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INSIGHTS

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2017 MALAYSIAN BUDGET HIGHLIGHTS

The 2017 Budget was announced on Friday 21 October 2016 against the background of a challenging economic environment. The Budget theme of **"Ensuring Unity and Economic Growth, Inclusive Prudent Spending, Well-being of the Rakyat"** although largely similar to recent Budget themes, is nonetheless ambitious given the current economic climate in the country and external factors. In the weeks leading up to the Budget proposals, we witnessed the usual lobbying for tax incentives to stimulate growth for various sectors. We also heard this year the call from some Government sectors to maintain budget allocations amidst fears that budget allocations would be further cut. As always, speculation was rife, with rumours circling around the possible reintroduction of estate duty, widening of capital gains tax and increased personal tax rates.

Given the Government's need to maintain revenues in view of the impact of reduced petroleum-based revenue, there has been a flurry of tax audit and investigation activity from the Inland Revenue Board (IRB) this year, and we can expect the same from the Royal Malaysian Customs Department. To encourage taxpayers to come forward and voluntarily disclose under-reported taxes from prior years, the IRB has offered an amnesty this year which expires on 15 December 2016. The amnesty essentially involves a waiver or reduction of penalties for voluntary disclosure of under-reported taxes in prior years. The introduction of Goods and Services Tax (GST) in 2015 has also been critical in plugging the deficit from petroleum taxes/revenue. Nonetheless, tax revenue must continue to grow in order to achieve a balanced Budget by 2020. Clearly, this must be coupled with measures to stimulate growth and to manage expenditure effectively with minimum leakages. Have the 2017 Budget proposals been crafted to set the nation in the right direction to achieve this?

The Government has projected a 3% fiscal deficit for 2017, a reduction from the 3.1% deficit expected for this year. Government revenue for 2017 is projected to be RM219.7 billion while the operating expenditure is RM214.8 billion and development expenditure is RM46 billion. The growth rate is projected to be between 4-5% in 2017 compared to 4-4.5% this year.

The following is a summary of the **key tax measures** announced in the 2017 Budget:

Corporate Tax

Tax Rate

- Recognising the economic challenges faced by companies, a reduced corporate tax rate is proposed for companies, Limited Liability Partnerships (LLPs) and other persons (such as a trust body, executor of an estate of an individual who was domiciled outside Malaysia at the time of his death and a receiver appointed by the Court) who successfully increase their taxable income in the years of assessment (YA) 2017 and 2018. The reduction in the corporate tax rate is based on the percentage of increase in a company's chargeable income ("CI") as follows:

Increased percentage of CI compared with immediately preceding year	Reduction in tax rate	Income tax rate after reduction
5% - 9.99%	1	23%
10% - 14.99%	2	22%
15% - 19.99%	3	21%
20% and above	4	20%

Example:			
YA	CI	Increased % of CI	Tax rate
2016	10,000,000	-	24%
2017	12,000,000	20%	20%
2018	13,000,000	8.3%	23%

The reduced tax rates in the above example will apply to RM2,000,000 in YA 2017 and RM1,000,000 in YA 2018.

- The corporate tax rate of 19% on the first RM500,000 of CI for small and medium enterprises (SMEs) and LLPs has been further reduced from 19% to 18%, from the year of assessment 2017. SMEs and LLPs refer to those with paid-up capital (or total contribution of capital for LLPs) of up to RM2.5 million.

Payments to Non-Residents for Technical and Other Services

- In a move to widen the tax base, payments to non-residents falling under Section 4A of the Income Tax Act, 1967 (ITA) will be subject to withholding tax regardless of where the services are performed and will no longer be confined only to services performed in Malaysia. Section 4A currently covers income of a non-resident from services performed in Malaysia (with the exception of routine day-to-day administrative services between a parent and branch/subsidiary) as well as rental or other payments made to a non-resident for the use of movable property. This change will be costly for Malaysian businesses which engage the services of foreign parties as typically, the foreign parties require the Malaysian entity procuring such services to bear the withholding tax cost. The tax authorities also take the view that where the Malaysian entity bears the withholding tax, this tax cost is not a deductible expense. This change will therefore result in significant additional costs for Malaysian businesses which engage the services of foreign parties.

Royalty

- The definition of the term 'royalty' has been significantly expanded to cover payments for:
  - the use of, or right to use, software
  - the receipt of, or the right to receive, visual images or sounds transmitted to the public by satellite or cable, fibre optic or similar technology
  - the use of, or the right to use, visual images and/or sound in connection with broadcasting by satellite or cable, fibre optic or similar technology
  - the use of, or the right to use, some or all of licensed radio frequency spectrums
  - the total or partial forbearance in respect of the use of, or rights covered by the royalty definition.

The change with regard to payments for the use of software sets an end to the long-held argument that such payments are not for the use of copyright, but are for the use of a copyrighted article and hence should not be viewed as royalties. In this regard, although the change in the royalty definition potentially results in additional tax revenues (via withholding tax on payments for software to non-residents), where tax treaty definitions of royalties are narrower, the treaty definitions will prevail. The other changes outlined above will primarily have an impact on businesses involved in the digital transmission of television programmes, films, music, games, etc.

Public entertainer

- The definition of the term 'public entertainer' has been widened and now includes the following persons:
  - "a compere, model, circus performer, lecturer, speaker, sportsperson, an artiste or individual exercising any profession, vocation or employment of similar nature; or
  - an individual who uses his intellectual, artistic, musical, personal or physical skill or character, in

carrying out any activity in connection with any purpose through live, print, electronic, satellite, cable, fibre optic or other medium, for film or tape, or for television or broadcast".

It is interesting to note that lecturers and speakers now fall under the category of public entertainers for the purposes of withholding tax under Section 109A of the ITA.

Tax deductions

- The current deduction of RM500,000 for sponsoring approved local and foreign arts, cultural and heritage activities will be increased to RM700,000 within which the current deduction limit of RM200,000 for sponsoring approved foreign activities (which take place in Malaysia) will be increased to RM300,000 from the YA 2017.

- Double deductions are currently given to companies for costs incurred in implementing structured internship programmes (SIPs) for students pursuing full-time degree and diploma courses. The double deduction which was to have expired in YA 2016, has now been extended to YA 2019. It has also been expanded to include Malaysian students pursuing full-time vocational level certification.

- At present, the law clearly provides that expenses incurred in relation to single tier dividends are to be disregarded in arriving at adjusted income. An amendment has now been introduced to disregard any deductions in relation to single tier dividend income in arriving at chargeable income. This gives rise to the question as to whether adjusted losses, donations, zakat payments, etc. need to be attributed to single tier dividend income and thereafter disregarded in computing chargeable income.

Incentives

Islamic Finance

- The tax incentives for International Currency Business Units which operate Islamic banking and takaful business activities in foreign currencies which were due to expire in YA 2016 have been extended to YA 2020 to enable Malaysia to maintain its competitive edge in the sphere of Islamic finance.

Tourism

- Given the importance of tourism to the nation, the time-line for the application for the current tax incentives (involving pioneer status or investment tax allowance) for 4 and 5 star hotels has been extended from 31 December 2016 to 31 December 2018. The applications for incentives are to be submitted to the Malaysian Investment Development Authority.

Halal Industry

- Currently, incentives are available to halal industry players operating in Halal Parks (promoted by the Halal Development Corporation) who produce speciality processed food, pharmaceuticals, cosmetics and personal care items, livestock, meat products and halal ingredients. Recognising the potential for growth in this industry, the Budget proposals have extended the qualifying halal products to include the production of nutraceutical and probiotic products.

Vendor Development Programme

- An extension of the time-line for application for tax incentives for anchor companies under the vendor development programme has been given for a further 4 years. Such anchor companies will need to sign memoranda of understanding with the Ministry of International Trade and Industry before 31 December 2020.

Personal Tax

- The current tax reliefs for the following will be merged into a single 'lifestyle relief' of up to RM2,500:
  - RM1,000 relief for purchase of reading materials

- RM300 relief for purchase of sports equipment
- RM3,000 for purchase of a personal computer (claimable once in 3 years)

The RM2,500 'lifestyle relief' will also cover the purchase of newspapers, smartphones/tablets, internet subscriptions and gym membership fees.

- Two new reliefs have been introduced to assist young families:
  - Relief of up to RM1,000 will be given once in 2 years for the purchase of breastfeeding equipment for women taxpayers with children aged up to 2 years
  - Relief of up to RM1,000 will be given to a parent who enrols his/her child in registered child care centres or kindergartens.

Stamp Duty

- To encourage home ownership, the current 50% stamp duty exemption for first-time home buyers which was due to expire on 31 December 2016 will be enhanced and extended. A 100% stamp duty exemption will now be given on the purchase of a first home costing not more than RM300,000. For houses priced between RM300,000 and RM500,000, the stamp duty exemption will still be given but only in respect of the value of RM300,000. For houses costing more than RM500,000, there will not be any stamp duty exemption. This exemption will be available for sale and purchase and housing loan agreements entered into between 1 January 2017 and 31 December 2018.

- On the other hand, there will be an increase in the rate of stamp duty on instruments for the transfer of real property worth more than RM1 million. The rate will increase from 3% to 4% with effect from 1 January 2018.

Goods & Services Tax (GST)

- Businesses are required to register for GST when their turnover threshold hits RM500,000. In determining this threshold, income arising from the supply of capital assets of the business which was previously excluded will now fall within the RM500,000 threshold, unless the capital assets are supplied or transferred as a result of the cessation of a business. However, supplies made within or between the free zones will now be excluded in determining the threshold.

- It is proposed that the GST treatment for free commercial zones and free industrial zones, which will now be collectively referred to as Free Zones, will be streamlined as follows:
  - GST will not be charged on the supply and removal of goods made within and between Free Zones
  - GST will not be due on goods imported into a Free Zone except for goods imported to be used or consumed in the Free Zone
  - GST will be suspended on the removal of goods from Free Zones to Designated Areas (i.e. Langkawi, Labuan and Tioman) and vice versa, and on the removal of goods from a free zone to an approved warehouse under the Warehousing Scheme, and vice versa.

- The rules for the Warehousing Scheme have been amended such that GST is suspended on imports into a 'warehouse' and disregarded on the supply of goods between 'warehouses'.

- The supply of land by a developer and landowner to the Government / Local Authority for the purposes of providing public amenities and public utilities will not be treated as a supply for GST purposes.

- The granting of GST relief for the supply of approved equipment for the disabled has been simplified and the list of approved equipment has been extended. Essentially, relief will be given directly to 'OKU cardholders' (i.e. persons with registered disabilities) by the Social Welfare Department's designated suppliers.

Tax Administration

- Several administrative measures have been introduced, including changes to facilitate the amendment of tax returns in certain circumstances which were not previously provided for in the law.

- An interesting proposal is the setting up of a Collection Intelligence Arrangement under the Ministry of Finance. It involves the IRB, Royal Malaysian Customs Department and the Companies Commission of Malaysia who will share data to enhance efficiency in tax collection and compliance. This, it is hoped, will also enable these agencies to tackle the taxation of the informal economy which, if done effectively, can lead to enhanced tax revenue collection.

Taxand's Take

From a tax perspective, we note that several of the Budget tax proposals serve to widen the tax base, without introducing any new taxes as such. Clearly, these proposals are intended to plug the revenue gap. The impact of some of these proposals result in additional costs to businesses. With increased costs and reduced subsidies, the key question as to whether the proposals adequately address the economic challenges faced by businesses as well as by households, particularly the lower income groups, is debatable. As we move forward to face the challenges of 2017, it is also incumbent upon the Government to ensure that the 2017 Budget allocations are appropriately and prudently utilised for the benefit of the nation as a whole.

TAXAND MALAYSIA will hold its Seminar on the 2017 Budget Outlook and Challenges on Wednesday, 2 November 2016 at the Mahkota 3 Ballroom, Hotel Istana, Jalan Raja Chulan, Kuala Lumpur. Please go to our website at **www.taxand.com.my** or contact **seminars@taxand.com.my** for details.