

2012 MALAYSIAN BUDGET HIGHLIGHTS

The Budget proposals for 2012 were tabled on 7 October 2011 by the Prime Minister who is also the Minister of Finance. The budget strategy focussed on addressing some key issues playing on the minds of Government policy makers. These include:

- ❖ Accelerating investment
- ❖ Enhancing human capital excellence through creativity and innovation
- ❖ Changing the rural social and economic landscape
- ❖ Strengthening the civil service
- ❖ Dampening inflation with particular focus on its impact on the lower income group

The Prime Minister, unlike his counterparts in many of the developed economies, was in the enviable position to deliver the Budget in expectation of the Malaysian economy continuing on its growth path. This is despite increasingly challenging global economic conditions in the latter part of 2011 and which is expected to remain so in 2012. Growth will be driven by domestic activities with increased domestic consumption and public and private investments.

This is in part the result of an uptake in the inflow of Foreign Direct Investment (FDI). A mildly expansionary policy stance initiated in the previous years in the form of a Special Stimulus Package through the Private Finance Initiatives (PFI) is expected to result in higher disposable income and greater employment opportunities. Income per capita is expected to increase from RM 28,725 to RM 30,856.

On the negative side, inflationary trends in the form of rising food and fuel prices continue to be a concern to policy makers, and this has resulted in the implementation of the Goods & Services Tax (GST) being further delayed.

The economy is expected to grow between 5% to 5.5% in 2011, and the anticipation is for an overall growth rate of between 5% to 6% in 2012. The fiscal deficit is expected to improve to 4.7% of Gross Domestic Product from the 2011 position of 5.4%. A total of RM232.8 billion is allocated for the 2012 operating and development expenditure. Of this amount, 78% (RM181.6 billion) is for operating expenditure and the rest on development expenditure. Total Government revenue is expected to increase marginally to RM186.9 billion in 2012. This leaves a current account surplus of RM5.3 billion but an overall deficit of just over RM43 billion.

Uncertainties with the US economy, and the EU economies exacerbated by serious concerns over the problems faced by the Eurozone, will continue to weaken the external environment with consequential challenges to the Malaysian economy. Trade and investment

opportunities will remain dependent on the regional economies rather than the traditional partners. Higher prices in the food, transport and utilities sectors will likely persist in view of such external factors. In this context, the projected 2012 growth rate appears optimistic. With these issues in mind, we now turn our focus to the key tax measures contained in the 2012 Budget announcements and our evaluation of the Budget itself.

- ❖ The 2012 Budget's fiscal thrust is tax neutral in many respects – no new taxes are introduced and neither were there any substantive increases in tax rates in light of the policy commitment to reduce the fiscal deficit. There is a lack of a concrete tax rationalisation framework involving a review of the corporate tax, personal tax, tax concessions and the impending GST, so as to build a solid tax base for the future.
- ❖ There was no significant claw-back of tax incentives or re-alignment of tax reliefs other than a minor tinkering with the shipping tax exemption and the reinvestment allowance.
- ❖ The increase in total Government revenue of 1.9% to RM186.9 billion will be mainly from the economic expansionary effects of the Government Economic Transformation Plan (ETP) initiatives announced and instituted about a year ago, and this is expected to contribute positively towards the Government coffers by way of additional tax revenues. In addition, there will be greater reliance on the tax authorities carrying out more tax audits and enforcement and compliance-enhancing initiatives.
- ❖ It is noteworthy that the Government, notwithstanding a marginal expected increase in revenue, has undertaken to deliver a lower fiscal deficit of 4.7% in 2012. It would appear that the thrust of such achievement is underpinned by the slew of PFI projects to be implemented. Some of these projects are already underway and many public projects will be implemented in due course.
- ❖ The services sector is expected to remain the key driver of growth and the further liberalisation of the services sector (including the professional sub-sectors) is a positive move.
- ❖ The social aspect of Government spending is another feature of this budget. It includes a slew of measures intended to benefit the less privileged and excluded segments of Malaysian society.

Corporate Tax

As a consequence of the 2012 Budget strategies outlined earlier, the tax proposals in the Budget announcements and the Finance (No. 2) Bill 2011 were limited. Of some significance are the following:

- ❖ Shipping companies have been enjoying tax exemption on income for a considerable length of time under the provisions of Section 54A of the Income Tax Act. This 100 % income tax exemption has been curtailed by limiting the exemption to 70%, in addition to introducing additional rules on treatment of losses and determination of income. This move is seen as a rationalisation of the tax incentive to bring it in line with most other activities and sectors.
- ❖ A number of amendments have been proposed to tighten the rules for granting the

reinvestment allowance on capital expenditure for expansion, modernisation, diversification and automation projects.

- ❖ Multinational corporations that locate their Treasury Management Centre (TMC) in Malaysia will be given 70% tax exemption on income from qualifying treasury services rendered to its related companies for a period of 5 years. In addition, interest payments made to non-resident banks and related companies would also be free from withholding tax. Incentives are also accorded to expatriates working in TMC's. This measure seeks to develop Malaysia as a competitive financial centre in the region.
- ❖ New investments in 4 and 5 star hotels in Peninsular Malaysia will be given tax incentives in line with what is currently offered in Sabah and Sarawak.
- ❖ Incentives were announced for the Kuala Lumpur International Financial District which would provide the platform to attract foreign and local players.
- ❖ Tax deduction is granted for expenses incurred in the issuance of Islamic securities based on *Wakalah* principles and the exemption period on income from trading in non-ringgit *sukuk* (bonds) has been extended.
- ❖ Extension of withholding tax rates on distributions from real estate investment trusts to 2016 as well as extension of tax incentives for hybrid and electric cars to 2013.
- ❖ 70% tax holiday for industrial design services as well as double deductions for companies that implement structured internship programmes, award scholarships and participate in overseas career fairs as part of steps to enhance the human capital needs of the nation.
- ❖ In an effort to further encourage the involvement of the private sector in providing education services and facilities, some fairly generous tax incentives have been proposed for profit-oriented private schools and international schools. In addition, tax deductions are to be granted to contributors who donate to national schools as well as to religious institutions.
- ❖ Employers will need to bear higher contributions (from 12% to 13%) to the Employees Provident Fund on the salaries of employees earning monthly remuneration of RM5,000 and below.
- ❖ Compensation for late refund of income tax is finally here subject to certain conditions, the time limit for tax audits will be lowered from 6 years to 5 years and pre-filing of tax returns will commence soon.

Personal Tax

- ❖ Individual owners of budget taxis and hire cars are to benefit from tax incentives and subsidies. Besides assisting such individuals, the measures are also seen as a boost for local car manufacturers.
- ❖ To aid the ageing population and to benefit the financial services sector, tax reliefs have been proposed for individuals contributing to the private retirement scheme.

Stamp Duty

- ❖ Stamp duty waivers have been granted to loan agreements executed by micro, small and medium enterprises. In addition, full exemption is also given on loan agreements for purchase of residential properties costing up to RM300,000 under specific schemes for the middle income group.

Real Property Gains Tax

- ❖ The Malaysian property market is experiencing a period of sharp increases in prices and a fair amount of speculative activities. The Budget proposes to revise the current tax rate on gains on disposals of real property by increasing the tax rate for disposals made within 2 years of acquisition from the current 5% to 10%. Disposals between 2 and 5 years of acquisition will be taxed at 5%, and disposals after 5 years will continue to be free of tax. It is left to be seen whether these measures will have any immediate or lasting impact. It was expected that the tax rates would revert to the earlier scale rates of 30% to 5% but the Government chose a cautious approach.

Conclusion

The 2012 Budget proposals are not specifically aimed at any one sector. Broadly, the 2012 Budget is a wide-ranging one in terms of the various sectors and components that were touched on and is basically seen as a people-friendly Budget. The particular positive aspect of the 2012 Budget proposals is that the projection of the country's economic growth is not dependent on trade with the traditional western economies. As a major export-driven economy, this is heartening in light of the serious problems faced by these economies. The many spending measures on social programmes have not made it necessary for the Government to abandon its commitment to reducing its deficit. This is laudable particularly when it is able to achieve this without raising taxes. It reflects the underlying strength of the Malaysian economy and its responsiveness to change, given the right policy measures. What is critical is that the various projects come to fruition as planned and achieve the desired results in terms of the impact on the economy. The Government's real challenge lies in the implementation of its policies and the manner in which the Budget allocations are spent to ensure that the budget deficit continues to decline without impacting the overall economic growth.

