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Outlines tax proposals from Malaysia's
Budget 2005 Announcements

Shamsir Jasani Grant Thornton 

Malaysian Budget 2005

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In Budget 2005, the Government took opportunity of the strengthening economy to effect bold structural changes. The transformation from export-based to domestic-led growth has shown great success. For this year's Budget, the Government is set to refocus on key strategic areas in order to further promote growth and ensure continuity and sustainability in our economy...

INDIVIDUAL TAX

1. Review of deadline for filing of income tax for taxpayers other than companies

The Self Assessment System (SAS) for companies has been implemented in 2001 whilst for taxpayers other than companies, it is effective from 2004. Presently, under the SAS, taxpayers other than companies such as sole proprietors, partnerships, clubs, associations and Hindu joint families are required to file their tax returns not later than 30 April each year, whereas trust bodies and cooperatives are required to file their tax returns not later than seven months after closing of their accounts. It is proposed that the deadline for tax filing for sole proprietors, partnerships, clubs, associations and Hindu joint families be extended from 30 April to 30 June each year.

Effective date: Y/A 2004

2. Review of income tax relief contributions to an approved provident fund or takaful or life insurance premiums

Currently, an individual income taxpayer is given tax relief on contributions made to an approved provident fund such as the Employees Provident Fund or takaful or on premiums for life insurance up to RM5,000 per year. It is proposed that the tax relief be increased from RM5,000 to RM6,000.

Effective date: Y/A 2005

3. Review of income tax relief for the disabled

Currently, a disabled person is given an additional income tax relief of RM5,000 apart from the personal relief of RM8,000. A disabled spouse is given an additional tax relief of RM2,500 apart from the spouse relief of RM3,000. It is proposed that the additional relief for the disabled taxpayer be increased from RM5,000 to RM6,000 and the additional disabled spouse relief be increased from RM2,500 to RM3,500.

Effective date: Y/A 2005



4. Review of tax rebate and relief to individuals for the purchase of computers and books

Currently, a tax rebate of RM400 is given to individual income taxpayers for the purchase of a personal computer for the family once in 5 years. In addition, a tax relief of RM500 is given to individual income taxpayers for the purchase of books. It is proposed that the tax rebate given for the purchase of a personal computer be increased from RM400 to RM500 and the income tax relief for the purchase of books be increased from RM500 to RM700 for each year.

Effective date: Y/A 2005

5. Review of income tax exemption on retirement benefits

Currently, income tax exemption is given on retirement benefits received by employees who retire:

- i. upon reaching the age of 55; or
- ii. on medical grounds.

In order to relieve the tax burden of employees in the private sector who go on compulsory retirement between the age of 50 and 55 pursuant to a contract of employment or collective agreement, it is proposed that income tax exemption be given on retirement benefits received by these employees, up to RM6,000 for each year of service.

Effective date: Y/A 2003

CORPORATE TAX

1. Simplifying the computation of industrial building allowance

Currently, the computation of Industrial Building Allowance (IBA) for a used building is calculated based on the residual value of its construction cost. The buyer is required to obtain information on the construction cost and the residual value of the building from the seller for purpose of claiming IBA.

In order to simplify claims for IBA, it is proposed that the basis of computation of IBA for a used building be calculated on the current purchase price where the seller will be subject to balancing allowance or balancing charge. However, a seller who owns the building before the implementation of this proposal, will not be subjected to the balancing charge if the building is sold after 50 years from its construction date.

Effective date: Y/A 2005

2. Tax deduction for zakat on business income paid by companies

Zakat paid on income by Labuan offshore companies is given tax rebate for the purposes of income tax under the Labuan Offshore Business Activities Tax Act 1990 (LOBATA) subject to a maximum of 3% of net profits or RM20,000. No rebate is given on *zakat* paid on income including business income by other companies.

It is proposed that *zakat* on business income paid by companies to the respective Islamic religious authorities be allowed as deduction for the computation of income tax not exceeding 2.5% of aggregate income.

Effective date: Y/A 2005

3. Extension of incentive period for food production

Currently, tax incentives are given to both the company that invests and its subsidiary company that is engaged in food production activities.

To increase food production and to attract more companies to participate in selected fields such as cultivation of vegetables, fruits, herbs and spices, aquaculture, rearing of cattle, goats and sheep, deep-sea fishing as well as kenaf, it is proposed that:

- i. the existing equity condition that requires the investing company to own 100% equity in the company that undertakes food production be reduced to at least 70% effective from 11 September 2004; and
- ii. the incentive period on income tax exemption and losses for this scheme be extended for applications received until 31 December 2010.

The applications are to be forwarded to the Ministry of Agriculture and Agro-based industry.

4. Accelerated capital allowance for agriculture sector

Currently, machinery and equipment used by companies in the agriculture sector including plantations are granted capital allowance of 20% as initial allowance and between 10% and 20% as annual allowance. As such, the capital allowance can be written off between 4 and 8 years.

To reduce dependence on labour and to promote mechanisation and automation, it is proposed that the write-off period for capital expenditure on machinery and equipment used in the agriculture sector including plantations be eligible for Accelerated Capital Allowance for

a period of 2 years. Thus, the annual allowance be increased from between 10% and 20% to 40%.

The machinery and equipment eligible for Accelerated Capital Allowance shall be determined by the Minister of Finance.

Effective date: Y/A 2005

5. Extending the scope of tax incentive for modernising the system for chicken and duck rearing

Currently, rearers of broiler and layer chicken and ducks who fulfil the minimum rearing capacity of at least 20,000 broiler chicken/ducks per cycle; or at least 50,000 layer chicken/ducks per cycle and reinvest for the purpose of shifting from open to closed house system are given Reinvestment Allowance (RA) for a period of 15 consecutive years commencing from the first year the reinvestment is made as follows:

- i. projects located in promoted areas that is the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak are given RA of 60% on qualifying capital expenditure incurred with the allowance deducted in each year of assessment to be set-off against 100% of statutory income; and
- ii. projects located outside promoted areas are given RA of 60% on qualifying capital expenditure incurred with the allowance deducted in each year of assessment to be set-off against 70% of statutory income.

As a continuous measure to modernise the system of rearing chicken and ducks through environment friendly practices, it is proposed that the scope of the existing incentive for broiler and layer chicken and ducks be extended to rearers of parent and grand parent stock of chicken and ducks, provided that:

- i. they rear at least 20,000 parent or grand parent stock of chicken/ducks per cycle; and
- ii. the project is approved by the Ministry of Agriculture and Agro-based Industry.

Effective date: Y/A 2005

6. Double deduction on expenses for halal certification and quality systems and standards certification

Currently, a company which incurs expenses in obtaining *halal* certification as well as quality systems and standards certification is allowed single deduction for the purpose of income tax computation.

In an effort to enhance competitiveness of local products in the global market particularly *halal* products, it is proposed that double deduction be given for the purpose of income tax computation to:

- i. a company which incurs expenses in obtaining quality systems and standards certification as well as *halal* certification from Jabatan Kemajuan Islam Malaysia (JAKIM); and
- ii. a company which incurs expenses in obtaining international quality systems and standards certification.

Effective date: Y/A 2005

7. Tax incentives for production of halal food

Currently, production of promoted food products is granted Pioneer Status with tax exemption of 70% of statutory income for a period of 5 years; or Investment Tax Allowance of 60% of qualifying capital expenditure within a period of 5 years. This allowance can be set-off against 70% of statutory income in each year of assessment.

In addition, SMEs producing promoted food products are granted Pioneer Status with tax exemption of 100% of statutory income for a period of 5 years; or Investment Tax Allowance of 100% of qualifying capital expenditure within a period of 5 years. This allowance can be set-off against 100% of statutory income in each year of assessment.

To encourage new investment in *halal* food production for the export market and to increase the use of modern and state of the art machinery and equipment in producing high quality *halal* food that comply with international standards, it is proposed that companies producing *halal* food be given Investment Tax Allowance of 100% of qualifying capital expenditure incurred within a period of 5 years. This allowance can be set-off up to 100% of statutory income in each year of assessment.

This incentive is granted on condition such companies have already obtained *halal* certification from JAKIM and other quality certification.

Effective date: Applications received by MIDA from 11 September 2004





Many were glued to the radio to get...

8. Tax exemption on interest income from bonds received by non-resident companies

Currently, a resident and non-resident company is not granted tax exemption on interest income from investments in securities and debentures. However, a resident and non-resident individual, unit trust or listed closed-end-fund is given tax exemption on interest income derived from investments in the securities or bonds issued or guaranteed by the Government; debenture, other than the convertible loan stocks, approved by the Securities Commission; and Malaysian Saving Bonds issued by Bank Negara Malaysia.

In order to expand the domestic capital market, it is proposed that tax exemption be given on interest income derived by non-resident companies from:

- i. ringgit-denominated Islamic securities and debentures, other than convertible loan stocks, approved by the Securities Commission;
- ii. securities issued by the Government of Malaysia.

Effective date: 11 September 2004

9. Tax treatment for Islamic financial and capital market products

Islamic financial and capital market products require additional transactions and instruments to comply with Syariah principles. Thus, these products are burdened with additional taxes and duties compared with conventional products. In order to ensure the competitiveness of these products against conventional products, tax and duty exemptions and specific income tax treatment were considered on a case-by-case basis.

As a measure to further stimulate the development of Islamic financial and capital market products, it is proposed that any additional tax or duty be exempted or given specific treatment provided that:

- i. the Islamic financial products are approved by the Syariah Advisory Council, Bank Negara Malaysia;
- ii. the Islamic capital market products are approved by the Syariah Advisory Council, Securities Commission.

The Islamic financial products include products offered by any other body outside the supervision of Bank Negara Malaysia, subject to the approval of the Syariah Advisory Council, Bank Negara Malaysia.

Effective date: Products approved from 11 September 2004

10. Tax treatment on interest-in-suspense

Currently, Bank Negara Malaysia categorises loans which are in arrears for a period of 6 months or more as non-performing loans and the interest accrued will be credited into the interest-in-suspense account. Such interest, although not received is subject to income tax.

In the 2000 Budget, interest-in-suspense was deemed as specific provision for bad debts and allowed 100% deduction in the computation of income tax for year of assessment 2000. However, tax was imposed when the interest was received.

As a measure to further strengthen the cash flow of financial institutions, it is proposed that interest-in-suspense be deemed as specific provision for bad debts and allowed full deduction in the computation of income tax. Income tax will be charged when the interest has been received.

Effective date: Y/A 2001

11. Tax treatment for real estate investment trust

Real Estate Investment Trust (REIT), also known as Property Trust Fund (PTF), mobilises funds from unit holders comprising individuals and companies for investments in the property sector and related assets and is subject to income tax at 28%. The after-tax income distributed to unit holders is eligible for tax credit.

In the 2004 Budget, it was announced that gains from disposal of real property by individuals or companies to REIT or PTF be exempted from RPGT; and instruments of transfer of real property from individuals or companies to REIT or PTF be exempted from stamp duty.



...first hand information on the new Budget.

In order to promote the development of REIT or PTF, it is proposed that REIT or PTF approved by the Securities Commission be given the following tax treatment:

- i. REIT or PTF be exempted from income tax on chargeable income distributed to unit holders whereas its undistributed chargeable income be taxed at 28%;
- ii. Income distributed to unit holders be taxed at their respective tax rates. For a non-resident unit holder, tax payable is at 28% and shall be withheld by REIT or PTF;
- iii. the accumulated income that has been taxed and subsequently distributed is eligible for tax credit in the hands of unit holders;

For the purpose of this tax treatment, a resident unit holder shall:

- i. declare his residence status to get full distribution from REIT or PTF; and
- ii. pay tax on income received from REIT or PTF.

REIT or PTF shall inform the Inland Revenue Board on distributions to each resident unit holder for each year of assessment.

Effective date: Y/A 2005

12. Incentive for relocating manufacturing activities to promoted areas

Currently, the flow of investments to the promoted areas in the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak continue to remain low.

In order to provide a competitive business environment, it is proposed that existing companies which relocate their manufacturing activities to the promoted areas, be given a second round of the following incentives:

- i. Pioneer Status with tax exemption of 100% of statutory income for a period of 5 years; or
- ii. Investment Tax Allowance of 100% of the qualifying capital expenditure incurred within a period of 5 years. This allowance can be used to set-off up to 100% of statutory income in each year of assessment.

Effective date: Applications received by MIDA from 11 September 2004

13. Accelerated capital allowance on equipment to maintain quality of power supply

Currently, equipment used by companies to maintain the quality of power supply is eligible for capital allowance i.e. initial allowance of 20% and annual allowance of between 10% and 20%. Thus, the period for capital allowance is between 4 and 8 years. However, the interruption in the supply of power caused by dips and surges of voltage affects companies' business.

In order to reduce the cost of doing business caused by interruptions in the power supply, it is proposed that companies that incur capital expenses on equipment to ensure quality of power supply be given Accelerated Capital Allowance for a period of 2 years.

The equipment eligible for Accelerated Capital Allowance shall be determined by the Minister of Finance.

Effective date: Y/A 2005

14. Extending the scope of double deduction to promote export of services

Currently, double deduction is granted on expenses incurred in promoting export of professional services. The eligible expenses are in respect of feasibility studies on projects overseas for the purposes of tender, tender preparations and technical information for export of professional services.

In an effort to enhance the competitiveness of export of professional services, it is proposed that double deduction be also allowed for expenses incurred in preparing architectural and engineering models, perspective drawings and 3-D animations for participating in competitions at international level.

Effective date: Y/A 2005

15. Incentives for commercialisation of public sector R&D

Currently, the initiative to commercialise R&D findings remain limited.

To encourage commercialisation of resource-based R&D findings by the public research institutes, it is proposed that an incentive package be given as follows:

- i. a company that invests in its subsidiary company engaged in the commercialisation of the R&D findings be given tax deduction equivalent to the amount of investment made in the subsidiary company; and
- ii. the subsidiary company that undertakes the commercialisation of the R&D findings be given Pioneer Status with 100% tax exemption on statutory income for 10 years.

The incentive is provided on the following conditions:

- i. at least 70% of the company is owned by Malaysians;
- ii. company which invests should own at least 70% of the equity of the company that commercialises the R&D findings;
- iii. only resource-based R&D findings are eligible; and
- iv. the commercialisation of the R&D findings should be implemented within one year from the date of approval of the incentive.

Applications for this incentive should be made through a committee at MIDA that includes a representative from the Ministry of Science, Technology and Innovation.

The proposal is effective for applications received from 11 September 2004.

16. Extension of the scope of incentives for renewable energy production

Currently, companies which sell energy generated from resources that are renewable and environment friendly such as biomass, hydropower and solar energy are given Pioneer Status with 70% tax exemption on statutory income for 5 years; or Investment Tax Allowance of 60% of qualifying capital expenditure incurred within a period of 5 years. This allowance can be set-off against 70% of statutory income in each year of assessment.



However, companies which generate such energy for their own consumption are not eligible for this incentive.

To further promote the use of energy generated from renewable resources, it is proposed that equipment used by companies to generate such energy for its own consumption be granted Accelerated Capital Allowance from between 4 and 8 years to one year, thus, the annual allowance be increased from between 10% and 20% to 80%.

The equipment eligible for Accelerated Capital Allowance shall be determined by the Minister of Finance.

Effective date: Y/A 2005

17. Review of tax treatment for trade associations

Currently, statutory income of trade associations received from members' subscription fees are exempted from income tax as determined by the following formula:

$$\text{Exempted income} = \frac{\text{Subscription fees}}{\text{Gross income}} \times \text{Statutory income}$$

The formula does not benefit trade associations that receive more income from business as compared to income from subscription fees.

In order to assist and encourage trade associations to increase their funds from sources other than member's subscription fees, it is proposed that the statutory income from member's subscription fees that is exempted be calculated according to the attributable method by taking into consideration actual expenditure incurred.

Effective date: Y/A 2005

18. Review of tax treatment for charitable organisations

Currently, approved charitable organisations are given income tax exemption on condition that at least 70% of their income is disbursed annually for charitable purposes. Failure to comply with the condition will result in the revocation of the approved status.

To enable charitable organisations to adopt long-term financial planning and maintain their approved status, it is proposed that the minimum expenditure condition be reduced from 70% to 50% of their income received in the preceding year.

Effective date: Y/A 2005

INDIRECT TAX & OTHERS

A. INDIRECT TAX

1. Exemption of entertainment duty on arts and cultural performances

Currently, exemption of entertainment duty is given on the following:

- i. stage shows and performances for charity purposes;
- ii. stage shows and performances by foreign artistes of international standing as certified by the Ministry of Culture, Arts and Heritage;
- iii. international performances, exhibitions, fairs and sports competitions held at the National Sports Complex, Istana Budaya, Balai Seni Lukis Negara and Petronas Philharmonic Hall;
- iv. performances by local artistes held at the Bukit Jalil National Sports Complex and Bukit Kiara Sports Complex; and
- v. stage performances by theatre groups held at the Federal Territory of Kuala Lumpur, Labuan and Putrajaya.

Other forms of arts and cultural stage shows and performances such as dances and musicals are not eligible for entertainment duty exemption.

It is proposed that the arts and cultural performances by local artistes held in the Federal Territory of Kuala Lumpur, Labuan and Putrajaya be given full exemption on entertainment duty provided such performances are approved by the Ministry of Arts, Culture and Heritage.

Effective date: 11 September 2004

2. Tax incentives for private institutions of higher learning that merge

Currently, private institutions of higher learning (IPTS) that merge are not eligible for any tax incentive.

It is proposed that stamp duty and real property gains tax exemptions be given to IPTS that merge. To expedite the mergers, these tax exemptions will be given for mergers approved by the Ministry of Higher Education and undertaken not later than 31 December 2006.

3. Incentive for outsourcing manufacturing activities

Currently, there are local companies including those with Malaysian brands names which have outsourced their activities to contract manufacturers, either locally or

abroad, to enable them to focus on high value added activities, such as design and R&D. These companies import raw materials or components for their contract manufacturers. Such companies are not eligible for import duty exemption as provided to manufacturers.

It is proposed that owners of Malaysian brands who outsource manufacturing activities be given import duty and sales tax exemptions on raw materials which are not manufactured locally and semi-finished goods imported from contract manufacturers abroad.

Effective date: Applications received by MIDA from 11 September 2004

4. Review of import duty on selected goods

Currently, high import duty is imposed on selected goods to protect local manufacturers. Besides this, tax anomaly arises when import duty is levied on raw materials and components whereas finished goods are not subject to import duty. This does not encourage the manufacture of such finished goods domestically as they are cheaper to import since they are not dutiable.

As a continuous effort to reduce the cost of doing business and tariff protection in stages, it is proposed that import duty on 118 goods be reduced and on 27 goods be abolished.

Effective from: 4.00pm on 10 September 2004

5. Import duty exemption on imported medical devices for purpose of kitting

Currently, most medical devices are sold in complete procedural kit form as required for performing certain surgical or nursing procedures. Local manufacturers who import medical devices to complete procedural kits have to bear the cost of import duty since exemption is given only on raw materials and components.

It is proposed that full import duty exemption be given on medical devices that are imported for the purpose of kitting or producing complete procedural sets, provided these medical devices are not manufactured locally.

Effective date: Applications received by MIDA from 11 September 2004



Does this year's Budget **add up** for you ?

6. Review of duty on cigarettes and liquor

To promote a healthy life style and to curb social ills resulting from addiction to smoking and drinking, it is proposed that the excise duty on cigarettes including cheroots, cigars and cigarillos as well as liquor be increased. It is also proposed that unit of quantity and the tax rates on cigarettes and liquor be harmonised and streamlined.

B. GOODS AND SERVICES TAX (GST)

The Government is taking several major measures to further strengthen its financial position and restructure the tax system to be more efficient so as to ensure that the management of expenditure is cost effective.

Towards this end, the Government proposes to review the consumption tax which in its present form, consists of sales tax and service tax. Sales tax is levied on goods at the point of import or at the manufacturers' level. Service tax, on the other hand, is imposed on selected services.

The Government proposes to replace both these taxes with a single consumption tax, based on value-added concept. The new tax, known as GST, will be more comprehensive, efficient, transparent and effective, thereby enhancing tax compliance.

The proposal will also ensure that low-income group will not be burdened by the implementation of GST. In this regard, goods and services considered as basic needs will either be zero-rated or exempted. In addition, small businesses will also be exempted from this tax.

The Government proposes to implement this new GST on 1 January 2007.

C. INCOME TAX REFUNDS

The Government has introduced assessment on current year basis and Self Assessment System (SAS) that require taxpayers to ascertain their tax payable. Since the introduction of SAS, there are companies that have made excess income tax payments. To expedite income tax refunds, the Government proposes the following measures:

- i. Fund for Tax Refund be established to provide for income tax refunds;
- ii. excess payments will first be offset against the current year tax liability of the company; and
- iii. refunds of excess payments be made from the Fund to companies, which do not have any income tax liability in the current year.

To ensure that our country's taxation system is efficient and equitable, the Government proposes to establish a Taxation System Review Panel to review our existing tax system, including the provisions of the Income Tax Act 1967. The focus of this review is to ensure that tax provisions remain relevant and existing provisions will be amended to improve clarity and transparency of tax administration.

Shamsir Jasani Grant Thornton

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For any tax-related enquiries, please contact your local Grant Thornton office.

KUALA LUMPUR

Ms Seah Siew Yun
Mr Murugan Anbanantham
Level 11-1, Faber Imperial Court
Jalan Sultan Ismail
P.O. Box 12337
50774 Kuala Lumpur
T (603) 2692 4022
F (603) 2721 2588
E sjgt@gt.com.my

KUANTAN

Ms Han Siew Bueh
A-105A, 1st Floor
Sri Dagangan
Jalan Tun Ismail
25000 Kuantan, Pahang
T (609) 515 6124
F (609) 515 6126
E info@sjgt-ktn.com.my

PENANG

Mr Adrian Lee
58-A, Jalan Cantonment
10250 Penang
T (604) 226 1852
F (604) 226 1873
E tax@sjgt-pg.com.my

JOHOR BAHRU

Mr Tommy Leong
Unit 29-04B, Level 29
Mailbox 227, Menara Landmark
12 Jalan Ngee Heng
80000 Johor Bahru, Johor
T (607) 223 1848
F (607) 224 9848
E info@sjgt-jb.com.my