COVER STORY

BLOOMBERG

Reforms needed in Budget 2024

STORIES BY **LEE WENG KHUEN**

Budget 2024, to be tabled in parliament on Oct 13, will be the second budget announced by the unity government. With the conclusion of the recent six state elections, is the administration ready to kick-start more unpopular moves and measures to address the shrinking revenue collection?

Taking our cue from the mid-term review of the 12th Malaysia Plan (12MP), Budget 2024 is likely to be an expansionary one. Nevertheless, a long-term solution is needed to enhance revenue sources.

Lee Heng Guie, executive director of the Associated Chinese Chambers of Commerce and Industry of Malaysia's (ACCCIM) Socio-Economic Research Centre (SERC), believes that Budget 2024 offers a good opportunity for the government to undertake reforms in view of the fiscal constraints and challenging global environment.

Therefore, unpopular moves, such as the reintroduction of the Goods and Services Tax (GST), should be given consideration to rebuild the country's fiscal buffers to ensure a sustainable economy as well as fiscal and debt levels.

"The government has to push for some measured pace of reforms. It has to start doing so because this will allow you time to manage the people's discontent over unpopular measures before GE16 (the 16th general election) in 2027," says Lee.

"What the government needs to do is announce a 12-month timeline to reintroduce GST, which means that it starts with a low rate. Of course, there will be some pockets of people who disagree but all of our chamber members support the move, based on a survey. Even Malay chambers gave their support."

Last week, the Malaysian Economic Association (MEA) urged the government to reintroduce GST to pare the budget deficit and boost investor confidence, while expanding government spending to promote strong economic growth.

While the government is worried about the political backlash and the impact on the low-income group, Lee highlights that those concerns can be mitigated by exempting certain essential items and offering GST vouchers.

"Ultimately, if you have GST, then you don't have to always look into how to get revenue and then come out with a luxury tax, which may not give you good revenue, but will affect the domestic luxury goods market. Even with the capital gains tax, people are worried that it may kill off entrepreneurs and start-ups," he stresses.

If GST cannot be implemented, Lee says the government definitely has to roll out the targeted subsidy programme, which is expected to be fully implemented at the start of next year. Minister of Economy Rafizi Ramli has said the time frame for the roll-out will be based on the scheduled launch of the main database system (Padu) in November, before it is opened to the public for verification of their socio-economic status in January 2024.

Overall, Lee expects Budget 2024 to be "restrictive" with responsible spending as the government reaffirms its commitment to continued fiscal reduction. "I think the budget deficit target for next year will be between 4% and 4.5% of GDP (gross domestic product), against 5% or slightly better this year."

Note that Putrajaya aims to reduce the fiscal deficit to between 3% and 3.5% by 2025, which economists say is a tall order without any effective mechanism to boost revenue and cut expenditure.

Lee highlights that the government should include a detailed plan on the measures to broaden revenue on a sustained basis with responsible spending for better outcomes. At the same time, he says a fiscal consolidation road map should be laid out to improve revenue and control expenditure.

"The government is attempting to address the revenue shortfall through the luxury tax and capital gains tax on unlisted shares, which I think it is ready to roll out in the coming budget," says Lee.

He notes that there are still risks to the domestic economy in the second half of this year and going into next year, including the lag effects of high interest rates in the advanced economies, particularly the US, as well as the downside risk to the Chinese economy due to its property sector.

In keeping with the spirit of the Madani economy, PwC Malaysia tax leader Jagdev Singh points out that Budget 2024 should focus on structural reforms and driving investments.

"Structural reforms need to be two-pronged — moving away from blanket subsidies to a more targeted approach and driving revenue growth for the govern-

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Construction, solar companies seen as key beneficiaries of Budget 2024

Construction and solar companies are expected to be the main beneficiaries of Budget 2024, according to analysts who are looking forward to more details on the execution of the recently unveiled New Industrial Master Plan 2030 (NIMP) and National Energy Transition Roadmap (NETR).

The NIMP requires an estimated total investment of RM95 billion in the seven years to 2030, while the total committed investments for Phase 1 of the NETR stood at RM25 billion.

Since the retabling of Budget 2023 in February, the FBM KLCI had declined by 0.5% to close at 1,450.23 points last Friday. The impact from the upcoming Budget 2024 could be muted considering that the broader market has had quite a good run since the start of the third quarter.

"The market has already done quite well, such as the construction and property sectors. I'm not sure how much better they can do even with the announcement of elevated development expenditure. We're not sure if there will be a big boost to the market," the head of a local research house tells The Edge.

A look at the past six federal budgets shows that the FBM KLCI mostly inched up higher a month after the tabling of the budget, but was generally down a month before the budget announcement on the back of market uncertainty.

Budget 2022 introduced the one-off prosperity tax, which took local corporates by surprise and resulted in the FBM KLCI falling 2% and 3.3% a week and a month respectively after the budget was tabled.

The research house head points out that investors are keeping a close eye on how the government plans to generate more income given the challenging external demand conditions, which have weighed on Malaysia's export performance. To achieve the targeted economic expansion of 5% to 6% during the 12th Malaysia Plan (12MP) period, from 2021 to 2025, attracting more investments and creating a more business-friendly environment are crucial, he adds.

He is of the view that the government has to reintroduce the Goods and Services Tax (GST) in the near term if it is committed to addressing the country's persistent fiscal constraints. "It doesn't have to impose a high tax in the beginning. It could probably start with a lower rate before increasing it over the years," he suggests.

Victor Wan, head of research at Inter-Pacific Securities, is hopeful of more good news following Prime Minister Datuk Seri Anwar Ibrahim's second visit to China recently. "We believe Budget 2024 will be very much in the same vein, which is the reiteration of the mid-term review of the 12th Malaysia Plan."

For MIDF Amanah Investment Bank Bhd research head Imran Yassin Yusof, external factors seem to have more influence on the local stock market.

"Based on previous budgets, the stock market did not react much. One of the reasons was that there was nothing new. If there are no negative measures in the upcoming budget, or even with a positive impact on earnings, then we can expect the market to remain muted," he observes.

That said, Imran expects construction counters to see a boost if there are more announcements of construction projects, particularly as the sector will be driven by the forecast RM90 billion allocation for development expenditure in 2024, even though it is lower than the estimated development expenditure of RM97 billion in 2023, according to the mid-term review of the 12MP. He stresses that foreigners are keen to see how the government plans to improve its finances as they want clarity on how the fiscal deficit will be reduced.

Apart from the construction and renewable energy sectors, the building materials industry will continue to attract market interest, says Malacca Securities Sdn Bhd head of research Loui Low. Nevertheless, he cautions that amid the share price run of construction and property stocks, some mega projects may need time to materialise.

Low observes that the NIMP and NETR have been quite well received by foreign investors, which could help maintain the market momentum.

"These blueprints have set a very good tone. I hope that impact can sustain even if the budget is not so significant right now," he says, adding that renewable energy will continue to be a key focus area as Malaysia aims to reach 70% renewables in its power mix by 2050 from the 40% currently.

TA Securities believes that Budget 2024 will likely be a non-event for the gaming sector.

"We believe the situation is different this time around for the unity government to consider another post-election tax hike as the gaming sector suffered badly during the Covid-19 period and is in the midst of recovering. [Any] increase would be considered inappropriate, which would derail the earnings recovery process," the research house says in a Sept 20 note.

Previously, the Pakatan Harapan-led government raised casino duties to 35% and reduced the number of four-digit special draws by 50% under Budget 2019 following the 14th general election in 2018.

For the plantation sector, it remains to be seen if the government will make any announcement on the windfall profit levy, which is currently under review. The Royal Malaysian Customs Department's website shows that the levy is being charged at a rate of 3% on palm oil prices above RM3,000 a tonne in Peninsular Malaysia and at a rate of 3% on palm oil prices above RM3,500 a tonne in Sabah and Sarawak. E

How the FBM KLCI has fared pre- and post-budget

DATE	PRE-BUDGET		POST-BUDGET	
	ONE WEEK (%)	ONE MONTH (%)	ONE WEEK (%)	ONE MONTH (%)
Feb 24, 2023*	-1.4	-2.8	-0.2	-3.9
Oct 7, 2022	0.8	-5.7	-1.7	2.6
Oct 29, 2021	-1.6	0.9	-2.0	-3.3
Nov 6, 2020	3.6	0.7	4.6	6.7
Oct 11, 2019	-0.1	-2.8	0.9	3.3
Nov 2, 2018	1.8	-4.7	-0.3	0.1

Note: *Retabling of Budget 2023

SOURCE: BLOOMBERG

ment. Subsidy rationalisation has been on the cards for a number of years now, and understandably so, given the complexities of transitioning to a more focused or targeted framework. There will never be a perfect model and the government will need to go with the option that is realistically implementable," he says.

"Structural reforms are equally needed on the government revenue side of things so that we can bring down the budget deficit to a more sustainable level. While the government has options in terms of introducing new taxes or even increasing some of the current taxes, having a broad-based consumption tax would be the most plausible measure to move the needle."

On the investment part, Jagdev says Malaysia needs to further differentiate itself as a destination of choice for selected areas of investment. "This could include applying a different lens in incentivising companies based on the outcomes they deliver, further government investment to create robust ecosystems, as well as simplifying the administrative processes for investors."

At the same time, he notes that Budget 2024 has to place emphasis on domestic investments, which have been declining over the years. "Size does matter and we need to quickly scale up our SMEs (small and medium enterprises) so that they are able to grow beyond our shores and tap into larger overseas markets, while maintaining a strong base here in Malaysia," he adds.

LOW YEN YEING/THE EDGE

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PWC MALAYSIA

"Structural reforms need to be two-pronged — moving away from blanket subsidies to a more targeted approach and driving revenue growth for the government." — Jagdev, PwC Malaysia

Addressing the income issue

As income levels have not risen fast enough for the bottom 60% group, Dr Yeah Kim Leng, professor of economics at Sunway University Business School, says more attention should be given to enhancing their income-generating capacity through better quality and high-paying jobs.

Certainly, all eyes will be on the execution of the progressive wage model, which complements the minimum wage policy. The new model is voluntary, incentive-based and linked to productivity.

Also, the measures taken to boost the labour force's share of income to 45% within 10 years, from 32.4% in 2022 will be in focus in the upcoming budget.

With the government seeking ways to increase its income, Yeah says the capital gains tax on unlisted shares, which is set to be implemented in 2024, should not affect business expansion activity. "You wouldn't want to deter business expansion as FDIs (foreign direct investments) continue to be the mainstay. You also need to sustain confidence and promote greater DDIs (domestic direct investments)."

It is worth noting that the sale of shares

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More forms of capital gains tax expected in future

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in real property companies (RPCs) is already subject to capital gains tax. An RPC is a controlled company (owned by not more than 50 members and controlled by not more than five persons) whose total tangible assets comprise 75% or more real property and/or shares in another RPC.

Jagdev believes the implementation of the capital gains tax in 2024 is likely to be the starting point for an expansion in scope to cover more forms of capital gains.

"As the lines between income and capital gains are increasingly blurred, the distinction in taxing one and not the other becomes less meaningful. The proposed approach of starting with a low rate and keeping it to the sale of unlisted shares by companies is a good starting point, but it needs to be expanded to make it more equitable," he says.

Incentives for EV players

In line with the National Energy Transition Roadmap (NETR), Yeah expects more tax incentives lined up for electric vehicle players to encourage the gradual shift to EVs. The government has stated its target of having 10,000 EV chargers available by 2025 under the Low Carbon Mobility Blueprint 2021-2030.

"A lot of FDIs now require clean energy as well as compliance with the ability to meet the requirements of all the SDGs (Sustainable Development Goals) before they invest. So, that can enhance Malaysia's attractiveness for FDIs that focus on net zero carbon. That momentum will be very good if we can capitalise on that," he says.

To encourage more digital businesses to relocate to Malaysia, the government has to make sure the 5G infrastructure is competitive, he adds.

Developing local champions

In an effort to develop local champions, Deloitte Malaysia country tax leader Sim Kwang Gek is calling for the revival of the Domestic Investment Strategic Fund (DISF), whose goal was to accelerate the shift of Malaysian-owned companies in targeted industries into high-value-added, high-technology, knowledge-intensive and innovation-based industries.

Due to overwhelming interest, the programme reached its fund capacity and has been put on hold since December 2021.

"While FDIs are crucial for the economic development of the country, we should develop and nurture our local businesses that have the potential to grow and build a brand that is 'uniquely Malaysian' in the international market," says Sim.

She opines that the framework should be aligned with the New Industrial Master Plan 2030 (NIMP). "A structured monitoring and implementation plan can be embedded into the funding arrangement to ensure tangible benefits are derived from such a scheme," she says.

Sim suggests the enhancement to the current research and development incentive, which offers a double tax deduction on qualifying R&D expenditure. For comparison, Singapore offers a tax deduction of up to 250% for qualifying R&D expenditure and an option to convert qualifying R&D expenditure into cash payouts under the Enterprise Innovation Scheme.

On the environmental, social and governance (ESG) agenda, she says environmental taxes could be introduced to prevent deterioration of the environment while encouraging corporates and consumers to make sustainable choices.

SAM FONG/THE EDGE

"You wouldn't want to deter business expansion as FDIs continue to be the mainstay. You also need to sustain confidence and promote greater DDIs." — Yeah, Sunway University Business School

DELOITTE MALAYSIA

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"Singapore's carbon tax will be increased by five times from S$5 to S$25 per tonne of GHG (greenhouse gas) emissions in 2024, followed by S$45 in 2026, before reaching S$50 to S$80 per tonne by 2030. Malaysia may consider similar measures to encourage businesses and consumers to adopt a behavioural change towards sustainable choices," says Sim.

She also recommends that the government consider the Extended Producer Responsibility (EPR) framework to ensure proper management of plastic packaging and electronic waste. In Malaysia, only 25% of e-waste is recycled.

"A holistic tax framework must be considered to ensure successful implementation of EPR in Malaysia. Issues such as tax treatment on deductibility of EPR-related costs incurred by producers, contribution of EPR fees by businesses and taxability of such receipts must be ironed out. A full tax deduction on the costs and exemption on the receipts, subject to certain parameters, should be accorded," says Sim.

Broadening tax base

Asked about the broadening of the tax base, Sim says the government has mentioned new taxes are on the cards, namely the capital gains tax on shares of unlisted companies and luxury goods tax, but the key question is: Will it move the needle in terms of tax revenue generation?

"While GST continues to be deliberated and we face depleting oil reserves, the government should take a longer-term perspective in identifying the type of taxes that would give a more sustainable source of tax revenue for the country. Consumption taxes may be the way forward and as a start, the current SST (Sales and Service Tax) system can be further enhanced to include some of the key features of GST, such as the availability of input tax credit and wider scope of coverage," she says.

In order to achieve the high aspirations of NIMP 2030, Sim is of the view that the policies implemented must encapsulate every aspect, including creating the right talent pool, availability of good infrastructure and strong ecosystem, pro-business policies, strong governance and tax incentives to encourage high-impact investments in Malaysia.

She expects to see more subsidy rationalisation to ensure that the subsidies are channelled to the deserving ones and there should be a mechanism in place to implement this scheme.

On the capital gains tax on shares of unlisted companies and the luxury goods tax, Sim says it will not be a surprise if both taxes are implemented in 2024, as the capital gains tax was mooted during the tabling of Budget 2023.

"This indicates that the government is taking a phased approach before embarking on a full-blown capital gains tax. We can expect more details related to the scope of coverage, rate of tax and whether special concessions or exemptions are provided," she adds.

For the luxury goods tax, Sim believes the government will not pull the brake on the positive momentum that the tourism sector is experiencing.

"It remains to be seen if both taxes will give a major boost to the tax revenue as the scope is limited to unlisted shares and luxury items. It will be a delicate balance between the need to increase tax revenue and maintaining a pro-business friendly environment," she says.

Jagdev notes that the implementation model of the luxury goods tax can be more complex depending on the mechanism used.

"It could either be in the form of a higher sales tax on selected items or a new tax at the retail level. While this is seen as a progressive measure, the revenue raised may not be significant and would depend on the items covered," he says.

Meanwhile, Sim says the SST regime can be further enhanced by expanding the scope of taxable goods and services.

"The current SST covers only 38% of goods and services while under the GST system, the coverage was 68%. Hence, there is certainly room to expand the scope of SST to include more taxable goods and services. Another consideration would be to introduce a higher tax rate on certain goods and services," she adds.

Jagdev, however, opines that the nature of SST as a single-stage tax makes it difficult to have its scope broadened without triggering a cascading tax on tax across the value chain.

"The current items that are not subject to sales tax are primarily essential goods as well as inputs into other manufacturing processes or commercial activities. Similarly, the list of areas covered by service tax already addresses most services directly rendered to the end consumer, with the exception of healthcare and education," he says.

"Hence, broadening SST would result in additional taxes on businesses in the value chain, which will then be passed on to consumers in the form of higher prices. This would be undesirable as some value chains may see more taxes embedded than others. In the absence of an input tax mechanism, this cannot be avoided."

In short, GST remains the most effective approach to taxing consumption as it tackles the shortcomings outlined above, he adds.

Meanwhile, Sim does not foresee any reduction in the current corporate income tax rate of 24% for non-SMEs as there is not much avenue for the government to look for alternative sources of tax revenue to fill the gap. "Until and unless GST is reintroduced, the corporate income tax rate may remain at 24%, which is not competitive with countries in the region such as Singapore (17%), Thailand (20%) and Vietnam (20%)," she says.

Similarly, she does not expect any further adjustments on individual tax rates this time around.

Under Budget 2023, the tax rate for the M40 group was brought down by two percentage points for those earning an annual chargeable income of between RM35,000 and RM100,000. Those earning an annual chargeable income of RM100,001 to RM1 million are subject to an increase of half a percentage point to two percentage points in the tax rate.

In Budget 2023, it was announced that SMEs would get a two-percentage-point tax rate cut for chargeable income of up to RM150,000. This means SMEs are subject to three tiers of tax rates depending on the income level — 15% on chargeable income of up to RM150,000, followed by 17% on chargeable income of RM150,001 to RM600,000, and 24% on the remaining income.

Sim hopes that under Budget 2024, the government will consider a two-tier tax rate for SMEs — 15% for income not exceeding RM600,000 and 20% on the remaining income. E