2010 MALAYSIAN BUDGET HIGHLIGHTS

The Budget proposals for 2010 were tabled in Parliament on 23 October 2009 by the Prime Minister, with a clear emphasis that the Budget would form "the foundation for the development of the new economic model" to steer Malaysia to becoming a more advanced economy premised on "innovation, creativity and high-value added activities". Several measures have already been introduced in this vein, such as the 1Malaysia concept, National Key Result Areas (NKRAs), Key Performance Indicators for the civil service, the liberalisation of the services sector, etc. The Budget strategies focus on the following:

- Driving the Nation towards a High-Income Economy;
- Ensuring Holistic and Sustainable Development, and
- Focusing on the Well-being of the Rakyat

The Government hopes to achieve the above based on an allocation of RM191.5 billion, of which 72.2% is intended for operating expenditure and 27.8% for development expenditure. Federal Government revenues are estimated to decline in 2010 to RM148.4 billion from RM162.1 billion in 2009, and the deficit of 7.4% of Gross Domestic Product (GDP) in 2009 is expected to improve to 5.6% in 2010. The focus on reducing the budget deficit is clearly a strategy in the right direction, but poses a significant challenge for the Government, particularly with the expected reduction in revenue in 2010. The allocation for operating expenditure will have to be closely monitored to ensure that money is well-spent. To this end, taxpayers would expect transparency, efficiency and productivity on the part of the Government. The continued focus on the private sector and foreign investment to spearhead growth is a move that is necessary for progression to an advanced economy.

As expected, there were no significant corporate tax measures, but the much discussed Goods and Services Tax (GST) remains an uncertainty pending the Government's review of the social impact of the implementation of GST. Clearly, the introduction of GST would impose some hardship on a large segment of the 'rakyat' who are not currently taxpayers in view of their income brackets. On the flip side however, a well-thought out GST which provides the appropriate exemptions and zero-rated supplies and services, would be the answer to the Government's much needed source of revenue.

The Real Property Gains Tax (RPGT) proposals concerning a 5% flat rate RPGT have caused some confusion as the proposed changes to the RPGT Act, 1976 as provided in Finance (No.2) Bill 2009 suggest the previous scale rates of RPGT would continue to apply with the lowest rate now being 5%. The changes to the Petroleum Income Tax Act, 1967 (PITA) streamlines the basis of assessment of tax for the upstream oil and gas sector with that under the Income Tax Act, 1967 (ITA). On the personal tax front, the reduction in the personal tax rates while small, is nonetheless welcomed. We set out below the tax highlights of the 2010 Budget.

Corporate Tax & Incentives

Health Tourism

The current incentive granting a 50% tax exemption on the statutory income of healthcare service providers in respect of the value of increased exports will be increased to 100% (subject to 70% of statutory income). This enhanced incentive will apply to the provision of healthcare services to foreign clients for the years of assessment 2010 to 2014. Health tourism is an area of growth which the Government is rightly seeking to expand and capitalise on.

Small and Medium Enterprises (SMEs)

In the hope of encouraging innovation and developing a more advanced economy, a deduction will be given to SMEs in respect of costs incurred in relation to the registration of patents and trademarks in Malaysia. While this is welcomed, it is unfortunate that companies which fall out of the prescribed definitions of SMEs who would arguably be in the forefront of such developments will not get relief for such costs.

'Green' Incentives

Further to the launch of the Green Building Index (GBI) in May this year, incentives will now be given to owners/buyers of buildings with GBI certificates. An owner of a building who incurs capital expenditure to obtain a GBI certificate will be granted an allowance equal to 100% of the capital expenditure incurred which may be offset against 100% of its statutory income. Buyers of buildings and residential properties which have GBI certificates will be entitled to stamp duty exemptions in respect of the additional costs incurred to obtain the GBI certificate. It is unclear at this stage as to how the mechanics of this exemption will operate, but this will presumably require the developers to indicate the additional costs incurred to obtain the GBI certificates. These incentives will apply in relation to costs incurred/buildings purchased between 24 October 2009 to 31 December 2014.

Incentives for Forest Plantations, Consolidation of the Management of Smallholdings and Idle Land and Strategic Knowledge Intensive Activities

To ensure that companies currently entitled to the incentives in respect of the above activities seek to utilise the incentives, a time-frame of up to 31 December 2011 has been imposed for the submission of applications for these incentives

Islamic Financial Sector

The Islamic financial sector continues to enjoy incentives to further stimulate the growth of this sector in line with the Malaysia International Islamic Financial Centre (MIFC) initiative. To this end, the time frame for several of the existing incentives has been extended to 31 December 2015, including the stamp duty exemption on approved Islamic financial instruments, the deduction for the costs of issuance of approved Islamic securities, the double deduction for expenses incurred in promoting Malaysia as an MIFC, the deduction for pre-commencement expenditure incurred in relation to the costs of establishing an Islamic stock-broking firm, etc. The time-frame extension also applies to the repatriation of profits from newly established overseas branches and subsidiaries of banking institutions and this incentive will also be expanded to insurance and Takaful companies. Further, the current exemption from tax on interest or discounts paid to individuals, unit trusts and closed-end funds in respect of debentures approved by the SC, is also extended to profits from Islamic securities approved by the SC.

The Budget proposals in relation to Islamic financing seek to encompass Labuan to some extent. The tax treatment for Special Purpose Vehicles (SPVs) established under the Companies Act, 1965 for the purpose of issuing approved Islamic securities has been extended to SPVs established under the Offshore Companies Act, 1990 which elect to be taxed under the ITA, effective from the year of assessment 2010. The tax treatment accorded to such SPVs essentially involves these entities being construed as 'see through' entities for tax purposes whereby the company establishing the SPV is taxed on the income of the SPV and is entitled to a deduction for expenses incurred by the SPV. In a further move to encourage the use of Labuan, the tax exemption currently granted on the profits from the issuance of non-Ringgit sukuk approved by the SC will now be extended to non-Ringgit sukuk approved by the Labuan Offshore Financial Services Authority (LOFSA) from the year of assessment 2010. Additionally, the deduction for the costs of issuance of Islamic securities approved by the SC will also be extended to such securities approved by LOFSA.

Personal Tax

Reduction in Tax Rate

The top rate of tax of 27% for individuals has been reduced to 26% for chargeable income in excess of RM100,000. (A corresponding reduction in tax rates has also been announced for co-operative societies)

Reliefs

- Personal relief for individuals has been increased from RM8,000 to RM9,000 resulting in a maximum tax saving of RM260 for taxpayers in the top bracket.
- Relief will be granted for up to RM500 per year in respect of broadband subscription fees for the years of assessment 2010 to 2012
- An additional relief of RM1,000 will be granted in respect of any payment of a premium for deferred annuity contracted on or after 1 January 2010, subject to a RM7,000 cap on the deduction for the aggregate of the deferred annuity premium, EPF and life insurance premiums.

Knowledge Workers in Iskandar Malaysia

Approved Malaysian and foreign 'knowledge workers' in Iskandar Malaysia (in Johor) will be entitled to be taxed at a reduced tax rate of 15%. Such individuals will not therefore be subject to the normal personal tax scale rates of taxation. Such 'knowledge workers' will be required to work in qualifying sectors which are the drivers of Iskandar Malaysia, including healthcare services, educational services, creative industries, financial advisory and consulting services, green technology, biotechnology etc. It is interesting to note that the proposed amendment to the Finance Bill to allow for the 15% tax rate does not refer to Iskandar Malaysia only and instead refers to 'specified areas'. It is therefore plausible that the reduced tax rates may be extended to apply to knowledge workers in the other designated 'corridors', in the future.

Tax Administration

A few administration changes have been introduced, such as the amendment to Section 83 of the ITA with regard to employers' filing obligations in relation to Forms E and EA, thereby removing the need for annual gazette orders in this regard, as well as the tightening up of some penalty provisions.

Real Property Gains Tax (RPGT)

The RPGT exemption granted with effect from 1 April 2007 is over from 1 January 2010 and a few changes have been proposed to the RPGT Act. As mentioned above, based on the Finance (No.2) Bill 2009, the proposed changes to the RPGT Act, 1976 appear to result in a harsher RPGT regime than we previously had. Previously, gains from the disposal of real property by individuals were subject to scale rates depending on the period of ownership, and after a 5 year ownership period, such gains were not taxable. The Bill indicates that the existing scale rates will continue to apply and that disposals from the fifth year will now be subject to RPGT at 5%. However, the Second Minister of Finance has since indicated that the intention of the proposals is merely to introduce a 5% flat rate of RPGT regardless of the period of ownership, and that this change will be enacted via a separate gazette order which is expected to take effect from 1 January 2010. It is hoped that this important issue will be clarified with some certainty in the next few days. Further, the collection mechanism for RPGT will include the requirement for the acquirer to withhold and pay 2% of the sales consideration to the IRB. There may well be instances where 2% of the sales consideration may exceed the tax payable on the gain. In such situations, the time-frame within which the IRB refunds the difference will obviously be of significance to taxpayers.

Additionally, it is noted that the proposed amendments to the RPGT Act provide that there will no longer be any relief for interest costs in respect of borrowings used to finance the acquisition of such investment properties. (Previously, such costs were allowed provided the costs were not deductible for income tax purposes). However, the relief for losses arising from the disposal of real property has been simplified and the exemptions for one principal private residence, and transfers between spouses, etc. remain.

Effectively, the resurfacing of RPGT will only have a real impact on serious property investors, but the changes (which require some clarification) are unlikely to discourage investment in property, given that Malaysia's property prices are amongst the most competitive in the region. RPGT is therefore unlikely to dampen the recovery of the property sector and will contribute a source of much needed revenue to the Government, albeit a small amount.

Petroleum Income Tax

Changes have been proposed to the PITA to tax profits from the upstream oil and gas sector on a self-assessment and current year basis, rather than on a preceding year basis. As a result, players in this sector will experience some cash-flow difficulties in settling two years taxes (i.e. for the financial years 2009 and 2010) in the year of assessment 2010. To alleviate these difficulties, a five year instalment plan will be given for the settlement of taxes in respect of the financial year 2009.

Indirect Tax

The only proposal with respect to indirect tax relates to the imposition of a service tax on credit cards and charge cards effective from 1 January 2010. In a move that is unlikely to be popular with banks and financial institutions which regularly offer 'free credit cards', principal cards will be subject to service tax of RM50, and supplementary cards will be subject to service tax of RM25.

Conclusion

The above provides a snap-shot of the key tax proposals arising in the 2010 Budget. From a tax perspective alone, the Budget proposals are not particularly exciting, but the broader Budget strategies and allocations are the key drivers towards the foundation of the 10th Malaysia Plan and towards the move to a more advanced economy. The focus on developing human capital, stimulating the agricultural sector, the eradication of poverty, enhancing the tourism and services sectors, and Islamic financial sector, awareness of environmental issues, innovation and the inclusive approach to development are all positive steps. 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.