Highlights of the Malaysian Budget 2011

November 2010

Private & Confidential

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Budget 2011

The Prime Minister and Minister of Finance YAB Dato' Sri Mohd. Najib Tun Abdul Razak unveiled the Malaysian Budget for the year 2011 ("**Budget**") on October 15, 2010.

The theme of the Budget is "Transformation Towards A Developed And High-Income Nation" and is viewed as a pre-cursor in the Government's final efforts towards achieving Vision 2020.

The four main strategies focused in the Budget are namely, reinvigorating private investment, intensifying human capital development, enhancing quality of life of the *rakyat* and strengthening public service delivery.

We set out below the highlights of the Budget:

1. Income Tax

1.1 Withholding Tax

The Finance Bill (No.2) of 2010 seeks to increase the scope of the withholding tax obligations by imposing additional tax penalties for incorrect tax returns submitted by a taxpayer.

In the event a taxpayer fails to deduct and remit the relevant withholding tax in accordance with Section 107A, 109, 109B and 109F of the Income Tax Act 1967, but makes a deduction for such payment that is subject to such tax in a return, the Director General of the Inland Revenue Board ("**Director General**") may impose a penalty under Section 113(2) of the Income Tax Act 1967 for incorrect returns even when the withholding tax together with the penalties for late payment of the withholding tax has subsequently been paid to the Director General. The penalty under Section 113(2) may amount to 100% of the tax undercharged in the absence of a prosecution being instituted by the Director General. In the event of a prosecution, the penalty on conviction is a fine of not less than RM1000 and not more than RM10,000 and a penalty of 200% of the tax undercharged.
This proposal is effective from 1 January 2011.

1.2 Tax Treatment of Bonds

The Finance Bill No. 2 of 2010 introduces a new Section 34C(1A) to the Income Tax Act 1967 to provide that in a case where discount from the issuance of bond is incurred as an expense to the company and the expenses could not be given in full to the source of that discount, such expenses may be deducted from the gross income of that company from any source consisting of a business. However, the proceeds from the issuance of such bond must be used wholly for the production of gross income from the source consisting of a business and the bond is not the stock in trade of such company.

This proposal is effective from 1 January 2011.

1.3. Tax Treatment of Distributions by Unit Trust

The Finance Bill No. 2 of 2010 makes amendments to Sections 60F, 60H and 63B of the Income Tax Act 1967 by stipulating that income from unit trust which includes Real Estate Investment Trust must be taken as part of the gross income of an investment holding company, closed-end fund company or unit trust in determining the expenses to be allowed in a basis period for a year of assessment in accordance with the formula in those sections.

This proposal is effective from 1 January 2011.

1.4. Double Taxation Agreements ("DTA") Update

1.4.1 New DTA's

Malaysia has extended its tax treaty network with the signing of double tax agreements (DTAs) with a few countries:

No.	Treaty Countries	Withholding Tax Rate for Interest	Withholding Tax Rate for Royalty	Withholding Tax Rate for Technical Fees
1.	Malaysia-Brunei (with effect from 1 January 2011)	10%	10%	10%
2.	Malaysia-Kazakhstan (with effect from 1 January 2011)	10%	10%	10%

1.4.2 Gazetted DTA's

The DTA entered into between Malaysia and the following countries have been gazetted and entered into force:

No.	Treaty Countries	Withholding Tax Rate for Interest	Withholding Tax Rate for Royalty	Withholding Tax Rate for Technical Fees
1.	Malaysia-Germany (gazetted on 10 June 2010)	10%	7%	7%
2.	Malaysia-San Marino (gazetted on 2 September 2010)	10%	10%	10%
3.	Malaysia-Senegal (gazetted on 25 May 2010)	10%	10%	10%
4.	Malaysia-Indonesia (gazetted on 1 September 2010)	10%	10%	10%
5.	Malaysia-Turkmenistan (gazetted on 1 January 2010)	10%	10%	0%

1.4.3 Amending Protocols

The DTA between Malaysia and Belgium was gazetted on 24 May 2010.

The new withholding tax rates are:

Interest	Royalty	Technical Fees
10%	7%	7%

1.4.4 Gazetted Exchange of Information Protocols

Malaysia's commitment in implementing the internationally agreed tax standards on transparency and exchange of information is evidenced in these Protocols.

The countries where Malaysia has signed the Protocols with are Australia, France, Ireland, Japan, Kuwait, Netherlands, Seychelles, Turkey and United Kingdom, Brunei, Belgium, Senegal, Laos, Bahrain and San Marino.

Further, as part of Malaysia's commitment to the international community, the Finance Bill (No.2) of 2010 introduces an enabling provision to allow the Inland Revenue Board to exchange information with other countries, where there are no tax treaties in place.

Section 132A allows the Government of Malaysia to enter into an arrangement with the government of any territory outside Malaysia for the purpose of exchange of information relevant to tax matters. However, this arrangement can only be made if there is no Double Taxation Agreement between Malaysia and the other country in force.

In the case where a DTA exists, the provisions of the DTA on EOI will apply.

2. Indirect Taxes

2.1 Abolishment of Import Duty on Tourism Products and Daily Used Product

In order to promote the tourism industry in Malaysia, the Government has announced that import duty imposed on tourism will be abolished. This proposal will result in the abolishment of duty imposed on circa 300 items, among others, such as handbags, apparel, jewellery and daily use products which are currently subject to an import duty of 5% to 30%. There are no changes to tourism products and daily use products which are subject to an import duty of more than 30%. This abolishment is effective from 4.00pm on October 15, 2010.

2.2 Review of Service Tax Rate

Currently, service tax is imposed in Malaysia on any taxable person who carries on a business of providing taxable services. The administration and operation of service tax is governed primarily by the Service Tax Act 1975.

The Government has proposed that the current rate of 5% service tax be increased to 6%, across the board on all taxable services. It is also proposed that service tax be imposed on all paid television and broadcasting services. The proposal for the increase in the rate of service tax to 6% as well as the imposition of service tax on paid television and broadcasting services is expected to come into effect on 1 January 2011.

With the increase in the rate of service tax, it appears that the implementation of the Goods and Service Tax concept in Malaysia will be postponed indefinitely.

2.3 Exemption of Sales Tax on Mobile Phones

Currently, mobile phones in Malaysia are subject to a sales tax of 10% while personal digital assistants, commonly known as PDA's, with global system mobile are exempted from sales tax. Under the Budget 2011, it is proposed that the tax treatment on PDA with GSM and ordinary mobile phones be harmonised. To this end, mobile phones are exempted from sales tax effective from 4.00pm on October 15, 2010.

3. Stamp Duty

3.1 Stamp Duty Amendment Bill 2010

The Stamp Duty Amendment Bill 2010 ("**SDAB**") was recently passed by Parliament.

Briefly, the SDAB seeks to:

(a) enable the transfer of non-standard properties to be expedited from the previous processing time of ten days, to the new processing time of two days as well as to fortify the enforcement of unpaid duties;

(b) introduce a new mechanism which allows for the payment of duty in advance for an instrument of transfer upon application of the payer to the Malaysian Stamp Office in order to expedite the stamping process; and

(c) fortify the enforcement against unpaid stamp duties by introducing new offences and heightened penalties.

The SPAB is currently pending gazette and is expected to come into force by early 2011.

3.2 Partial Stamp Duty Exemptions on Loan Agreements and Instruments of Transfer for The Purchase of First Residential Property

Under the Budget 2011, it has been proposed that stamp duty exemption of 50% be given on loan agreements and a stamp duty exemption of 50% be given on instruments of transfer for a residential property priced not exceeding RM350,000.

The exemption is granted on the first residential property purchased by a Malaysian citizen and eligible to be claimed once only within the exemption period. The MOF interprets the term "first residential property," to mean the first and sole property in the taxpayer's name upon disposal. This refers to a situation whereby an individual does not own any other residential property (or does not own a part of a residential property in the case of joint ownership) in his/her name at the time he/she applies for the 50% stamp duty exemption for residential property priced not exceeding RM350,000. The eligible residential property is limited to a terrace house, condominium, apartment or flat.

The proposal will be effective for sales and purchase agreements executed from 1 January 2011 to 31 December 2012.

4. Incentives

4.1 Tax Incentive for the Issuance of Islamic Securities

In line with the Government's intention to encourage innovation and to promote transactions in *Bursa Suq al-Sila*, it has been proposed that the expenses incurred in the issuance of Islamic securities under the principles of *Murabahah* and *Bai' Bithaman Ajil* based on tawarruq be given deduction for the purpose of income tax computation. It should be noted that the issuance of such sukuk must first be approved by the Securities Commission or the Labuan Financial Services Authority.

The effective date will be commencing from YA 2011 until YA 2015.

4.2 Extension on Stamp Duty Exemption on Instruments used in Islamic financing

To further encourage the development of Islamic financial sector, it is proposed that 20% stamp duty exemption is given on instrument used in Islamic financing for a "3-year" period. The 20% exemption is subject to the condition that the Islamic financial product has obtained prior approval from Bank Negara Malaysia, Syariah Advisory Council or alternatively, the Securities Commission, Syariah Advisory Council.

This exemption is extended until YA 2015.

4.3 Double deduction incentive on expenses incurred in the promotion of Malaysia as an International Islamic Financial Centre

Currently expenses incurred in the promotion of Malaysia as an International Islamic Financial Centre are given a double deduction incentive. This incentive is extended until YA 2015.

4.4 Tax Incentive on Export Credit Insurance Premium Based on Takaful Concept

Currently, double tax deductions are given on payment of conventional insurance premium for export credit to companies approved by the MOF with effect from YA 1986.

From YA 2011, payments of insurance premium for export credit based on t*akaful* concept will be given double tax deduction, so long as the insurance premium is purchased from *takaful* operators that are approved by the MOF.

4.5 Extension of Application Period for Tax Incentives for the Generation of Energy from Renewable Sources

Presently, companies generating energy from renewable sources are entitled to various forms of tax incentives, among others, pioneer status, investment tax allowance and import duty-sales tax exemption on equipment used to generate energy from renewable sources. Pursuant to the Budget 2011, it has been proposed that the current tax incentive application period be extended.

4.6 Extension of Application Period for Tax Incentives for Energy Conservation

Similar to the foregoing it has been proposed under the Budget 2011 that the application period for the current tax incentives offered for energy conservation be extended.

4.7 Extension of Tax Incentives Period for Reduction of Greenhouse Gas Emission

Presently, income received from the sale of Certified Emission Reductions from Clean Development Mechanism projects approved by the Ministry of Natural Resources and Environment is granted a tax exemption from YA 2008 up to YA 2010.

This proposal will commence from YA 2011 and the exemption period is extended to YA 2012.

4.8 Extension and Enhancement of Tax Incentive Application Period Hybrid Cars

Presently, franchise holders of CBU hybrid cars are given 100% import duty and 50% excise duty exemption on new CBU hybrid cars for applications submitted to the MOF from 30 August 2008 to 31 December 2010.

The proposal is to give full tax exemptions on import duty and excise duty of new CBU hybrid cars for applications received by the MOF from 1 January 2011 until 31 December 2011. This incentive is extended to electric cars as well as hybrid and electric motorcycles.

4.9 Extension of Tax Incentives Application Period for Food Production

Incentives that are presently granted to companies which invest and to companies with subsidiaries which are engaged in the food production will be extended for a further five years till 31 December 2015, commencing from 1 January 2011.

4.10 Extension of Application Period for Tax Incentive for Last Mile Network Facilities Provider for Broadband Iskandar Malaysia

Presently, companies investing in last mile broadband infrastructure are given the following tax incentives for application received until 31 December 2010.

It has been proposed for the application period to be extended to 31 December 2012.