

Tax Reforms

**THE WAY FORWARD FOR
THE MALAYSIAN TAX SYSTEM**



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FOREWORD



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President of MICPA

Tax is simply defined as the Government's source of income administered through a tax system that imposes compulsory financial charges on taxpayers in order to fund various public expenditure. A tax system on the other hand, is defined as a set of taxes in force in a country at a given time, and ideally, a good tax system should strike a balance between the interests of taxpayers and the Government, duly supported with, and guided by the presence of some characteristics on which a solid foundation should be built.

The Malaysian tax system has to-date seen some progress, albeit not at the desired speed nor completeness in certain areas of tax reform. The shift from the Official Assessment System to the Self-Assessment System in the year 2000 has brought along several notable spinoff effects in particular with various facilities accorded to taxpayers via the use of technology.

Over the years, most of the changes to the tax provisions announced during the Budget were merely the tweaking of tax provisions which were not necessarily impactful. There were occasions where the tweaking was major, but carried with it a negative impact, albeit unintended. A clear example which led to a negative repercussion was the new definition of 'plant' (on which a tax deduction by way of capital allowances is available for businesses) as announced in the 2021 Budget.

It is now timely that the Government introduces a structured approach in reforming the Malaysian tax system which yields the desired outcome palatable to most taxpayers including foreign direct investors that are looking for suitable business bases in the region.

It is on this note that the Institute together with Deloitte is pleased to release this report on *Tax Reforms – The Way Forward for the Malaysian Tax System* to provide our proposals on the areas of tax reform for the Malaysian tax system, duly calibrated to business needs, the country's current economic situation, and suited for roll-out in stages as we move out of the COVID-19 pandemic.

FOREWORD

Heraclitus, the Greek philosopher said “change is the only constant in life”. While there were deliberations in instituting broad reforms to the nation’s tax regime, major policy changes have yet to be seen. This is understandable as any major change to our tax system may have profound implications to the businesses and the man on the street and hence ought to be intricately weighed. Political dynamics also form part of the equation.

Should a broad-based consumption tax such as GST be re-introduced to widen Malaysia’s tax base? Should wealth tax or capital gains tax be introduced to mitigate poverty and income inequality? These are difficult questions to address as the benefits derived from the introduction of new taxes will not be equally enjoyed by everyone whereas some will be placed in a disadvantaged position.

Indeed, there will never be a “right time” to introduce game-changing tax reforms. However, as the saying goes “when the going gets tough, the tough get going”, As Malaysia gears up for full economic and fiscal recovery following the unprecedented COVID-19 pandemic, envisioned by the recently announced 12th Malaysia Plan, it calls for bold moves from the Government to take a long-term strategic position in its tax reform pursuits so as to create a conducive environment for businesses to thrive and to have the prosperity derived shared by all Malaysians under the ‘Malaysian Family’ concept mooted by the Prime Minister Datuk Seri Ismail Sabri Yaakob.

Last but not least, the impending introduction of BEPS 2.0, especially Pillar Two, commonly known as the Global Minimum Tax proposal, in a way, provides an opportunity for Malaysia to re-assess its non-tax factors and strive harder with a view to ensuring that Malaysia remains a favoured destination for investments.



Mr Yee Wing Peng
Country Managing Partner,
Deloitte Malaysia



EXECUTIVE SUMMARY



This report discusses certain areas that Malaysia may consider in reforming its existing tax system with a view to achieving its goal as a high income and developed economy. The reform is more critical than ever due to the on-going COVID-19 pandemic that has disrupted the economic activities of the nation and the prolonged fighting of pandemic has increased the Government spending considerably.

To fund rising operating and capital expenditure, the Government needs to increase tax revenue. Our tax system should be easy to understand and not onerous to comply. Greater transparency and accountability of public spending would undoubtedly promote taxpayers' compliance to tax laws.

The open economy has been contributing its fair share of taxes but not the hidden economy which is estimated at 18% of GDP for 2019. Vigorous actions need to be taken to put the hidden economy to the tax net.



The following aspects are discussed in this report:

- (a) Streamlining of tax incentives to optimise economic returns arising from the tax benefits granted to targeted economic activities at designated locations.
- (b) Broadening the tax base by comprehensively considering various taxes including GST, CGT and wealth tax.
- (c) Enhancement of the individual income tax framework to promote greater inclusivity and equality in wealth distribution.
- (d) Introduction of environmental tax such as carbon tax and green tax to address key environmental, social and governance (ESG) challenges such as climate change.
- (e) Tax reforms measures undertaken by selected countries.

It is hoped that this report will provide some valuable input for the consideration of the relevant authorities as they embark on tax reform to enhance the competitiveness of the nation's business environment.

INTRODUCTION

AN OVERVIEW OF THE MALAYSIAN TAX SYSTEM

Income of a person accruing in or derived from Malaysia is chargeable to income tax. Foreign-source income is exempt. However, a resident company carrying on a business in the banking, insurance, air transport, or shipping sectors will be taxed on foreign source income. Hence, income tax in Malaysia is territorial except for the specifically mentioned sectors.

Residence

A company carrying on a business is resident in Malaysia if its management and control is exercised in Malaysia. A body of persons such as a trade association is resident in Malaysia if the management and control of its affairs is exercised in Malaysia. On the other hand, resident status of an individual is determined by reference to the number of days an individual is present in Malaysia. Generally, individuals are considered a tax resident if they are present in Malaysia for 182 days or more in a calendar year. Alternatively, residence may be established by physical presence in Malaysia for a mere day if it can be linked to a period of residence of at least 182 consecutive days in an adjoining year.

Losses

Losses may be carried forward for seven consecutive YAs (except where there is a substantial change in corporate ownership of a dormant company). The carryback of losses is not permitted.

Foreign tax relief

Foreign tax paid may be credited against Malaysian tax on the same profits (limited to 50% of foreign tax in the absence of a tax treaty), but the credit is limited to the amount of Malaysian tax payable, if any, applicable on the foreign income.

Labuan company

A Labuan company carrying on a Labuan business activity that is a Labuan trading activity is taxed at 3% of the audited accounting profit, provided it fulfills the substance requirements specified in the relevant legislation. Otherwise, the tax rate of 24% will apply.

Income and rates

The company's income tax rate is 24% in general, while the rate for resident small and medium-sized companies (i.e., companies resident and incorporated in Malaysia with paid-up capital of RM2.5 million or less, that are not part of a group containing a company exceeding this capitalisation threshold, and that have gross income from business sources of no more than RM 50 million for the Year of Assessment (YA) is 17% on the first RM 600,000, with the balance being taxed at the 24% rate. Income tax rate on a resident individual is on a progressive basis where the rate is 0% on chargeable income not exceeding RM 5,000 and 30% on chargeable income exceeding RM 2 million. A non-resident individual will be subject to tax at 30% on his income.

Single tier

All companies in Malaysia are required to adopt the Single-tier System (STS). Dividends paid by companies under the STS are not taxable on the shareholders.



INTRODUCTION

• Capital gains •

Capital gains are not taxed in Malaysia, except for gains derived from the disposal of chargeable assets (i.e. real property or on the sale of shares in a real property company). Currently, companies as well as individuals will be subject to Real Property Gains Tax (RPGT) upon the disposal of chargeable assets at the rates ranging from 5% to 30% depending on the holding period of each chargeable asset. In general, a citizen or a permanent resident may elect to claim an exemption for capital gains on the disposal of one residential property during a lifetime.

Disposal	RPGT rate		
	Companies / Trustee ¹ / Society ²	Individuals (Malaysia citizen or permanent resident)	Individuals ³ , Executor of estate of deceased person ³ and Companies ³
Within 3 years	30%	30%	30%
In the 4th year	20%	20%	30%
In the 5th year	15%	15%	30%
In the 6th and subsequent years	10%	5%	10%

¹ - Companies incorporated in Malaysia or a trustee of a trust

² - Society registered under the Societies Act 1966 (w.e.f. 1 January 2021)

³ - Non-citizens, non-permanent residents, and companies not incorporated in Malaysia

• Incentives •

A wide range of incentives are available for certain industries, such as manufacturing, hotels, healthcare services, information technology services, biotechnology, Islamic finance, venture capital, tourism, energy conservation, and environmental protection. Incentives include tax holidays of up to 10 years Pioneer Status (PS); Investment Tax Allowances (ITAs) (i.e., a 60% to 100% allowance on capital investments made up to 10 years); Accelerated Capital Allowances (ACAs); double deductions; and Reinvestment Allowances (RAs) (i.e., a 60% allowance on capital investments made in connection with qualifying projects).

• Basis period •

The basis period (tax year) is the fiscal year (generally the accounting year) for a company, limited liability partnership, trust body or a co-operative society. For other taxpayers, the basis period is the calendar year.

• Returns, instalments and surrender of losses •

Each company is required to file a separate tax return. However, subject to certain conditions under the group relief incentive, 70% of a company's adjusted loss may be used to offset profits of a related entity. The losses that may be surrendered generally are limited to those that relate to the first three YAs following a company's first 12-month fiscal year of operations.

Malaysia operates a self-assessment regime. Advance corporate tax (estimated tax) is payable in 12 monthly instalments. A tax return must be filed within seven months of the company's financial year end, with the balance of tax payable, if any, after offsetting monthly instalments, due at the same time. Tax on employment income is withheld by the employer under a pay-as-you-earn (PAYE) scheme and remitted to the IRB. An individual deriving employment income or business income must file a tax return and settle any balance owed by 30 April or 30 June, respectively, in the following calendar year.

• Penalties •

Penalties may apply for failure to comply with the tax law such as late filing of returns, incorrect information furnished in the returns and non-payment of instalments.

INTRODUCTION

• Rulings •

Taxpayers may request an advance ruling from the IRB on the tax treatment of a specific transaction. Public rulings and guidelines also are issued by the IRB from time to time to state the practice adopted by the IRB.

• Withholding tax* •

Rates

Type of payment	Non-residents	
	Company	Individual
Dividends	0%	0%
Interest	0%/15%	0%/15%
Royalties	10%	10%
Fees for onshore services**/use of moveable property	10%	10%
Other gains or profits falling under Section 4(f)	10%	10%

* Malaysia generally does not levy withholding tax on payments between residents. The rates listed for non-residents are applicable in situations in which the non-resident's income is not attributable to a business carried on in Malaysia and may be reduced under a tax treaty.

** Fees paid to a non-resident for services rendered offshore are currently exempt from withholding tax.

• Anti-avoidance rules •

In addition to the general anti-avoidance rule which allows tax schemes that are entered into with a primary or dominant purpose of obtaining a tax benefit to be disregarded, there are also several specific anti-avoidance rules. Transfer pricing rules apply. Taxpayers can request an Advanced Pricing Agreement (APA). Country-by-Country Reporting (CbCR) has been introduced. A reporting entity (i.e., a Malaysian ultimate parent entity or surrogate parent entity of a multinational group with total consolidated group revenue of RM 3 billion or more in the financial year preceding the reporting financial year) must file a CbCR for the entire financial year no later than 12 months from the close of the reporting entity's financial year.

Earnings Stripping Rule (ESR)s are applicable to the basis periods for YAs beginning on or after 1 July 2019. Interest deductions on loans between companies in the same group (or between the company and a third party outside Malaysia whose financial assistance is guaranteed by a company in the same group) are limited based on 20% of the tax Earnings Before Interest, Tax, Depreciation, and Amortisation (EBITDA).

INTRODUCTION

• Sales tax and service tax •

Malaysia levies Sales Tax and Service Tax (SST) on certain goods and services. Sales tax is charged on taxable goods manufactured in, or imported into, Malaysia (subject to exceptions). Service tax is imposed on prescribed taxable services including, among other things, digital services, domestic air passenger transport, telecommunication services, provision of accommodation, food and beverages, services in health and wellness centers and golf clubs, and certain professional services.

Imported taxable services acquired by a consumer in Malaysia from any person (vendor) outside Malaysia also are subject to service tax. Foreign service providers of digital services that meet the registration threshold (RM 500,000 per year of turnover from digital services provided to Malaysian consumers, including businesses and private consumers) generally are required to register and collect service tax from the service recipients from 1 January 2020. If the foreign service provider is not registered in Malaysia or does not account for the service tax, a Malaysian business receiving services is required to account for the service tax under a reverse-charge mechanism.

The standard sales tax rates are 10% or 5%, and the service tax rate is 6%. Goods that are exempt from sales tax generally include live animals, unprocessed food and vegetables, antibiotics, certain machinery, certain chemicals, and certain raw materials for the manufacture of goods.

The threshold for SST registration generally is RM 500,000 per annum of taxable goods/taxable services, except for restaurants, where the threshold is RM 1.5 million per annum of taxable services.

SST collected is to be paid to the Royal Malaysian Customs Department (RMCD) within one month after the end of a taxable period (which generally is two months). Where service tax on imported taxable services is to be paid to the RMCD under the reverse-charge mechanism, it must be paid within one month after the month in which the Malaysian business recipient of the service (i) makes the payment to the overseas vendor, or (ii) receives the invoice from the overseas vendor, whichever is earlier.

Where there is a registered foreign service provider that is required to account for service tax, the service tax is to be paid to the RMCD within one month after the end of a taxable period (which generally is three months).

• Stamp duty •

Stamp duty is levied at rates between 1% and 4% of the value of property transfers, and at 0.3% on share transaction documents. Other rates will apply depending on the instrument required to be stamped.

• Net wealth/worth tax or inheritance/estate tax •

There is no net wealth/net worth tax nor inheritance/estate tax.

INTRODUCTION

A GOOD TAX SYSTEM

A good system should strike a balance between the interest of the taxpayer and the Government. There are some characteristics that should be present in a good system. Some of these characteristics are described below:

• *Equity/Fairness* •

Every person who is resident or earns income in Malaysia should pay tax depending on the individual or company's ability to pay. A person with a higher income should pay more tax. Thus, taxes are proportionate to the income earned. Lower income taxpayers will pay lower taxes. Ideally, taxes are based not just on income but also on wealth and consumption.

• *Certainty* •

The tax that a person is required to pay should not be determined arbitrarily. The taxpayer should know in advance what tax he is required to pay, how much tax is to be paid and when is the tax to be paid. The Government should also be certain how much tax it can collect for its budgeted operational and development expenditure. The tax base should be diversified with taxes collected from a variety of sources to prevent a fluctuation in total revenue.

• *Convenience* •

The tax payment and timing when the tax is to be charged should be convenient for the taxpayer. If the tax is based on income, the tax should be paid at the time the income is earned. On the other hand, if the tax is based on sales, it should be paid at the time the transaction takes place. If the tax is based on wealth (such as an inheritance tax), the tax should be paid at the time of transfer of assets such as shares and property.

• *Economy* •

The cost of collection should be low compared to the tax collected. Those taxes with the greatest difference between revenue and collection costs should be preferred. Taxes with high cost of collection should be avoided. Tax collection should be efficient taking no more from the taxpayer than is necessary to defray the cost of providing services by the Government.

• *Efficiency* •

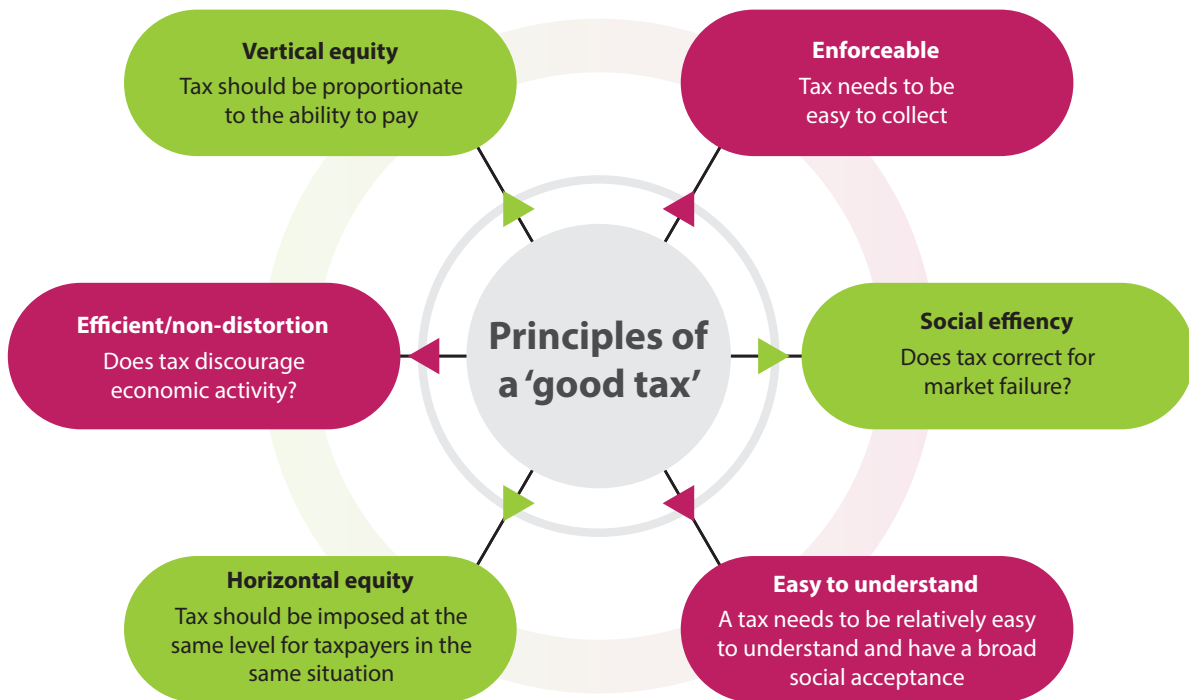
A good tax system should encourage economic growth and create jobs within the country. It should be competitive with other countries so that it does not encourage resources to flow to other countries. The taxes imposed should not favour one business over another business. It should not favour one individual over another individual. Tax should be a tool aimed at influencing taxpayers' behavior.

INTRODUCTION

• *Simplicity and accountability* •

The easier a tax is to understand, the higher the voluntary compliance by taxpayers. This would lead to lower enforcement cost. Public acceptance of the tax system calls for transparency in the tax administration. Simple taxes are to be preferred over complex taxes. Changes in taxes should be infrequent to provide stability to taxpayers in planning the taxes to be paid.

An interesting diagram outlining the principles of a 'good tax' (adapted from Economics Help.org)¹ is shown below:



Source: Economics Help.org¹

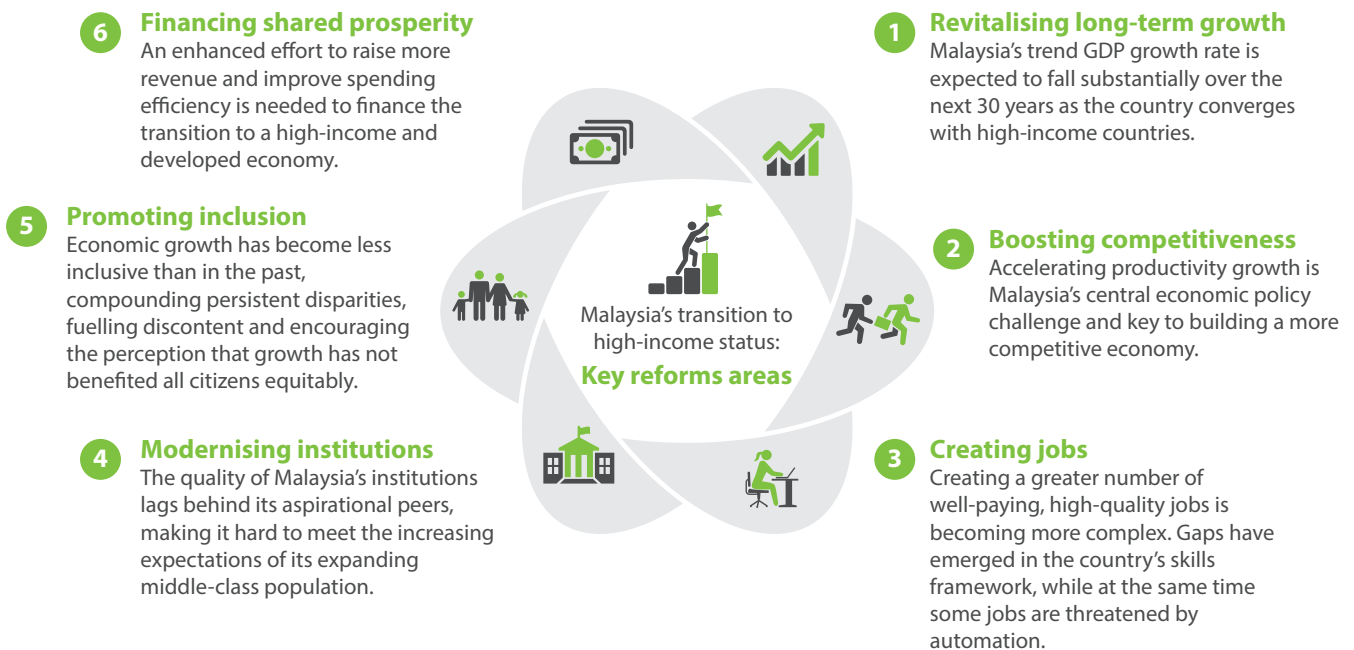
¹ Economics Help.Org <https://www.economicshelp.org/>

INTRODUCTION

TAX REFORM – THE WAY FORWARD

On March 16, 2021, the World Bank Group released a new Flagship Report “Aiming High—Navigating the Next Stage of Malaysia’s Development”² which looks at the next frontier of the country’s development as the reality of being a high-income economy becomes all the more apparent.

In the report, the World Bank Group looked beyond the COVID-19 pandemic to chart out the development pathway for Malaysia in the years ahead, looking at how economic performance could be improved. Malaysia has long aspired to become a high-income and developed economy. With the right reforms there is every likelihood that Malaysia will achieve that goal and will likely be reclassified as high-income within the next five years.³ The analysis in this report suggests that for Malaysia to fulfil its potential, transition to high-income status, and sustain equitable growth beyond the COVID-19 pandemic, reforms are needed in six broad and inter-linked areas:



Source: Aiming High: Navigating the Next Stage of Malaysia’s Development²

One of the key reforms as rightly pointed out by the World Bank Group in the report is to raise more revenue and improve spending efficiency. Similar to most economies across the world, Malaysia has been severely affected by COVID-19. Malaysia faces not only a global pandemic and a worldwide recession, but also a looming international debt crisis, a heightened risk of a resurgence in trade disputes, the potential unraveling of global value chains, and the impact of disruptive technologies that could change the socio-economic dynamics of nations.⁴ “In positioning Malaysia for a post-pandemic economic recovery, rebound and growth, we will continue to strengthen the country’s revenue base and improve our tax framework”, said Tengku Zafrul Aziz, the Minister of Finance. In echoing the direction of the Ministry of Finance (MoF), it is time Malaysia strives to strengthen and increase the effectiveness of our tax system to generate more revenue. Tax policy, therefore, will be one of the longer-term levers that our Government can use to generate revenue to manage increased levels of national debt. Governments and relevant stakeholders need to pay greater attention to the spillovers from their tax policies and step up their support for a fair and efficient system of taxation, including efforts to fight tax evasion and tax avoidance. *Jim Yong Kim*, the former President of the World Bank Group once said that “Fair and efficient tax systems, combined with good service delivery and public accountability, build citizens’ trust in Government and help societies prosper.”

² World Bank. 2021. Aiming High: Navigating the Next Stage of Malaysia’s Development. Country Economic Memorandum; World Bank, Washington, DC. © World Bank. <https://openknowledge.worldbank.org/handle/10986/35095> License: CC BY 3.0 IGO.

³ World Bank Blogs, It is Time for Malaysia to Aim High, Author: Richard Record, Lead Economist <https://blogs.worldbank.org/eastasiapacific/it-time-malaysia-aim-high>

⁴ Official Address and Launch of Report by the World Bank Group “Aiming High: Navigating the Next Stage of Malaysia’s Development”, By YB Senator Tengku Datuk Seri Utama Zafrul Aziz, Minister of Finance Malaysia <https://www.worldbank.org/en/country/malaysia/publication/aiminghighmalaysia>

CORPORATE TAX

INCREASE IN TAX EFFORT (REDUCING THE TAX GAP)

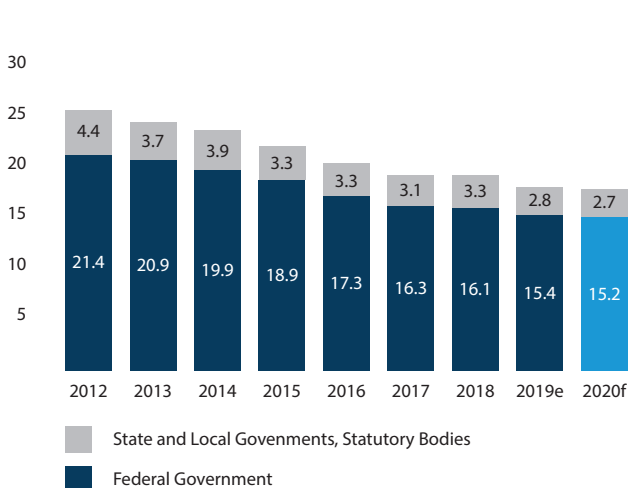
Compliance and enforcement

In Malaysia, the authorised body in the tax system which deals with direct taxes is the IRB. The IRB is an agency set up under the MoF to act as an agent to provide services in assessing, administering, collecting and enforcing the payment of income tax and other taxes that are within the board’s jurisdiction.

Tax revenue is one source of fund available for financing Government expenditure and enhancement of a nation’s sustainable development. Based on the World Bank Group report, Malaysia’s public revenue collection is on a downward trend, lagging comparators.

Malaysia’s revenue collection has been on a steady decline since 2012...

General Government revenue, Percentage of GDP

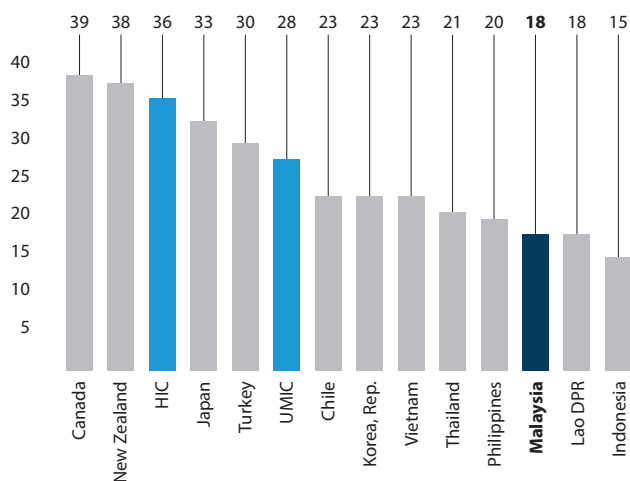


Source: World Bank staff calculations based on MOF data

Source: Aiming High: Navigating the Next Stage of Malaysia’s Development²

...and is well below the average of comparator countries

General Government revenue, Percentage of GDP



Source: World Bank staff calculations based on MOF and IMF data

But what drives people and businesses to pay taxes? The intrinsic willingness to pay tax can greatly assist Government in the design of tax policies and their administration, particularly in developing countries where compliance rates are low. However, voluntary compliance is not only determined by tax rates or the threat of penalties, but also by a wide range of socio-economic and institutional factors which vary across regions and populations. An Organisation for Economic Co-operation and Development (OECD) Study recommended that tax administrators should simplify the process of filing tax returns while the Government should ensure transparency and accountability in tax revenue in order to enhance trust in Government and tax administration.⁵

Certain tax administration processes which were originally paper-based and partly manual have been digitalised. Digitalisation has increased the efficiency and effectiveness of tax administration and has helped to reduce burdens to a greater or lesser extent for different taxpayer segments. For example, improvement in services for taxpayers through e-filing, e-payment, online self-service tools and targeted help such as online live chats are making it easier for taxpayers to understand and to meet their tax obligations.

² World Bank. 2021. Aiming High: Navigating the Next Stage of Malaysia’s Development. Country Economic Memorandum; World Bank, Washington, DC.

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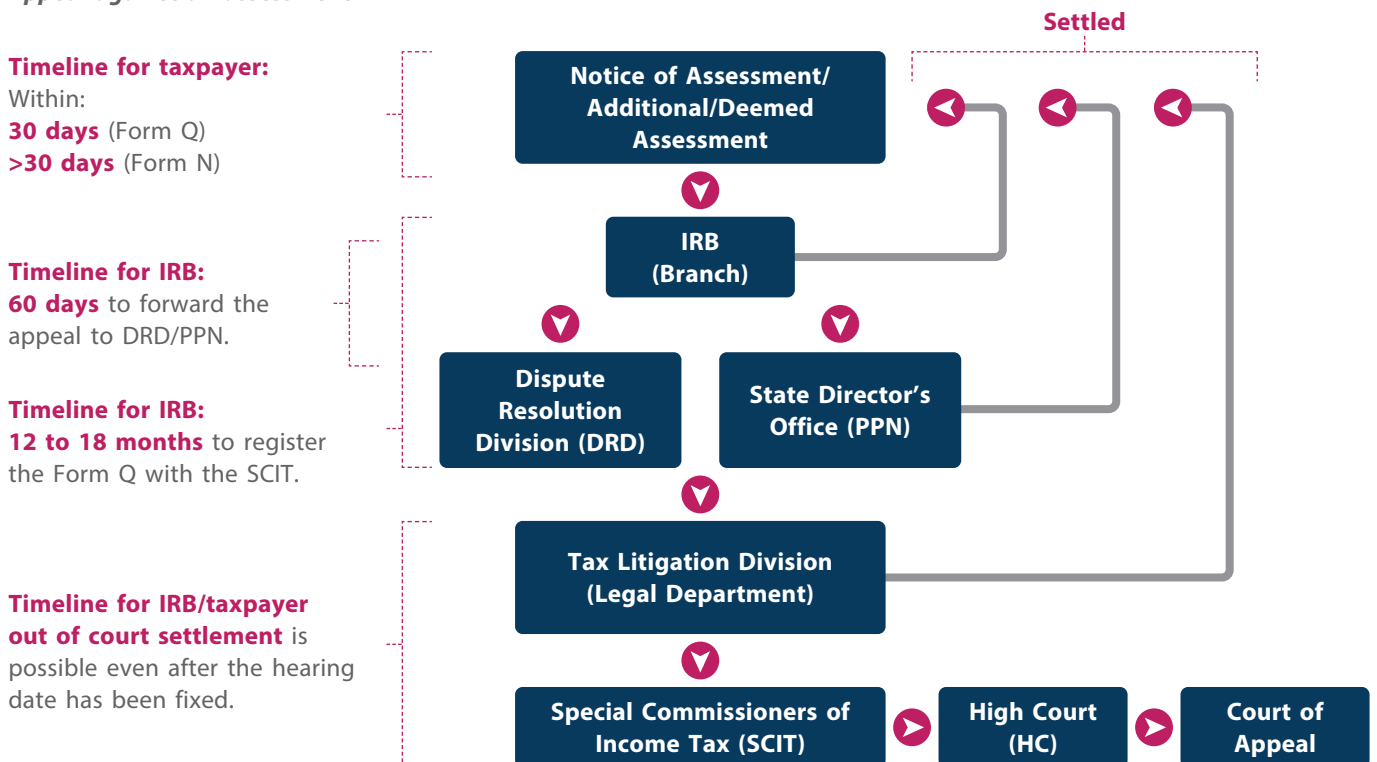
⁵ OECD (2019), Tax Morale: What Drives People and Businesses to Pay Tax?, OECD Publishing, Paris, <https://doi.org/10.1787/f3d8ea10-en>.

CORPORATE TAX

While these developments have benefited both taxpayers and tax administrators, the current tax administration system continues to have some significant limitations on the outcomes it can achieve. Firstly, meeting tax obligations require a lot of effort and cost. Taxpayers have to take active steps to understand, process, calculate and report tax liabilities as well as keep records for tax audit and investigation purposes. As a result, the overall costs of compliance, which includes both monetary and opportunity costs, can be high.⁶ In the report on 2021 Asia Pacific Tax Complexity Survey conducted by Deloitte [for the purpose of the survey, “Complexity” refers to the perceived level of difficulty in interpreting and understanding the respective jurisdiction’s tax laws and regulations based on the respondent’s knowledge and experience.], more than 80 percent of respondents across the region view tax compliance and reporting obligations in the countries in which they operate were not considered to be simple. Furthermore, in the 2021 survey, there are 19 jurisdictions with substantially more responses saying that the tax regime has become more complex over the last three years than those saying that the regime has become less complex. The growing complexity of the tax environment in the region is understandable considering the number of new rules introduced in this region to deal with specific Base Erosion and Profit Shifting (BEPS) issues. This is an interesting result as having a simplified tax system is still often hailed as a key attraction for foreign investment. For Malaysia, 58% of respondents surveyed view tax compliance and reporting obligations in Malaysia as somewhat complicated and 25% said they are complicated, compared to 55% and 25% respectively 3 years ago.

Further, it takes a significant amount of time for the appeals of taxpayers to be heard by the Special Commissioners of Income Tax (SCIT) and taxpayers are required to pay the outstanding taxes as stated in the Notice of Assessment issued by the IRB within 30 days. This has led taxpayers to seek alternative remedies such as filing an application for judicial review at the High Court (HC), where the time taken for the appeal to be heard is generally shorter and more remedies are offered to the taxpayers.⁷ However, the HC usually will only allow judicial review in exceptional circumstances. This means that judicial review proceedings in normal circumstances, where an alternative remedy under the law exists, will not be allowed.

Appeal against an assessment



⁶ OECD (2020), *Tax Administration 3.0: The Digital Transformation of Tax Administration*, OECD, Paris. <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm>
⁷ Raja, Darryl & Loh, *The Future of Tax Appeals – Are Taxpayers’ Rights Being Protected?* By Vijey M. Krishnan, William Wong and Nicholas Mark Pereira <https://rajadarrylloh.com/the-future-of-tax-appeals-are-taxpayers-rights-being-protected/>

CORPORATE TAX

Another limitation is that different systems used by different Government agencies make it difficult to share data or use common processes. This can create a burden for taxpayers, for example, by being unable to use their identity credentials across Government agencies and potentially being subject to multiple different reporting requirements. It can mean that some taxpayers may miss out on benefits that they may be entitled to. It can also make it more difficult to address fraud if information available to one part of Government is not able to be matched and analysed with other relevant information available to another part of Government.⁶

These limitations can lead to persistent issues and problems for tax compliance, compliance burdens and revenue collection.

Digitalise the tax administration system

The combination of human staff and skills with advanced analytics and decision-supporting tools such as artificial intelligence will support effective data management of the tax authorities, taxpayers' compliance and in detecting anomalies, leakages and flaws in the tax system.⁶ It will also result in greater efficiency across all functions such as enhanced risk management for better audit case selection, better ability to detect fraudulent tax refunds, ability for the tax authorities to view the taxpayer in an integrated way across all tax types as well as reduction in taxpayer compliance costs and agency costs.⁸ The agility of people, processes and systems assures that the tax administration can stay aligned with societal and economic change as well as respond to changes in circumstances, including crises, help increase tax compliance and reduce the cost of tax administration.⁶ In this COVID-19 pandemic, many have been working from home to break the ongoing COVID-19 transmission chain especially in the workplace, including the tax authorities. Adjusting to remote and hybrid work is an unprecedented event in which all kinds of norms that have been accepted practice for decades will be put to the test.

The nature of the changes occurring around us through the increasing digitalisation of the economy and of society in general allow, and indeed call for, a different model of tax administration. Digitalisation may be the area that causes, or at least accelerates, the most permanent changes post-crisis. It quickly became very clear that Governments and Government agencies (including tax authorities), businesses and households that could operate

digitally would fare better during the crisis. Artificial intelligence tools and algorithms such as real-time taxpayer accounts (with crediting and debiting of tax payments and refunds) will also support the characterisation and assessment of tax liabilities and will increasingly support decision-making. Taxpayers will have the opportunity to check and question taxes assessed, paid and due in real-time. It will be clear to the taxpayers as to which tax rules have been applied to which data, reflecting facts and circumstances. This will allow taxpayers to challenge both automated and human decision-making. Individuals and businesses will be able to check the origin and accuracy of the data used and can grant or deny access to personal data sources not required for tax purposes. Although the tax legislation might still be complicated, the underlying tax administration process and results will be increasingly accessible and transparent to taxpayers.⁶

Directionally, the tax authorities' movement towards digital was already afoot, such as the launch of "Hasil Knowledge Centre" (which is an interactive system that offers search support for obtaining tax information instantaneously based on the keywords entered by users) but the COVID-19 pandemic has made digitalisation more imperative. Although communication channels (via call centre and chat functionalities) and service efforts have improved substantially over the years, large numbers of taxpayers still viewed reaching the IRB officers for a one-to-one discussion on specific tax matters a challenge. New communication channels should be explored to improve services to taxpayers. For example, in the United States, the Internal Revenue Service's (IRS's) web-based application called the Taxpayer Digital Communication Outbound Notification (TDC-ON) gives individual taxpayers access to specific IRS notifications through the Online Account (OLA) application. Taxpayers can register for an Online Account to be able to access notifications, as well as view account balances and make payments. This tool increases Online Account functionality and will reduce the volume of notices that need to be mailed and the associated costs for those mailings. The application integrates with the existing OLA web application infrastructure and leverages the same IRS e-authentication platform.⁹ In Australia, the Australian Tax Office (ATO) has continued to enhance the functionality of its mobile app, which it launched in July 2013. The app offers a variety of tools and features, including key dates, enabling clients to add reminders to their calendar, and etc. In 2015, the

⁶ OECD (2020), *Tax Administration 3.0: The Digital Transformation of Tax Administration*, OECD, Paris.

<https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm>

⁸ Asian Development Bank, *Tax Administration Information Systems* by David Tansey

<https://www.adb.org/sites/default/files/publication/510286/governance-brief-036-tax-administration-information-systems.pdf>

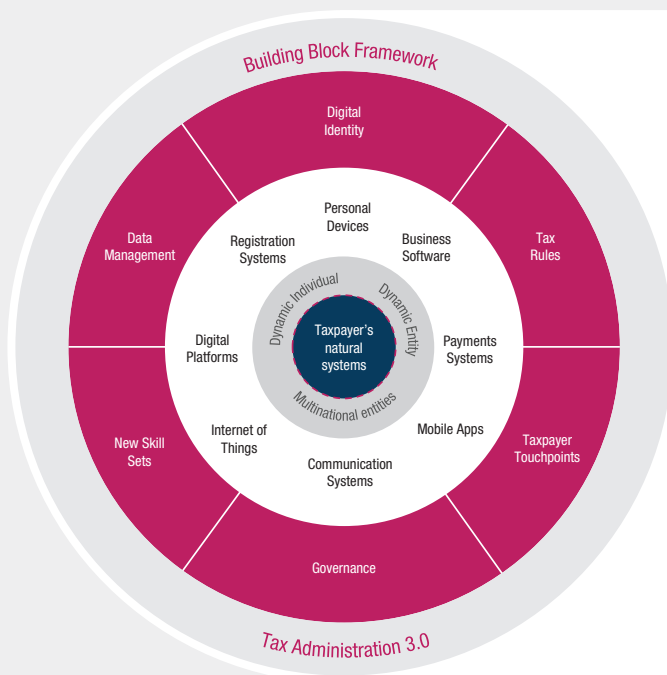
⁹ Internal Revenue Service, *Accelerating Digital Communications to Solve Pandemic Challenges and Improve the Taxpayer Experience*

<https://www.irs.gov/about-irs/accelerating-digital-communications-to-solve-pandemic-challenges-and-improve-the-taxpayer-experience>

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myDeductions tool was added to the app, allowing users to record tax deductions on the go. Using the camera on their device, taxpayer can capture receipts and use location services to record work-related car trips for vehicle deductions, eliminating the need for paper records. From July 2016, taxpayers are able to upload these deductions to their tax return. Features and updates are built using iterative design and are delivered in smaller releases.¹⁰

In a report on “Tax Administration 3.0: The Digital Transformation of Tax Administration” published by the OECD, six core building blocks of future tax administration were identified by the tax administrations which led the work on this discussion paper.⁶ The tax authorities may consider some of the recommendations and good practices adopted by other authorities shared in the report.



Source: The core building block framework, OECD (2020), Tax Administration 3.0: The Digital Transformation of Tax Administration, OECD, Paris.⁶

Access to information via well-developed information sharing mechanism

Taxation services should be joined-up with other Government services and functions such as the RMCD and the Companies Commission of Malaysia (CCM), employing common engagement models with individuals and businesses. This will allow the IRB to gain, verify and ascertain relevant information and thereby reduce the need for site visits that may be burdensome and deter business operations. One digital identity will support a seamless connection between processes and data sources of various Government functions thereby removing cost-ineffective processes. Payments, benefits and refunds are matched and balanced from an individual and business perspective.⁶

The proposed initiative to assign a Tax Identification Number (TIN) to all Malaysians above the age of 18 and corporate entities as announced in Budget 2020 is an effective initiative and should be implemented without any further delay.

⁶ OECD (2020), Tax Administration 3.0: The Digital Transformation of Tax Administration, OECD, Paris. <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm>

¹⁰ Organisation for Economic Co-operation and Development (2017). Shining Light on the Shadow Economy: Opportunities and Threats <https://www.oecd.org/tax/crime/shining-light-on-the-shadow-economy-opportunities-and-threats.pdf>

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Simplify the appeal process

In the 2020 Budget, it was proposed that the SCIT and Customs Appeal Tribunal (CAT) be merged into a Tax Appeal Tribunal effective from the year 2021 with an aim to improve efficiency of management of taxpayer appeals. By virtue of this proposed merger, any taxpayer who is aggrieved by a decision of the Director General of Inland Revenue (DGIR) or Director General of Customs (DGC), may submit an appeal to the Tax Appeal Tribunal under the applicable tax laws.

Currently, the main challenge in the tax appeal process is the insufficient number of commissioners appointed. Hence, simplifying the appeal process especially for the first stage of appeal at the SCIT should be considered. The existing timeframe for disposal of appeals (made via a Form Q) by the DGIR should be reviewed and reduced to a period of 6 months. In addition, more Special Commissioners should be appointed, which can include not only civil servants but also distinguished lawyers/tax practitioners who are able to serve as Special Commissioners.¹¹ In Japan, for example, the National Tax Tribunal (NTT) is independent from the Nation Tax Agency (NTA). To ensure its independence, NTT employs its own staff, including lawyers and CPAs from private sector as well as ex-judges and ex-prosecutors. NTA is bound by NTT's ruling but taxpayers have the option of accepting the ruling or appealing to a higher court. Additionally, NTT is expected to issue its ruling within one year from receiving the appeal from taxpayers. Besides that, a Tax Court which is a specialised court of law focusing on tax-related disputes and issues should also be considered so that cases can be heard in a quicker manner. For instance, the tax court in the United States is a federal court established by Congress hears tax-related cases and is not associated with the Internal Revenue Service. The Tax Court of Canada is a superior court independent of the Canada Revenue Agency and other departments of the Canadian Government, hears tax-related cases in Canada.

The Dispute Resolution Proceedings Department (DRPD) of the IRB is currently responsible for hearing and considering appeals by taxpayers before their cases are presented to the SCIT but limited to taxpayers under Multinational Tax Branch, Special Industry Branch, Large Taxpayer Branch, Investigation Branch, Special Operation Department and Special Task Department.¹² Other cases will be handled at the PPN. The dispute resolution process could be enhanced to allow more appeals to be covered with a view of resolving the cases before the case is heard by the SCIT.

Appeals should be lodged to the IRB via an online platform and this should also be linked to the DRPD directly rather than taxpayers having to deal with the assessment branch in the State concerned. Reference can be made to the "Faceless Appeal Scheme, 2020" introduced by India's Central Board of Direct Tax (CBDT). Faceless appeals are part of the broader program of faceless proceedings being introduced across India to improve efficiency, transparency and accountability. Faceless appeal eliminates personal interaction between the appellant taxpayer and the Commissioner of Income tax (Appeals) (CIT(A)).¹³

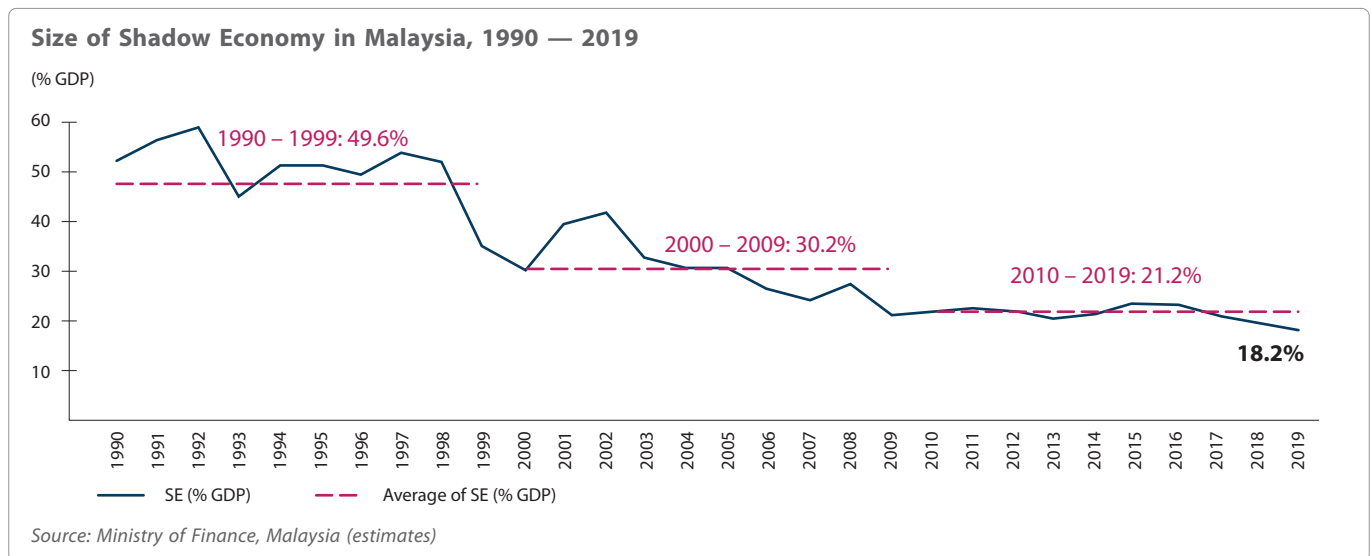
¹¹ CCH IntelliConnect, *Whither Tax Reforms?* By Dr Veerinderjeet Singh, Non-Executive Chairman of Tricor Services (Malaysia) Sdn Bhd

¹² Inland Revenue Board Of Malaysia, *Guidelines on Dispute Resolution Proceeding* http://phl.hasil.gov.my/pdf/pdfam/GP_Prosiding_Resolusi_Pertikaian_2.pdf

¹³ Deloitte | tax@hand (taxathand.com), CBDT notifies Faceless Appeal Scheme, 2020
<https://www.taxathand.com/article/15493/India/2020/CBDT-notifies-Faceless-Appeal-Scheme-2020>

Coverage of the informal/hidden sector

According to the Economic Outlook 2021 report released by the MoF, the MoF stated that a study estimated that the average size of the shadow economy in Malaysia was at 33.7% of GDP from 1990 – 2019. Figure 3.4.2. in the Economic Outlook 2021 report indicates that the size of the shadow economy has declined over the years. The size of the shadow economy continued to fall to about 30% between 2000 – 2009 before averaging about 21% between 2010 – 2019. In 2019, the size of the shadow economy stood at 18.2%. In this context, shadow economy is defined as legal productive economic activities that remain unreported from the official authority to avoid Government regulations, tax obligations and social security contributions.¹⁴



The MoF stated that although the size of the shadow economy is on a declining trend, its presence is still significant and it deprives the Government of potential high tax revenue collection to finance development projects, such as healthcare, education and public transportation.

Generally, the shadow economy activities include non-registered businesses, under-reporting of business income, unreported sources of income, over-claiming of expenses, generating fictitious invoices and receipts, illegal activities such as money laundering, identity fraud, illicit trafficking, etc. as well as other economic activities which are hidden from the IRB for monetary, regulatory, and institutional reasons.¹⁰

In addition to less revenue being collected to fund the country’s development and operating expenditures, the shadow economy also has major adverse social and economic implications. It undermines trust in the tax system and the social norms supporting voluntary compliance which can have a significant impact on compliance attitudes as Malaysia’s tax administration rely on taxpayers to self-declare or self-assess their income.

It can also increase other Government and business costs, for example, social security costs, loss of regulatory fees and compensation to customers who have suffered financial fraud.¹⁰ Other negative impacts include competition distortions in the marketplace which can create an unfair playing field for registered businesses and individuals, corruption and sale of low quality goods which can potentially be harmful to customers’ health and safety.

In the report, the MoF noted that measures which could help to reduce the size of the shadow economy and the incidence of tax evasion include adopting advanced technologies, promoting data sharing among Government agencies, simplifying tax compliance procedures with greater adoption of technology, enhancing and emphasising the rule of law and enforcement.¹⁴

“The Government will enhance efforts to make working in the formal sector more beneficial, for example, by improving efficiency in the labour market and simplifying tax compliance procedures with greater adoption of technology. Efforts will be continued to enhance and emphasise the rule of law and enforcement, rather than increasing the number of regulations,” MoF said.

¹⁰ Organisation for Economic Co-operation and Development (2017). *Shining Light on the Shadow Economy: Opportunities and Threats* <https://www.oecd.org/tax/crime/shining-light-on-the-shadow-economy-opportunities-and-threats.pdf>

¹⁴ Ministry of Finance, *Economic Outlook 2021* <https://belanjawan2021.treasury.gov.my/pdf/economy/2021/economic-outlook-2021.pdf>

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Implement Tax Identification Number

The Government should implement the TIN as proposed in the 2020 Budget. Successful implementation of the TIN should help increase the number of registered taxpayers, reduce tax arbitrage activities and increase tax collection.¹⁵ It will also provide information on the expenditure patterns of individuals and businesses and the tax authorities may analyse the collected data effectively and identify fraudulent tax activities.¹⁴

Requirement for both buyers and sellers to state their TIN in agreements or invoices can be implemented to reduce the incidence of tax evasion.¹⁶ Additionally, the tax authorities may consider widening the scope of withholding tax (WHT) to cover all payments among residents and exempting such WHT only if a TIN is disclosed to the payer.¹¹ Thailand and Indonesia impose WHT on certain gross payment made by a resident to another resident for technical service, consulting service, rentals, etc.

Enhance enforcement and widen investigation activities

The tax authorities' effort in working together with other Government agencies, including local authorities, to track and influence behaviour of the hidden/informal sectors to pay taxes are commendable. This initiative must and will continue. An effective mechanism to share details, information and sources in relation to businesses operating in the formal and shadow economy would be crucial. In addition, the relevant tax authorities could also consider collaborating with customers, suppliers and traders to trace the supply chains, involving sub-contractors, manufacturers and service providers in the formal sectors.

Similar to most economies across the world, Malaysia has been severely affected by COVID-19. Lockdowns and stringent standard operating procedures have brought much economic activity in the country to a halt. The significant reduction in business activity was a direct consequence of the closures that Governments adopted to help contain the transmission of the virus and many self-employed individuals and small businesses are amongst the hardest hit. Many have turned to the gig economy which is gaining prominence and is growing as gig workers are likely to have better income prospects

especially so during this COVID-19 pandemic. Whilst the emergence of the gig economy allows the migration from cash to digital transactions and creates digital footprints, this gig economy activities are often hard to police, and in many cases, income may not have been reported to the authorities. In order to reduce the risk of the sharing and gig economy from expanding into the shadow economy via unreported existing or new activities, the setting up of a task force to monitor the activities of this sector is recommended. The tax authorities may explore available options and take action to facilitate the growth of online intermediaries, sharing economy and gig agents while ensuring that they fulfil their tax obligations. For example, in Singapore, the Inland Revenue Authority has reached out to a number of sharing and gig economy platforms and relevant trade associations in Singapore to disseminate tax information to individual platform sellers to clarify tax rules through email communications they have with their users or via links to the dedicated tax administration webpage on their respective websites.¹⁷ Compliance can be enhanced where there is advice and support available. As part of making tax administration less burdensome, many tax authorities are also seeking to use the channels that are easiest for taxpayers, reducing the burdens of administration and reducing the likelihood that tax gets crowded out by other factors, including cash flow, e.g. the mobile app by ATO.

Further, the tax authorities should widen its investigation activities to tackle the shadow economy. For example, in Singapore, the Inland Revenue Authority uses vehicle records and employee Central Provident Fund contribution data to help determine whether a company has a business presence, thus indicating if it is active or dormant. In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) collects merchant acquirer data to identify non-compliance through the calculation of "dynamic benchmarks". These are used to compare the value of debit and credit card sales relative to declared turnover (under the Value Added Tax (VAT) regime) for businesses of a similar size, from the same operating sector and geographical location. The benchmark tells HMRC what "average" business turnover might look like in specific sectors and places. As a result, potential non-compliance stands out for further investigation. Dynamic benchmarks enable HMRC to identify risks in both the hidden and

¹¹ CCH IntelliConnect, *Whither Tax Reforms?* By Dr Veerinderjeet Singh, Non-Executive Chairman of Tricor Services (Malaysia) Sdn Bhd

¹⁴ Ministry of Finance, *Economic Outlook 2021* <https://belanjawan2021.treasury.gov.my/pdf/economy/2021/economic-outlook-2021.pdf>

¹⁵ Ringgit Plus, *Malaysians Will Be Assigned Tax Identification Numbers In January 2021* By Alex Cheong <https://ringgitplus.com/en/blog/personal-finance-news/malaysians-will-be-assigned-tax-identification-numbers-in-january-2021.html>

¹⁶ Free Malaysia Today, *What's a tax identification number and how does it work?* By Joel Shasitiran <https://www.freemalaysiatoday.com/category/nation/2019/10/25/whats-a-tax-identification-number-and-how-does-it-work/>

¹⁷ OECD (2019), *The Sharing and Gig Economy: Effective Taxation of Platform Sellers: Forum on Tax Administration*, OECD Publishing, Paris, <https://doi.org/10.1787/574b618-en>.

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formal economy (where tax evasion is a risk). Once a risk is identified, it is assessed to decide the appropriate level of intervention for each business according to HMRC's "Promote, Prevent & Respond" compliance strategy. It was reported that HMRC's use of merchant acquirer data in "compliance taskforces" (focused activity in a specific area or sector) has improved risk targeting (7% increase in hit-rate) and facilitated the collection of GBP 210 million in yield.¹⁰

Raise public awareness through education

Tax education activities should be intensified to create a knowledgeable society and to promote taxation in the country. The Government should continue raising public awareness through education about the importance of paying tax in supporting socio-economic development and providing essential public services and infrastructure, i.e. to view paying tax as a contribution to the nation's coffers instead of as an expense. Social norms can be reinforced by educating taxpayers about the damage caused by the shadow economy activities. For example, the tax authorities may consider engaging with the community with a view to identifying and rejecting businesses operating in the shadow economy through campaigns. These campaigns can be effective in influencing social norms at a high level, sending strong messages about the risks of non-compliance as well as the dangers of dealing with business operators in the shadow economy.

In the United Kingdom, HMRC has undertaken targeted "campaigns" approaches concentrating on particular sectors most at risk from shadow economy activity, working across professional and trade sectors. An example of a campaign is that relating to "moonlighters" who earn a second income not declared for tax. HMRC worked with employers to increase tax awareness using staff newsletters and pay slip notices to remind employees of their tax obligations with a facility offered to disclose additional income. A second income campaign web page was set up, supplemented by an advice line. The campaign method ensured that more taxpayers voluntarily declared the additional income thereby ensuring that only the most complex evaders required costly one-to-one contact. Information learnt during campaigns will be used for future strategies. Successful campaigns include those on let property, plumbers, electrician, e-market places and offshore evasion. Together they have resulted in over GBP 1 billion in tax payments.¹⁰

Simpler tax rules for small and medium enterprises

Small and Medium Enterprises (SMEs) play an essential role towards economic growth in Malaysia. According to the data released by the Department of Statistics Malaysia (DOSM), SMEs contributed 38.9% of Malaysia's GDP and 17.9% of total exports as of the year 2019. The number of employees working in SMEs was 7.3 million in 2019, comprised of 48.4% from national employment.¹⁸ However, SMEs are financially less stable compared to larger corporations as they own fewer assets and cash reserves. Production levels for SMEs are also generally lower. As a result, the COVID-19 pandemic has had significant adverse implications on them. The challenges experienced by SMEs during the pandemic include a sharp decline in sales revenue, higher operating costs, worsened liquidity, difficulties in adopting technological solutions as well as insufficient cash reserves to survive without Government support.¹⁹

As the backbone of the country's economy, targeted financial support has been introduced and implemented by the Government to mitigate the impact of the COVID-19 pandemic on SMEs. Liquidity supports include tax relief measures, wage subsidies, moratorium on loans and lowering the interest rate of the RM 500 million Micro Credit Scheme from 2% to 0%, among others. In addition, the Government has also implemented structural support measures for digitalisation, innovation and reskilling to enhance resilience and recovery of SMEs.

From a tax perspective, SMEs represent a high risk group for non-compliance because, in addition to lower cash flow and unstable income, they usually lack tax knowledge and do not have well-developed structures for record keeping, independent audit of accounts and cash handling that can help to minimise the risks of under-reporting when compared to larger businesses. As such, tax compliance among the SMEs is a major concern for the Government. One of the challenges faced by SMEs with regard to tax compliance is the complexity of the current tax rules and regulations. Tax complexities include ambiguity and frequent changes in tax laws, tedious tax computations,

¹⁰ Organisation for Economic Co-operation and Development (2017). *Shining Light on the Shadow Economy: Opportunities and Threats* <https://www.oecd.org/tax/crime/shining-light-on-the-shadow-economy-opportunities-and-threats.pdf>

¹⁸ Department of Statistics Malaysia, *Small and Medium Enterprises (SMEs) Performance 2019* https://www.dosm.gov.my/v1/index.php?r=column/cthemByCat&cat=159&bul_id=VjM1enZ2RmlVRDVTNFawRWZiZUs3QT09&menu_id=TE5CRUZCbLh4ZTZMODZlbnk2aWRROQT09

¹⁹ Penang Institute, *Helping SMEs Rise to Challenges Posed by the COVID-19 Pandemic* by Dr Negin Vaghefi and Yap Jo-ye (Senior Analyst and Analyst, Socioeconomics & Statistics Programme) <https://penanginstitute.org/publications/issues/helping-smes-rise-to-challenges-posed-by-the-COVID-19-pandemic/>

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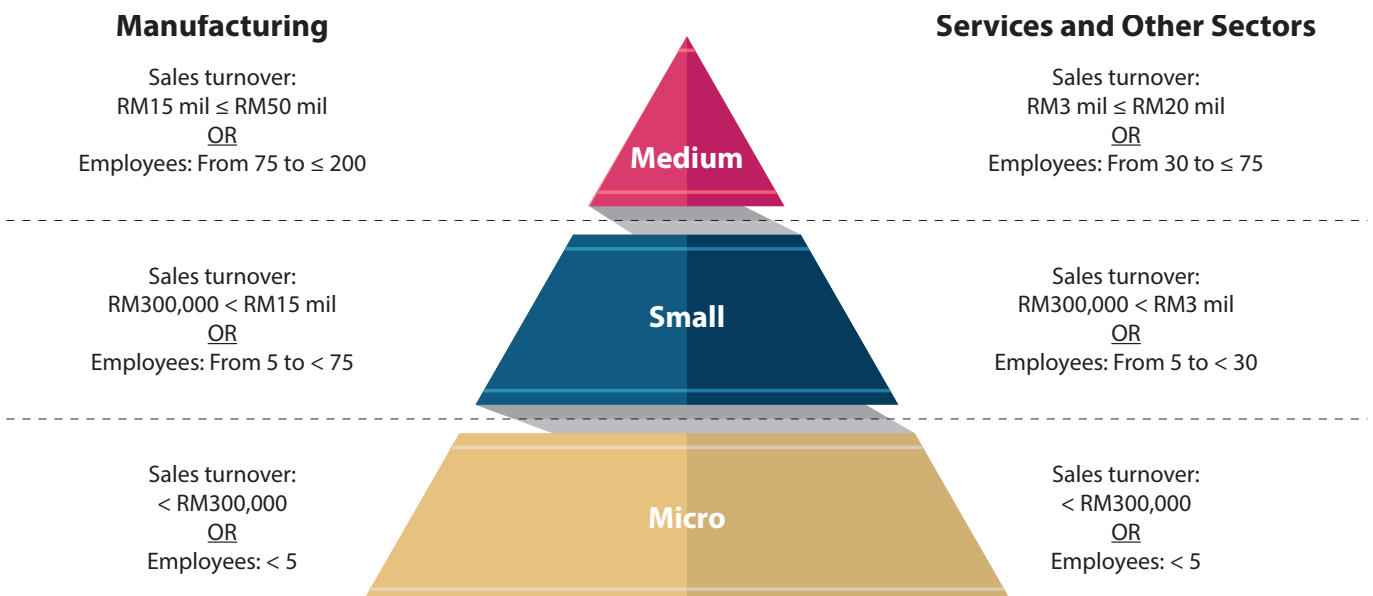
numerous tax rules and regulations, confusing forms and record keeping issues. This could lead to unintentional non-compliance, which happens when a taxpayer has the intention to be compliant but was non-compliant as a result of the complexity of the tax system.²⁰

Further, in order to comply with the tax obligations and requirements, SMEs have to incur tax compliance costs in addition to their tax payment liability. Tax compliance costs include monetary cost spent on tax agents and accountants, time costs on record keeping for tax purposes, completing the tax return and dealing with the tax authorities. These tax compliance costs can add a burden to the SMEs and would encourage non-tax compliance.²¹ The Government can play a key role in supporting SMEs' compliance with the tax law and in reducing the burdens they are confronted with.

Definition of SME in the Income Tax Act 1967 and SME Corporation Malaysia should be aligned

Currently, there is a mismatch of the definition for SME between the Income Tax Act 1967 and SME Corporation Malaysia. The tax definition for SME is based on the company's paid-up capital in respect of ordinary shares at the beginning of the basis period and gross income from business sources. On the other hand, the SME Corporation Malaysia's definition of SME is based on sales turnover or number of full-time employees of the SME subject to further conditions stipulated under the guideline of SME definition established by SME Corporation Malaysia.¹¹

The paid-up capital of a company may not be an accurate measure of the company's SME status. Therefore, the revision of the definition for SME in the Income Tax Act 1967 to be aligned with the definition outlined by the SME Corporation Malaysia may be considered. This consistent definition would ease companies in determining whether they satisfy the definition of SME for both tax and non-tax purposes. This would also allow more companies to qualify as SME and enjoy the preferential tax rate.¹¹ Detailed definition of category, namely micro, small and medium, as outlined by the SME Corporation Malaysia is shown in the diagram below:



Source: SME Corporation Malaysia : SME definitions²²

¹¹ CCH IntelliConnect, *Whither Tax Reforms?* By Dr Veerinderjeet Singh, Non-Executive Chairman of Tricor Services (Malaysia) Sdn Bhd

²⁰ ©2019 AESS Publications. *International Journal of Asian Social Science, Factors Affecting Tax Compliance among Malaysian SMEs in e-Commerce Business*, By Nadiah Abd Hamid, Nur Ain Ibrahim, Nur Aini Ibrahim, Noratikah Ariffin, Raudah Taharin and Fatin Amira Jelani [http://www.aessweb.com/pdf-files/IJASS-2019-9\(1\)-74-85.pdf](http://www.aessweb.com/pdf-files/IJASS-2019-9(1)-74-85.pdf)

²¹ Pope, Jeff & Abdul-Jabbar, Hijattulah. (2014). *Small and Medium-Sized Enterprises and Tax Compliance Burden in Malaysia: Issues and Challenges for Tax Administration*. *Small Enterprise Research*. 16. 47-60. 10.5172/ser.16.1.47. https://www.researchgate.net/publication/274776694_Small_and_Medium-Sized_Enterprises_and_Tax_Compliance_Burden_in_Malaysia_Issues_and_Challenges_for_Tax_Administration

²² SME Corporation Malaysia, SME definitions <https://www.smecorp.gov.my/index.php/en/policies/2020-02-11-08-01-24/sme-definition>

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Presumptive taxation for SMEs based on the sales made in a year

In order to support the SMEs in making tax a part of their natural environment, it may be worthwhile to consider establishing a simpler set of tax rules for SMEs which would address low tax compliance, reduce compliance costs and burden of administrative requirements. For example, SMEs below a certain threshold of sales may be taxed based on a fixed prescribed amount or based on a percentage of sales generated¹⁰ as shown in the SMEs' audited financial statements. This can be made a choice that an SME can opt for. In the Philippines, a taxpayer is allowed to opt for a standard deduction of 40%.²³ This means that the net income is calculated on 60% of sales revenue. This option is not revocable.

Elevate the tax experience and reduce administrative burden for SMEs

Taxation may never become citizens' favourite interaction with Government. The easier that experience is made for them, whether through reduction in manual calculations, better access to information, or user-friendly design interfaces, the greater their tax compliance. The clearest path toward elevating the tax experience is by meeting citizens where they are: on their mobile phones, in their email inboxes, or via smart home devices.²⁴

It may be timely to consider setting up a mobile application for SMEs which consist of a variety of tools and features, including keyed-in dates such as the due dates for submission of estimated tax payable and tax return, enabling users to add reminders to their calendar, report concerns as well as a tool which allow users to record tax deductible expenses on the go. Receipts can be captured using the camera on their mobile devices, which can then be uploaded to the mobile application for record keeping purposes. This will make the tax filing process simpler and easier for SMEs.






A simpler tax system which includes predicable solutions, consistent rules which are clearly communicated and well-integrated with other tax regulations will help accelerate the growth of SMEs and increase voluntary tax compliance among them. This will also lead to better use of resources of both the SMEs and the authorities.

However, implementing these changes will require significant digital capabilities, the kind that can only be built through deliberate investment.

Depreciation versus capital allowance

In Malaysia, no deduction is allowed for expenses incurred on acquiring an asset and depreciation charged in the accounts for tax purposes. However, the Income Tax Act 1967 provides for deduction of qualifying capital expenditures incurred on certain assets used for business purposes in the form of capital allowance, industrial building allowance, ACA, agricultural allowance and forest allowance.

In accounting, all capital expenditures are subject to depreciation, including quarries and sites used for landfill but exclude land as it has an unlimited useful life and therefore is not depreciated. Under the Malaysian Financial Reporting Standard (MFRS) 116, depreciation is defined as the systematic allocation of the depreciable amount of an asset over its useful life. The term "depreciable amount" is also defined in MFRS 116 and it means the cost of an asset, or other amount substituted for cost, less its residual value. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. Some standard rates of depreciation based on straight-line method adopted by companies in Malaysia are:

	Building	3%
	Computer equipment	10% – 33.3%
	Furniture and fittings	10%
	Office equipment	10% – 33.3%
	Motor vehicles	20%

However, in taxation, only certain types of capital expenditure qualify for capital allowances. These qualifying capital expenditures include the cost of assets used in a business (e.g. plant and machinery, office equipment, furniture and fittings, motor vehicle, etc.), the cost of construction and installation of plant and machinery (subject to payment of WHT if the installation is carried out by a non-resident), expenditure on fish ponds, animal pens, chicken houses, cages and other structures used for agricultural or pastoral pursuits. Further, effective from the YA 2021, "plant" is defined in the Income Tax Act 1967 to

²³ Republic of the Philippines, Bureau of Internal Revenue, Frequently Asked Questions https://www.bir.gov.ph/index.php/tax-information/income-tax.html#it_index

²⁴ Deloitte Insights, The revenue agency of the future: Seven keys to digital transformation <https://www2.deloitte.com/global/en/insights/industry/public-sector/digital-revenue-agency-of-the-future.html>

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mean “an apparatus used by a person for carrying on his business but does not include a building, an intangible asset, or any asset used and functions as a place within which a business is carried on”. Generally, qualifying capital expenditures are categorised into three main categories of assets. The rates of capital allowances provided under Schedule 3 of the Income Tax Act 1967 and P.U.(A) 52/2000 are prescribed for the three main categories of assets:²⁵

Category of Qualifying Asset	Rate (%)	
	Initial Allowance	Annual Allowance
Heavy machinery, motor vehicle	20	20
Plant and machinery	20	14
Others	20	10

As a result, the capital allowances provisions in the Income Tax Act 1967 which allows the taxpayers to write off the cost of an asset over four years, six years and eight years apply to a narrower list of assets. The cost of some depreciable assets under MFRS 116 does not fit into the capital allowance regime and consequently these costs are not recognised for deduction for tax purposes under the Income Tax Act 1967.

Australia has solved the problem through a reform of the capital allowance regime, where the term ‘plant’ has been substituted with ‘depreciating asset’, which expands the type of assets that are eligible to receive the capital allowance.²⁶ Similar to Malaysia, the Australian income tax law allows taxpayers to claim certain deductions for expenditure incurred in gaining or producing assessable income, for example, business income. Some expenditure, such as the cost of acquiring capital assets, is generally not deductible. Generally, the value of a capital asset that provides a benefit over a number of years declines over its effective life. Because of this, the cost of capital assets used in gaining assessable income can be written off over a period of time as tax deductions. Before 1 July 2001, the cost of plant (for example, cars and machinery) and software was written off as depreciation deductions. Since 1 July 2001, a Uniform Capital Allowance (UCA) rules apply to most depreciating assets, including plant. Under UCA, deductions for the cost of a depreciating asset are based

on the decline in value of the asset. UCA maintains the pre 1 July 2001 treatment of some capital expenditure and allows deductions for some capital expenditure that did not previously attract a deduction. Most of these deductions are only available if the expenditure does not form part of the cost of a depreciating asset.²⁷ A further purpose of the UCA reform was the elimination of “blackholes”, comprising types of business expenditure that were not either deductible or accounted for in any provision of the tax law. The Australian Government claimed that “the new legislative framework will address blackhole expenditures and remove many anomalies”.²⁶

Recognise depreciation as a deductible business expense

There is no clear rationale for permitting capital allowances only for certain assets for tax purposes. The Government should consider reforming the current capital allowances regime to recognise depreciation of assets as a normal deductible business expense so long as these assets are incurred by the taxpayer and used for its business purposes. These are also the existing qualifying conditions for claiming capital allowances.²⁸ In accounting, depreciation is a systematic allocation of the depreciable amount (i.e. cost of an asset, or other amount substituted for cost, less its residual value) of an asset over its useful life. It follows accounting’s matching concept, where expenses must be matched with revenues earned, including depreciation. On the other hand, in calculating taxable profits, the Income Tax Act 1967 allows a deduction for expenses wholly and exclusively incurred in the production of gross income, expenses incurred on an asset and depreciation charged in the accounts are not deductible. Accounting principles require that depreciation be provided on assets acquired and used in the business, as acquisition of assets for use in business is part of a normal course of doing business. On the same basis, depreciation should be considered as an expense incurred wholly and exclusively in the production of gross income, i.e. deductible for tax purposes. Otherwise, the payments made for the purchase of assets which are depreciable assets but not qualifying for capital allowances will become permanent losses to the business.²⁸

Alternatively, we may adopt the successful reform of the capital allowances regime by the Australian Government, in particular where the term ‘plant’ was substituted with ‘depreciating asset’.

²⁵ Inland Revenue Board of Malaysia, Public Ruling No. 12/2014 Qualifying Plant and Machinery for Claiming Capital Allowances http://phl.hasil.gov.my/pdf/pdfam/PR_12_2014.pdf

²⁶ Stewart, M. (2007). Capital Allowances for Depreciating Assets: A Successful Reform?, University of Melbourne Legal Studies Research Paper No 320. https://www.researchgate.net/publication/228192327_Capital_Allowances_for_Depreciating_Assets_A_Successful_Reform

²⁷ Australian Tax Office, Guide to depreciating assets 2021 <https://www.ato.gov.au/uploadedFiles/Content/IND/Downloads/guide-to-depreciating-assets-2021.pdf>

²⁸ Salwa Hana Yussof, Khadijah Isa, Raihana Mohdali, An Analysis of the Gap between Accounting Depreciation and Tax Capital Allowance in Malaysia, *Procedia – Social and Behavioral Sciences*, Volume 164, 2014, Pages 351-357, ISSN 1877-0428, <https://www.sciencedirect.com/science/article/pii/S1877042814059072>

CORPORATE TAX

STREAMLINE THE TAX INCENTIVE REGIME

Similar to certain developing and even developed nations, Malaysia offers a wide range of tax incentives for the promotion of investments in selected industry sectors, which include the traditional manufacturing and agricultural sectors, as well as other sectors such as those involved in Islamic financial services, information and communication technology, education, tourism, healthcare as well as Research & Development (R&D). These tax incentives appear in various forms, such as exemption on income, extra allowances on capital expenditure incurred, double deduction of expenses, special deduction of expenses, preferential tax treatment for promoted sectors, etc. Some of the major tax incentives available in Malaysia are PS, ITA and RA. Through tax incentives, the Government aims to attract Foreign Direct Investments (FDIs) as investors from abroad need to be incentivised to relocate or set up their operations in Malaysia.

It is generally recognised that tax incentives can be costly to Malaysia. The most direct cost is the loss of tax revenue, which mainly comes from the forgone tax revenue that otherwise would have been collected from the activities undertaken and lost revenue from investors who would have paid tax on income arising from their investments.²⁹ Other costs include the distortion of resource allocation since tax incentives can influence investment choices/decisions of investors. Tax incentives could attract investors looking for short-term profits and this can be evidenced by companies relocating (or threatening to relocate) after the end of their tax holiday period. In this regard, the Government should consider the cost of granting tax incentives as well as its effectiveness in attracting FDIs.³⁰

In the 2020 Budget, the Government announced that it has embarked on a comprehensive review and revamp of the existing incentive framework, comprising the Promotion of Investments Act 1986, Special Incentive Package and incentives under the Income Tax Act 1967. In the 2021 Budget, an amendment was introduced to provide for a special tax rate applicable (not more than 20%) for an incentive scheme approved by the Minister of Finance and the tax treatment on income received by any person in respect of qualifying activities under Approved Incentive Scheme (AIS). Some of the incentives have also been tightened recently in relation to compliance with the OECD BEPS Action Plan 5 – Forum on Harmful Tax Practices (FHTP) requirements.

In addition, the development of tax incentives in Malaysia has not really gone through a focused review. Some of the incentives have been reviewed by the World Bank over the years using economic analysis to assess the effectiveness and impact of fiscal incentives. However, there does not appear to be any clear policy framework adopted since then to re-evaluate the tax incentives in Malaysia.³⁰ It is noted from the 2021 Fiscal Outlook and Federal Government Revenue Estimates published by the MoF that the tax incentive packages will be consolidated and further strengthened to be more targeted, based on a higher impact and cost-benefit approach³¹, the proposed revamp of the Promotion of Investments Act 1986 is still pending.

Moreover, there is scope for abuse with regards to Malaysia's tax incentive structure. For example, entities may set up a new company to manufacture a product and with a slight adjustment to the technology, another period of tax holiday is applied for. There is a lack of a cohesive framework to move investment agencies to look at the overall benefits to the country rather than be primarily led by vested interests, i.e. focusing on their key performance indicators of bringing in investors.³⁰

On 1 July 2021, the G20/OECD Inclusive Framework on BEPS published a statement on the key components of global tax reform, which has been agreed by a majority of its members. This included the reallocation of a share of the global residual profit of certain businesses to market countries (Pillar One), and a Minimum Effective Tax Rate (METR) in each country where a business operates, of at least 15% (Pillar Two). For Pillar Two concerning METR, it's important to note that new rules will ensure that large multinational businesses pay a METR of at least 15% on profits in all countries. The Income Inclusion Rule (IIR) will result in additional "top up" amounts of tax being payable by a parent entity of the group to its tax authority if a subsidiary in another jurisdiction pays a tax of less than 15% on profits.

²⁹ *The Star*, Tax incentives in Malaysia, By Harvinder Singh <https://www.thestar.com.my/business/business-news/2021/03/01/tax-incentives-in-malaysia>

³⁰ CCH IntelliConnect, Reforms relating to Tax Compliance and Tax incentives, by Dr Veerinderjeet Singh, Chairman of Axcelasia Taxand Sdn Bhd

³¹ Ministry of Finance, 2021 Fiscal Outlook and Federal Government Revenue Estimates <http://belanjawan2021.treasury.gov.my/pdf/revenue/2021/fiscal-outlook-2021.pdf>

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What does METR mean to Malaysia? Companies enjoying tax incentives in Malaysia may have lower Effective Tax Rate (ETR) due to exemption on income, extra allowances on capital expenditure incurred, double deduction of expenses, special deduction of expenses, and preferential tax treatments for promoted sectors among others. Multinational Enterprises (MNEs) operating in Malaysia may have lower jurisdictional ETR, say 10%, due to the Malaysian tax holiday, although the headline tax rate here is 24%. Assuming that the METR is finally agreed at 15%, it is very likely that the MNE group would be subject to top-up tax in respect of its Malaysian operations, which would represent an overall increase in taxation for the group. This may be problematic for Malaysia as its attractiveness may be eroded by the additional tax burden on the group. Instead of the Malaysian tax authorities collecting the additional revenue, the fiscal authorities of another jurisdiction would do so. This is likely to be the headquarters jurisdiction, assuming that the jurisdiction has implemented the IIR under Pillar Two. As a result, MNEs would be subject to this additional tax burden in respect of Malaysian operations, which may be viewed as a “penalty” for operating in a tax jurisdiction that offers legitimate tax holidays.

Global minimum tax – introduce rules for top-up tax to be paid in Malaysia

Given that the top-up tax in respect to Malaysian-based operations would likely be collected by the tax authorities of other jurisdictions, Malaysia may consider introducing rules that would ensure that any such top-up tax be paid in Malaysia. This should allow the jurisdictional ETR of the relevant MNE group to be raised to the minimum ETR, through the payment of tax here, instead of in another jurisdiction. While the additional tax burden on groups investing in Malaysia may be inevitable, introducing this measure would at least allow us to benefit from the additional revenue, which could be used to further incentivise investment here. Malaysia may consider enhancing and/or introducing non-tax incentives in attracting FDIs. Malaysia may also need to relook and revise the existing Malaysian tax system, with a view to protecting our tax base. The introduction of tax reforms should now be instituted seriously as we now have the opportunity to deal with all issues at one go and as such, clear strategies must be set out and executed almost immediately so that we can see results over the next few years. This is important given that the Government’s revenue has been affected significantly by the COVID-19 pandemic.

Consolidate/minimise number of incentives and further strengthen them to be more targeted

Income tax incentives are provided for in the Promotion of Investments Act 1986 and Income Tax Act 1967. These Acts cover investments in the manufacturing, agriculture, tourism (including hotel) and approved services sectors as well as R&D, training and environmental protection activities.

The Promotion of Investments Act 1986 covers two major tax incentives in Malaysia i.e. PS and ITA. These two incentives are closely related as both apply to the same kinds of promoted activity or product, albeit there are many different kinds of promoted activities or products. The Promotion of Investments Act 1986 is a very difficult Act to read and understand as there are no sub-headings to identify the industry or activity that is eligible for a particular incentive and the conditions that have to be satisfied. Many of the sub-sections in the Promotion of Investments Act 1986 require cross-referencing to other sub-sections in the act. A revamp of the Promotion of Investments Act 1986 is needed to consolidate the kinds of promoted activity or product and eligibility conditions for the incentive as well as to eliminate or reduce cross-referencing to facilitate easier reading and comprehension by local and foreign investors.

Currently, there is a substantial loss of tax revenue caused by tax incentives that either fail to attract the right investments or are provided to companies that would have made the investments even in the absence of such incentives. Hence, a cost-benefit study of all tax incentive schemes should be carried out to identify and withdraw incentives/exemptions which are ineffective/outdated.³⁰ In addition, the Government should consider enhancing and/or introducing non-tax incentives in attracting FDIs with a view to protecting our tax base and ensure Malaysian-based operations of MNEs pay their taxes (METR) here in Malaysia, instead of in another jurisdiction, assuming the METR is finally agreed and implemented at 15%. The Government should also consider granting tax incentives to desired sectors/type of investment only (i.e. to focus on prepackaged incentives for big-ticket investments). Incentives linked to the amount of investment undertaken such as ITA and RA should be retained. Additionally, removing ACAs granted on certain capital expenditures where the full amount could be claimed in 1 or 2 years is recommended as these incentives are ineffective and can add administrative and compliance burden to the taxpayer.¹¹

¹¹ CCH IntelliConnect, *Whither Tax Reforms?* By Dr Veerinderjeet Singh, Non-Executive Chairman of Tricor Services (Malaysia) Sdn Bhd

³⁰ CCH IntelliConnect, *Reforms relating to Tax Compliance and Tax incentives*, by Dr Veerinderjeet Singh, Chairman of Axcelasia Taxand Sdn Bhd

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Further, the Government should set up a clear robust measurement tool to evaluate the effectiveness of tax incentives every 3 to 5 years and the tool should be enhanced and updated regularly.¹¹

Simplify incentives legislation

Currently, tax incentives are provided under the Promotion of Investment Act 1986 (e.g. PS and ITA) as well as the Income Tax Act 1967 (e.g. RA). The Government should consider revoking the PIA (after reviewing/eliminating ineffective incentives) and thereafter, placing the remaining incentives under the Income Tax Act 1967¹¹ (e.g. the new Section 6(1A) of the Income Tax Act 1967). An efficient tax incentive system that is simple, transparent and automatic can help to remove uncertainty, facilitate and enhance compliance as well as reduce tax leakages.

Incentivise both local and foreign investments with lower tax rate

As part of the move to attract both local and FDIs as well as to remain competitive, the Government should consider lowering the Corporate Income Tax (CIT) rate after realising the savings from eliminating ineffective/outdated incentives (e.g. gradual 1% annual cut until the current CIT rate of 24% drops to 20%) and at the same time, all other aspects of doing business needs to be streamlined.¹¹ However, it will be a challenge for the Government to reduce the corporate tax rate under the current economic circumstances due to the COVID-19 pandemic. Therefore, lowering the corporate tax rate may take a much longer timeframe.

Further, the Government should consider using the corporate tax rate as an incentive, i.e. either offer a 5% rate or a 10% rate or even 15% instead of total exemption. This will encourage investment and at the same time ensure that any FDIs/MNEs operating in Malaysia will not be penalised for operating in a tax jurisdiction that offers legitimate tax holidays, assuming the METR is finally agreed at 15% and implemented.³⁰

FINANCIAL REPORTING IMPLICATIONS

In Malaysia, the accounting standards are issued by the Malaysian Accounting Standards Board (MASB). MASB was established under the Financial Reporting Act 1997 as an independent authority to develop and issue accounting and financial reporting standards in Malaysia. The MFRS framework was introduced by the MASB and came into effect on 1 January 2012. Entities other than private entities shall apply the MFRS framework for annual periods beginning on or after 1 January 2012, with the exception of entities that have in the alternative chosen to apply Financial Reporting Standards shall comply with MFRSs for annual periods beginning on or after 1 January 2018. The MFRS framework is fully compliant with the International Financial Reporting Standards (IFRS) framework, which enhances the credibility and transparency of financial reporting in Malaysia. The adoption of the MFRS framework allows Malaysian entities to be able to assert that their financial statements are in full compliance with IFRSs. Private entities (this would cover many small medium companies) shall comply with either the Malaysian Private Entities Reporting Standard (MPERS) in their entirety for financial statements with annual periods beginning on or after 1 January 2016 or the MFRS in their entirety. Private entities that have applied FRSs shall apply either MFRS or the MPERS for annual periods beginning on or after 1 January 2018.

Since its inception, the Malaysian accounting standards i.e. MFRS/MPERS have undergone fundamental changes so as to fairly reflect business transactions and the underlying economic reality in the modern business environment. Recently, two new standards, i.e. MFRS 15 – Revenue from Contracts with Customers (effective for annual periods beginning on or after from 1 January 2018) and MFRS 16 – Leases (effective from 1 January 2019) have been issued, which have significant tax implications.

The objective of MFRS 15 is to have a single revenue standard and model of accounting for revenue applicable across all industries and capital market. The changes in the accounting method of revenue recognition due to the adoption of MFRS 15 will impact the tax liability and deferred taxes of the entity. The difference in the amount recognised under MFRS 15 and the Income Tax Act 1967 is a mere timing difference and the entire amount from the contract would eventually be subjected to tax. Exceptions to this principle are where specific tax treatment has been established through case law or provided under the tax

¹¹ CCH IntelliConnect, *Whither Tax Reforms?* By Dr Veerinderjeet Singh, Non-Executive Chairman of Tricor Services (Malaysia) Sdn Bhd

³⁰ CCH IntelliConnect, *Reforms relating to Tax Compliance and Tax incentives*, by Dr Veerinderjeet Singh, Chairman of Axcelasia Taxand Sdn Bhd

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law (Section 24 Income Tax Act 1967 of gross income for tax purposes), or specific tax treatments for construction business, property development and leasing transactions, provided by regulations made under Section 36 of the Income Tax Act 1967.³²

MFRS 16 effectively eliminates the classification of leases as either operating leases or finance leases for a lessee. For lessee accounting, MFRS 16 introduces a single measurement model where all leases with a term of greater than 12 months are recognised on the balance sheet. The right of use asset on the balance sheet represents the lessee's rights to use the underlying leased asset while the lease liability represents the lessee's obligation to make lease payments. Despite these changes in lessee accounting, MFRS 16 does not change the treatment of leases for income tax purposes for the lessee. The general deduction rules under Section 33(1) of the Income Tax Act 1967 still apply whereby lease rental (interest and principal portion) is a deductible operating expense if wholly and exclusively incurred in the production of gross income. However, depreciation and interest on lease liability are not deductible under Section 33(1) of the Income Tax Act 1967. As for the lessor, there are no changes for income tax purposes.³²

Convergence between accounting profits and taxable profits

Why are these changes to the MFRS/MPERS framework relevant for tax? Under the accounting standards, we see the terms profit before tax, profit after tax and total comprehensive income, none of which is referenced to under the Income Tax Act 1967. From an income tax perspective, corporate tax is imposed on chargeable income and concepts under the Income Tax Act 1967 refer to gross income, adjusted income, statutory income and aggregate income, nothing on accounting profits. In accounting, the term profit is defined as "the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income". Both accounting profit and taxable profit result from deducting expenses from gross income. Yet, in almost all cases, the accounting profit must be adjusted to arrive at taxable income. Section 33(1) of the Income Tax Act 1967 contains the phrase "Subject to this Act...", which means that income is calculated not only by deducting all expenses wholly and exclusively

incurred in the production of income, but it must also take into account all other provisions of the Income Tax Act 1967.³³ In practice, the starting point for the calculation of tax liability is the profit before tax and adjustments in the tax computation will be required where the tax treatment differs from the accounting treatment.

Although both accounting and tax rules focus on the determination of net income, they are two separate systems with different objectives. The main objective of accounting standards is to provide trusted and reliable information about the company's financial performance and position that can also be used to safeguard investors and creditors from fraud on the part of the company. In contrast, the objective of taxation is to raise revenue for the Government. Tax revenue is used to fund Government expenditure and finance Government projects. In view of the above, accounting profit and taxable profit should not be completely aligned. Nevertheless, as the two systems are closely related to each other, the IRB should look into reducing the gap between accounting profit and taxable profit while maintaining the objectives of each system.³³

The implementation of MFRS 15 and MFRS 16 has increased taxpayers' compliance burden as more tax adjustments are needed in arriving at taxable profit, after applying the provisions under the Income Tax Act 1967. For example, MFRS 15 focuses on when control of those goods has been transferred to the customer where revenue is recognised either at a point in time or over time, whilst the amount of revenue that is recognised by a taxpayer in a year should be the amount of income that has accrued to the taxpayer in that year i.e., the amount of income that the taxpayer has become entitled to in the year or when debt owing to the taxpayer has arisen. Because of this divergence, tax adjustments need to be made to the accounting revenue in applying the provisions under the Income Tax Act 1967 and information relating to the adjustments such as financing component and income recognition relating to transitional adjustments, etc. are required to be clearly disclosed in the tax computation. Taxpayers are also responsible to ensure that the reconciliations are properly documented. This has resulted in higher tax compliance cost to taxpayers.

³² *The Malaysian Institute of Accountants, How will MFRS 15 and 16 Affect Tax Reporting?* by Abdul Razak Rahman <https://www.at-mia.my/2018/08/01/how-will-mfrs-15-and-16-affect-tax-reporting/>

³³ Yussof, Salwa. (2014). *The Intersection of Accounting and Taxation in Malaysia*. *Bulletin for International Taxation*. 68. https://www.researchgate.net/publication/304569438_The_Intersection_of_Accounting_and_Taxation_in_Malaysia



In order to facilitate tax administration and reduce the cost of tax compliance on taxpayers, the principles of recognition of profit and expenditure under the revenue laws should converge as far as possible with the principles prescribed in the MFRS/MPERS barring situations where specific rules/legislation are necessary. As such, the Government should consider simplifying the tax legislation by aligning revenue recognition for tax purposes with MFRS 15 as well as eliminating the classification of leases as either operating leases or finance leases in respect of the lessee for tax purposes.

This convergence would overcome the problem of mismatching that arises from different accounting and tax treatment for specific items (whether income or expenditure). For example, the acceptance of the accounting revenue as determined under MFRS 15 is consistent with the “debt owing / entitlement to income” tax principle. An entity would continue to be entitled to

its income once the service is performed or goods are transferred. Any difference in the amount of revenue recognised under MFRS 15 from the amount of revenue recognised otherwise is largely a timing difference given that the entire amount of revenue from a contract would eventually be subject to tax. This would also lower tax compliance costs for taxpayers, thereby reducing unintentional tax avoidance.³²

In Singapore, the Inland Revenue Authority has taken the position in the IRAS e-Tax Guide “*Tax Treatment Arising from Adoption of FRS 115 or SFRS(I) 15 – Revenue from Contracts with Customers (Second edition)*” that with the adoption of FRS 115 or SFRS(I) 15, the accounting revenue as determined in accordance with the Standard would continue to be accepted as the revenue in most cases for tax purposes, except where specific tax treatment has been established through case law or provided under the law, or where the accounting treatment deviates significantly from tax principles.³⁴

³² The Malaysian Institute of Accountants, *How will MFRS 15 and 16 Affect Tax Reporting?* by Abdul Razak Rahman <https://www.at-mia.my/2018/08/01/how-will-mfrs-15-and-16-affect-tax-reporting/>

³⁴ Inland Revenue Authority of Singapore, *IRAS e-Tax Guide, Tax Treatment Arising from Adoption of FRS 115 or SFRS(I) 15 – Revenue from Contracts with Customers (Second edition)* https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguide_Tax%20Treatment%20Arising%20from%20Adoption%20of%20FRS%20115.pdf

INTERNATIONAL TAX



REALIGNMENT WITH INTERNATIONAL TAX STANDARD

An alignment of the present tax treatment for certain items with the generally adopted global tax positions would aid in providing tax certainty to taxpayers.

One of them would be the scope of royalty and in particular, software-related payment. As a matter of policy, the Government may want to consider adopting the “right-based” approach in determining whether a software related payment constitutes royalty.

Likewise, the Government may wish to revisit the position of payment of charter and voyage hire to non-residents as in the shipping world, this income is clearly shipping income as opposed to rental income from moveable property. As such, WHT should not apply.

TRANSFER PRICING

The transfer pricing policies and regime in Malaysia largely mirror the 2017 Transfer Pricing Guidelines issued by the OECD. In recent years, Malaysia has been taking an increasingly aggressive stance in enforcing transfer pricing rules.

With the recent amendments to the Income Tax Act 1967, transfer pricing regulations are becoming increasingly stringent. Effective 1 January 2021, imprisonment for a term not exceeding six months and/or a fine (penalty if no prosecution is instituted) ranging between RM 20,000 and RM 100,000 will be imposed on companies that fail to furnish contemporaneous transfer pricing documentation upon request by the IRB. A new surcharge of up to 5% would be imposed on the transfer pricing adjustment amount, thereby widening the base for collection, by extending the cash tax implications of a transfer pricing

adjustment to companies enjoying incentives or with other tax attributes, such as unabsorbed business losses, capital allowances, etc. Further, the DGIR is now empowered to disregard, re-characterise and make adjustments to the structure of a controlled transaction that would be reflective of arm’s-length arrangements having regard to the economic and commercial reality. The introduction of criminal liability, surcharge and expansion of the DGIR’s powers will certainly require the taxpayers to be more vigilant on potential transfer pricing risks as well as making concerted efforts to ensure compliance with the new transfer pricing regulations.

Limited risk entities are entities that undertake limited functions and are guaranteed a routine profit. In normal circumstances, the IRB would expect these entities to be profitable regardless of the economic cycle. However, as value chains are adversely affected globally due to the impact of the COVID-19 pandemic, these limited risk operators in Malaysia, especially distributors, may incur losses as they bear some degree of market risk or would have to share a portion of the overall financial losses suffered by the group. This presents a challenge to limited risk entities from the documentation perspective.

The Malaysia Transfer Pricing Guidelines is applicable in full to a business with gross income exceeding RM 25 million, and the total amount of related party transactions exceeding RM 15 million. With regard to financial assistance the guidelines are only applicable if that financial assistance exceeds RM 50 million³⁵. There are multiple provisions which need to be considered in arriving at the conclusion of whether two parties are associated or not from the Malaysian Transfer Pricing perspective. Furthermore, the Transfer Pricing law, the Transfer Pricing Rules and the Transfer Pricing Guidelines apply to both cross-border and domestic controlled transactions.

³⁵ Inland Revenue Board of Malaysia, *Transfer Pricing Guidelines* http://phl.hasil.gov.my/pdf/pdfam/Malaysian_Transfer_Pricing_Guidelines_2017.pdf

INTERNATIONAL TAX

Reduce transfer pricing documentation requirements for certain companies/transactions

Currently, the Malaysian Transfer Pricing Guidelines do not provide any safe harbour for preparation of transfer pricing documentation. The thresholds mentioned in the foregoing paragraph merely govern the contents of the transfer pricing documentation (detailed versus simplified), based on the revenue/related party/outstanding loan thresholds. The IRB should consider, among other measures deemed suitable:

- (a) Setting a higher gross income and total amount of related party transactions threshold for the guidelines to be applicable in full (detailed documentation). For example, for taxpayers with cross border-controlled transactions, the gross income threshold could be increased to RM 50 million, while the total amount of related party transactions threshold could be altered to more than 20% of net revenue or RM 30 million (whichever is lower). For taxpayers with only domestic controlled transactions and no tax attributes, higher gross income and total amount of related party transaction thresholds could be applied, as the risk of tax base erosion is significantly lower. All of these thresholds can be increased over time depending on compliance behaviour of the taxpayers;
- (b) Providing clarity to the taxpayers below the thresholds suggested in (a) above, on the format/ contents of simplified TP documentation required to be maintained. For example, a tabular format with relevant appropriate information focused only on testing the arm's length character of the controlled transactions could be prescribed in the guidelines;
- (c) Adopting the OECD safe harbour guidance on low value adding intragroup services for both inbound and outbound transactions, with a de-minimis rule, i.e. for similar transactions exceeding RM 30 million, the safe harbour would not apply; and
- (d) Exempting certain passive/non-trade domestic controlled transactions, e.g. interest and rental income, from the requirement of transfer pricing documentation, with a de-minimis rule, i.e. for similar transactions exceeding RM 30 million, the exemption would not apply.

For instance, Australia's safe harbour in relation to simplification of documentation reduces the compliance burden for taxpayers, which can be time-consuming and costly. In some cases, the compliance burden can be disproportionate to the functions and the risks assumed by the taxpayer. At the same time, the rule requires taxpayers to meet certain criteria in order to qualify for safe harbour that reduces the administration burden for the tax authority. Further, in safe harbour rules such as the ones implemented by India, Singapore and Russia, taxpayers are provided with safe harbour parameters deemed appropriate by the tax administration. This provides certainty on pricing and treatment of related party transactions for taxpayers, whereas tax authorities can focus on transactions which potentially carry more risk/exposure. This enables tax administrations to redirect their administrative resources from the examination of lower risk transactions to examinations of more complex or higher risk transactions and taxpayers.

As can be observed above, implementation of safe harbours, which constitute simplified approaches (applied in appropriate circumstances) can be beneficial for both taxpayers and tax administrations. Simplicity can be conducive to ease of tax administration and ease of tax compliance. Ease of tax administration, which refers to the reduction of the administrative burden borne by the tax authorities and the associated mobilisation of resources necessary to be employed for the examination of transfer pricing issues. The costs of tax administration must be balanced against the revenue collected. Therefore, increasing the effectiveness of tax administration is a desired tax policy objective. Ease of tax compliance refers to the extent of the compliance burden relative to tax costs borne by a taxpayer. Where the compliance costs exceed the tax costs, the general policy objectives may not be necessarily achieved.

INTERNATIONAL TAX



Issue guidelines on information/documents required to justify low profitability/loss of companies due to unfavourable external economic circumstances

Malaysia has experienced over a full year impact from the COVID-19 pandemic. As the economic effects of the pandemic became apparent, some of the key transfer pricing considerations taxpayers may have include the following:

- i. potential loss-making positions of limited risk operating entities;
- ii. practical issues of benchmarking and documentation during the COVID-19 pandemic; and
- iii. the impact of the pandemic on existing or new APAs. This includes questions on how COVID-19 has impacted the taxpayer from a quantitative perspective (e.g., comparison of forecasts against actual financial results), as well as qualitative questions (e.g., site closures and Government assistance).

While the OECD has released a consensus guidance on some of the above issues on 18 December 2020 and the IRB is expected to follow the same in its assessment of impacted taxpayers, a formal guidance from IRB, especially around any deviations in stance from the OECD guidance would provide the much-needed clarity. The IRB should consider issuing guidelines to advise affected taxpayers on issues that may arise or be exacerbated by the COVID-19 pandemic e.g. set out the information/documents that are required in order to justify the company's lower profitability/loss.

Related party definition under the Income Tax Act 1967

Currently, there are multiple provisions in the Income Tax Act 1967 which need to be considered in arriving at the conclusion of whether two parties are associated or not from the Malaysian Transfer Pricing perspective. Some of the relevant provisions under the Income Tax Act 1967 are:

- i. Section 2(4) – “Where companies in the same group”;
- ii. Section 139 – “controlled companies”;
- iii. Section 140A(5) of the Income Tax Act 1967 read with Rule 3 of Transfer Pricing Rules – “controlled transaction”;
- iv. Paragraph 5 of Malaysian Transfer Pricing Guidelines 2012 – meaning of “control” and “associated”; and
- v. Section 140A(5A) – expanded definition of control.

It is extremely intricate, and at times confusing, to navigate the definition of associated enterprise in arriving at the conclusion of whether two parties are associated or not from the Malaysian Transfer Pricing perspective. For compliance with transfer pricing documentation requirements, it is pragmatic to have a single provision in the Income Tax Act 1967 providing comprehensive definition of associated enterprise. It will be more prudent if the relationship criteria are aligned to the Malaysia CbCR Rules on constituent entities, which works based on accounting consolidation rules prescribed in Accounting Standards. It will also, in a way, align it with the Accounting Standards on consolidation and will be easier to regulate. Considering that returns are expected to be based on audited financial statements, this is a much-needed alignment.

INDIRECT TAX AND OTHER TAXES

BROADEN SST/RE-INTRODUCE GST

Many calls have been made to either broaden the scope of the SST or reintroduce Goods and Services Tax (GST). Effective 1st September 2018, Malaysia reintroduced the SST to replace the GST. The current Finance Minister said “Whether or not to diversify or look at new avenues such as the GST, we are still studying all forms of taxes” at a press conference held in Putrajaya on 18 March 2021. It is hoped the MOF could consider some of the economic costs or implications of reverting to SST system since 2018 as discussed below.

Comparison of revenue generated

It was reported that the total GST collection in 2017 (last full year of GST) was RM 44bil. As a comparison, SST raised RM 18bil in 2015, and under SST 2.0, revenue rose to RM 28bil in 2019. Based on the Fiscal Outlook 2021 report released by the MoF, revenue from SST is expected to be lower at RM 24.5bil with sales tax collection projected to reduce by 21.4% to RM 12.1bil (2019: RM 15.4 billion). This is in line with the Government’s initiative to provide tax exemptions for the purchase of locally assembled and fully imported passenger cars under the PENJANA package.³¹

Experts’ view on SST and GST

These key principles of flexibility, efficiency, transparency, and the ability to be tax neutral (i.e. tax everyone equally) are some of the key reasons why many economists and tax policy experts favour the GST. For example, In the ASEAN+3 Macroeconomic Research Office (AMRO) 2020 Annual Consultation Report on Malaysia³⁶, AMRO stated that when the economic recovery is on a firm footing, tax reforms may be implemented to guide the federal Government debt back to the pre-pandemic statutory limit over the medium term. It elaborated that reintroducing the 6% GST would raise the additional revenue needed to narrow the deficit and substantially lowers Government debt towards the desired limit. It went on to suggest that the scope of the SST can be broadened before the re-introduction of GST.

So how does the SST model differ from the GST? There is a number of critical points of difference.

Firstly, on scope. The GST is a broad-based tax and applies to all sales (referred to as supplies) of goods and services unless specifically excluded by the Law. The SST on the other hand consists of two separate and independent taxes. The sales tax applies broadly to prescribed taxable goods at varying rates but is limited to only the acts of importing or local manufacture. The service tax applies only to the provision of prescribed services such as professional services, telecommunication, insurance, etc. As a consequence, under the SST if your business falls outside of these categories, i.e. an importer, a manufacturer, a prescribed service provider you are entirely outside of the SST net. The narrower base of the SST means that prescribed businesses and industries are effectively carrying the entire burden of tax collection, whereas under the GST this obligation is more evenly shared given the broader focus. Tax neutrality is more easily achieved with the GST than with the SST.

Further on the issue of scope, as the service tax in particular requires a service to specifically prescribed to be in scope, it limits the ability and the flexibility of the tax to adapt as quickly to new service industries. The GST system with its ‘all in’ model ensures that any and all types of supplies are in scope even where those services may not have existed when the tax was devised. The need to be prescriptive for service tax also creates considerable confusion as categories of services are not appropriately defined resulting in uncertainty as to what services the Government intends to tax or exclude (e.g. information technology services, management services, digital services). This has resulted in numerous commercial disputes between parties on whether the tax should have been levied or not on a particular transaction.

Another critical point of difference between the SST and the GST, is the availability of an input-credit mechanism in the latter. Generally speaking, business to business transactions do not have a GST cost, as businesses are allowed to offset GST paid on purchases with GST collected on sales. The GST model is designed specifically so that only the final consumer bears the cost of the tax and there is no cascading of the tax. Unfortunately, with the SST, no such mechanism exists and a good or service sold to an end consumer is likely to have embedded in the price multiple layers of SST that would have been incurred and cascaded through the supply chain. The Government has tried to rectify this through introducing a vast array of exemptions but this has only served to add further complexity to the tax. Critically, there is a lack of

³¹ Ministry of Finance, 2021 Fiscal Outlook and Federal Government Revenue Estimates <http://belanjawan2021.treasury.gov.my/pdf/revenue/2021/fiscal-outlook-2021.pdf>

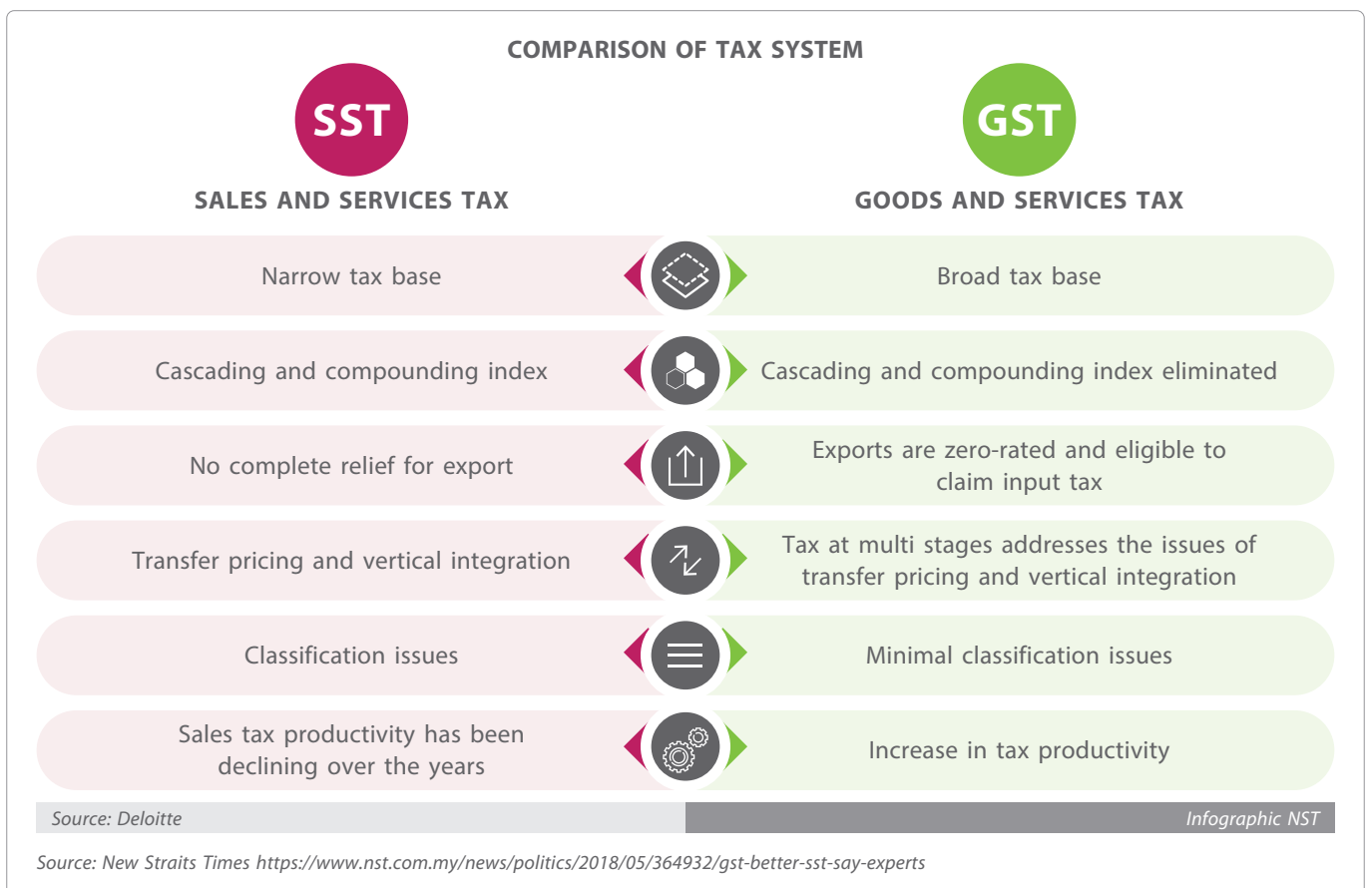
³⁶ ASEAN+3 Macroeconomic Research Office Annual Consultation Report Malaysia – 2020 https://www.amro-asia.org/wp-content/uploads/2021/05/Malaysia-ACR_2020.pdf

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transparency as the consumer does not really know how much tax they have paid when they buy a good or a service. The Government is also unable to easily trace through the transactions to work out if the right amount of tax has been collected or paid. In circumstances where the Government has given exemptions, it is also unclear if the benefits of that exemption flow through to the final consumer.

Another critical area of difference is how the two taxes treat exports, which is critically important for an export-focused economy such as Malaysia. The GST taxes the export of goods and services at a 0% rate and the exporter is entitled to receive full refunds of any tax that is paid through the supply chain. The treatment of exports under the SST is considerably more complex. Whilst there are some exemptions available for services, these are generally quite narrow, and the majority of services provided to recipients outside of Malaysia would be subject to tax. In relation to the export of either goods or services, the ability to recover embedded SST in the supply chain by the exporter is either non-existent or limited. As a consequence, exports are effectively taxed under the SST model and this negatively impacts the price competitiveness of Malaysia as an export economy.

There is also a misconception amongst the general public that a GST system would result in a greater increase in the price of goods and services in comparison to the SST. Global supply chains are very complex and the price paid for goods and services are impacted by many factors that can impact cost include the price of fuel, exchange rate, the availability of resources, etc. The imposition of indirect taxes such as GST or SST represent a small element that would contribute to the overall price impact of a particular good or service. It would be misleading to suggest that the introduction of either tax would result in an increase or reduction of the price of goods or services. Price fluctuations have been noticeable in Malaysia during the period of both the GST and the SST. A further discussion is whether the GST is more suitable for developed countries which have a better ability to absorb the costs of such a tax. This is another area of misconception as the GST (or VAT) has been adopted worldwide whether that be in developed or developing nations. If we use Southeast Asia as a reference point, Indonesia, Philippines, Thailand, and Vietnam, have adopted GST systems with standard rates of 7% or higher and with fewer exemptions than Malaysia. If we compare the cost of living in those countries to Malaysia, we note that these are either similar or lower.



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SST tax leaks as compared to GST

In the near term, without GST in place, AMRO recommends that the Government broadens the SST to approximate the coverage of the GST. While the SST coverage had been broadened in 2019 to cover amusement parks, cleaning services and imported digital services, it can be broadened further. Currently, the SST covers 38% of goods in the Consumer Price Index (CPI) basket and the number of goods exempted via SST is 10 times more than those exempted through GST. Broadening the SST coverage to 50% of goods in the CPI basket – close to the level of GST coverage at 52% to 60% – could increase tax collection by 0.9% of GDP.³⁶ This same view of broadening the SST coverage has also been expressed in page 32 of an OECD report entitled “OECD Economic Surveys Malaysia July 2019”.³⁷

Alternatively, AMRO suggests that the authorities might need to review the scope for reducing the number of goods exempted from the standard SST rate to reduce the administrative burden on businesses and, at the same time, broaden the tax base. Other possible tax measures that could be undertaken are the introduction of Capital Gains Tax (CGT) and carbon tax, as well as increasing tobacco excise taxes and raising the income tax rate for high-income earners.

WEALTH TAX

What is wealth tax?

Presently, Malaysia only imposes tax on income and consumption. No tax is imposed on wealth. Some believe that the imposition of wealth tax is one way to combat the inequality in wealth distribution among citizens in the Malaysian economy. The purpose of wealth tax is to redistribute the fortunes of the richest Malaysians to the ordinary people to achieve a fairer society and reduce the wealth inequalities between the rich and the poor.

Wealth tax is defined as a tax on an individual’s stock of assets, and not on income, profits or transactions.³⁸ A

wealth tax is a tax levied on the net fair market value of a taxpayer’s assets including cash, bank deposits, shares, fixed assets, personal cars, real property, pension plans, money funds, owner-occupied house, and trusts.³⁹ Wealth tax is generally assessed periodically, usually on an annual basis.

The Institute for Research and Development of Policy Malaysia representatives had opined that wealth and inheritance tax should have a high threshold value such as assets worth above a specific threshold will be subject to such tax. This will ensure that this tax only affects those who are extremely rich.⁴⁰

How unequal is wealth distribution in Malaysia?

The World Bank has, in its Malaysia Economic Monitor December 2020 edition, proposed that Malaysia looks into expanding CGT; exploring other forms of progressive taxes, including wealth taxes; maximising gains from tax expenditures; and enhancing revenue administration.⁴¹ The income inequality in Malaysia was reported to have widened even while median household income rose to RM 5,873 in 2019. The official statistics showed that income inequality in the country has gone up in 2019 compared to 2016. Income inequality was calculated based on two categories – gross income (which is before payment of tax and contributions to social security scheme) and disposable income (which is after deducting tax, zakat and social security scheme contribution) using the DOSM’s figures reported in the released Household Income and Basic Amenities Survey Report 2019. The income inequality in Malaysia was measured using the Gini coefficient, with a higher value showing higher inequality in income.⁴²

The crisis has exacerbated existing inequalities (OECD, 2020[3]). In particular, those sectors affected by confinement measures, comprising large shares of low-skilled workers, have suffered extreme income losses, while labour markets for many higher-income workers have hardly deteriorated at all (OECD, 2020[4]; Palomino, Rodriguez and Sebastian, 2020[5]). At the same time, asset prices have increased in many economies.⁴³

³⁶ ASEAN+3 Macroeconomic Research Office Annual Consultation Report Malaysia - 2020

https://www.amro-asia.org/wp-content/uploads/2021/05/Malaysia-ACR_2020.pdf

³⁷ OECD (2019), OECD Economic Surveys: Malaysia 2019, OECD Publishing, Paris, <https://doi.org/10.1787/eaaa4190-en>.

³⁸ The Business Times, In The Line Of Duty, by Gayle Goh

<https://www.businesstimes.com.sg/brunch/in-the-line-of-duty-on-wealth-taxes-singapore-must-decide-what-it-most-wants-to-achieve-and>

³⁹ Investopedia, Wealth Tax Definition, by Michelle P. Scott <https://www.investopedia.com/terms/w/wealth-tax.asp>

⁴⁰ New Straits Times, Impose Wealth, Inheritance Taxes, By Nordiana Izzura Mohd Azhar & Dr Mohd Ariff Mohd Daud

<https://www.nst.com.my/opinion/letters/2019/10/529351/impose-wealthinheritance-taxes>

⁴¹ World Bank Group, Malaysia Economic Monitor December 2020 <https://openknowledge.worldbank.org/bitstream/handle/10986/34929/155096.pdf>

⁴² Malay Mail, Income inequality in Malaysia, by Ida Lim

<https://www.malaymail.com/news/malaysia/2020/07/10/income-inequality-in-malaysia-widened-even-while-median-household-income-ro/1883232>

⁴³ OECD (2021), Tax Policy Reforms 2021: Special Edition on Tax Policy during the COVID-19 Pandemic, OECD Publishing, Paris,

<https://doi.org/10.1787/427d2616-en>

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Current OECD countries with wealth tax and the tax rate

Certain OECD countries i.e. France, Portugal, and Spain all have wealth taxes.³⁹ Wealth taxes are gaining traction, as countries dig deep to fund their pandemic responses. Calls for net wealth taxes are growing. Bolivia approved net wealth tax in December 2020. Recently, the US Democrats led by Elizabeth Warren proposed an Ultra-Millionaire Tax Act, which would annually tax households worth over US\$50 million by up to 3 per cent. Argentina had recently passed a one-time net wealth tax in December 2020. This calls on individuals worth over 200 million pesos (SGD 2.94 million) to surrender up to 3.5 per cent of their wealth in the country, and up to 5.25 per cent of their wealth abroad.³⁸ The one-off wealth tax on the wealthiest Argentinians brought in around \$2.4 billion to help address the COVID-19 pandemic costs.⁴⁴

Currently, New Zealand does not impose wealth tax. The Inland Revenue Department and the New Zealand Treasury had in 2018 released a paper which provides an initial overview of how New Zealand taxes capital income and discusses the role that wealth taxes could play in reducing inequality for consideration by the Tax Working Group (TWG).⁴⁵ The TWG has, however, ruled out a general wealth tax. Nonetheless, in the 2021 Budget, the Inland Revenue Department has been allocated NZD 5 million over two years aimed at “collecting information on the level of tax paid by high-wealth individuals and their related entities.”⁴⁶ Is this an indication the New Zealand Government is reassessing the overall distribution of income and wealth in New Zealand and the role of wealth tax, given concerns about rising inequality?

Risks of wealth tax

As it turns out, taxing the rich has always been proven to be difficult. Tax them in one jurisdiction, and they pop up in another e.g. the IKEA billionaire who legally avoided taxes from 1973 until 2015. In order to avoid wealth taxes in his home country Sweden, the IKEA founder moved from Sweden to Switzerland in 1973 for 40 years.⁴⁷

Another problem with wealth taxes would be tracking wealth held abroad. A wealth tax could be imposed on just domestic assets, but that would create a large incentive for the wealthy to hold their assets abroad. So, Governments would likely impose the tax on worldwide assets, yet that would create a large incentive for evasion. The tax authorities would have a challenging task of auditing assets owned globally and judging whether the valuations on all those foreign assets are fair. Further, Malaysia may have to move from a territorial basis of taxation to a worldwide tax system adopted mainly by advanced countries.⁴⁸

Another issue is that the rich have greater access to wealth planning services. They can avail themselves of exemptions, trusts and other means to shield themselves from the taxman. They also tend to have more lucrative investments, which means a wealth tax hurts them less compared to those with lower returns on their assets. These factors help explain why property tax has outlasted most other wealth taxes today, including here in Malaysia. It is hard to hide or relocate a house. Valuations are generally straightforward, and ownership is transparently documented.³⁸

In France, for instance, a long-standing wealth tax, repealed in 2018, was blamed for an increase in tax dodging and the flight of thousands of the country's richest citizens. It is said that it can lead to the exit of wealth, which is of no benefit to any country.⁴⁹

On 1 January 2018, France abolished its wealth tax (which was assessed on individual's worldwide assets where the net value of the assets exceeds €1.3 million per household) and replaced it with a tax levied only on real estate (which applies to taxpayers if the net worth of their real estate exceeds €1.3 million per household).

Thirty years ago, 12 countries in the OECD levied net wealth taxes. One by one, they peeled away. Austria (1994), Denmark and Germany (1997) went first, followed by the Netherlands (2001), Finland, Iceland, Luxembourg and Sweden (2006-07), and finally France (2018). Spain repealed the tax in 2008 but reinstated it in 2011. Now only three (Norway, Spain and Switzerland) OECD countries levy wealth tax.³⁸

³⁸ *The Business Times*, *In The Line Of Duty*, by Gayle Goh

<https://www.businesstimes.com.sg/brunch/in-the-line-of-duty-on-wealth-taxes-singapore-must-decide-what-it-most-wants-to-achieve-and>

³⁹ Investopedia, *Wealth Tax Definition*, by Michelle P. Scott <https://www.investopedia.com/terms/w/wealth-tax.asp>

⁴⁴ *Business Insider*, *Critics say a wealth tax wouldn't work*, by Juliana Kaplan

<https://www.businessinsider.com/one-time-wealth-tax-in-argentina-brought-in-24-billion-2021-5>

⁴⁵ Tax Working Group – New Zealand, *Taxation of capital income and wealth: Background Paper for Session 5 of the Tax Working Group – March 2018*

– Information Release [Taxation of capital income and wealth: Background Paper for Session 5 of the Tax Working Group – March 2018 – Information Release – Tax Working Group – New Zealand](#)

⁴⁶ Deloitte | tax@hand (taxathand.com) – Snapshot of recent developments – Tax legislation and policy announcements, Deloitte New Zealand

⁴⁷ *Forbes*, *How IKEA Billionaire Legally Avoided Taxes From 1973 Until 2015*, by Robert W. Wood

<https://www.forbes.com/sites/robertwood/2015/11/02/how-ikea-billionaire-legally-avoided-taxes-from-1973-until-2015/?sh=64e402ac5af5>

⁴⁸ Cato Institute, *Taxing Wealth and Capital Income*, by Chris Edwards

<https://www.cato.org/tax-budget-bulletin/taxing-wealth-capital-income#complex-administration>

⁴⁹ *Washington Post*, *Should the rich pay for the pandemic? Argentina thinks so. Other countries are taking a look*, by Diego Laje and Anthony Faiola

https://www.washingtonpost.com/world/the_americas/coronavirus-argentina-wealth-tax/2021/02/19/96fd1ec4-711b-11eb-93be-c10813e358a2_story.html

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Wealth tax measured as a percentage of total tax revenues

In the OECD data, revenues from net wealth taxes made up 3.79 percent of total tax revenues in Switzerland in 2019 but just 0.19 percent of revenues in France. Among those five OECD countries (i.e. Colombia, France, Norway, Spain, and Switzerland) collecting revenues from net wealth taxes, revenues made up just 1.2 percent of total revenues on average in 2019.⁵⁰

Design of wealth tax

We look at a recent country which successfully imposed net wealth tax of \$2.4 billion i.e. Argentina. Under the Argentine tax regime, the wealth tax is levied annually on all assets held by individuals and undivided estates as of December 31, based on the place where they are domiciled (whether in Argentina or abroad):

- i. All rural premises owned by individuals or undivided estates are exempted from the wealth tax, regardless of their purpose or use (leased, assigned, exploited, or not exploited).
- ii. As from fiscal period 2018, the residual value of real estate will be compared to the appraisal for tax purposes made in 2017, updated by the CPI, as of the date on which the fiscal year ended.
- iii. As from fiscal period 2018, its National Office of Motor Vehicles and Pledges issued a table which shall be compared to the amount appraised for tax purposes.
- iv. As from fiscal period 2019, the minimum non-taxable amount is set at ARS 2,000,000 (\$20,844). In addition, dwelling houses will only be subject to wealth tax if their appraised value exceeds ARS 18 million (\$187,594).
- v. Under the new legislation, the wealth tax will continue to be levied during subsequent fiscal periods, but with a new minimum non-taxable amount for taxpayers domiciled in the country, a progressive tax rate scale, some changes in the way real estate and motor vehicles are appraised, and the exemption applicable to rural premises and dwelling houses (the latter with a cap).⁵¹

Wealth tax – to introduce or not to introduce?

Noting that Malaysia is currently not taxing capital gains (other than RPGT), Malaysia, if at all, it wishes to introduce wealth tax, may take guidance from the Swiss's success in imposing wealth tax. Looking at the Swiss taxation system in totality, a lot of very wealthy people derive most of their income from dividends, which are preferentially taxed. Switzerland is also one of the few developed countries where capital gains are not taxed. In other words, the ultra-wealthy are willing to bear with wealth taxes, so long as other forms of taxation are not too onerous. Switzerland reaps value from its wealth tax, but it taxes the rich more lightly in other ways, compared to its regional peers; so the overall tax burden evens out. That is a balancing act the Government will have to figure out, if they want to emulate the Swiss system.³⁸

Given how other countries have gradually dropped wealth tax over the years and noting that revenues may not be significant and which may also result in the wealthy shifting out of Malaysia, a permanent wealth tax may not be feasible. Instead, the Government may consider a one-time wealth tax to help rebuild the country, as although income taxes can help, but the best way to reduce inequality is to tax wealth. The implementation of a one-time net wealth tax by Argentina was recently passed in December 2020.

Having said that, wealth tax may not be necessary if there are comprehensive capital income taxes, including CGT as discussed under *'Implementing CGT moving forward with increased complexities in tax administration'* of this report. After all, policy decisions in Malaysia should be driven by what is appropriate for Malaysia. An issue identified, or a solution developed, in another country is not necessarily an issue in, or a solution for, Malaysia. We could learn from the overseas experience but any introduction of major taxes in Malaysia must be carefully considered. A more in-depth study is required before a conclusion could be reached on whether to introduce wealth tax. Any comparison with other jurisdictions would also need to look at the economic development and income structure in those jurisdictions *vis-a-vis* that of Malaysia.

³⁸ *The Business Times, In The Line Of Duty*, by Gayle Goh

<https://www.businesstimes.com.sg/brunch/in-the-line-of-duty-on-wealth-taxes-singapore-must-decide-what-it-most-wants-to-achieve-and>

⁵⁰ Tax Foundation, *Wealth Taxes in the OECD and Lessons for the U.S.*, by Daniel Bunn <https://taxfoundation.org/wealth-taxes-in-the-oecd/>

⁵¹ KPMG Global, *Argentina – Wealth Tax Reform* <https://home.kpmg/xx/en/home/insights/2019/04/flash-alert-2019-071.html>

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CAPITAL GAINS TAX

What is CGT?

CGT is a tax on capital gains, the profit that is realised on the sale of a non-inventory asset. The most common capital gains are from the sale of stocks, bonds, precious metals, and real properties. Not all countries implement CGT and most have different rates of taxation for individuals and corporations.⁵²

Should the Government consider implementing CGT in Malaysia? What is clear is that the Government will not be introducing any new additional taxes for now as it is seeking ways to broaden its revenue post-pandemic, according to Finance Minister Tengku Zafrul Aziz. The timing (introduction of a new tax system) is also important," he said during a media briefing in Putrajaya on 18 March 2021.⁵³

Current CGT assets

Presently there is no CGT regime in Malaysia except for the Real Property Gains Tax Act 1976 that imposes tax on gains arising from the disposal of real property located in Malaysia and shares in a real property company. Where the gain is of a revenue nature (e.g., profits of a property development company), it would not be subject to RPGT. Income tax under the Income Tax Act 1967 will apply. Broadly speaking, a gain arising from the sale of shares (other than RPC shares) by an investor and sale of business (including goodwill, know-how, etc.) are viewed as gains that are of a capital nature and do not fall within the ambit of Income Tax Act 1967 or the Real Property Gains Tax Act 1976. This also applies to disposal of private assets such as antiques, paintings, yacht, diamonds, gold, jewellery, luxury watches, stamps, coins, etc.

CGT: Equitability and fairness (Taxing the high net worth)

Malaysia applies a capital/revenue boundary to taxation. Revenue gains are subject to income tax, capital gains are not. The introduction of a CGT in Malaysia may give rise to the following positive effects:

- i. A CGT regime may promote equity. Taxpayers who take their income in the normal manner will not be disadvantaged compared to taxpayers who choose to take their income as capital. Further, wealthier income bracket taxpayers are more likely to have capital income, compared to those in the lower-income groups. As such, revenue gained from such a tax can be used to address poverty and income inequality.⁵⁴
- ii. Malaysia's existing tax structure base is already quite narrow as it is reliant on CIT, personal income tax, petroleum income tax and SST. Taxing capital gains would broaden the tax base. Further, in the recent years, petroleum income tax has seen a slight drop due to oil price volatility.
- iii. The current absence of CGT creates opportunities for aggressive tax planning and avoidance by the higher wealth bracket.
- iv. CGT is important when it comes to taxation on intangibles and other digital assets in the future.⁵⁴

OECD Tax Policy – Overview of CGT

Most OECD countries have a general CGT regime.⁵⁵ Many countries tax capital gains at concessionary tax rates. The combined rates of taxation on gains on long-held shares for corporate and individual levels range from 3% to 56.2% with an average of 35.7% in 2016.

Statutory tax rates on capital gains from long-held property arise only from personal taxation, although many OECD countries do not tax these gains. The tax rates range from 0% to 35%, with a simple average combined rate of 15.7%.

⁵² Capital gains tax – Wikipedia https://en.wikipedia.org/wiki/Capital_gains_tax

⁵³ The Edge Markets, No GST or new additional tax for now, says Tengku Zafrul, by Sulhi Khalid [No GST or new additional tax for now, says Tengku Zafrul | The Edge Markets](https://www.theedgemarkets.com/article/irb-ceo-govt-should-consider-introducing-capital-gains-tax)

⁵⁴ The Edge Markets, IRB CEO: Govt should consider introducing capital gains tax, by Arjuna Chandran Shankar <https://www.theedgemarkets.com/article/irb-ceo-govt-should-consider-introducing-capital-gains-tax>

⁵⁵ Australia, Austria, Canada, Chile, Estonia, Finland, Greece, Hungary, Iceland, Ireland, Israel, Luxembourg, Mexico, Norway, Portugal, South Africa, Spain, Sweden, UK, USA

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All OECD countries that tax capital gains do so upon realisation. Some countries do not tax capital gains on shares or real property at the individual level.

Several OECD countries apply a holding period test which reduces or eliminates taxation of capital gains on an asset that has been held for longer than a certain period. The longest holding period for shares range from 6 months to 20 years and for real property from 1 year to 30 years.⁵⁶

Distributional data from countries with CGT, such as Australia and the United States, show the distribution of taxable capital gain income is highly skewed to the wealthiest households, so not taxing capital gains raises fairness concerns.⁵⁷

CGT design generally

Most countries tax capital gains as part of the income tax. Capital gain refers to an increase in a capital asset's value and is considered to be realised when the asset is sold. A capital gain may be short-term (one year or less) or long-term (more than one year). Short-term gains are charged to income tax whereas long-term gains are charged to CGT at a lower rate. Unrealised gains and losses, sometimes referred to as paper gains and losses, reflect an increase or decrease in an investment's value but are not considered a taxable capital gain. A capital loss is incurred when there is a decrease in the capital asset value compared to an asset's purchase price.⁵⁸

Practical considerations have led virtually all countries with CGT to adopt a realisation basis. With a realisation basis, CGT would be imposed when the assets are sold. This would obviate potential liquidity difficulties and the need for a periodic asset valuation under an accrual basis. For example, Canada, Australia, Germany, UK, US, Japan and India all tax capital gains on assets on a realisation basis.

Potential negative ramifications may arise from the introduction of a CGT regime

Nonetheless, the following potential negative ramifications may arise from the introduction of a CGT regime:

- i. Increasing the taxation of capital gains is likely to increase ETRs on some investments, and thereby reduce levels of investment. By itself, this is likely to have a negative impact on productivity and economic growth.
- ii. The extension of CGT will increase compliance and administration costs to both the taxpayers and the tax authority. The administrative complexity of a broad-based CGT should not be underestimated.
- iii. A CGT regime is often perceived by taxpayers as being unfair or unreasonable, causing an adverse reaction among those impacted.
- iv. The revenue volatility from taxing capital gains will pose challenges for fiscal management. The direct macroeconomic impact will be counter-cyclical: tax revenue will increase as asset prices rise and reduce as asset prices fall.⁵⁷
- v. The risk of introducing new taxes, or expanding existing scope, may make doing business in Malaysia more expensive. While there may be a long-term gain in tax revenue, the mid to long term risk is that businesses may move out of the country, which will eventually result in an overall reduction in tax revenue.

To overcome the above negative ramifications, the responsibilities lies with the tax authorities, the advisers and the professional associations to educate the taxpayers from time to time through seminars, workshops, circulars, updates, etc. Further, CGT should be implemented gradually by way of a lower rate and limited scope, for starters. This is so as to not cause a major shock to the market, which may portray Malaysia as business unfriendly.⁵⁹

⁵⁶ Statutory tax rates on dividends, interest and capital gains, OECD Taxation Working Papers No. 34, Harding, M and M. Marten. (2018) https://edisciplinas.usp.br/pluginfile.php/5366273/mod_resource/content/1/dividendos%20ocde.pdf

⁵⁷ Tax Working Group, Discussion Paper Extending the Taxation of Capital Income https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3933713-extending-the-taxation-of-capital-income_1.pdf

⁵⁸ Investopedia, Capital Gain Definition <https://www.investopedia.com/terms/c/capitalgain.asp>

⁵⁹ The Edge Markets, The State of the Nation: Careful study on impact of capital gains tax on economy needed, say experts, by Cheryl Poo and Esther Lee <https://www.theedgemarkets.com/article/state-nation-careful-study-impact-capital-gains-tax-economy-needed-say-experts>

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Implementing CGT moving forward with increased complexities in tax administration

During the initial years of CGT, some uncertainties and practical difficulties are bound to arise. No doubt, it may be administratively complicated to implement a full-fledged CGT regime. Any new tax needs to be relatively simple and should not impose undue compliance costs on the community and a disproportionate administrative burden on the revenue authorities. It needs to be fit for purpose and future proofed.

Most countries that tax capital gains have included the gains under the income tax legislation, where capital gains are to be taxed at different rates from other forms of income. Some countries have capital gains taxed as a separate tax at a flat rate which is not integrated with the income tax legislation. At times, it may mean that capital gains are taxed at a higher rate than other forms of income. On the other hand, a separate flat tax could simplify administration and compliance by making it easier for taxes to be withheld on capital gains without any subsequent adjustments.

At all, if CGT is implemented, we are of the view the current Real Property Gains Tax Act 1976 could be a starting point to a full-fledged CGT legislation. The current RPGT form could be amended for the purpose of CGT. A collection mechanism such as withholding of tax may also be considered.

Notwithstanding this, proper economic and distributional analysis would need to be carried out if the Government wishes to consider a full-fledged CGT to be introduced given that Malaysia is still a developing nation and is competing for FDI with various countries in the region. However, a merger of the current RPGT into the income tax structure does make sense as an approach to enhance efficiency and reduce compliance costs.

INDIVIDUAL INCOME TAX

TAX RELIEF TARGETED FOR B40 AND M40 GROUPS

The Government should not only maintain the existing relief but should also consider increasing the relief for EPF & life insurance premiums. This can be done by simply maintaining the existing combined relief of RM 7,000 for EPF/approved scheme (currently restricted to RM 4,000) and life insurance premiums (currently restricted to RM 3,000), by removing the restriction on the respective category of RM 3,000 and RM 4,000. With a gross salary of RM 3,050 per month, the EPF contribution would be RM $335 (11\%) \times 12 = \text{RM } 4,020$. An income of up to RM 4,849 per month falls under the B40 group. EPF contribution is compulsory whereas contributing RM 3,000 per year for life insurance may not be affordable to B40 and the lower range of M40 group (RM 4,850 – RM10,959).

REVIEW RATES FOR M40 GROUP

More can be done to increase the disposable income of the M40 group and one way is to lower the tax rate by one to two percentage points for those earning an annual chargeable income of between RM 70,001 and RM 100,000, as well as broadening the income brackets and reducing the number of bands.⁶⁰ The Government can also increase the tax relief for individual and lifestyle tax relief to, say, RM 10,000 and RM 3,000 respectively from RM 9,000 and RM 2,500 currently. With the effective personal income tax payable reduced, this may help to improve consumers' sentiment and restore their purchasing power. Any positive change in sentiment will hopefully translate into further domestic spending, which will spur the general economy and cascade to the real estate and the share market.⁶¹

EXEMPTION FROM FILING INCOME TAX RETURNS FOR SENIOR CITIZENS (70 YEARS AND ABOVE) WHO ONLY HAVE MALAYSIA SOURCED PENSION AND INTEREST INCOME

With a view to easing the compliance burden for our elderly residents, we are of the view the Government may exempt senior citizens who are 70 years and above and derive only pension (not more than one) and interest income in a financial year, from filing income tax returns. Hence, they will not be required to file income tax returns

(ITR) anymore as their receipts from pension and interest received from money deposited in all approved institutions are tax-exempted. This proposal is adopted from India Budget 2021 announcement.⁶²

SIMPLIFICATION OF PERSONAL RELIEFS

The IRB has listed seventeen personal reliefs that a resident individual may claim in the filing of his Income Tax Return Form (ITRF) for YA 2020. Among these reliefs are: individual RM 9,000, a handicapped individual RM 6,000 (further deduction), medical for family for serious disease RM 6,000, medical for parents RM 5,000 or elderly parents support RM 3,000, education for self RM 7,000, basic support equipment for family/parents RM 6,000, lifestyle RM 2,500, contribution to National Education Saving Scheme RM 8,000, spouse or ex-spouse receiving alimony RM 4,000, handicapped spouse RM 3,500, child/children RM 2,000 – RM 8,000 per child, breast feeding equipment RM 1,000, child care/kindergarten RM 3,000, life insurance/employee provident fund RM 3,000/RM 4,000, medical/education insurance RM 3,000, private retirement scheme/deferred annuity RM 3,000 and contribution to Social Security Organisation (SOCSCO) RM 250.⁶³ It is proposed that the number of reliefs be reduced. This would simplify the submission of the ITRF by resident individuals. The proposed deductions may fall into two categories:

- Category 1 Personal relief: individual – single RM 15,000; married or divorced and paying alimony RM 30,000; if handicapped, additional RM 10,000; with child/children, additional RM 10,000.
- Category 2 (with statements/receipts): a maximum of RM 20,000 to cover all categories that have an element of savings – National Education Savings Scheme, life insurance/employee provident fund, medical/education insurance, private retirement scheme/deferred annuity and contribution to SOCSCO.

The amount of deduction shown may be adjusted based on an analysis of current claims for individual relief by taxpayers so that the Government would not lose much tax revenue with the proposed change. Adjustments may be made every three years based of the rate of inflation over the three years and rounded to the nearest thousand.

⁶⁰ The Edge Markets, Cover Story: Wish list for Budget 2020, by Esther Lee <https://www.theedgemarkets.com/article/cover-story-wish-list-budget-2020>

⁶¹ The Edge Markets, Cover story: Budget 2021 wish lists, by The City & Country team <https://www.theedgemarkets.com/article/cover-story-budget-2021-wish-lists>

⁶² Business Standard News, No ITR for those of 75 years and above if pension, FD interest in same bank

https://www.business-standard.com/budget/article/no-itr-for-those-of-75-years-and-above-if-pension-fd-interest-in-same-bank-121020101330_1.html

⁶³ Inland Revenue Board of Malaysia, Home/Tax Relief http://www.hasil.gov.my/bt_goindex.php?bt_kump=5&bt_skum=1&bt_posi=3&bt_unit=1&bt_sequ=1

INDIVIDUAL INCOME TAX



TAX DEDUCTION FOR DONATIONS TO CHARITABLE ORGANISATIONS

Presently, companies and individuals are allowed to claim a deduction of up to 10% of their aggregate income on contributions made to an approved organisation specified under Section 44(6) of the Income Tax Act 1967. This restriction has an impact on the total amount of donations that the private sectors/individuals may wish to make for charitable purposes.

In line with the Government's efforts to promote a caring society, the Government should consider removing the limitation on deduction that a company/individual is entitled to claim for donations made to charitable organisations.

At the same time, there is a need to consolidate the granting of charitable status to various organisations to curtail possible abuse. The Government needs to also look into ensuring that all institutions which are entitled to claim charitable status for income tax purposes must also maintain proper financial documents and perhaps, charitable status for income tax purposes should be limited to a fixed period of 10 years to enable the institution to build its reserves through fund-raising and after that, they could apply for an extension of another 10 years.

ENVIRONMENTAL SUSTAINABILITY

TRANSFORMING THE GREEN TAX POLICY

Under the 2016 Paris Agreement, the Malaysian Government has committed to reduce carbon emissions by 45% (from the 2005 levels) by 2030.⁶⁴ Malaysia had initiated the National Energy Efficiency Action Plan 2016-2025 to ensure sustainable economic development by encouraging the adoption of energy efficiency in the public and private sectors through reducing electricity demand growth by 8% over the 10-year period with a total reduction of Greenhouse Gas (GHG) emissions of 38 million tonnes of carbon dioxide equivalent. Under the Action Plan, the Government had prioritised green technology adoption by extending the Green Investment Tax Allowance (GITA) for the purchase of green technology assets and Green Income Tax Exemption (GITE) on the use of green technology services until 2023. The GITE was also extended to companies which undertake solar leasing activities to increase participation in the Net Energy Metering Scheme (NEM) which was introduced by the Sustainable Energy Development Authority (SEDA).⁶⁵

In attaining Malaysia's goal to generate 20% of our energy consumption from renewable sources by 2025, the Government had significantly expanded the qualifying list of green assets GITA under the MyHijau directory and extended the income tax incentives under GITA and GITE to 2023. These measures are aimed at incentivising businesses to tackle climate change. The Government should also introduce carbon taxes before 2025 i.e. to penalise environmentally harmful behaviours, which combined with the existing and proposed green initiatives, would help the Government reduce carbon emissions by 45% (from the 2005 levels) by 2030, as it had committed under the 2016 Paris Agreement.

Indeed, in the OECD's report "Overview of the 2019 Economic Survey of Malaysia", the OECD has recommended that in order to achieve this target, Malaysia's economic development path needs to become less carbon intensive. One of the OECD's findings is that the ratio of environment-related taxes is low in Malaysia and implementation of carbon tax may be considered. This would help reduce carbon emissions and air pollution, while providing a steady flow of substantial tax revenues.

In the OECD's estimation of the impact of key recommendations on the federal Government's fiscal balance, the impact of introducing carbon tax on the federal Government's fiscal balance is 1% to GDP [Assuming carbon tax at EUR 7.7 or RM 35.6 per tonne of CO₂ emissions (based on the average carbon tax rate of 14 OECD countries in 2015). The net contribution to revenue collection may be lower if the carbon tax is implemented together with programmes to ease the impact of potential rising cost of living].³⁷

Deloitte's 2021 Millennial and Gen Z Survey finds that nearly 40% of millennials cite employer sustainability as a factor in deciding where to work, the report underlines. Climate change and protecting the environment was millennials' No. 1 personal concern a year ago. Perhaps unsurprisingly, this year, health and unemployment fears topped the list of personal concerns for millennials. Yet, their continued focus on environmental issues (coming in third), and the fact that it remains the No. 1 concern for Gen Z—even during a global pandemic, when other threats to their health, family welfare, and careers may feel more imminent, demonstrates how important this issue is for younger generations. Many believe (37% of millennials and 40% of Gen Zs) that more people will commit to take action on environmental and climate issues after the pandemic. However, approximately 60% of millennials and Gen Zs fear business' commitment to helping combat climate change will be less of a priority as business leaders reckon with challenges brought on by the pandemic.⁶⁶ It is timely for the Government to consider introducing carbon tax, which would not only help reduce carbon emissions and air pollution, fulfill the Government's commitment under the 2016 Paris Agreement, but also provide a steady flow of tax revenues.

³⁷ OECD (2019), *OECD Economic Surveys: Malaysia 2019*, OECD Publishing, Paris, <https://doi.org/10.1787/eaaa4190-en>.

⁶⁴ *The Edge Markets, Climate and environmental Governance: Five years on from the Paris Accord, where are we?*, by Sunita Rajakumar and Luanne Sieh <https://www.theedgemarkets.com/article/climate-and-environmental-governance-five-years-paris-accord-where-are-we>

⁶⁵ Malaysian Investment Development Authority, *Energy Efficiency and Energy Conservation* <https://www.mida.gov.my/industries/services/green-technology/energy-efficiency-and-energy-conservation/>

⁶⁶ *Global Millennial and Gen Z Survey reveals two generations pushing for social change and accountability*, Deloitte SEA, press report.

ENVIRONMENTAL SUSTAINABILITY

TAX TO PENALISE ENVIRONMENTALLY HARMFUL BEHAVIOURS

What is carbon tax?

According to The World Bank, a total of 64 carbon pricing instruments are now in operation around the world, covering over 20% of global GHG emissions and generating \$53 billion in revenue.⁶⁷ The United Nations Climate Change states that the carbon pricing curbs GHG emissions by placing a fee on emitting carbon and/or offering an incentive for emitting less carbon. Carbon pricing generally takes the form of a carbon tax or a permit based Emission Trading System (ETS). Carbon pricing is advancing rapidly as an approach to spur climate action.⁶⁸

Countries with carbon taxes

About 78 jurisdictions (46 national and 32 sub-national jurisdictions) have implemented, or have plans to implement, carbon pricing. These jurisdictions account for roughly half of global GHG emissions. A few of these jurisdictions such as Finland, Norway and Sweden have implemented carbon pricing as early as the 1990s.⁶⁹

Benefits of carbon taxes

A carbon tax will enhance/stimulate clean technology and market innovation, incentivise emitters to factor in the costs of their GHG emissions in their business decisions. This would encourage companies to improve their energy efficiency and innovate to reduce their GHG emissions, as

espoused by Singapore.⁶⁹ Malaysia's closest neighbour, Singapore, was the first country in Southeast Asia to introduce a carbon tax in 1 January 2019 at SGD 5 per tonne of GHG emissions (tCO₂e).⁷⁰ On 23 September 2020, the Environment and Water Ministry secretary-general said that Malaysia is considering imposing carbon tax on future investments to support the sustainability agenda in a bid to tackle climate change.⁷¹

The European Commission on 14 July 2021 adopted the "Fit for 55" package of legislative proposals, within the framework of the European Green Deal intended to reinforce the EU's position as a global climate leader. Among the 13 proposals are climate measures to prevent carbon leakage via a new Carbon Border Adjustment Mechanism (CBAM) Regulation (becomes operational in 2026). The underlying aim of CBAM is to reduce the risk of carbon leakage by ensuring that the price of imports of certain products at high risk of carbon leakage, (i.e., iron and steel, cement, fertiliser, aluminum, and electricity generation) more accurately reflects their carbon content where third countries do not have climate policies equivalent to those of the EU. Where a non-EU producer can show that they have already paid a price for the carbon used in the production of the imported goods in a third country, the corresponding cost would be fully deductible for the EU importer. There may be implication on Malaysian exports and the Government should take this into consideration in the future direction on carbon tax.

⁶⁷ World Bank, Carbon Prices now Apply to Over a Fifth of Global Greenhouse Gases

<https://www.worldbank.org/en/news/press-release/2021/05/25/carbon-prices-now-apply-to-over-a-fifth-of-global-greenhouse-gases>

⁶⁸ United Nations Climate Change, About Carbon Pricing | UNFCCC

<https://unfccc.int/about-us/regional-collaboration-centres/the-ci-aca-initiative/about-carbon-pricing#eq-1>

⁶⁹ United Nations Climate Change, National Climate Change Secretariat, Carbon Tax FAQs <https://www.nccs.gov.sg/faqs/carbon-tax/>

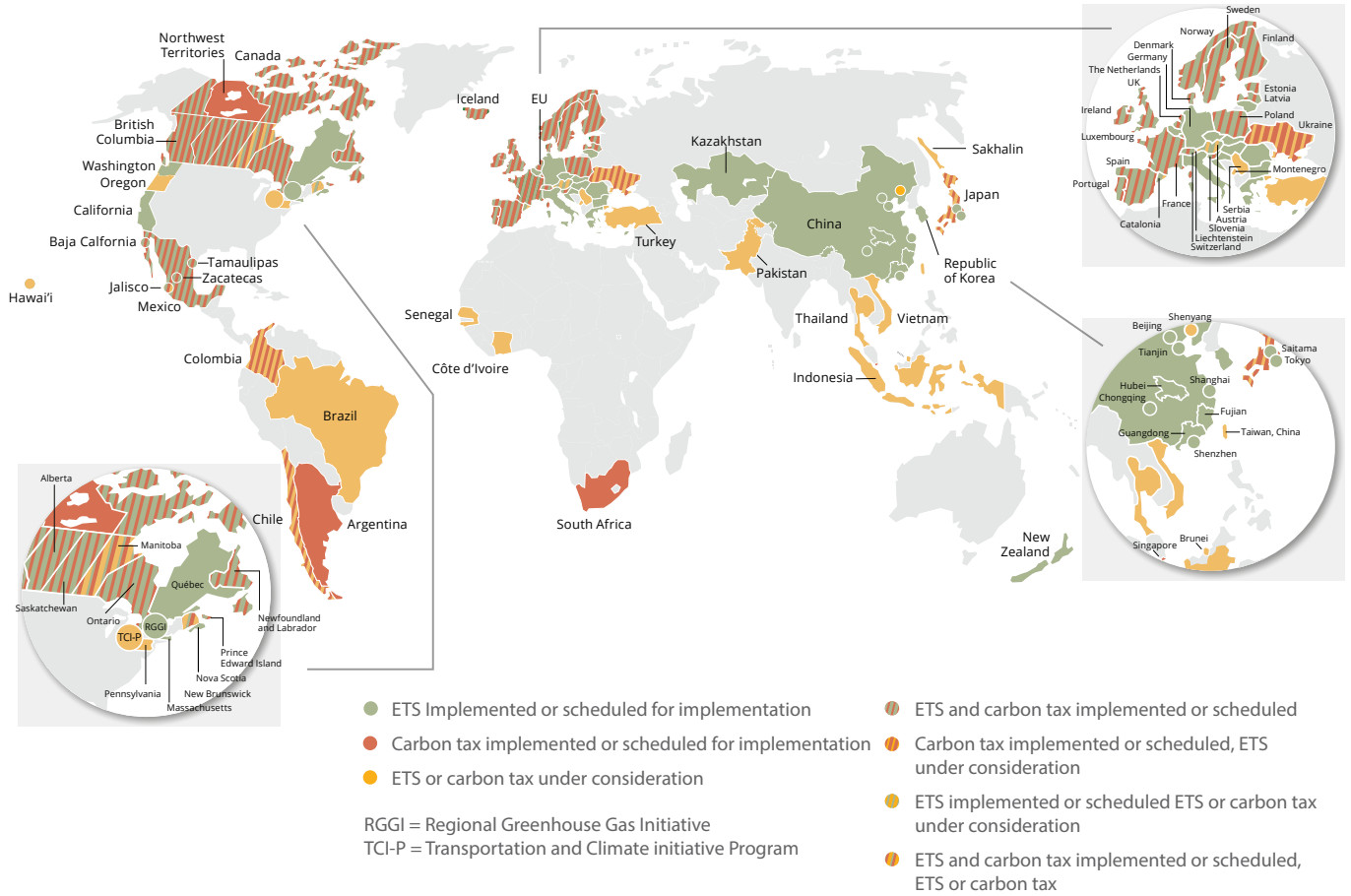
⁷⁰ United Nations Climate Change, National Climate Change Secretariat, Carbon Tax <https://www.nccs.gov.sg/singapores-climate-action/carbon-tax/>

⁷¹ Malaysian Investment Development Authority, Malaysia mulls imposing carbon tax on future investments

<https://www.mida.gov.my/mida-news/malaysia-mulls-imposing-carbon-tax-on-future-investments/>

ENVIRONMENTAL SUSTAINABILITY

See below Figure 1: Map of carbon taxes and emissions trading systems⁷²



The large choices represent cooperation initiatives on carbon pricing between subnational jurisdictions. The small circles represent carbon pricing initiatives in cities. In previous years, Australia was marked as having an ETS in operation. However, the Safeguard Mechanism Functions like a baseline-and-offsets program, falling outside the scope of the definition of ETS used in this report. Therefore, the system was removed from the map. Rio de Janeiro and Sao Paolo were marked as considering the implementation of an ETS based on scaping work done in 2011 and 2012 respectively. Given there have been no updates since, the these were removed from the map.

Note: Carbon pricing initiatives are considered “scheduled for implementation” once they have been formally adopted through legislation and have an official, planned start date. Carbon pricing initiatives are considered “under consideration” if the government has announced its intention to work towards the implementation of a carbon pricing initiative and this has been formally confirmed by official government sources. The carbon pricing initiatives have been classified in ETSs and carbon taxes according to how they operate technically. ETS not only refers to cap-and-trade systems, but also baseline-and-credit systems as seen in British Columbia. The authors recognise that other classifications are possible.

⁷² World Bank. 2021. *State and Trends of Carbon Pricing 2021*. Washington, DC: World Bank. © World Bank. <https://openknowledge.worldbank.org/handle/10986/35620> License: CC BY 3.0 IGO.

ENVIRONMENTAL SUSTAINABILITY

Green tax on old vehicles which are polluting the environment

A green tax may be imposed on old, polluting vehicles in Malaysia in a bid to protect the environment and curb pollution as the age of a vehicle is identified as a major contributor to pollution emissions. Generally, among factors which may lead to a car insurance with a high loading would be the age of the vehicle. Some insurers may consider it as a risk when they bring the owners onboard as a policyholder of their car insurance as the perception that an 8-year-old car is more likely to encounter problems due to daily wear and tear. It may also be hard to get a comprehensive car insurance policy for a car that is pushing 15 years of age. Subject to further research on “old” or “end-of-life” vehicle, perhaps a green tax rate at 10-25% of road tax could be charged for commercial vehicles older than 8 years. Meanwhile, personal vehicles older than 15 years and public transport vehicles, such as city buses, would be charged a lower green tax. This is intended to reduce the pollution level by making the polluters pay for pollution. Revenue collected from the green tax would be kept in a separate account and used for tackling pollution. However, those vehicles operating on clean technologies like hybrids, electric or using alternative fuels like CNG, ethanol and LPG will be exempted from green tax. Other exempted vehicles are those used for farming, such as tractors, harvesters and tillers. The benefits of green tax include dissuading people from using vehicles which damage the environment and motivating them to switch to newer, less polluting vehicles. Such a proposal has been approved by the India Government in 2021.⁷³

The Government may also consider other measures in encouraging electric vehicle (EVs) usage such as improving infrastructure/charging stations installation at Government car park, offer exempted/reduced parking fee and/or toll fees as an incentive to EV drivers.

EXPANDING THE INCENTIVE SCOPE – DIRECT TAX INCENTIVES

Malaysia can also adopt green tax incentive reforms which have been implemented in certain developed countries in Europe, for example:

- **Special deduction for car-sharing systems made available to employees**

A new tax incentive is made available to companies and individuals that incur expenses with car-sharing system. For companies, the benefit could consist of an additional tax deduction of 10% of expenses; for individuals, the additional tax deduction would be 40%. For these purposes, taxpayers must sign a contract with car-sharing companies in order to address the staff needs related to home/work journeys. Car sharing must be made available to all the employees.
- **Special deduction/tax depreciation for environmental clean-up cost**

A new special deduction/tax depreciation should be made available to all industries for provisions made for environmental clean-up costs.⁷⁴ This would be on top of the already applicable income tax exemption for waste management industries in Waste Eco Parks.⁷⁵
- **Waive tax for Battery Electric Vehicles (BEVs)**

The “Low Carbon Mobility Blueprint 2021-30: Decarbonising Land Transportation” draft report published by the Malaysian Green Technology And Climate Change Centre (MGTC), proposes that the Government waive excise duty and import tax for up to 10,000 units of BEVs until 2022, followed by a 50 per cent exemption between 2023 and 2025, as reported by the news media.⁷⁶

While the Government’s plans to reduce electric powered vehicle tax including for the transport of passengers and goods by road should be applauded, a stronger tax incentive should be given to boost the use of electric vehicles (EVs). Going by Maybank IB Research’s latest report, Malaysia is further behind than other countries such as Thailand, Indonesia and Singapore, whose policies are more pro-EVs.⁷⁷

⁷³ The Hindu, Over 4 crore old vehicles on Indian roads, Karnataka tops list at 70 lakh

<https://www.thehindu.com/news/national/over-4-crore-old-vehicles-on-indian-roads-karnataka-tops-list-at-70-lakh/article34182242.ece>

⁷⁴ PricewaterhouseCooper, Highlights on the Green Tax Reform and Personal Income Tax Reform

https://www.pwc.pt/pt/pwcinforfisco/reforma/fiscalidade-verde/images/pwc_analise_reformas2015-eng.pdf

⁷⁵ MIDA, Incentives for Waste Eco Parks, Forms and Guidelines <https://www.mida.gov.my/forms-and-guidelines/services-sector/waste-eco-parks/>

⁷⁶ New Straits Times, Low carbon mobility blueprint to drive larger participation of EV players, by Ayisy Yusof

<https://www.nst.com.my/business/2021/04/683754/low-carbon-mobility-blueprint-drive-larger-participation-ev-players>

⁷⁷ The Star, EV policy shift needed <https://www.thestar.com.my/business/business-news/2021/04/24/ev-policy-shift-needed>

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES

Countries	Tax reform
AUSTRALIA	<p>The Government has recently introduced significant tax reform aimed at reducing personal income tax on individuals particularly those on low incomes. The top threshold of the 32.5% rate bracket increased from AUD 87,000 to AUD 90,000 in 2018 (the threshold will increase further to AUD 120,000 from 2022 and then AUD 200,000 from 2024, effectively abolishing the 37% bracket). The top threshold of the 19% tax bracket will also increase from AUD 37,000 to AUD 45,000 in 2024.</p> <p>Furthermore, to increase tax relief for low incomes, a new 'low and middle-income tax offset' was introduced to provide tax relief of up to AUD 1,080 between 2018 and 2022. Entitlement to this new offset is in addition to the existing "low income tax offset". From 2022, a new "low income tax offset" will replace both the current "low income tax offset" and the "low- and middle-income tax offset". This new "low income tax offset" will increase from AUD 445 to AUD 700.</p> <p>Further, to assist older Australians who receive a redundancy payment but are not yet entitled to receive the Age Pension, the Government is aligning tax concessions afforded to genuine redundancy and early retirement scheme payments with the Age Pension qualifying age.</p> <p>Further, the scheduled CIT rate cuts for SMEs have been brought forward by five years. The CIT rate for companies with an annual turnover below AUD 50million will be 26% in 2020-21 and 25% in 2021-22%.</p> <p>In 2018 Australia removed GST on feminine hygiene product and implemented a reform to eliminate VAT relief regime for imports of low-value goods which led to reported revenues of AUD 81 million in the first quarter of the operation of the regime.⁷⁸</p>
CANADA	<p>Canada has recently cut its federal small business CIT rate from 10% to 9% (on the first CAD 500,000) effective 1 January 2019, as part of a gradual SME CIT reduction that started in 2016. This measure was accompanied by tighter rules on passive income. For businesses with passive income in excess of CAD 50,000, the first CAD 500,000 of income might be taxed at a significantly higher rate.</p> <p>Canada has significantly expanded its capital allowances. Immediate expensing was introduced for investment in machinery and equipment used in manufacturing and goods processing. The objective is to enhance the competitiveness of sectors that might be significantly affected by the US tax reform. Immediate expensing was also introduced for specified clean energy equipment. A third incentive was put in place for businesses of all sizes across all sectors that provides a first-year capital cost allowance equal to up to three times the amount that would otherwise apply in the year an asset is put in use. By allowing businesses to write off a larger share of their costs in the year investments are made, these new incentives are expected to lower the cost of capital, free up business capital and more generally boost business confidence. These three measures will apply to qualifying assets acquired after 20 November 2018, and will gradually phased out between 2024 and 2027.⁷⁸</p>

⁷⁸ OECD (2019), *Tax Policy Reforms 2019: OECD and Selected Partner Economies*, OECD Publishing, Paris, <https://doi.org/10.1787/da56c295-en>.

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
JAPAN	<p>Japan (along with New Zealand and Czech Republic) recorded significant increases in VAT revenues as a share of GDP between 2000 and 2017. Japan had increased its consumption tax rate from 8% to 10% in 2019 (8% reduced rate applies for basic foodstuffs). Raising standard VAT rates was a common strategy for countries seeking to achieve fiscal consolidation in the wake of the crisis e.g. 2007-08 financial crisis as increasing VAT rates provides immediate revenues without directly affecting competitiveness and has generally found to be less detrimental to economic growth than raising direct taxes, although the standard VAT rates for many OECD countries have been stabilised and come to a halt in recent years.⁷⁸</p> <p>Other recent tax reforms in the past four years include tax relief for open innovation where tax deduction is given to companies that carry on qualifying business and made investments in venture capital between 1 April 2020 and 31 March 2022 for which 25% or less of the acquisition cost is recognised as an expense for accounting purposes; a special depreciation of 30% or tax credit of 15% is available for certified mobile network operators established for promoting the use of 5G mobile communication systems, allowing the extension of filing due date for consumption tax⁷⁹; revision to Permanent Establishment (PE) related provision under Japanese tax law to more closely align with the definition under the BEPS project and revised OECD model tax treaty and if there is any difference between the definition of a PE under a tax treaty than that under Japanese tax law, the definition under the tax treaty will be applied to determine whether or not a non-resident subject to the treaty has a PE under Japanese tax laws; and introduction of international tourism passenger tax of JPY 1,000 is collected from tourists departing from Japan on or after 7 January 2019.⁸⁰</p>
CHINA	<p>In 2019, China amended its individual income tax law and introduced some fundamental changes that affect the tax system at its calculation, application, and enforcement stages, for both Chinese and foreign nationals.</p> <p>The key amendments include introduction of a "183 days" to replace the "one year" rule test to define tax residence for non-domiciled individuals, consolidation of four categories of income (salaries and wages, remuneration for independent services, author's remuneration, and income from royalties) into a single new category called "comprehensive income", broadening of the three lowest tax brackets, increasing the standard tax-free deduction from CNY 3,500 per month to CNY 5,000 per month and repealing the additional deduction of CNY 1,300 per month available for foreign individuals. Further, there are additional itemised deductions where resident taxpayers will be allowed to deduct certain additional items from their comprehensive income. These items include education expenses for children, expenses for further self-education, health care costs for serious illnesses, housing loan interest/housing rent, and expenses for taking care of elderly parents. Also, the introduction of anti-avoidance rules into individual income tax which will give the authorities additional powers to enforce tax adjustments on non-arm's length transactions (where two or more parties involved have some vested interest in helping each other, e.g. family members, affiliated businesses) among related parties, offshore tax avoidance schemes, and commercial arrangements from which inappropriate tax benefits are derived.⁸¹</p>

⁷⁸ OECD (2019), *Tax Policy Reforms 2019: OECD and Selected Partner Economies*, OECD Publishing, Paris, <https://doi.org/10.1787/da56c295-en>.

⁷⁹ Deloitte, Japan: Inbound Tax Alert, 2020 Japanese Tax Reform Proposal <https://www2.deloitte.com/content/dam/Deloitte/jp/Documents/tax/bt/jp-bt-japan-inbound-tax-legal-december-2019-no48-en.pdf>

⁸⁰ Deloitte, Japan: Inbound Tax Alert, 2018 Tax Reform Proposals – Announced <https://www2.deloitte.com/content/dam/Deloitte/jp/Documents/tax/bt/jp-bt-japan-inbound-tax-alert-dec-2017-no26.pdf>

⁸¹ EURObiz, Spotlight on China's Individual Income Tax Reform <https://www.eurobiz.com.cn/spotlight-on-chinas-individual-income-tax-reform/>

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
HONG KONG	<p>Over the recent three years Hong Kong has made tax changes with tax relief by waiving property rates for four quarters of 2020/21 subject to a ceiling of HKD1,500 per quarter for each rateable property, reducing salaries tax and tax under personal assessments for 2019/20 by 100% subject to a ceiling of HKD 20,000, reducing 2019/20 final profits tax payable by 100% subject to a ceiling of HKD 20,000, waive the stamp duty on stock transfers by Exchange Traded Funds (ETFs) market makers in the course of treating and redeeming ETF units listed in Hong Kong, providing tax concession for the ship leasing business including offering a profits tax exemption to qualifying ship lessors and a half-rate profits tax concession to qualifying ship leasing managers, and halving profits tax for eligible insurance business including marine insurance.⁸²</p>
INDIA	<p>India's biggest recent reform is said to be the introduction of GST on 1 July 2017 and changes has continued to be introduced in the past three years. These changes were primarily focused on rationalising rates, simplifying procedures, and curbing tax evasion. Stabilising one of the world's biggest online tax systems i.e. Goods and Services Tax Network (GSTN) was also a key focus area for the Government.⁸³ The GSTN is a GST portal used by the Government to track every financial transaction, and will provide taxpayers with all services – from registration to filing GST taxes and maintaining all GST tax details.⁸⁴</p> <p>Other recent reforms in the past two years are that the Dividend Distribution tax on companies was replaced by taxation in the hands of shareholders which allowed lower tax treaty rates on dividends to apply for foreign investors, introducing the tax dispute resolution for settlement of tax disputes to help de-clog the legacy litigation, lowering personal income tax rates for individual taxpayers who forgo certain tax deductions/exemptions in order to relieve taxpayers in the lower income bracket and levying of health cess (i.e. customs duty⁸⁵) of 5 percent on specified imports of medical equipment to promote domestic manufacturing.⁸⁶</p> <p>India's Government had on 13 August 2020 launched the "Transparent Taxation – Honoring the Honest" platform to further a number of objectives, including to reduce the burden of tax compliance for honest taxpayers, to make the existing tax system more "people-centric and public friendly," to reduce human interface, to improve transparency and accountability, and to promote the ideology of "Minimum Government, Maximum Governance." The three main features/objectives of the platform are "faceless" assessment, faceless appeals, and a "Taxpayers' Charter."⁸⁷</p> <ul style="list-style-type: none"> • Faceless assessment: Prior to the launch of the platform, the CBDT launched an e-assessment scheme for 2019 assessment proceedings to eliminate personal interaction between the taxpayer and the Income Tax Department (ITD). The CBDT now has amended the existing e-assessment scheme to align it with the faceless assessment feature of the new platform. • Faceless appeals: The Faceless Appeal Scheme, 2020 that applies as from 25 September 2020 was introduced to eliminate personal interaction between the appellant taxpayer and the Commissioner of Income-tax(Appeals) (CIT(A)) and also clarify the tax authorities' jurisdiction under the tax law to exercise powers and perform functions to resolve appeals in accordance with the provisions of the scheme. Faceless appeals are part of the broader program of faceless proceedings being introduced across India to improve efficiency, transparency, and accountability.

⁸² Deloitte China, Hong Kong SAR Budget 2020/2021: Summary of Tax Measures

<https://www2.deloitte.com/cn/en/pages/tax/articles/hk-budget-2020-2021-summary.html>

⁸³ Deloitte, Three years of GST Journey so far and the way forward <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-GstPOV-noexp.pdf>

⁸⁴ cleartax, GSTN - Know about the Goods and Service Tax Network in India <https://cleartax.in/s/what-is-gstn>

⁸⁵ Deloitte | tax@hand (taxathand.com) Increase in import duty for medical devices and regulatory changes

<https://www.taxathand.com/article/13034/India/2020/Increase-in-import-duty-for-medical-devices-and-regulatory-changes>

⁸⁶ Deloitte, Union Budget 2020 Economic indicators

<https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-india-budget-2020-top-10-highlights-and-economic-indicators-noexp.pdf>

⁸⁷ Deloitte | tax@hand (taxathand.com) Platform for transparent taxation introduced to reward honest taxpayers

<https://www.taxathand.com/article/15238/India/2020/Platform-for-transparent-taxation-introduced-to-reward-honest-taxpayers->

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
INDIA (CONT'D)	<ul style="list-style-type: none"> • Taxpayers' Charter: The Taxpayers' Charter is divided into two parts: the ITD's commitments and its expectations for taxpayers. Some of the highlights of the Taxpayers' Charter are: <ul style="list-style-type: none"> ➤ The ITD commits to: <ul style="list-style-type: none"> ✓ provide prompt, courteous, and professional assistance in all dealings with the taxpayer; ✓ treat every taxpayer as honest, unless there is a reason to believe otherwise; ✓ provide decisions in every income tax proceeding within the prescribed timeframe. ➤ The ITD expects the following from taxpayers: <ul style="list-style-type: none"> ✓ to honestly disclose complete information and fulfill their compliance obligations; ✓ to keep accurate records required under the law; ✓ to make submissions required under the tax law in a timely manner; ✓ to pay amounts due under the law in a timely manner.
KOREA	<p>Korea enacted the 2021 tax reform bill⁸⁸ (effective 1 January 2021) after it was approved by Korea's National Assembly on 2 December 2020. Some of the changes are summarised below:</p> <ul style="list-style-type: none"> • Expansion of investment tax incentives The amendment will consolidate the tax incentives and expand the targeted assets to all business-related tangible assets (excluding land, buildings, motor vehicles and selected assets). This revision is intended to allow corporations to have more options in their investment decision-making, where the current law prescribes specific eligible facilities categories and limited scope to particular corporations. In addition to the basic deduction, the revision will strengthen the incentives by providing additional deduction rates on the increased investments over the past three years' investment average. • Extension of foreign tax credit carry forward and expense of unused credits Under the amendment, the alternative to deduct foreign taxes paid for corporations is eliminated but the foreign tax credit carry forward period will be extended to 10 years (previously 5 years) and any unused tax credits can be expensed in the year following the 10 year period (e.g. in the 11th year). These revisions will apply with respect to foreign tax credits that have not lapsed as of the end of 2020. • Issuance of electronic donation receipts and waiver of statement retention requirement⁸⁹ <ul style="list-style-type: none"> ➤ The definition of donation receipts is extended to include receipts issued in accordance with the methods established by the presidential decree amending the CITL. ➤ Donors no longer will be required to retain and submit a donation statement if the donation receipt was issued electronically. ➤ Likewise, the requirement to submit a donation receipts issuance statement will be waived if the receipt was issued electronically.

⁸⁸ Deloitte Korea, 2020 Korean Tax Law Revision <https://www2.deloitte.com/kr/en/pages/tax/articles/2020/korean-tax-law-revision-2020.html>

⁸⁹ Deloitte | tax@hand (taxathand.com), Tax law amendments approved by National Assembly <https://www.taxathand.com/article/16115/Korea/2020/Tax-law-amendments-approved-by-National-Assembly>

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
PHILIPPINES	<p>On 26 March 2021, the second package of the Philippine Government's comprehensive tax reform program was signed into law as <i>Republic Act No. 11534 or the Corporate Recovery and Tax Incentives for Enterprises Act (the "CREATE Law")</i>⁹⁰. The significant tax reforms include:</p> <ul style="list-style-type: none"> • Retroactive reduction of regular CIT rate The CREATE Law reduces the regular CIT rate of domestic corporations, resident foreign corporations (e.g., branch offices) as well as non-resident foreign corporations (paid as final withholding) from 30% to 25%. Further, for domestic MSME corporations (i.e., micro, SMEs whose total assets do not exceed Php 100 million, exclusive of the land on which its office, plant, and equipment are situated) with net taxable income not exceeding Php 5 million for the taxable year, the regular CIT rate will only be 20%. • Rationalisation of tax incentives enjoyed by business enterprises registered with investment promotion agencies <ul style="list-style-type: none"> a) <u>For qualified export enterprises</u> – Income Tax Holiday (ITH) of 4 to 7 years (depending on the location and industry), followed either by a special CIT of 5% (based on gross income earned, in lieu of all national and local taxes) for a period of 10 years or enhanced deductions from the taxable income (applying the regular CIT rate) for a period of 10 years, at the option of the export enterprise; <u>For qualified domestic market enterprises</u> – ITH of 4 to 7 years (depending on the location and industry), followed by enhanced deductions for a period of 5 years; b) Duty free import of capital equipment, raw materials, spare parts, or accessories directly and exclusively used in the registered project or activity; and c) VAT exemption on import and VAT zero-rating on local purchases of goods and services directly and exclusively used in the registered project or activity.
SINGAPORE	<p>The following are some of the tax changes announced in Singapore's Budget⁹¹ for the financial year 2021 on 16 February 2021:</p> <ul style="list-style-type: none"> • Enhance the Double Tax Deduction for Internationalisation (DTDi) scheme The scope of the DTDi scheme will be enhanced to cover the following specified expenses incurred to participate in approved virtual trade fairs: <ul style="list-style-type: none"> a) Package fees charged by event organisers for virtual exhibition hall and booth access, collateral creation, business meeting/match sessions, pitches/product launches/speaking slots, webinar/conference, and post event analytics; b) Third-party costs for design and production of digital collaterals and promotion materials for virtual fairs; and c) Logistics costs incurred to send materials/samples overseas to potential clients met at virtual trade fairs.

⁹⁰ Lexology, *Philippine corporate tax reforms by Nagashima Ohno & Tsunematsu*
<https://www.lexology.com/library/detail.aspx?g=7f1d349b-6e04-4e04-9e7f-dcd6363e9d23>

⁹¹ Inland Revenue Authority of Singapore, *Budget 2021 – Overview of Tax Changes by IRAS*
<https://www.iras.gov.sg/irashome/News-and-Events/Singapore-Budget/Budget-2021---Overview-of-Tax-Changes/>

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
SINGAPORE (CONT'D)	<ul style="list-style-type: none"> • Extend and enhance the Investment Allowance (Energy Efficiency) (IA-EE) scheme <ul style="list-style-type: none"> a) Expansion in the scope of qualifying projects to include projects involving a reduction of GHG emissions; and a) Streamlined and updated eligibility conditions. These will apply to all projects (i.e. there will no longer be a distinction between data centres and non-data centres). • Extension of GST to low-value goods (i.e. goods that are valued up to (and including) the current GST import relief threshold of SGD 400) which are imported via air or post and business-to-consumer (B2C) imported non-digital services from 1 Jan 2023, through the extension of the Overseas Vendor Registration and reverse charge regimes.
THAILAND	<p>Tax reforms proposed by Thorn Pitidol in "Changing Thailand's Future with Tax Reform"⁹² include:</p> <ul style="list-style-type: none"> • Expanding the tax base while reducing unnecessary tax privileges <ul style="list-style-type: none"> a) Enlarge the tax base by bringing more people to register their personal income tax and CIT; b) Reduce the complexity of rules and regulations related to income tax; and c) Limit unnecessary tax benefits, such as tax benefits from investments in Long-Term Funds (LTF) and Retirement Mutual Funds (RMF) which lead to a loss of tax revenue as well as disproportionately advantage the rich. • Expanding tax revenue from wealth-base taxes such as inheritance taxes and land taxes • Developing new forms of taxes such as earmarked tax and CGT on gains from the stock market • Adopting tax measures to solve environmental problems <ul style="list-style-type: none"> a) Introduce environmental taxes, such as a carbon tax to enhance the competitiveness of Thailand's exports, especially to countries with strict environmental standards; and b) Collect taxes and fees to raise the cost and reduce the use of products such as plastics bags and foam containers. Revenue generated can be used to subsidise more environmentally friendly products.

⁹² Pitidol, T. (2018). *Changing Thailand's Future with Tax Reform*. *Thammasat Review of Economic and Social Policy*, 4(1), 26-54. <https://library.fes.de/pdf-files/bueros/thailand/14720.pdf>

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
UNITED KINGDOM	<p>Comprehensive tax reforms proposal by The Tax Foundation in “A Framework for the Future: Reforming the UK Tax System”⁹³ include:</p> <ul style="list-style-type: none"> • Individual tax: Lowering and flattening rates The current Additional rate of income tax should be abolished to improve competitiveness and remove negative incentives for individuals as they earn higher wages. • Property tax: Overhaul business rates so that they are based on underlying site values Businesses should not face a tax hike when they improve their properties through renovations or new construction. A reformed tax base should reflect the value of the underlying site given its permitted use, but should exclude buildings, plant and machinery, and any other improvements a business might make. • Property tax: Abolish Stamp Duty Land Tax (SDT) and stamp taxes on shares • Consumption tax: Broaden the UK’s VAT base so that it is as broad as the OECD average, while introducing measures to offset the impact on low-income households • Corporate tax: Either make the Annual Investment Allowance unlimited while introducing a neutral tax code which allow corporations to fully deduct the cost of their investments in the first year (i.e. neutral cost recovery) for structures and buildings or make the temporary £1m Annual Investment Allowance permanent while introducing neutral cost recovery for all other capital expenditure • International tax: Repeal the Digital Services Tax and focus on internationally agreed-upon solutions <p>Introduction of plastic packaging tax⁹⁴</p> <ul style="list-style-type: none"> • The UK Government announced in Budget 2018 that legislation would be introduced to tax the production and importation of plastic packaging. • From 1 April 2022, the plastic packaging tax will apply to plastic packaging manufactured in or imported into the UK that does not contain at least 30% recycled plastic. Both filled and unfilled packaging will be liable to the tax. • The registration threshold is 10 tonnes of plastic packaging per annum and once breached, the plastic will be taxed at GBP 200 per tonne.

⁹³ © Centre for Policy Studies & Tax Foundation 2020, A Framework for the Future: Reforming the UK Tax System by Tom Clougherty, Daniel Bunn and Elke Asen <https://files.taxfoundation.org/20201023134831/A-Framework-for-the-Future-Reforming-the-UK-Tax-System-PDF.pdf>

⁹⁴ Deloitte | tax@hand (taxathand.com), Key measures from Spring Budget 2021 for non-UK owned groups <https://www.taxathand.com/article/16267/United-Kingdom/2021/Key-measures-from-Spring-Budget-2021-for-non-UK-owned-groups>

TAX REFORM PROCESS ADOPTED BY OTHER COUNTRIES COVERED

Countries	Tax reform
VIETNAM	<p>Vietnam's reformed and approved <i>Law on Tax Administration</i>⁹⁵ took effect on 1 July 2020. Below are some of the significant changes:</p> <ul style="list-style-type: none">• Legal representatives of an entity in Vietnam will need to ensure their companies are tax compliant. Under the new law, authorities may prevent legal representatives from leaving the country if their employer has not paid due taxes.• Business organisations will be allowed to submit additional tax declaration documents after the tax authorities have announced an audit or inspection decision.• Taxpayers that want to appeal a decision are required to pay the full tax amount as well as any penalties and late payment interest. However, if the taxpayer wins the appeal, they can request the tax authorities to pay an interest of 0.03% per day on the refunded amount.• Commercial banks will be required to withhold and pay taxes on behalf of e-commerce companies that do business abroad but earn income from Vietnam.• E-commerce companies that do business on digital platforms without a PE in Vietnam will be required to make appropriate registration, declare and pay tax on Vietnam-source income, either directly or by authorisation.• E-invoices will be mandatory for all enterprises from November 2020. <p>On 25 September 2020, Vietnam signed off on implementing a 30% reduction in CIT for the 2020 financial year. This incentive is available to businesses with revenue not exceeding US\$ 8.8 million (VND 200 billion) in 2020. As a result, eligible taxpayers will only pay a 14% headline CIT rate.⁹⁶</p>

⁹⁵ Vietnam's Briefing, *Vietnam's Tax Administration Law Takes Effect in July 2020* by Pritesh Samuel
<https://www.vietnam-briefing.com/news/vietnams-tax-administration-law-takes-effect-july-2020.html/>

⁹⁶ Vietnam Briefing, *Planning Your 2021 Budget: Opportunities in Vietnam* by Ayman Falak
<https://www.vietnam-briefing.com/news/planning-2021-budget-opportunities-in-vietnam.html/>

IN CONCLUSION

It is prudent for any Government to undertake periodic reviews of the tax system to ensure that taxes are evaluated from a macro perspective and they achieve what they need to achieve in a ‘fair’ and efficient manner. Ensuring a tax system is fit for purpose involves examination of how much tax revenue is required and what can be taxed to raise that revenue, generally in the least distortionary way.

Moreover, since the onset of the COVID-19 pandemic last year, many businesses have been faced with challenges to sustain their operations. The OECD has encouraged tax administrations to provide guidance on the application of the domestic law requirements, deferrals of domestic filing and payment, and other guidance to minimise or eliminate unduly burdensome compliance requirements for taxpayers in the context of the COVID-19 pandemic. It is commendable how swiftly the Malaysian Government has reacted and adopted some of the recommendations and implemented various measures to provide some security and cushion the adverse impact to the rakyat and businesses. These measures focused mainly on operational leeway and have been effective in temporarily bolstering the economy as businesses scramble in these trying times. Alongside these necessary measures, the Government has to deploy monetary and fiscal policy to sustain individuals, health care providers, businesses and their employees, charities, and others during the temporary pause in economic activity.

The OECD has recently released a report on “Tax Policy Reforms 2021: Special Edition on Tax Policy during the COVID-19 Pandemic”.⁴³ In the report, the OECD recommended some broad guiding principles to address two significant tax policy challenges faced by almost all countries in the short run, namely the withdrawal of relief where it is no longer needed and the provision of well-designed recovery-oriented stimulus measures. It also recommended that in the medium run, tax and spending policies should be reassessed. Such a reassessment should take into account both the challenges brought to the fore by the crisis as well as those related to ongoing structural trends including climate change, rising health risks, digitalisation, population ageing and increasing inequalities. Tax revenues can be supported and enhanced with measures within the tax system (e.g. adjusting tax rates, broadening tax bases), but also with structural reforms (e.g. better education and training, reforms in the labour and product markets) that are not directly related to taxation but would support long-term economic growth and, in turn, growing tax bases. At the same time, policies will have to be inclusive and address inequalities. Countries will also need to address the challenges and seize the opportunities arising from digitalisation. The

increasing use of digital solutions can also play a key role in improving the functioning of tax administrations, as well as the design and implementation of tax policies. Ensuring that the recovery is sustainable will be another major priority, which will involve, among other reforms, greater carbon pricing efforts. At the same time, policy packages should take account of the potential adverse impacts of carbon pricing on equity and affordability.

To ensure the Government continues to collect the tax revenue it needs, the emphasis should be on initiatives that encourage the economy to grow with increased tax revenues flowing from that growth. The tax system should also be analysed on the basis of what it best for the tax system; what are the fairest and most efficient ways of collecting tax. Addressing or mitigating the effects of the shadow economy should be a priority of the Government. The digital nature of the growing gig economy facilitates data collection and this is necessary to ensure the gig economy does not contribute to an increase in the shadow economy.

As part of the Government’s initiatives to attract both local and FDIs to relocate or set up their operations in Malaysia as well as to remain competitive, our tax rules need to be designed to both tax and retain what capital is already invested here, but also to attract and retain foreign capital. That said, one competitive advantage Malaysia currently has is the lack of a general CGT. Our tax system needs to achieve two broad outcomes. First to tax what is here and will remain here (economic rents); second to ensure that it is able to compete against other tax systems in the region to attract FDIs. It is therefore important that when analysing Malaysian’s tax system, regard is duly taken of the tax systems in other countries.

While there are a wide range of different taxes around the world, what is not known to us is the level of efficiency and effectiveness of these taxes. Taxes are about raising revenue required for Governments; our tax system should therefore favour taxes which are the most effective and efficient. Any new taxes would add compliance costs which need to be considered in assessing the merits of such.

The task to future-proof our tax system is a critical challenge. It is doubly challenging when we cannot gauge if the world post-COVID-19 will revert to pre-COVID-19 levels or be radically different. This is thus the best time for the authorities to reassess the Malaysian tax system in order to put Malaysia in a stronger competitive position, in positioning Malaysia for a post-pandemic economic recovery, rebound and growth over the term of the 12th Malaysian Plan and beyond.

⁴³ OECD (2021), *Tax Policy Reforms 2021: Special Edition on Tax Policy during the COVID-19 Pandemic*, OECD Publishing, Paris, <https://doi.org/10.1787/427d2616-en>



ABBREVIATIONS AND ACRONYMS

ACA	Accelerated Capital Allowance	IIR	Income Inclusion Rule
AIS	Approved Incentive Scheme	IRBM	Inland Revenue Board of Malaysia
AMRO	ASEAN+3 Macroeconomic Research Office	IRS	Internal Revenue Service
APA	Advance Pricing Agreements	ITA	Investment Tax Allowance
ATO	Australian Tax Office	ITD	Income-Tax Department
AUD	Australian Dollar	ITH	Income Tax Holiday
BEPS	Base Erosion and Profit Shifting	ITRF	Income Tax Return Form
BEV	Battery Electric Vehicle	JPY	Japanese Yen
CAD	Canadian Dollar	MASB	Malaysian Accounting Standards Board
CbCR	Country-by-Country Reporting	METR	Minimum Effective Tax Rate
CBDT	Central Board of Direct Tax	MFRS	Malaysian Financial Reporting Standards
CGT	Capital Gains Tax	MNE	Multinational Enterprise
CIT	Corporate Income Tax	MoF	Ministry of Finance
CIT(A)	Commissioner of Income Tax (Appeals)	MPERS	Malaysian Private Entities Reporting Standard
CNY	Chinese Yuan Renminbi	OECD	Organisation for Economic Co-operation and Development
CPI	Consumer Price Index	PE	Permanent Establishment
DGIR	Director General of Inland Revenue	PPN	State Director's Office
DOSM	Department of Statistics Malaysia	PS	Pioneer Status
DRD	Dispute Resolution Division	R&D	Research and Development
DRPD	Dispute Resolution Proceedings Department	RA	Reinvestment Allowance
DTDi	Double Tax Deduction for Internationalisation	RM	Ringgit Malaysia
ESR	Earnings Stripping Rule	RMCD	Royal Malaysian Customs Department
ETF	Exchange Traded Fund	RPGT	Real Property Gains Tax
ETR	Effective Tax Rate	SCIT	Special Commissioners of Income Tax
ETS	Emission Trading System	SGD	Singapore Dollar
EV	Electric Vehicle	SME	Small and Medium Enterprise
FDI	Foreign Direct Investment	SOCSO	Social Security Organisation
FRS	Financial Reporting Standards	SST	Sales Tax and Service Tax
GBP	British Pound Sterling	STS	Single-tier System
GDP	Gross Domestic Product	Tax EBITDA	Tax Earnings Before Interest, Tax, Depreciation, and Amortisation
GHG	Greenhouse Gas	TIN	Tax Identification Number
GITA	Green Investment Tax Allowance	TWG	Tax Working Group
GITE	Green Income Tax Exemption	UCA	Uniform Capital Allowance
GST	Goods and Services Tax	USD	United States Dollar
GSTN	Goods and Services Tax Network	VAT	Value-added Tax
HC	High Court	VND	Vietnamese Dong
HKD	Hong Kong Dollar	WHT	Withholding Tax
HMRC	Her Majesty's Revenue and Customs	YA	Year of Assessment
IFRS	International Financial Reporting Standards		

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