# 2016 MALAYSIAN BUDGET HIGHLIGHTS

**The 2016 Budget Proposals** were announced by the Prime Minister, Dato Seri Najib Razak on 23rd October 2015. The 2016 Budget sets the framework for the 11th Malaysia development plan, with five years to go to achieve the much anticipated 'Vision 2020' objective of a high income nation. The 2016 Budget has to be looked at from the point of view of the realities facing Malaysia's economic and financial position. With the combination of low oil prices, a depressed currency, sluggish domestic performance and the declining state of the world economy (particularly China), the key challenge is ensuring that the Government's fiscal deficit does not worsen. Somewhat surprisingly the 2016 deficit is projected to be 3.1%, an improvement, albeit of 0.1%. This comes from a projection of crude oil prices at USD50 in 2016 against the projection of USD63.60 by the Economist Intelligence Unit. So one may say the local projection is conservative, and hence the estimated fiscal deficit is reasonable. The 2016 economic growth rate projected at 4% to 5% is fairly respectable.

The introduction of Goods and Services Tax (GST) this year to replace the previous Sales Tax and Service Tax will boost revenue collection by RM39 billion in 2016, which is partly off-set by increased BR1M (cash assistance scheme) payments of RM5.9 billion intended to boost domestic consumption and assist lower income households. The flip side to the introduction of GST and reduced subsidies has seen an increase in the cost of living, which the 2016 Budget has addressed with a slew of measures to benefit the middle class as well as the urban and rural poor. The announcement of the Trans-Pacific Partnership ("TPP") has been met with mixed reactions, and in any case, the impact of this, if signed, will not be felt immediately. In September this year, an interim RM28 billion stimulus package was announced to boost the economy. This included a RM2 billion allocation for Small and Medium Enterprises (SMEs) to help finance their operations in the face of the declining currency, import duty exemptions on 90 or so tariff lines to reduce the cost of business primarily for the manufacturing sector, an allocation of RM1 billion for the Domestic Investment Strategic Fund to mobilise more domestic investment and value added activities. These measures were met with some level of warmth, and were the appetisers to the 2016 Budget proposals.

Does the 2016 Budget have enough to revive confidence in the economy and to spur growth?

We set out below some of the key tax proposals from the 2016 Budget and our thoughts thereon:

## Corporate Tax

- Provisions relating to Goods and Services Tax ("GST") - With the introduction of GST with effect from 1 April 2015, the Income Tax Act 1967 ("ITA") has been amended to take into account corporate tax adjustments in respect of GST:
    - Input tax costs will not be deductible for corporate tax purposes where a GST registered person is entitled to claim the input tax for GST purposes. The same will apply where a person is required to be registered for

GST and has failed to do so. For such persons, where the input tax relates to an asset, the input tax cost in relation to that asset would not qualify for tax depreciation or capital allowances. This is on the basis that the input tax should not be a cost to the GST registered person as they would be entitled to credit the input tax against their GST output tax. However, for those persons who are involved in making exempt supplies for GST purposes and are thus not able to claim back their input taxes, this would be a cost and would be tax deductible for corporate tax purposes. The same would apply in relation to 'blocked input tax'.

- In the same vein as the above, where a GST registered person, or where a person is required to be registered for GST and has failed to do so, bears any output tax, this output tax cost is not tax deductible. This would include situations where the person has borne the output tax in relation to deemed supplies, for example, pursuant to the GST 'gift rule'.

- Where any adjustments are made in respect of input tax paid under the GST Act, the Director General may give effect to such adjustments, where these affect the corporate tax position of the taxpayer based on the above rules. This adjustment is also applicable where the input tax relates to qualifying plant expenditure, qualifying building expenditure, qualifying agriculture expenditure or qualifying forest expenditure.

These amendments are effective from the year of assessment 2015 and are also applicable to the Petroleum Income Tax Act 1967.

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- As a result of recent decisions made by the Courts against the Inland Revenue Board ("IRB"), the following provisions in the ITA have been amended to overturn these decisions and to tighten the relevant provisions, as follows:

  - In the case *Clear Water Sanctuary Golf Management Berhad v Ketua Pengarah Hasil Dalam Negeri*, the courts held that Section 24 of the ITA (which discusses the basis period in which business income should be assessed to tax) requires services to have been rendered before the income in respect of such services is recognised for tax purposes. The Finance Bill 2015 amends Section 24 to ensure that income is recognised for tax purposes in respect of both services rendered or to be rendered. This is also applicable to gross income earned for the use or enjoyment of any property dealt with or to be dealt with (e.g. rental income comprising a business source) at any time in the course of carrying on a business.

    This will mean that all 'deferred income' (whether or not such income is refundable) will be assessed to tax in the year of receipt. Where a portion of the deferred income assessed to tax is eventually refunded to a customer, the amount refunded will qualify for a tax deduction.

  - The case *TSD v Ketua Pengarah Hasil Dalam Negeri* held that an owner of a school building who did not operate the school was entitled to claim industrial building allowances notwithstanding that the operation of the school was undertaken by a third party. A new paragraph 16B, has been introduced to Schedule 3 of the ITA by the Finance Bill 2015, which states that where certain buildings are used by the owner for the purpose of letting of property, industrial building allowances are not allowable. This provision is applicable to licensed private hospitals, maternity homes and nursing homes, buildings used for research, buildings used as a warehouse (for the storage of goods for export or the storage of imported goods which are to be processed/distributed/ re-exported), buildings used for approved service projects, hotels, airports, motor racing circuits, living accommodation for employees, schools or educational institutions.

    This change will impact many property owners who rent out buildings which are used as hotels, educational institutions, hospitals, etc. by the operators of those businesses. Commercially, it is often the case, particularly in a group of companies, where a company in the group is set up as the property holding entity for properties used in businesses operated by the group companies

    It should be noted, however, that the change does not apply to factories

- ***Deductibility of interest*** – In the previous Budget, a change was made to the rules regarding the deductibility of interest, whereby, with effect from the year of assessment ("YA") 2014, a deduction can only be claimed when the interest is due to be paid (rather than when it is incurred). The deduction for the interest will be claimed when the interest is due to be paid, but it will be allowed for the period in which it was incurred. Therefore, technically the taxpayer would need to revise the tax return that was filed for the earlier year in which the interest was incurred. The Finance Bill 2015 seeks to address the administrative aspect of this, whereby a claim for deduction is to be made not later than 12 months from the end of the basis period for the year of assessment in which the sum is due to be paid and the Director General may then issue a reduced assessment in respect of the year in which the amount was incurred. Thus, there would not be a need to revise the earlier tax return.

- ***Islamic Financial Sector*** – To maintain Malaysia's competitiveness in the Islamic Financial sector and to promote the issuance of Sustainable and Responsible Investments Sukuk, a deduction for issuance costs incurred and approved by the Securities Commission of Malaysia will be given for five years, i.e. the YAs 2016 to 2020. Further, to encourage involvement of individual investors in the capital market, a three year extension from YA 2016 to YA 2018 is given on the double deduction on additional issuance costs of retail bonds and sukuk (Mudharabah, Musyarakah, Istisna', Murabahah and Bai' Bithaman Ajil based on tawarruq) and a further deduction on additional issuance of sukuk (Ijarah and Wakala).

- ***R&D expenditure for SMEs*** – SMEs will be allowed to automatically claim a double deduction for R&D project expenditure of up to RM50,000 for the YAs 2016 to 2018 but there will still be a requirement to submit an application for the R&D project to the IRB. It is expected that the approval requirements for such SMEs may be less stringent than those currently available for R&D projects under Section 34A of the ITA.

- ***Real Estate Investment Trusts ("REIT")*** – As part of a strategy to promote Malaysian REITs (listed on the Malaysian Stock Exchange) and to boost the capital market, the reduced withholding tax rate of 10% on REIT distributions to non-corporate investors and foreign institutional investors (particularly pension funds and collective investment funds) has been extended for another three years from 1 January 2017 to 31 December 2019. The tax rate on income distributed by a REIT to a unit holder which is a non-resident company has also been reduced to 24% from 25% with effect from YA 2016.

- ***Capital allowances*** – where any part of an asset ceases to be used for the purposes of a business and that part is due to be replaced with a new part which is depreciated separately based on generally accepted accounting principles, that part of the asset is deemed to have been disposed in that basis period.

# Incentives

- To capitalise on tourism and to take advantage of the weak Ringgit, the current tax incentive for tour operators which was due to expire in YA 2015 will be extended to YA 2018.

- To stimulate the agricultural sector, the current tax deduction for investors for the cost of investing in companies undertaking food production projects, as well as the tax exemption for food-production companies carrying out new projects, or for expanding existing projects, will be extended for a further 5 years (i.e. to applications received between 1 January 2016 to 31 December 2020). The types of agro-food and agro-based industries which qualify for this incentive have also been widened.

- SMEs will enjoy similar tax incentives to manufacturing and agricultural companies which attain a percentage of value added in respect of exports. SMEs will enjoy a tax exemption from the YAs 2016 to 2018 on statutory income equal to 10% or 15% of the value of increased exports which attain a 20% or 40% value added respectively.

- A company which is an independent conformity assessment body (ICAB) will enjoy tax incentives as follows:
  - A new ICAB will be entitled to a tax exemption of 100% of statutory income for a period of 5 years, or an investment tax allowance on 60% of qualifying capital expenditure for 5 years against 100% of statutory income.
  - Existing ICABs will also enjoy the investment tax allowance outlined above for a period of 5 years.

- To continue to maintain Malaysia's competitive edge as an Islamic Financial Centre, the present tax exemptions for companies providing Shariah compliant fund management services to investors, as well as to business trusts and REITs in Malaysia will be extended from the YAs 2017 to 2020.

- The Reinvestment Allowance (RA) incentive which has gradually been tightened over the years has now been extended again, in a move to retain foreign investment and to encourage domestic reinvestment. For those companies for whom the 15 year RA entitlement period has lapsed, they will now qualify for the 'Special RA' incentive for a further 3 years in respect of qualifying capital expenditure incurred from the YAs 2016 to 2018.

# Personal Tax

- In a turn of events from last year which saw a reduction in the personal income tax rate from 26% to 25% for the top income bracket, the 2016 Budget now proposes higher tax rates as follows:
  - 26% for income in the RM600,000 to RM1 million band; and
  - 28% for income above RM1 million.

  This is a relatively significant increase in tax rates for high income earners, particularly in the wake of GST, and this proposal has been met with mixed reactions. It is reported that the increase will only impact 17,000 taxpayers and generate an additional RM400 million in tax revenue. In addition, non-resident individuals will also be subjected to a higher 28% income tax rate.

- Increased personal tax reliefs are however included in the Budget proposals including the following:
  - 'Child relief' for children under the age of 18 will increase from RM1,000 to RM2,000,
  - Relief for children over the age of 18 pursuing tertiary education will increase from RM6,000 to RM8,000. This will also apply to handicapped children over the age of 18 for whom handicapped child relief of RM6,000 is claimable (in addition to the RM8,000),
  - 'Spouse relief/Alimony relief will increase from RM3,000 to RM4,000,
  - A new relief has been introduced for 'parent care' of RM1,500 for each of the taxpayer's parents, subject to certain conditions,
  - The tax relief for taxpayers seeking tertiary education or certain post-graduate qualifications will be increased from RM5,000 to RM7,000,
  - A new relief of RM250 per year in respect of employees' contributions to the social security protection scheme (SOCSO) has been introduced.

# GST

- Several food products which were previously standard rated will now be zero-rated in line with the other food products in the same categories, e.g. organic-based and soy bean-based milk for infants and children will now be zero-rated.
- Several drugs and over-the-counter medicines which were previously standard rated will now be zero-rated which will clearly be beneficial to many. Private healthcare costs have risen since the introduction of GST given that private healthcare centres are largely exempt from charging GST and therefore have been unable to recover their input taxes in respect of standard rated drugs/medicines. This measure will ease the burden of high private healthcare costs.
- Domestic passenger air transportation services under the 'Rural Air Services' in Sabah and Sarawak (including Labuan), will be exempt from GST.
- Companies involved in maintenance, repair and overhaul activities for the aerospace industry will be eligible to apply for the Approved Trader Scheme which allows a suspension of GST on imported goods, subject to meeting the requisite criteria. This will have a positive impact on cash-flow as the time-lag between paying GST and obtaining GST refunds has been quite long in practice, notwithstanding the 14 day and 28 day time-frames for GST refunds which the authorities have committed to (where GST returns are filed electronically and manually respectively).
- In a further move to ease cashflow issues, GST relief will be given in respect of the re-importation of:
  - goods which are temporarily exported for the purposes of promotion, research or exhibitions,
  - eligible equipment which is temporarily exported under lease arrangements overseas, e.g. equipment used in the upstream oil and gas industry.
- GST relief will also be given for approved teaching materials and equipment for parties that conduct accredited training programmes under the National Skills Development Act 2006.
- After much debate in relation to the telecommunications sector, mobile phone users who use prepaid services will receive rebates equivalent to the GST paid (which will be credited directly to their pre-paid accounts). However, this measure will only be for the 2016 calendar year.


# Others

- The present 20% stamp duty exemption on Shariah based home financing will be extended for two years to 31 December 2017.
- Likewise, the present stamp duty exemption for rescuing contractors involved in reviving abandoned housing projects and for purchasers of these houses will be extended for two years to 31 December 2017.
- Various tax administration measures have been introduced in the context of compliance penalties for both income tax as well as for GST.
- Similar to the changes in the ITA, amendments have also been made to the Real Property Gains Tax Act, 1976, and the Petroleum (Income Tax Act), 1967 to take account of GST input tax, etc.

# Taxand's Take

The 2016 Budget seeks to appease the majority of the population with tax initiatives, expense allocations targeted at the middle income and low income groups, pay rises for civil servants, additional BR1M payments and an increased minimum wage to meet the challenges of the rising cost of living. The increase in personal income tax rates for the higher income group will not be welcomed by the small minority of the population that will be impacted by this measure. Included in this group will be many senior expatriates, and comparisons will undoubtedly be drawn with neighbouring Singapore where the top tax rate is only 20% and this applies to income in excess of S$320,000. The 28% tax rate for the highest income bracket in Malaysia as well as the 28% flat rate for non-residents is relatively high and goes against the Government's previous commitment to lower tax rates in the wake of GST.

The corporate tax measures and GST measures announced are unlikely to have a significant impact on strengthening and growing the economy. Nonetheless, the additional incentives and extension of certain existing incentives such as the special RA incentive and the food production incentives will play a role in encouraging reinvestment. These measures should have some impact on spurring domestic reinvestment and growth. The time frames and extended time frames for these incentives is relatively short though, and the impact, if any, may only be felt in the short term.

GST which is expected to generate RM27 billion in revenues in 2015 has clearly been important in shielding the impact of the drop in oil revenues for the country this year. Notwithstanding the Budget proposals targeted to stimulate domestic spending, caution is to be exercised in assessing whether the projected GST revenue of RM39 billion in 2016 will be achievable given the economic climate. It is also interesting to note that of the total Budget allocation of RM267.2 billion, only RM52 billion (19%) of this is for development, while the remaining RM215.2 billion (81%) is for operational expenditure. A large portion of the operational expenditure will be to fund emoluments given the notably large civil service in Malaysia, which in turn should boost consumer spending.

However, with only 19% of the Budget allocation being channelled into development, is this sufficient to grow the economy while achieving fiscal prudence on the final leg of the Vision 2020 journey? On the administrative front, it is hoped that the authorities will act quickly to ensure that the legislative changes will be implemented smoothly and promptly to facilitate clarity and certainty in assisting taxpayers to meet their compliance obligations.

TAXAND MALAYSIA will hold its 2016 Annual Budget Seminar on Friday, 6 November 2015 at the Maya Hotel, Jalan Ampang, Kuala Lumpur. Please go to our website at **www.taxand.com.my** or contact **seminars@taxand.com.my** for details.