Wong & Partners

MEMBER FIRM OF BAKER & MCKENZIE INTERNATIONAL

Highlights of the Malaysian Budget 2017

October 2016

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Budget 2017

On 21 October 2016, the Prime Minister and Minister of Finance, YAB Dato' Sri Mohd Najib Tun Haji Abdul Razak unveiled the Malaysian Budget for the year 2017 ("**Budget**").

The theme of the Budget is "Ensuring Unity and Economic Growth, Inclusive Prudent Spending, Wellbeing of the *Rakyat*[1]". The Budget centers around enhancing the living standards of the people, prioritising especially the wellbeing of the lower and middle income groups.

Acknowledging the current global economic uncertainties and the reduction in revenue from the oil and gas industry, the Budget emphasises the importance of enhancing the revenue collection mechanism, including the introduction of the Collection Intelligence Arrangement, an initiative to implement data-sharing between the Inland Revenue Board, Royal Malaysian Customs Department and Companies Commission of Malaysia. The Budget also focused its attention on developing certain selected sectors and businesses, with its ultimate goal of promoting start-ups and small and medium enterprises ("**SMEs**").

We set out below the highlights of the Budget:

1. Corporate Income Tax

1.1. Decrease in Corporate Income Tax Rates for SMEs

For the purposes of corporate income tax, a SME is a company with paid up capital of up to RM 2.5 million or a limited liability partnership with a total contribution of capital up to RM 2.5 million. Presently, SMEs in Malaysia are taxed at 19% on chargeable income up to RM 500,000 with the remaining chargeable income taxed at 24%.

It is proposed that with effect from the year of assessment ("**YA**") 2017, the corporate income tax rate for the chargeable income up to RM 500,000 will be reduced by 1%, from 19% to 18% to ensure that SMEs remain competitive.

1.2. Decrease in Corporate Income Tax Rates based on Percentage Increase in Chargeable Income

Currently, companies are taxed at a fixed corporate income tax rate of 24%.

It is proposed that for YAs 2017 and 2018, corporate income tax rates would be reduced based on the percentage increase in the chargeable income of a company compared to the chargeable income for the immediate preceding YA, as set out in the table below.

[1] *Rakyat* is defined as the people, in Malay.

Percentage Increase In Chargeable Income Compared To The Immediate Preceding YA	Percentage Reduction	Corporate Income Tax Rate on Additional Chargeable Income After Reduction
Less than 5%	NIL	24%
5% - 9.99%	1%	23%
10% - 14.99%	2%	22%
15% - 19.99%	3%	21%
20% and above	4%	20%

For instance, if a company's chargeable income is RM 10 million for YA 2016 and RM 12 million for YA 2017, the income tax imposed for the first RM 10 million will be 24% (i.e., the chargeable tax will be RM 2.4 million), whereas the remaining RM 2 million will be taxed at 20% (i.e., the chargeable tax will be RM 400,000). As such, the overall effective tax rate will be 23.3%.

2. Personal Income Tax

2.1. Lifestyle Tax Relief

Presently, individual taxpayers can claim tax relief for expenditure on reading materials, sports equipment, digital products and subscription of broadband internet, up to certain capped amounts allocated to the different categories of expenditure.

With effect from YA 2017, it is proposed that these tax reliefs will be combined into a new relief to be known as the "lifestyle relief", with a limit of up to RM 2,500 per year. The scope of the lifestyle relief is also expanded to include purchase of printed daily newspapers, purchase of smartphones or tablets, internet subscription and gymnasium membership fees.

3. Goods and Services Tax ("**GST**") Updates

3.1. Streamlining of GST Treatment In Free Zones

Goods and Services Act 2014 ("**GST Act**") is applicable to free zones which include the Free Commercial Zone ("**FCZ**") and Free Industrial Zone ("**FIZ**") established under the Free Zones Act 1990. Presently, special treatment is provided under the GST Act where GST is not imposed on imported goods into FCZ for the following purposes:

(a) commercial activities; or

(b) retail trade activities approved under the Free Zones Act 1990.

GST is, however, imposed on goods imported into a FCZ if it is to be consumed within the zone. GST is also levied on goods imported into FIZs, on the supply or removal of goods made within FIZs , between FIZs and between FIZs and FCZs.

For the purposes of streamlining the GST treatment in the free zones consisting of FIZs and FCZs, it is proposed that with effect from 1 January 2017, the GST treatment should be determined based on the following:

(a) GST is not chargeable on the supply and removal of goods made within and between FCZs;

(b) GST shall not be due and payable on goods imported into FIZs;

(c) GST is not chargeable on the supply and removal of goods made within and between FIZs;

(d) GST is not chargeable on the supply of goods made within FCZs and FIZs;

(e) GST is not chargeable on the removal of goods from a FCZ to a FIZ and vice versa;

(f) GST is suspended on the removal of goods from free zones to Designated Areas (i.e. Langkawi, Labuan, Tioman) and vice versa; and

(g) GST is suspended on the removal of goods from free zones to an approved warehouse under the Warehousing Scheme and vice versa.

The above GST treatment shall not be applicable on the supplies listed below:

(a) goods as prescribed under the Free Zones (Exemption of Goods and Services) Order 1998;

(b) goods and services as prescribed under the Goods and Services Tax (Imposition of Tax for Supplies in Respect of Designated Areas) Order 2014; and

(c) any other goods prescribed by the Minister of Finance.

3.2. Streamlining of GST Treatment Under The Warehousing Scheme

Currently, the Warehousing Scheme under the GST Act allows GST to be suspended on goods imported and deposited into an approved warehouse. Approved warehouses under this scheme include Public Bonded Warehouse, Private Bonded Warehouse, Duty Free Shops and Inland Clearance Depot. Under this scheme, imported goods deposited into the warehouse and supplied within and between these warehouses are not subject to GST whereas removal of goods from the warehouses is subject to the imposition of GST.

Goods from the Principal Custom Area ("**PCA**") and Free Industrial Zone ("**FIZ**"), deposited into and supplied within the warehouses are not entitled for the facility provided under the Warehousing Scheme. Such supplies of goods made within and between the warehouses are subject to GST.

To streamline the GST treatment between imported goods and goods from PCA and to facilitate GST administration under the Warehousing Scheme, it is proposed that with effect from 1 January 2017, no GST shall be charged on goods from PCA (which consists of the Licensed Manufacturing Warehouse, Excise

Warehouse and FIZs) that are deposited into and supplied within and between warehouses under the Warehousing Scheme.

4. Tax Incentives

4.1. Extension of Income Tax Incentive for New Four and Five Star Hotels

Presently, income tax incentives are granted to hotel operators who undertake investments in new 4 and 5 star hotels. The incentives are as shown in the table below:

Incentives	Peninsular Malaysia	East Malaysia
Pioneer Status Incentive; or	An exemption of 70% of statutory income for a period of 5 years	An exemption of 100% of statutory income for a period of 5 years
Investment Tax Allowance	An allowance of 60% on the qualifying capital expenditure incurred within a period of 5 years. This allowance can be set-off against up to 70% of statutory income for each YA	An allowance of 100% on the qualifying capital expenditure incurred within a period of 5 years. This allowance can be set-off against up to 100% of statutory income for each YA

These incentives may only be granted for applications received by the Malaysian Investment Development Authority ("**MIDA**") by 31 December 2016.

In the Malaysian Government's efforts to promote tourism in Malaysia, it is proposed that the application period for Pioneer Status and Investment Tax Allowance for any investments in new four or five star hotels in both Peninsular and East Malaysia be extended for another two (2) years from 1 January 2017 to 31 December 2018.

4.2. Extension of Tax Incentive for Anchor Companies Under the Vendor Development Programme

At present, anchor companies that develop local vendors under the Vendor Development Programme (VDP) and who have signed the Memorandum of Understanding ("**MOU**") with the Ministry of International Trade and Industry ("**MITI**"), are entitled to double deduction for the following operating expenses:

(a) costs of product development, R&D, innovation and quality improvement;

(b) costs of obtaining ISO/ Kaizen/ 5s certifications, evaluation programme and business process reengineering for the purpose of increasing vendor capabilities; and

(c) costs of vendor skills training, capacity building, lean management system and financial management system.

The double deductions are subject to the following conditions:

(a) the qualifying operating expenses must be certified by MITI before the anchor companies claim the deduction;

(b) the qualifying operating expenses shall be capped at RM 300,000 per year; and

(c) the deduction is only given for three (3) YAs.

The incentive is offered to anchor companies that have signed the MOU with MITI from 1 January 2014 to 31 December 2016.

To further encourage the development of competitive local vendors by anchor companies, it is proposed that the current incentives be extended for another 4 years. This incentive will be granted to anchor companies that have signed the MOU with MITI from 1 January 2017 to 31 December 2020.

4.3. Extension of the Period and Expansion of the Scope of Double Deduction Incentive for the Structured Internship Programme ("**SIP**")

Currently, companies that participate in the SIP approved by TalentCorp are eligible for double deduction on expenses incurred in implementing the programme. SIP is made available for Malaysian students pursuing full-time degree and diploma courses in institutions of higher learning that are registered with the Ministry of Higher Education or for equivalent vocational level (Malaysian Skills Certificate Level 4 and 5) as recognised by Malaysian Qualifications Agency or Department of Skills Development for the following:

(a) students pursuing a Degree: from YA 2012 until YA 2016; and

(b) students pursuing a Diploma and Vocational level: from YA 2015 until YA 2016.

To encourage companies to participate in SIP and to increase employability of local graduates through gaining working experience at an early stage, the current incentive is extended for a period of three (3) years. The SIP will also be expanded to include Malaysian students pursuing full-time vocational level (Malaysian Skills Certificate Level 3). This incentive will be effective from YAs 2017 to 2019.

4.4. Expansion of Scope of Halal Products Eligible For Incentives for Halal Industry Players

Halal Industry Players operating in Halal Parks promoted by the Halal Development Corporation ("**HDC**") currently receive the following tax incentives:

(a) full income tax exemption on qualifying capital expenditure for a period of 10 years; or income tax exemption on increase of export sales for a period of five years;

(b) import duty exemption on raw materials used for the development and production of promoted halal products; and

(c) double deduction on expenses incurred in obtaining international quality standards certification, Sanitation Standard Operating Procedures and compliance with regulations for the purposes of exporting the products, such as Food and Traceability from farm to fork.

The qualifying halal produces include specialty processed food, pharmaceuticals, cosmetic and personal care, livestock and meat products and halal ingredients.

To further enhance the competitiveness of Malaysia's halal industry, it is proposed that existing incentives be extended to include production of nutraceutical and probiotic products by the Halal Industry Players in Halal Parks. These incentives will take effect for applications received by HDC from 22 October 2016 onwards.

5. Islamic Banking Incentives

5.1. Extension of Income Tax and Stamp Duty Exemption for Islamic Banking and Takaful Businesses

Currently, the International Currency Business Unit which operates Islamic banking and takaful activities transacted in foreign currencies are given:

(a) full tax exemption on income received by Islamic banks licensed under the Islamic Financial Services Act 2013 and financial institutions licensed under the Financial Services Act 2013 operating Islamic banking business transacted in foreign currencies including transactions with Malaysian residents;

(b) full tax exemption on income received by takaful companies and takaful unit licensed under the Islamic Financial Services Act 2013 and Financial Services Act 2013 operating takaful business transacted in foreign currencies including transactions with Malaysian residents; and

(c) full stamp duty exemptions on instruments executed pertaining to Islamic banking and takaful activities transacted in foreign currencies.

The exemptions in (a) and (b) are only available till YA 2016, while the exemption in (c) expires on 31 December 2016.

To further promote the Islamic financial markets, it is proposed that the three (3) exemptions outlined above be extended for another four years, i.e., with respect to (a) and (b), for YAs 2017 to 2020, and with respect to (c), until 31 December 2020 .

6. Stamp Duties on Real Property Purchases

6.1. Extension of Stamp Duty Exemption for the Purchase of First Residential Home

Under the Stamp Duty (Remission) Order 2014, 50% of the stamp duty chargeable on instruments of transfer and loan agreements for the purchase of first residential homes worth less than RM 500,000 is remitted, where (i) the sale and purchase agreement is executed from 1 January 2015 to 31 December 2016 and (ii) the individual has never owned any residential property including a residential property which is obtained by way of inheritance or gift, held either individually or jointly .

To reduce the costs of ownership for first-time home owners, it is proposed that the stamp duty exemption for purchases of first residential homes be increased to the following rates:

Price of property purchased	Stamp Duty Exemption	Effective Date
Less than RM 300,000	100% stamp duty exemption on the instrument of transfer and loan agreement	For sales and purchase agreement executed from 1 January 2017 to 31 December 2018
Exceeding RM 300,000 to RM 500,000	100% stamp duty exemption on the instrument of transfer and loan agreement, on the first RM 300,000 of the value of the residential home. The remaining balance of the value of the home is subject to the prevailing stamp duty rates.	

6.2. Increase of Rate of Stamp Duty for Properties Exceeding RM 1 million

Currently, under Item 32 of the First Schedule of the Malaysian Stamp Act, *ad valorem* stamp duty is payable on an instrument of transfer of property on the consideration or market value of the property transferred, whichever is greater. Stamp duty payable is chargeable at an *ad valorem* rate of:

(a) 1% for the first RM 100,000;

(b) 2% from RM 100,001 to RM 500,000; and

(c) 3% on any amount in excess of RM 500,000.

It is proposed that effective from 1 January 2018, the rate of stamp duty on instruments of transfer of real estate worth more than RM 1 million will be increased from 3% to 4%. This increase would likely be imposed on the amount in excess of RM 500,000 of the market value or consideration of the property, whichever the higher.

7. Establishment of the Collection Intelligence Arrangement ("**CIA**")

The Malaysian Government has announced that it will establish the CIA under the Ministry of Finance, which will comprise the Inland Revenue Board, the Royal Malaysian Customs Department and Companies Commission of Malaysia. These bodies will share data amongst each other to enhance efficiency in tax enforcement, collection and compliance. This is a clear indication to taxpayers that there will be a structured mechanism for the relevant authorities to share data and also may indicate an increase in tax, GST and customs audits for companies.

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