2011 MALAYSIAN BUDGET HIGHLIGHTS

The Budget proposals for 2011 were tabled in Parliament on 15 October 2010 by the Prime Minister. The theme of the 2011 Budget, in line with the New Economic Model (NEM) launched earlier this year, is *"Transformation Towards a Developed and High-Income Nation"*. The Budget is intended in the words of the Prime Minister to lay *"the foundation for Malaysia to become an advanced economy"*. To this end, the four key strategies are as follows:

1) Reinvigorating private investment;
2) Intensifying human capital development;
3) Enhancing the quality of life of citizens; and
4) Strengthening public service delivery

While the proposals and allocations in relation to the strategies relating to human capital development, improving the quality of life of citizens and strengthening the delivery of public service are commendable (provided these are implemented efficiently and effectively), the question that arises for the private sector, is whether the Budgetary measures are sufficient to reinvigorate private investment, given the declining foreign direct investment figures and the fact that the Government will be relying on the "private sector to resume its role as the engine of growth".

In light of the on-going debate amongst the major economies whether to cut spending in order to reign in large budget deficits or to continue to spend more to push for full economic recovery, the policy stance in this Budget is middle-of-the-road. There will be no significant reduction in the deficit which is expected to decline by only 0.2% of Gross Domestic Product (GDP) from 5.6% in 2010 to 5.4% in 2011. This will be on the back of a commendable 6% growth forecast for 2011given the dampened global economic trend.

Growth will be driven by infrastructure investments on projects outlined in the Tenth Malaysia Plan which will commence in 2011. However the government expects the private sector to shoulder the bulk of such investments. Private investment is estimated to expand 12.5% in 2011 to RM 86 billion, ultimately financing 92% of all the 12 National Key Economic Areas (NKEA) projects, when these come on stream. This explains why of the total Budget allocation of RM212 billion, approximately 77% (RM162.8 billion) will be for operating expenditure and only RM49.2 billion will be for development expenditure.

The arguably limited 23% allocation for development expenditure clearly shows that the Government will be relying heavily on private investment. Is there enough in the 2011 Budget to attract private investment? Typically, tax measures offer a catalyst for private investment, and in this context, the Government has announced that a special incentive package will be given for the development of the Kuala Lumpur International Financial District (KLIFD). It is expected that those involved in other large public-private partnership projects and entry point projects will also be able to negotiate tax incentives on a case by case basis, but aside from this, the 2011 Budget is largely tax neutral exhibiting the tight fiscal constraints under which the Government is operating.

We set out below the key **tax** proposals arising from the 2011 Budget

Corporate Tax

The corporate tax rate remains unchanged much to the disappointment of businesses. However, several minor corporate tax measures were introduced including the following:

- To boost the Islamic financial sector:

  - the deductibility of costs incurred in relation to the issuance of certain Islamic securities has been widened to include Islamic securities issued under the principles of *Murabahah* and *Bai Bithaman Ajil* based on the principle of *Tawarruq*.
  - double deductions which are currently given in respect of insurance premiums paid for export credit will also be given for export credit based on the *takaful* concept.

- To address environmental concerns, the existing incentives for the generation of energy from renewable sources and for the conservation of energy will be extended for a further 5 years to 31 December 2015, and the current tax exemption on income derived from the sale of Certified Emission Reductions will be extended for another 2 years till the year of assessment 2012. Lastly, the 50% excise duty exemption given to franchise holders of hybrid cars has been enhanced to allow for a 100% duty exemption and has been extended to include electric cars, and hybrid and electric motorcycles.

- The existing incentives for food production projects have also been extended for a further 5 years to 31 December 2015.

- The investment allowance for last mile broadband service providers has been extended for a further two years to 2012

- A change has been proposed to the Income Tax Act, 1967 in relation to the Reinvestment allowance incentive which now clearly restricts companies from claiming the reinvestment allowance and pioneer incentive in the same basis period (financial year) albeit in relation to different products. This change appears to plug a loop-hole which taxpayers have sought to take advantage of, and which the tax authorities have consistently challenged. A recent High Court decision in favour of a taxpayer is likely to have initiated this change in the law.

Personal Tax

There are few changes of significance to the personal tax regime. Nonetheless, the following should be noted:

- The existing RM6,000 relief for life insurance premiums and contributions to the Employees Provident Fund (EPF) will be extended to include contributions to private pension funds (PPFs) for both employees and the self-employed. The reality is that a significant portion of employees who would potentially have the capacity to contribute to PPFs are likely to already fully utilise the RM6,000 relief in respect of their EPF and life insurance contributions. While the self-employed may find this proposal beneficial, the widening of the RM6,000 relief is unlikely to give private pension funds the boost that is needed to kick-start these funds and revitalise the capital markets as announced by the Prime Minister.

- The scope of the existing RM5,000 relief for medical costs incurre d for parents has been widened to include the costs of day-care facilities or carers and other costs in relation to special needs for ageing parents.

Indirect Tax

Although the much debated Goods and Services Tax (GST) is unlikely to materialise in the near future, the following is interesting:

- Instead of introducing GST, the Government has decided to increase the rate of service tax from the existing rate of 5% to 6%. Additionally, the scope of service tax has also been extended to include paid television broadcasting services.

- There are also several measures to reduce indirect taxes, including abolishing import duties on 300 consumer items to promote Malaysia as a tourist destination, the exemption of sales tax on all mobile phones, an extension of the current import duty and sales tax exemption on broadband equipment to 2012, increasing the current exemption of excise duties on national cars purchased by the disabled from 50% to 100%, etc.

- In line with the extension of the 'green' tax incentives referred to above (i.e. renewable energy projects, energy conservation, etc.), existing import duty and sales tax exemptions available for such projects will be extended to 31 December 2012

Stamp Duty

To encourage home ownership, a 50% stamp duty exemption will be given in respect of the first time acquisition of homes costing not more than RM350,000 as well on loan agreements in relation to the purchase of such homes

Conclusion

The above summarises the key tax measures announced in the 2011 Budget. These are not bold measures and are unlikely to create a material impact to encourage private investment and Foreign Direct Investment. The introduction of GST with a corresponding reduction in corporate tax rates would have been a bold measure which would have created a sustainable source of revenue to the Government as well as given businesses an impetus to invest. However, while tax incentives are important, the reality is that tax measures will only be drivers when it is clear that private sector investment will generate the desired returns. The business environment, the absence of red-tape and bureaucracy, transparency, a sound legal framework, the availability of quality human capital are all essential to attract private investment. These coupled with bold tax measures would stimulate the country on its path to becoming an advanced economy. We have ten years to go and a lot to achieve within this relatively short period of time.