as the economy moves into recovery mode.

“Looking at the medium and long term is equally important as we position ourselves to take advantage of the economic recovery. This would include reshaping the government revenue side of the equation, growing and increasing the competitiveness of our small and medium enterprises (SMEs), strategic inbound and outbound investments as well as stepping up to be a high income nation,” he adds.

Another critical aspect of the economy that should be given priority in the budget is investment growth.

“The government is expected to continue to support the SMEs that are still struggling from the impact of the pandemic through favourable tax schemes and, at the same time, ensure a stable and conducive environment for potential foreign investments. Furthermore, incentives for new sources of growth — including Industrial Revolution 4.0 digitalisation, green technology and sustainability — could be further enhanced in the budget,” says RHB Research economist Peck Boon Soon in his report.

It is no surprise that many have been calling for more support for the SME industry. KPMG Tax Services Sdn Bhd corporate tax executive director Lim Wai Yin highlights that the category represents about 98% of Malaysian businesses, and as such, their survival is critical to the overall growth of the Malaysian economy.

Another aspect of expenditure that is likely to take precedence is development expenditure, which is expected to remain high in 2021.

Peck says it could remain a priority for the government in light of weak private investment prospects as well as Malaysia’s need to remain economically competitive.

“We believe the allocation will be focused on the economic sectors, especially transport due to the ongoing large rail and highway infrastructure projects, as well as digital and communications infrastructure to accelerate the shift to a digital economy,” he explains.

According to AffinHwang Capital Research, development expenditure is projected to be around RM60 billion per annum for the next five years.

Based on our estimate, we believe the allocation for the development expenditure ceiling over the five-year period from 2021-2025 in 2MP may be raised to a target of about RM320 billion, which will translate to an average spend of between RM60 billion and RM65 billion per annum.

“We believe that development expenditure plays an important role in sustaining the country’s economic growth, thereby preserving the revenue source generated by economic activities,” notes the research house.

KPMG’s Lim also calls for the government to enhance its public service delivery to ensure that every ringgit disbursed from the budget is utilised efficiently, with minimum wastage and leakage.

Fiscal deficit: Justified, but government must spend wisely

According to UOB’s Goh, the measures taken to contain the pandemic have weighed heavily on the economy, labour market, households, SMEs and large companies, particularly in the most affected industries.

The economy contracted 5.6% year on year in the first half of 2020 and although economic indicators have improved since May, conditions are far from pre-pandemic levels.

The government targets economic growth of between 5.5% and 6.0% in 2023, from a deficit of 5.5% to 5.5% in 2020.

“The pace of recovery hinges on the distribution of an effective and safe Covid-19 vaccine, geopolitical risks and US-China relations. Earring any negative surprises, we expect policy rates to remain on hold in the near term,” she says.

The health crisis has widened the fiscal deficit amid lower government revenue, which fell 22% year on year from January to August. Ongoing expenditures, comprising 148% of revenue, and the direct fiscal injection of RM50 billion amounting to 3.7% of GDP is projected to widen the nation’s fiscal deficit to 6% of GDP in 2020.

Meanwhile, RHB Research’s Peck says that while revenue is expected to improve with better economic growth next year, it could well be weaker than the level seen in 2018. Similarly, expenditure is expected to narrow in the absence of one-off extensive support measures, he adds.

It is clear to experts that although there have been attempts by the government to lower the fiscal deficit since the Asian financial crisis (AFC) of 1997 and 1998, the widening gap is justified since the pandemic’s impact on fiscal sustainability is deeply felt by governments around the world.

Majariyat: Malaysia needs to formulate its own strategy to balance our economy for our country today, and take care of those in need.

nation is spared. As such, any negative repercussions from higher budget deficits or public debt should not apply in this cycle, economists say.

As Malaysia was recovering from the AFC, its fiscal deficit expanded to 8.5% in 2000, after which it improved to -3.5% in 2007 before sinking to a record -5.2% during the global financial crisis in 2009. In 2019, it stood at -2.2%, having hovered between -3.1% and 3.9% since 2013.

“Malaysia will not be singled out — as long as our growth number is recovering,” Institute for Democracy and Economic Affairs (IDEAS) Malaysia research manager Lau Zheng Zhou says.

He points out that what is more pressing are the areas of spending and whether they will be effective in stimulating growth and sparking recovery, rather than disbursing funds on “wasteful items such as indiscriminate subsidies on petrol”.

Allowing is to jack up a huge share of the government’s operational spending, so is there any room to rationalise the public sector size? he asks.

Lau explains that the current low interest rates provide fiscal space to borrow and invest in capital-intensive items such as public infrastructure in rural areas as well as nurture the renewable energy industry.

He adds that investors in Malaysian government bonds will need to be assured that spending on this is not made for unsustainable short-term gains but, rather, for growth impetus in the long run.
Stimulus packages recap

Since the start of 2020, the government has doled out over RM300 billion in stimulus to support the nation’s economy in light of the global health pandemic. Here, we recap the highlights from each stimulus plan.

FIRST STIMULUS PACKAGE
Date announced: Feb 27, 2020
Package size: RM250 billion

Spending highlights:
- Direct government spending: RM10 billion
- Loan moratorium: RM10 billion
- Tax incentives: RM5 billion
- Training and upskilling programmes: RM2 billion
- Others: RM165.5 billion

PENJANA STIMULUS PACKAGE
Date announced: June 5, 2020
Package size: RM50 billion

Spending highlights:
- Direct government spending: RM10 billion
- Wage subsidy programme extension: RM3.5 billion
- Hiring and training assistance for businesses: RM1.5 billion
- Training and upskilling programmes: RM2 billion
- Others: RM165.5 billion

PRIHATIN STIMULUS PACKAGE
Date announced: March 27, 2020
Package size: RM50 billion

Spending highlights:
- Direct government spending: RM25 billion
- Baruan Prihatin Nasional: RM10 billion
- Wage subsidy programme extension: RM3 billion
- Small infrastructure projects: RM2 billion
- HealthCare (Covid-19): RM1.5 billion
- Food Security Fund: RM1 billion
- Mudah Credit Scheme: RM50 million
- Assistance for Tertiary Students: RM70 million
- Others: RM30 million
- Economic Stimulus Package (Feb 27): RM2.3 billion

Public and Private Institution: RM225 billion
- Loan moratorium: RM102 billion
- Small business schemes: RM102 billion
- EPF: RM50 billion
- Others: RM225 billion

KITA PRIHATIN STIMULUS PACKAGE
Date Announced: Sept 25, 2020
Package Size: RM10 billion

Spending highlights:
- Direct government spending: RM10 billion
- Targeted wage subsidy Programme: RM4.2 billion
- Prihatin special grant - RM600 billion
- Baruan Prihatin Nasional 2.0: RM17 billion
- Others: RM5.5 billion
- Economic Stimulus Package (Feb 27): RM15.5 billion

Tax authorities may intensify tax audit activities to beef up tax collections. With the adoption of the Common Reporting Standard (CRS) and Malaysia’s commitment to automatic exchange of information, taxpayers can expect higher scrutiny on their sources of income, she adds.

In addition, there may be a review of the existing scope of tax to include online transactions and cross-border activities so as to reduce tax leakages from the shadow economy and profit-shifting activities. This may include tax informal sectors of the economy such as unregistered online businesses and online purchases by individuals. Data analytics and technology tools could be used to detect anomalies in sources of income versus spending as a proxy for underreporting of income for tax purposes, as well as enhancements in information sharing across different regulatory agencies, and with foreign tax authorities to identify possible non-reporting of offshore income, says KPMG’s Lim.

As the likelihood of widening of the income tax bracket for individuals or a reduction in income tax for individuals and corporates, KPMG’s Lim says that a reduction in income tax rates for SMEs — by way of a direct rate cut or a tax rebate — would be beneficial as Penjana’s provision of a tax surcharge relief of RM100 million for SMEs is currently limited to newly established businesses. SMEs are currently taxed at 17% on their first RM600,000 of chargeable income and 24% on the remaining chargeable income, hence a reduction of up to 20% on the remaning chargeable income would be welcomed as SMEs are already experiencing significant disruptions.

Tax consultants also point out that a review of the GST tax regime to address weaknesses in the system would be helpful, such as eliminating the cascading effects of the GST that ultimately increase business costs and providing clarity on the scope of taxable services.

“GST is timely to revisit the GST system and enhance the framework, such as facilitating GST refunds and stringent enforcement of the Anti-Profit Act to ensure the GST system is able to collect for unreasonable gains,” says Deloitte’s Lim.

For context on the consumption-based tax, Ernst & Young Asean and Malaysia tax leader Amarjigit Singh notes that imposing tax on the rich with the hope of sufficiently managing the fiscal position of the country will not meet that aim as the high-income group in Malaysia is relatively small.

“One GDP per capita income today is about US$4,100 per annum compared with Singapore’s US$54,600 per annum. Are we a high-income nation? Yet, we do need to broadly the tax base. However, it is a delicate balance as we need to also find ways to encourage businesses to operate in Malaysia and generate jobs. Today, there is a heavy reliance on government investments to sustain and spur the economy. Therefore, we must encourage private businesses to participate in the growth of the economy, which will improve Malaysia’s fiscal position,” he adds.

Within the region, Malaysia’s corporate tax rate stands at 24%. Indonesia’s prevailing 35% will be reduced to 22% by the end of 2020, and to 20% by 2022; the Philippines’ 30% is slated for a preliminary reduction to 25% and, thereafter, an annual reduction of 1% until it reaches 20% by 2027; Singapore’s is 17%, Thailand’s is 20%, and Myanmar’s is 30%.

According to Amarjigit, the implementation and broadening of consumption-based taxes have been trending globally, with many nations considering replacing corporate tax. However, critics have slammed this as being “regressive” as such taxes impact the lower income group disproportionately harder than the wealthy.

“Malaysia needs to analyse this carefully and formulate its own view on what the right balance is for our country today,” he adds.

He provides the illustration of two people, one with an income of RM2,000 and the other, RM1,000, buying a carn of Coke for RM1. Based on a GST of 6%, the six will be more of a pinch to the lower wage earner than the rich. Therefore, the right support must be in place for the lower-income group, who will have to pay consumption tax when the time comes.

He explains that the support measures may even supersede the tax contribution paid by the poor.

“We also need to tweak the broader consumption tax base to ensure that those who are in need are taken care of in the right way,” he says.

For reference, Singapore’s Budget 2020 will defer the rate of consumption tax for lower to middle income citizens with the S$8 billion Assurance Package, through which adult citizens will receive a cash payout of S$500 to S$1,000 over the next five years. The scheme will come into effect when the GST rate rises to 7% from 2021.

24% is the elevated unemployment levels and reduced workers’ compensation, which further diminish any potential increase in income taxes. One possible avenue for an increase is the better outlook for commodity prices, which may benefit revenues tied to these commodities.

In the challenging economic outlook, tax revenue, which makes up a substantial part of overall government revenue, is expected to decline. As such, it would not be surprising if the government decides to tax some income or gains which are currently not taxable,” agues of PwC Malaysia says.

Most tax consultants believe that, as higher taxes, will not be the case in the near term although the government has indicated that it will consider every avenue for an increase in the revenue base, which has been forecasted to grow 4.8% year on year to RM341 billion in 2023 from RM328 billion in the current year.

“Although there is talk of bringing back GST (Goods & Services Tax), this may not be the right time for immediate implementation, but a reasonable timeframe for the implementation may be announced,” says Deloitte’s Lim.

Sim Kwang Gel. While globally, more countries are adopting the broad-based GST, some countries believe what would be more likely is an expansion of the scope of taxable services under the Sales and Services Tax (SST) regime and lowering of the registration threshold for SST to cast a wider net to include more business segments.
How to revitalise private investments

Revisit private investments in the country has been a common refrain over the last few years. And now, with the Covid-19 pandemic affecting almost every facet of the economy, it is even more crucial for policymakers and regulators to address this issue, especially with most businesses refraining from making new investments or putting further funds into existing businesses.

The year 2020 is seen as a "last year" for private investment, as evident from the total approved investments of RM21.30 billion recorded for 2020, as reported by the Malaysian Investment Development Authority. Even at an annualised figure of RM30.0 million, it is only slightly more than half of the RM32.1 billion total approved investments recorded in 2019.

It is worth noting that the growth of total approved investments had been slowing down in the past five years, although it grew from RM20.4 billion in 2015 to RM23.1 billion in 2016. Total approved investments grew 10.0% from RM16.0 billion to RM18.0 billion in 2015 and 2016, falling from RM23.1 billion to RM18.0 billion in 2017.

Meanwhile, foreign direct investment (FDI) increased by 5.0% to RM8.3 billion from RM6.6 billion over the same period.

At a recent economic briefing organised by the Council of Presidents of Commerce and Industry of Malaysia (ACCIM)/Socio-Economic Research Centre, the latter's executive director, Lee Hong Guat, said investors are looking forward to the upcoming budget for some form of comfort to revive business sentiment.

He also said that the government's measures are clear and easy to implement and that these measures as well as Malaysia's positive attributes are made known to the world. Our neighbours are good at getting the right publicity and attracting attention from investors. We need to continue to improve on this front. "

Amarjot also highlights that it is crucial to look after existing businesses and investors, adding that the expectation of investors today has gone beyond incentives. "Investors want to operate within a supportive ecosystem, including an efficient operating environment with a high degree of certainty and consistency. They want the government to stand by their side and support them through the out their stay in Malaysia. For example, if an investor is given a tax holiday and has followed through on its commitments to Malaysia, the investment promotion agency should support the audit process when the investor is audited by the tax authorities to ensure that the spirit of the incentive is upheld," Amarjot says.

Others agree that foreign investors are not only drawn to incentives. "While tax incentives are a key factor in attracting FDI, sometimes it is not the only consideration. In my investor meetings, international funds are clear in their requirements. They expect transparency and a predictable environment. They want to be assured that their investments are safe and will be supported by the government," says Amarjot.

He believes that Malaysia has all the right attributes, with the government putting in place many measures to attract foreign investors. However, the competition for foreign investors in the region is stiff.

Hence, to distinguish Malaysia, it is important that the government's measures are clear and easy to implement and that these measures

Approved private investments in the last decade

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<th>Year</th>
<th>Domestic direct investment</th>
<th>Foreign direct investment</th>
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<td>2020</td>
<td>56.5</td>
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Budget wish lists

1. Holistic review of current tax regime
   - Ensure framework is current, relevant and competitive
   - Streamline tax incentive provisions under the Promotion of Investment Act 1986 and Inland Revenue Act 1996
   - Review Sales and Services Tax regime to address weaknesses in the system

2. Incentives to encourage digital adoption
   - Accelerate investments in digital transformation via a special tax incentive package

3. Reduce penalties for voluntary disclosures made by taxpayers
   - Reduce penalties from 5% to 10% of 35%, and no penalties on voluntary disclosure on genuine errors

4. Relax current group relief rules
   - Allow all companies including small and medium enterprises to access the group relief facility and removal of the 70% restriction

Healthcare expenditure likely to be in focus

With the resurgence of Covid-19 in Malaysia, the healthcare sector is likely to be in focus as the government allocates more funds to healthcare services. The government has already increased the healthcare budget to RM38.3 billion in the 2020 Budget, a 5.0% increase from the 2019 Budget of RM37.8 billion.

Affirmative Investment Research says in its report that the government is likely to spend on the social services sector, especially on building new public hospitals and upgrading healthcare facilities to meet the rising demand for public healthcare services amid the pandemic.

"We also expect the government to allocate funds for a vaccine. The Minister of Science, Technology and Innovation recently noted the proposal to the finance minister for RM3 billion to be allocated in Budget 2021, mainly for the purchase of a vaccine. Malaysia is not expected to receive any subsidy or financial assistance from the World Health Organization's (WHO) global Covid-19 vaccine access plan as Malaysia is categorised as a middle-income country," adds the research house.

In terms of the vaccine, United Overseas Bank (M) Bhd believes the top concern will be the cost, especially upfront payments. The cost is said to be set at a ceiling price of US$250 (RM1,000) per vaccine dose for committed purchases under the Covid-19 Vaccine Global Access (COVAX).

"Using that as a base price, the down payment to immunise 10% of the country's population could go up to RM9.0 million," says the research house.

Healthcare expenditure in the budget over the last 5 years

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<th>Healthcare expenditure (RM million)</th>
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