INNOVATING A PROGRESSIVE TAXATION SYSTEM

Tax reforms mooted by Budget 2019 seeks to ensure efficiency, effectiveness and fairness in the Malaysian tax system

By **CS Cheah**

The recently-unveiled Budget 2019 stood out from its peers not because it was the maiden budget by a new government in Malaysia's 61-year history. It stood out for boldly attempting to address ballooning debts inherited from the previous administration amidst the hostile global environment while at the same time allowing the government's monetary policy to be accommodative and conducive for economic growth.

Against such a backdrop, *Smart Investor* engages experts from the accounting fraternity to gauge their views on how the various tax reforms (which have been praised by the World Bank) can help the government to achieve fiscal balance without compromising the goal to accelerate economic growth and improve the overall well-being of the people.

Deloitte Malaysia Financial Services Tax Leader Chee Pei Pei and Financial Services Tax Executive Director Gooi Yong Wei

Gooi Yong Wei

Heading into the Budget season, there were hints dropped by the government of "new taxes" to help address the immense national debt. However, what was announced was not so much new taxes as they were:

- Widening of the scope of existing taxes (such as digital tax which is a service tax on electronically-supplied services, and soda tax which is

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an imposition of excise duty on sugar sweetened beverages);
• Increase in rates (increase of real property gains tax rates from 5% to 10%, and a 1% point rise in stamp duty rates); and
• Limiting the availability of tax shelters by imposing a time limitation on unutilised incentive allowances and losses.

Among the objectives of the 13 tax reforms which will lead to a more progressive and effective taxation system is to raise government revenue. Under the Special Voluntary Disclosure Programme, taxpayers can voluntarily declare any unreported income for Malaysian tax purposes, including those in offshore accounts in return for a significantly reduced penalty of between 10% and 15% compared to the maximum possible penalty of 300% under the law.

The concession under this programme is valid only if the voluntary disclosures are reported before March 31, 2019 (for 10% concessionary rate) and June 30, 2019 (for 15% concessionary rate).

Neoh Beng Guan

This is also timely given Malaysia's participation in the OECD Common Reporting Standards where financial information of Malaysian residents will be automatically received by the taxman moving forward.

While Budget 2019 is a short-term measure to rebuild Malaysia, it appears to be a comprehensive and innovative one aimed at improving the country's potential to compete at the global frontier.

KPMG Tax Services Sdn Bhd
Executive Director (Corporate Tax)
Neoh Beng Guan

With the inevitable evolution to Industry 4.0 and the boost of e-commerce, the announcement of Digital Tax in the form of service tax on imported services was a deft move by the government to increase tax revenue.

In essence, it will allow digital businesses and traditional businesses to compete on a more level playing field. However, the challenges would be in its implementation and enforcement, especially where the service providers are located in foreign jurisdictions.

A more direct impact would be the government's proposal to limit the carry-forward losses and allowances to a maximum of seven consecutive years. For a start, businesses will need to keep track of their losses and allowances while the most significant impact will be on businesses that are capital-intensive or with long gestation period.

The island of Labuan did not go unnoticed. Labuan's tax restructuring has recently been crafted to steer away from ring-fencing. Easing of restrictions through allowing Labuan entities to transact with Malaysian residents and in Malaysian ringgit will promote more investments into Labuan although – once in – businesses need to meet the substantive conditions to enjoy the preferential tax regime.

In the quest for transparency, it is no longer about getting investors but getting the right ones.

Overall, Budget 2019 provides a clear message that the government is serious about reforming the economy and plugging leakages to reposition the nation to propel forward despite challenging times.

We can certainly expect more tax reforms and possibly new taxes to follow. Nevertheless, any new taxes and taxation policies should be carefully thought through in consultation with relevant stakeholders (e.g. investors, businesses, regulatory authorities, professional bodies) prior to implementation.

The tax regime should not be overly complex and must not be implemented in a rush such that taxpayers need to incur high compliance and administrative costs. Whilst there is a need to increase revenue, it is equally important to sustain growth and promote investments.

Leow Mui Lee

Axcelasia Taxand Sdn Bhd Managing Director Leow Mui Lee

Whilst no new taxes have been introduced, there are new initiatives to increase collection to address current national debt levels and fulfil election promises. Among the proposed changes, the following are the most significant:

• **Seven-year time limitation for businesses to carry forward losses, capital allowances, reinvestment allowances, pioneer losses and unutilised investment tax allowance:** At present, any business losses which are unutilised in the current year of assessment may be carried forward indefinitely until it has been fully utilised.

Similarly, any unutilised capital allowances, reinvestment allowances, pioneer losses and unutilised investment tax allowance may also be carried forward indefinitely until fully absorbed.

It has been proposed that unabsorbed business losses can be carried forward for a maximum period of only seven consecutive years of assessment. The proposal takes effect from the year of assessment 2019. A similar measure applies to any unutilised capital allowances, reinvestment allowances, pioneer losses and unutilised investment tax allowance.

We also understand that there would be grandfathering provisions for existing unabsorbed losses/allowances whereby any accumulated losses/allowances up to the year of assessment 2018 can be carried forward for up to seven years.

Although we had anticipated this proposal, it was a big surprise to corporate Malaysia and would have a significant tax impact. Companies with unabsorbed business losses, unutilised capital allowances, reinvestment allowances, pioneer losses and unutilised investment tax allowance will now have to keep track of the losses and allowances incurred.

Businesses can no longer rely on carry forward losses and allowances as a means to shelter future profits beyond the seventh year.

• **Review of group relief for business losses:** Currently, group relief for current year adjusted losses allows a surrendering company to surrender losses indefinitely. But it has been proposed that the surrendering company be allowed to surrender losses only 12 months after commencement of business and limited to three consecutive years of assessment.

This proposal is intended to limit the group relief to enable only start-up companies to surrender losses. Essentially, a start-up company would be able to surrender the losses incurred after the basis period of its first year of assessment after commencement of its business provided it has been in operation for at least 12 months.

Group companies which have long utilised this group relief for losses to manage the group's tax liability would now have to consider its overall group tax position as the group relief is significantly curtailed.

PwC Malaysia Tax Partner and Leader (Entrepreneurial & Private Business) Fung Mei Lin

Investors can breathe a sigh of relief as capital gains tax was not part of Budget 2019 amid all the speculations prior to the Budget announcement on Nov 2. Proposals impacting individual and corporate property owners in relation to revised real property gains tax (RPGT) and stamp duty rates were not too unpleasant either.

Given the Budget's focus on Industry 4.0, it is a no-brainer for investors to look out for businesses that are able to take advantage of the financing and support offered by the government.

Although no significant tax incentives have been proposed, businesses would do well to adopt smart technology such as automation, robotics, modernisation and artificial intelligence through the soft loans and grants offered (totalling more than RM5 bil).

Fung Mei Lin

Amarjeet Singh

Manufacturing and manufacturing-related players will be the main beneficiaries of this. Having said that, the ramp-up in activity should lead to multiplier effects benefiting the supply chain.

In addition, the introduction of digital tax on imported online services got a lot of businesses excited. It is expected to impact various stakeholders throughout the value chain – from suppliers to consumers – and create a level playing field for local service providers.

But how the tax will be implemented and how businesses (both local and foreign) stand to reap benefits from it – without being overburdened administratively – still remains to be seen.

All-in-all, private investments appear to be the order of the day to drive economic growth in Malaysia. The policy direction taken by the government to avoid participating in business is expected to boost investor confidence and stimulate pro-competitive economic reforms.

Ernst & Young Tax Consultants Sdn Bhd Partner and Malaysia Tax Leader Amarjeet Singh

Budget 2019 has been carefully crafted to improve Malaysia's fiscal position and enhance competitiveness. There are proposals to tighten corporate tax provisions, introduce a voluntary disclosure scheme, and broaden the tax base through consumption taxes (sugar tax, online services) to help increase tax revenue.

On the other hand, there are budget allocations and incentives for regional hubs, education, tourism, aerospace, green technology and Industry 4.0 to provide a conducive and favourable environment to attract investors and businesses.

Pending the tabling of the Financial Bill, it is difficult to comment on how the new taxes will affect the investor community. Nevertheless, some immediate and more important tax proposals include:

- Limiting the ability to carry forward unabsorbed losses and unutilised allowances (including unutilised incentive benefits) to a maximum period of seven consecutive years of assessment;
- Imposing service tax on importation of taxable services into Malaysia;
- Increasing the RPGT rate by 5% on gains arising from the disposal of real properties and shares in real property companies (in the sixth and subsequent years); and
- Reviewing tax treatments for the Labuan International Business Financial Centre (IBFC) where Labuan companies will no longer be able to elect for income tax at the fixed rate of RM20,000 and will be subject to tax at the rate of 3% (while transactions with Malaysian residents may be allowed, the deductions for such Malaysian residents will be limited to 3% of the allowable expenditure).

It is worthwhile for corporates/investors to assess how these provisions may impact their tax positions and where there are significant adverse consequences, to consider the following:

- Options to mitigate the adverse consequences by realigning their business or corporate structure; and
- Where options available are not practical to implement and taxpayers view the new provisions as adversely impacting their business, to engage with the policy-makers to share their concerns.

The Finance Minister also announced the launch of a Special Voluntary Disclosure Programme whereby taxpayers are given up to June 30, 2019 to disclose any understated tax. If these disclosures are made by March 31, 2019, a concessionary penalty of 10% will apply; and a penalty of 15% will apply if disclosures are made by June 30, 2019.

Upon the end of the Programme, penalty rates will range between 80% and 300%. This Programme should be considered in light of the OECD Automatic Exchange of Information programme that is now in place and which involves more than 100 jurisdictions agreeing to exchange information between tax authorities.

Hence this Programme presents an opportunity for non-compliant taxpayers to come clean and make disclosures of under-declared tax before such information is discovered by the Inland Revenue Board. SI