Possible tax measures to strengthen fiscal position

By DAVID LAI

BUDGET 2023 laid the groundwork for the principles of Madani, focusing on sustainability, prosperity, innovation, trust, and compassion.

Budget 2024 continued this focus with an emphasis on good governance, economic reforms, and raising living standards. Budget 2025, themed "Ekonomi Madani: Negara Makmur, Rakyat Sejahtera," is expected to build upon these principles.

However, there is increasing pressure on the government to strengthen Malaysia's fiscal sustainability.

This article explores the current issues and possible tax measures to be unveiled in Budget 2025 on Oct 18, 2024.

Strengthening revenue collection

One of the most significant impacts of Budget 2024 is the implementation of e-invoicing starting Aug 1, 2024. The Inland Revenue Board (IRB) has introduced e-invoicing rules intended to limit tax deductions to allowable expenses evidenced by valid documentation and provide the IRB with real-time information on revenue generated from business transactions.

This initiative aims to bring transactions from the shadow economy, estimated to be approximately 21% of gross domestic product or RM330bil, into the formal economy.

In Budget 2025, we can expect further tightening of provisions in the Income Tax Act 1967 and an increase in tax compliance procedures and scope of penalties to enhance the effectiveness of e-invoicing and encourage its adoption. These amendments could significantly boost revenue collection through improved tax compliance and reduced revenue leakages.

Widening tax base

In the re-tabled Budget 2023, the Prime Minister stated that it was not the right time to reintroduce the goods and services tax (GST) due to affordability concerns of the rakyat. Instead, a capital gains tax (CGT) was introduced at 10% on gains from the disposal of unlisted shares, and the Service Tax rate was increased from 6% to 8% in Budget 2024.

A key consideration for the government in Budget 2025 is whether it is timely to further widen the scope of CGT and Service Tax.

For CGT, the exclusion of individual disposers and the limitation to unlisted shares were intended to minimise any negative impact on the Malaysian stock market and maintain Malaysia's attractiveness for investments.

Although the Malaysian stock market and investment climate may have improved in the first half of 2024, any widening of CGT should be carefully analysed to avoid adverse effects on capital markets, given the regional competition for investment.

For the Service Tax, any further expansion would result in undesirable effects of cascading and inflation inherent in the system.

While the Prime Minister previously expressed that it was not the right time to implement GST due to affordability concerns, it may also not be the right time to expand CGT or Service Tax in Budget 2025, considering the ongoing efforts to enhance the attractiveness of the Malaysian capital markets and investment climate.

Environmental tax

Environmental tax has not been frequently discussed by the government, but it may be a feasible option to widen the tax base.

If implemented correctly, environmental tax could result in a win-win situation.

International investors are increasingly prioritising environmental, social and governance or ESG factors in their investment decisions, and tax revenue could be generated from taxes on carbon emissions, plastic waste, etc, to promote sustainable practices. Furthermore, like in many other developed jurisdictions, the additional tax revenue generated from environmental tax could be recycled to provide incentives in the form of tax credits or rebates to encourage other green practices.

Run-up to

Greater transparency and clarity in the country's long-term tax direction would increase attractiveness to investors.

Streamlining of incentives

Malaysia offers a wide range of tax incentives to attract foreign and domestic investments in selected industries.

These incentives may include tax exemptions, reduced tax rates, additional allowances on capital expenditure, additional deductions for expenses, and indirect tax exemptions.

The list of promoted activities and products under the Promotion of Investments Act 1986 (PIA) was last revised in 2012.

Given the significant advancements in technology and changes in opportunities for economic growth since then, a thorough review of the industries and types of value-added activities that Malaysia intends to attract seems long overdue.

This review should be carried out holistically to simplify the incentives offered under the PIA and Income Tax Act 1967.

Incentives must be offered only to desired activities that have high value add and high growth potential, which would directly translate to multinationals relocating to Malaysia, as well as investments in Malaysia by domestic enterprises which may otherwise be invested overseas.

Tax revenue could be saved from streamlining the above, as activities previously eligible for tax incentives may no longer fall within the above criteria.

A shift from tax incentives to tax rebates or credits may be more attractive to taxpayers who need to comply with the 15% global minimum tax effective Jan 1, 2025.

Profiling Malaysia as a services hub

Remote working in the region has become more popular since the pandemic. Many multinationals are also reassessing the location of their services functions to optimise efficiency.

Malaysia may capitalise on this growing trend by profiling itself as a preferred location in the region for a global services hub.

Inherent advantages in Malaysia include a ready pool of graduates, excellent infrastructure, and lower costs compared with many neighbouring countries.

The government may consider promoting value-added global services by offering lower corporate and individual tax rates of 15%.

The types of value-added global services which would involve skilled manpower may include accounting, legal, engineering, information technology, education and other Business Process Outsourcing or BPO services.

Conclusion

A key focus of Budget 2025 should be to strengthen Malaysia's fiscal position through clear, long-term tax policies aligned with global standards. We anticipate more tax proposals aimed at making Malaysia a more attractive destination for investment and business, particularly in high value-added services.

This shift should lead to higher income jobs and increased tax revenue over time.

Malaysia is not yet able to risk deterring potential investors with rapid tax increases and uncertain long-term tax policies.

Any planned tax increases or significant tax policy changes should ideally be announced 12 to 24 months in advance to provide ample notice.

Greater transparency and clarity in the country's long-term tax direction would increase attractiveness to investors and should therefore be a priority for Budget 2025.

Replacing legacy incentives with more targeted, outcome-based incentives will better position Malaysia to attract high-income activities, ensuring a more sustainable flow of tax revenue.

Additionally, introducing an environmental tax at this time could be well-received, especially if it aligns with ESG principles and the global demand for green practices.

David Lai is executive director and head of tax advisory, BDO Tax Services Sdn Bhd. He is also a member of The Malaysian Institute of Certified Public Accountants. The views expressed here are the writer's own.