UDGET 2016, the first under the ninth Malaysia Plan, marks the beginning of the final lap of the national vision of becoming a high-income advanced economy. Faced with a challenging economic landscape along with low growth globally, reduced commodity prices and a weakening ringgit, Prime Minister and Finance Minister Datuk Seri Najib Razak presented a measured response to deal with the issues facing the nation.

The long-standing budget deficit has been in this spotlight in addressing the last few budgets. Budget 2016 continues the trend of gradually reducing the fiscal deficit. As such, fully, the bold move to introduce the Goods and Services Tax (GST) helped cushion the drop in direct taxes and petroleum-related revenue, hence reducing the overall deficit to 2.1% of GDP.

For corporates, the 1% reduction in tax rates announced two years ago kicks in next year. While it is a positive move, a further reduction of corporate tax rate would be reduced further to remain competitive within the region, the government has decided to wait a little longer to see the full impact of GST revenue. In order to incentivize the manufacturing sector to continue investing, additional incentives to the form of reimbursement allowance have been brought back. This will be especially important for the manufacturing companies. However, given the fierce competition for investments, a more holistic review of the incentives would have been timely to take us to the next level.

The government, which has been trying to improve the tax system by helping first-time home buyers, has stayed on course by continuing and enhancing the various property financing initiatives such as PRAM and the First House Deposit Financing Scheme. This is expected to further alleviate the burden of the rakyat grappling with the rising cost of living brought about by the current volatile economic conditions.

There is no doubt that given the current economic backdrop of falling revenue from oil and commodity prices as well as turbulence in the foreign exchange market, the government will find it difficult to make significant changes to the tax system.

As it stands, Malaysia's financial position will come under further pressure, although it is recognized that the introduction of the Goods and Services Tax (GST) revenue has contributed significantly to the government's coffers.

With the introduction of the assumption tax on everyone's mind, it is a relief that additional goods, for example, certain foods prices and importantly controlled drugs, medicines and medical devices, have been included in the list of items subject to GST at the zero rate.

The major focus for Budget 2016 is to ensure the government has decisively increased the quantum of certain reliefs and introduce new reliefs in relation to parent care and Socso contributions. While this is seen as a measure to assist the middle-income group by reducing their tax burden, there are a number of key observations:

1. With the implementation of the GST, personal tax rates should be reduced considerably to compensate for money spent on this consumption tax. If the experience of Singapore is anything to by, the introduction of the GST back in 1993, at the rate of 3%, saw a reduction at the same rate of personal taxes.

2. The majority of fresh graduates entering the workforce will get into a taxation position very quickly as the relief available to them are limited; the primary relief for these new entrants is to be claimed at the rate of RM8,000.

On the personal side, Budget 2016 increased the personal relief to an amount more reflective of the cost of living.

Effective Tax rate for a resident individual

<table>
<thead>
<tr>
<th></th>
<th>US$30,000</th>
<th>US$50,000</th>
<th>US$100,000</th>
<th>US$300,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective Tax Rate (%)</td>
<td>10</td>
<td>12</td>
<td>20</td>
<td>30</td>
</tr>
</tbody>
</table>

Impact of additional tax reliefs

<table>
<thead>
<tr>
<th>GOVERNMENT EXPENDITURE (RM)</th>
<th>TAXABILITY (FOR RM100)</th>
<th>EXEMPTION</th>
<th>COMPARISON</th>
</tr>
</thead>
<tbody>
<tr>
<td>60,000</td>
<td>538</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>100,000</td>
<td>660</td>
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</tr>
<tr>
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</tr>
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<td>2,249</td>
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<td>250</td>
</tr>
<tr>
<td>1,000,000</td>
<td>3,500</td>
<td>750</td>
<td>500</td>
</tr>
</tbody>
</table>

*Assuming claims of personal relief, spouse relief, relief for one child below 18 and one above 18 in tertiary education, parent care relief, and relief for EPF and Socso.*

For individuals expecting further tax cuts, it was reported that higher income tax rates were imposed on high-income earners — 28% for individuals with a chargeable income of RM600,001 to RM1 million and 28% for individual with chargeable income exceeding RM1 million.

This is unusual. On a global basis, the current trend for governments seeking to increase tax revenue is to raise GSTWNT (value-added tax) rates and personal income tax rates. The 28% rate also applies to non-resident individuals.

While such tax increases should affect only a small number of taxpayers, the incremental total tax revenue from this measure may be limited as taxpayers can choose to structure their incomes accordingly.

Given that this proposal will result in a significant divergence between the top rate of individual income tax at 28% and 19% for small and medium enterprises (SMEs), it could distort investment decisions.

While the existing scope of tax relief for individuals has been enhanced (for example, by increasing the current limits for spouse and child relief, and introducing tax relief for the GST), there is a growing concern that this may not be sufficient, particularly to taxpayers from the lower-income group who are paying tax at scale rates.

An alternative approach would be to give tax rebates, which would directly reduce the amount of tax to be paid. For example, a tax rebate of RM800 would be more valuable to someone paying tax at the lower rates as opposed to a tax relief that will have an incrementally smaller effect on someone paying income tax at the highest rate.

For corporations, it was a relatively plain budget with key incentives introduced for specific industries and groups, for example, food production projects, SMEs and manufacturers making reinvestments. Amendments to the tax legislation are targeted at tightening existing provisions and aligning the tax treatment arising from the GST.

On a prospective basis, there is perhaps an opportunity for the government to reduce compliance cost by simplifying the existing tax system. An example of this could be allowing capital intensive way of form of tax depreciation (20%) to be claimed by companies on a pooling basis as opposed to the current practice of tracking and valuing these assets individually.

Overall, Budget 2016 was relatively low-key in terms of change with the main aim being to deliver relief and goodies to targeted groups.

Nicholas Crist is chief operating officer and Thin Siew Chi an executive director at KPMG Tax Services Sdn Bhd.

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