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MEMBER FIRM OF BAKER & MCKENZIE INTERNATIONAL

Highlights of the Malaysian Budget 2015

October 2014

The law is stated as at 10 October 2014.

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Budget 2015

The Prime Minister and Minister of Finance, YAB Dato' Sri Mohd Najib Tun Haji Abdul Razak unveiled the Malaysian Budget for the year 2015 ("**Budget**") on 10 October 2014.

The theme of the Budget is "People's Economy" and is formulated to ensure economic growth and the well-being of the *rakyat* (people of Malaysia).

The Budget focused on seven main strategies, namely strengthening economic growth, enhancing fiscal governance, developing human capital and entrepreneurship, advancing the *bumiputera* agenda, upholding the role of women, developing the National Youth Transformation Programme and prioritising the well-being of the *rakyat*.

We set out below the highlights of the Budget:

1. Income Tax

1.1. Reduction in Corporate Income Tax Rates

At present, the corporate income tax rate is 25% on the chargeable income of a company. It is proposed under the Budget that the corporate income tax rate will be reduced from 25% to 24% with effect from the year of assessment ("**YA**") 2016.

The income tax rate for small and medium enterprises ("**SMEs**") will also be reduced by 1 percentage point from 20% to 19% for chargeable income of up to RM 500,000.

1.2. Reduction in Individual Income Tax Rates

Resident individuals in Malaysia are presently taxed at a graduated rate of between 0% to 26%.

To alleviate the tax burden on individuals following the implementation of the Goods and Services Tax ("**GST**"), it is proposed that with effect from YA 2015, the income tax rate for resident individuals will be reduced by 1% to 3% depending on the chargeable tax bracket. The current maximum rate of 26% will be reduced to 24%, 24.5% and 25% effective from YA 2015. Additionally, the individual tax brackets will also be re-structured such that the chargeable income tax bracket which is subject to the maximum rate of income tax will be increased from above RM 100,000 to above RM 400,000.

1.3. Reduction in Co-operatives' Income Tax Rates

At present, the income tax rates applicable to co-operatives are between 0% to 25% on chargeable income.

In line with GST implementation and to further drive the growth of co-operatives in Malaysia, it is proposed that the co-operative income tax rates be reduced by between 1 % to 2%. Additionally, co-operatives will be allowed to take deductions in respect of secretarial fees and tax filing fees. This proposal is effective from YA 2015.

2. Goods and Services Tax ("GST")

2.1. Additional items exempted from GST

Following the introduction of the GST regime from 1 April 2015, the Prime Minister had announced in the Budget that the Government expects to collect revenues of approximately RM 23.2 billion (approximately USD 7.12 billion) in 2015 from GST.

During the Budget 2014 announcement, it was proposed that basic food items and services will not be subject to GST. In the current Budget, the scope of items which will not be subject to GST has been expanded to include the following:

(a) all types of fruits, whether local or imported;

(b) white bread and wholemeal bread;

(c) coffee powder, tea dust and cocoa powder;

(d) yellow mee, kuey teow, laksa and meehoon;

(e) the National Essential Medicine covering almost 2,900 medicine brands. These medicines are used to treat 30 types of diseases including heart failure, diabetes, hypertension, cancer and fertility treatment;

(f) reading materials such as children’s coloring books, exercise and reference books, textbooks, dictionaries and religious books; and

(g) newspapers.

It should be noted that at current time, it is unclear whether these items are not subject to GST by reason of being zero-rated supplies or exempted supplies.

3. Real Property Gains Tax ("RPGT")

3.1. Increase in sum withheld by purchaser for RPGT

Currently, in instances where the consideration paid for the disposal of real property consists wholly or partly of money, the acquirer is required retain and remit the whole of that money or a sum not exceeding 2% of the total value of consideration, whichever the lower, to the Malaysian Inland Revenue Board (“**MIRB**”) within 60 days from the date of such disposal.

It is proposed in the current draft Finance (No. 2) Bill 2014 ("**Finance Bill**"), that the retention sum to be withheld by the acquirer shall be increased from 2% to 3%, with effect from 1 January 2015.

3.2. Implementation of Self-Assessment System for RPGT

At present, gains from the disposal of property under RPGT Act 1967 are assessed formally by the MIRB. Disposers of real property are required to file a return with the MIRB within 60 days from the date of disposal of the property, and upon receipt of the return by the MIRB, an assessment will be raised on the disposer in respect of the RPGT payable.

In tandem with the move to the self-assessment system for the individual and corporate income taxes, it is proposed in the Budget that RPGT will be also be self-assessed by taxpayers with effect from YA 2016.

4. Stamp Duty

4.1. Extension of Stamp Duty Exemption for Purchase of First Residential Property

Based on the 2013 Budget announcement, a stamp duty exemption of 50% on the instrument of transfer and loan agreements for the purchase of a first residential property not exceeding RM 400,000 was granted for sale and purchase agreements executed between 1 January 2013 to 31 December 2014.

To further reduce the transaction cost of home ownership of first-time buyers and in light of the increasing price of residential properties, it is now proposed that the 50% stamp duty exemption be extended for a further term of 2 years until 31 December 2016. It is also proposed that the qualifying threshold of the residential property price for the exemption will be also increased from RM 400,000 to RM 500,000.

5. Incentives

5.1. Capital Allowance to Increase Automation in Labour Intensive Industries

To encourage automation in the manufacturing sector, capital allowance will be given for expenditure on automation in the following categories:

(a) High labour intensive industries (such as rubber products, plastics, wood, furniture and textiles): An automation capital allowance of 200% will be provided on the first RM4 million expenditure incurred within the period from 2015 to 2017; and

(b) Other industries: An automation capital allowance of 200% will be provided on the first RM2 million expenditure incurred within the period from 2015 to 2020.

5.2. Tax Incentive for Industrial Area Management

To encourage the private sector to be involved in the management, maintenance and upgrading of industrial estates in less developed areas, the Government has proposed that the following incentives be offered:

(a) 100% income tax exemption for a period of 5 years for companies which undertake the management, maintenance and upgrading of industrial estates in less developed areas; and

(b) 70% income tax exemption for a period of 5 for companies which undertake the management of industrial estates in other areas.

5.3. Tax Incentive for Establishment of Principal Hub

To further incentivise multinational companies to set up their global operational centres in Malaysia, it is proposed that customised incentives for principal hubs be introduced. Further details regarding the proposed incentives and effective dates are anticipated to be released in early 2015.

5.4. Tax Incentive for Training

Currently, employers of manufacturing companies, non-manufacturing companies and companies carrying on hotel or tour operating business who send employees for training at approved training institutions are eligible for deductions on the training expenditure incurred.

It is proposed that from YA 2015 onwards, further deductions shall be given for training expenses incurred by companies for employees to obtain industry recognised certifications and professional qualifications under training programmes being approved by agencies appointed by the Minister of Finance.

5.5. Tax incentives and Assistance for GST Implementation

To assist business with the implementation of GST, it is proposed that the following tax incentives and assistance will be offered:

(a) training grant of RM100 million provided to businesses for their employees to attend GST courses;

(b) financial assistance amounting to RM150 million provided to SMEs for the purchase of accounting software;

(c) accelerated capital allowance on purchase of information and communications technology ("**ICT**") equipment and software; and

(d) expenses incurred for training in accounting and ICT relating to GST will be given additional tax deduction.

5.6. Tax Incentives for Investment Account Platform ("IAP")

To enhance the competitiveness of IAP, a new shariah-compliant funding model aimed at facilitating the provision of funding for individual investors in Malaysian SMEs, it is proposed that an income tax exemption on the income earned by individual investors from investments made through IAP for 3 consecutive years be offered, subject to the following conditions:

(a) the investment is made for a period of 3 years starting from the operation date of the IAP;

(b) the investment activities must be in Malaysia, in Malaysian-owned venture companies or locally incorporated companies; and

(c) the tax exemption shall only be accorded for investments made in SMEs (as defined by SME Corporation Malaysia) and venture companies in any sectors.

The incentive will be effective from the operational date of IAP which is scheduled to be from 1 September 2015 to 31 August 2018.

5.7. Extension of Tax Incentive for Issuance of Sukuk

At present, a deduction is allowed on expenses incurred for the issuance of sukuk under the principles of *Mudhrabah, Musyarakah, Ijarah, Istisna', Murabahah, Bai' Bithaman Ajil* based on *Tawarruq* and *Wakalah* approved by the Securities Commission or the Labuan Financial Services Authority. The incentive is effective from YA 2003 to YA 2015.

To further promote the sukuk market at the international level, it is proposed that the deduction on the expenses incurred for the issuance of sukuk under the principles of *Ijarah* and *Wakalah* be extended for a further term of 3 years from YA 2016 to YA 2018.

5.8. Tax Incentive for Medical Tourism

Currently, companies which provide private healthcare facilities services to healthcare travelers may qualify for an income tax exemption equivalent to an investment tax allowance ("**ITA**") of 100% on qualifying capital expenditure for a period of 5 years, for applications received from 1 January 2010 to 31 December 2014.

To further stimulate the growth of the medical tourism industry in Malaysia, it is proposed that a tax exemption on income equivalent to an ITA of 100% on qualifying capital expenditure for a period of 5 years be given to new companies and existing companies engaged in expansion, modernization and refurbishment, where at least 5% of the total patients consist of healthcare travelers.

This incentive is effective for applications to be received by the Malaysian Investment Development Authority from 1 January 2015 to 31 December 2017.

6. Review of Tax System

6.1. Time Bar for Transfer Pricing Adjustments

In the current draft Finance Bill, it is proposed that the Director-General of Inland Revenue ("**DGIR**") may raise an assessment or additional assessment in consequence of a transfer pricing adjustment arising from a substitution of price, under Section 140A(3) of the Income Tax Act 1967 ("**Income Tax Act**"), within 7 years from the relevant YA. The proposal is effective upon the coming into operation of the Finance Act.

Presently, the DGIR may raise an assessment or additional assessment within a period not exceeding 5 years from the relevant YA. It is interesting to note that the time bar period for assessments was reduced from the original 6-years period to 5 years from 1 January 2014 onwards, and this current proposal to lengthen the time bar period for transfer pricing related adjustments has been mooted less than 1 year from the effective date of the last change, although the current proposal is limited to a transfer pricing adjustment.

6.2. Increased Penalties for Offences under the Income Tax Act

Currently, the maximum penalty which may be imposed upon conviction for the following offences under the Income Tax Act is RM 2,000:

(a) failure to furnish return or give notice of chargeability;

(b) persons leaving Malaysia without payment of tax; and

(c) other offences under the Income Tax Act, such as failure to comply with requirements relating to the preparation and submission of employer's returns and failure to furnish tax estimates.

Pursuant to the draft Finance Bill, it is proposed that the maximum penalty be increased from RM 2,000 to RM 20,000. This significant increase in the maximum penalty may be construed as an indication that the Government will be taking a stricter approach with regards to compliance with the requirements on the Income Tax Act moving forward.

6.3. Extension of Definition of a Company that Establishes a Special Purpose Vehicle ("SPV") for Issuance of Islamic Securities

Under the Income Tax Act, a company that establishes a special purpose vehicle ("**SPV**") solely for the issuance for Islamic securities approved by the Securities Commission ("**SC**") or Labuan Financial Services Authority ("**LFSA**") is accorded a tax transparent status (i.e., any source and income of the special purpose vehicle shall be treated as a source and income of that company).

The current draft Finance Bill proposes to amend the definition of the company referred above to include a unit trust approved by the SC as a Real Estate Investment Trust or Property Trust Fund. This proposal shall come into effect from YA 2015 onwards.

6.4. Change in Due Date for Monthly Corporate Income Tax Instalments

Currently, companies are required to make payment of the monthly tax instalments based on the tax estimates for a YA by the 10th day of the calendar month.

Pursuant to the current draft Finance Bill, it has been proposed that from 1 January 2015 onwards, the due date for the payment of the monthly instalment shall be changed to the 15th day of each calendar month.

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