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Outlines tax proposals from Malaysia's
Budget 2006 Announcements

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Malaysian Budget 2006

Budget 2006 suggested a paradigm shift in economic policies and new tax incentives to stimulate economic growth. Ambiguous tax systems were made clearer and stringent regimes were abolished. The government is also offering generous tax measures that would benefit both the local and foreign investors, and ultimately...the entire economy.

INDIVIDUAL TAX

1. Review of child relief for tertiary education

Currently, individual income taxpayers are given relief for each child studying at tertiary level of up to RM4,000 (i.e. 4 times the normal child relief) for each child studying at a local institution of higher learning; and RM1,000 for each child pursuing further education abroad. Claims for child education relief need to be supported by documentary evidence. Normally, expenses incurred for a child's tertiary education are more than RM4,000 per year.

It is proposed that:

- i. automatic child relief of RM4,000 be given for each child pursuing tertiary education at a recognised local institution of higher learning at diploma level and above; and
- ii. child relief as in sub-paragraph (i) be extended to each child studying at a recognised institution of higher learning abroad at degree level and above.

Effective date: Y/A 2006

2. Introduction of relief for disabled child pursuing tertiary education

Currently, a taxpayer is given relief of RM5,000 for each disabled child. However, no specific relief is given for a disabled child studying full time at a higher educational level.

It is proposed that a further deduction of RM4,000 be given for each disabled child pursuing education in a recognised institution of higher learning at diploma level and above in Malaysia or at degree level and above outside Malaysia.

Effective date: Y/A 2006

3. Extending the scope of individual tax relief for further education

Currently, individuals pursuing further studies in science, technical, vocational, industrial skills or qualifications as well as information and communication technology (ICT) at recognised local institutions of higher learning are eligible for relief not exceeding RM5,000 per annum on the fees for such courses.



To enhance capacity building and in line with long life learning policy, it is proposed that the scope of courses eligible for relief not exceeding RM5,000 per annum be extended to professional courses, accountancy and law undertaken at recognised institutions of higher learning in the country. The eligible professional fields are to be approved by the Ministry of Finance.

Effective date: Y/A 2006

4. Extending the scope of real property gains tax exemption on residential property

Currently, an individual can claim real property gains tax (RPGT) exemption on one residential property during his/her lifetime. However, for a married couple, the right to elect for such an exemption is given only to the husband even though the property is owned by the wife, on condition that he has not done so before marriage. On the other hand, if the husband has elected for such an exemption before marriage, the wife is not eligible to do so even though she is the sole or joint owner of the property.

In the event the husband has claimed RPGT exemption on the residential property owned by the wife, he is no longer eligible to claim RPGT exemption on his own house later.

It is proposed that the election to claim RPGT exemption on a residential property is given to both husband and wife on one residential property each, once in a lifetime.

Effective date: 1 October 2005

5. Review of tax exemption on royalty from artistic works

Currently, an individual resident who receives royalty income or payment from the publication of, or the use of or the right to use, any artistic works (other than any original painting) and recording discs or tapes, is given income tax exemption up to RM6,000 a year.

It is proposed that income tax exemption on royalty or payment from publication of, or the use of or the right to use, any artistic works (other than original painting) and recording discs or tapes be increased to RM10,000 a year.

Effective date: Y/A 2006

6. Review of withholding tax on technical fees

Currently, income received by non-resident skilled teaching personnel in the performing arts and the production of crafts is subject to withholding tax of 10%. It is proposed that income received by non-resident

individuals who train Malaysians in such fields and related technical areas be exempted from withholding tax.

The proposal is effective for applications received by the Ministry of Culture, Arts and Heritage for a period of 5 years from 1 October 2005.

7. Tax treatment on benefits from Employees' Share Option Scheme (ESOS)

To ensure that the benefit derived by employees from ESOS is not reduced if prices of shares are on a downtrend, it is proposed that the value of the benefit for each share option be determined based on the difference between the market price on the date the share option is exercised or exercisable, whichever is the lower, and the discounted price offered by the employer. The benefit is liable to tax in the year the option is exercised.

Effective date: Y/A 2006

CORPORATE TAX

1. Introduction of group relief as tax treatment

To enhance private sector investment in high-risk projects, it is proposed that group relief be provided to all locally incorporated resident companies under the Income Tax Act 1967. The group relief is limited to 50% of current year unabsorbed losses to be set-off against the income of another company within the same group (including new companies undertaking activities in approved food production, forest plantation, biotechnology, nanotechnology, optics and photonics) subject to the following conditions:

- i. the claimant and the surrendering companies each has a paid-up capital of ordinary shares exceeding RM2.5 million;
- ii. both the claimant and the surrendering companies must have the same accounting period;
- iii. the shareholding, whether direct or indirect of the claimant and surrendering companies in the group must not be less than 70%;
- iv. the 70% shareholding must be on a continuous basis during the preceding year and the relevant year;
- v. losses resulting from the acquisition of proprietary rights or a foreign-owned company should be disregarded for the purpose of group relief; and
- vi. companies currently enjoying the following incentives are not eligible for group relief:

- a. Pioneer Status;
- b. Investment Tax Allowance / Investment Allowance;
- c. Reinvestment Allowance;
- d. Exemption of shipping profits;
- e. Exemption of income tax under Section 127 of the Income Tax Act 1967; and
- f. Incentive Investment company

With the introduction of the above incentive, the existing group relief incentive for approved food production, forest plantation, biotechnology, nanotechnology, optics and photonics will be discontinued. However, companies granted group relief incentive for the above activities shall continue to set-off their income against 100% of the losses incurred by their subsidiaries.

Effective date: Y/A 2006

2. Streamlining tax treatment for pioneer status companies

Currently, Pioneer Status companies are not allowed to carry forward losses and unabsorbed capital allowances incurred during the pioneer period to the post-pioneer period.

To further enhance the effectiveness of this incentive, it is proposed that accumulated losses and unabsorbed capital allowances incurred by companies during the pioneer period be allowed to be carried forward and deducted from post-pioneer income of a business relating to the same promoted activity or promoted product.

The proposal is effective for companies whose pioneer period will expire on and after 1 October 2005.

3. Review of tax treatment on losses and unabsorbed capital allowances

Currently, companies are allowed to carry forward their accumulated losses and unabsorbed capital allowances to be set-off against their future income for an unlimited period of time. Furthermore, companies that ceased operations for several years may still utilise accumulated losses and unabsorbed capital allowances to be set-off against new business income or by new shareholders.

To discourage companies from taking advantage of loss-making companies, it is proposed that accumulated losses and unabsorbed capital allowances of a company are not allowed to be carried forward in the event there is a change of more than 50% in its shareholdings.

Effective date: Y/A 2006

4. Extension of application period for incentives for promoted areas

Currently, companies undertaking manufacturing, agriculture and tourism activities in promoted areas are given the following tax incentives:

- i. Pioneer Status with tax exemption of 100% of statutory income for 5 years; or
- ii. Investment Tax Allowance of 100% of the qualifying capital expenditure incurred within a period of 5 years. The allowance can be set-off against 100% of the statutory income in each year of assessment; and
- iii. 100% Infrastructure Allowance on capital expenditure incurred for the provision of infrastructure such as bridges, roads and ports. The allowance can be set-off against 85% of statutory income in each year of assessment.

Promoted areas are the Eastern Corridor of Peninsular Malaysia (i.e. Kelantan, Terengganu, Pahang and the District of Mersing in Johore), Sabah, Sarawak and the Federal Territory of Labuan (for hotel and tourism activities only).

The current application period for the above incentives that will expire on 31 December 2005 is now extended for another 5 years until 31 December 2010.

5. Tax treatment on income of investment holding company

An investment holding company (IHC) is a company engaged wholly (100%) in holding of investment and its income is normally derived from dividends, rental and interests. Currently, income of an IHC is deemed as passive income. As such, an IHC is allowed deduction only on 25% of permitted expenses.

To enhance investments by IHCs, it is proposed that the income of IHCs listed on Bursa Malaysia, be treated as business income and the expenses be given full deduction for the purpose of income tax. An IHC is redefined as a company that derives at least 80% of its gross income from holding of investment. However, losses and unabsorbed capital allowances are not allowed to be carried forward.

Effective date: Y/A 2006



Did Budget 2006 stack up to our **expectations...**



6. Extending the scope of allowable expenses for companies

Currently, expenses incurred on audit fees are not eligible for deduction for tax purposes as they do not contribute directly to the generation of income.

To enhance corporate compliance, it is proposed that expenses incurred on audit fees by companies be deemed as allowable expenses for deduction in the computation of income tax.

Effective date: Y/A 2006

7. Flexibility in estimating tax payable for companies

Under the Self Assessment System (SAS), companies are required to provide estimates of tax payable for the current year and these estimates should not be less than the estimates or the revised estimates of the preceding year. Companies are allowed to revise their estimates on the 6th and the 9th month of their financial year.

To render flexibility to companies in providing estimates of tax payable for the current year, it is proposed that such estimates for companies be lowered from not less than 100% to not less than 85% of the preceding year's estimates or revised estimates.

Effective date: Y/A 2006

8. Review of tax treatment on small value assets

Currently, qualifying expenditure on assets is given deduction in the form of capital allowances (CA) over a period of time. Proper accounting to keep track of the tax written-down value of each small value asset is cumbersome.

To simplify the computation of CA for small value assets, it is proposed that CA on qualifying expenditure on such assets be given 100% allowance for assets of value not exceeding RM1,000 each. However, the total value of such assets are capped at RM10,000.

Effective date: Y/A 2006

9. Review tax treatment on interest expense for leasing activity

Currently, leasing and non-leasing income is treated as separate sources of business income for the purpose of income tax computation and their common expenses are apportioned based on gross revenue.

To streamline tax treatment for companies undertaking leasing and non-leasing activities, it is proposed that interest expense be apportioned between leasing and non-leasing activities based on the respective amount of funding used.

Effective date: Y/A 2006

10. Tax treatment on estimated losses of low cost housing projects

Property developers are required by the Government to undertake low cost housing projects. Such projects are often not profitable. In the preparation of estimates of tax payable for the current year, property developers are not allowed to set-off estimated losses of one property development project against estimated profits of another project.

It is proposed that the estimated losses of low cost housing projects be allowed to be set-off against estimated profits of other property development projects in the preparation of estimates of tax payable for the current year.

Effective date: Y/A 2006

11. Review of tax treatment on bonds

Currently, tax treatment on the issuance of bonds by financial institutions (FI) or non-financial institutions (NFI) is as follows:

...or were there **missing pieces?**

Tax treatment	FI	NFI
Discount/ Premiums Income	Taxed annually until the date of maturity of the bond (Accrual principle)	Taxed on the date of maturity of the bond (Realised principle)
Discount/ Premiums Expenses	Allowed annual deduction until the date of maturity of the bond (Accrual principle)	Allowed deduction on date of maturity of the bond (Realised principle)

To accord equal tax treatment, it is proposed that expenses incurred on discounts or premiums for the issuance of bonds, be given deduction on an annual basis until the date of maturity of the bonds, i.e. according to the accrual principle. Similar treatment be given on income derived from investment on bonds by NFI.

Effective date: Y/A 2006

12. Extending the scope of industrial building allowance (IBA)

To encourage the construction of more buildings in Cyberjaya for use by MSC status companies, it is proposed that IBA for a period of 10 years be given to owners of new buildings occupied by MSC status companies in Cyberjaya. Such new buildings include completed buildings that are yet to be occupied by MSC status companies.

Effective date: Y/A 2006

13. Extending the scope of incentives for multimedia activities

Currently, MSC status multimedia companies operating in Cybercities (Cyberjaya, Kuala Lumpur City Centre, Technology Park Malaysia, Bayan Lepas in Penang and Kulim Hi-Tech Park in Kedah) and multimedia faculties in institutions of higher learning outside the Cybercities, are eligible for Pioneer Status with 100% tax exemption on

statutory income for a period of 10 years; or Investment Tax Allowance of 100% of qualifying capital expenditure incurred within a period of 5 years to be set-off against 100% of statutory income for each year of assessment.

Apart from this, multimedia companies involved in the development of computer software outside the Cybercities are eligible for Pioneer Status with 70% tax exemption or Investment Tax Allowance of 60% for 5 years.

It is proposed that selected companies undertaking such activities outside the Cybercities be given the following incentives:

- i. Pioneer Status with tax exemption of 50% of statutory income for a period of 5 years; or
- ii. Investment Tax Allowance of 50% of qualifying capital expenditure incurred within a period of 5 years to be set-off against 50% of statutory income for each year of assessment.

Selected companies eligible for such incentives require the recommendation of the Multimedia Development Corporation (MDC).

The proposal is effective for applications received by MDC from 1 October 2005.

14. Tax treatment on expenses incurred for new courses by private higher education institutions

Currently, expenses incurred by private higher education institutions (PHEIs) to develop and comply with regulations to introduce new courses are not eligible for any deductions for tax purposes.

To encourage PHEIs to increase the number of new courses, it is proposed that deductions to be amortised for 3 years be allowed on expenses incurred by PHEIs on the development of new courses; and compliance with regulatory requirements for introducing new courses.

The commencement of the deduction for the development of new courses be allowed from the year of completion of the process of developing the course, i.e. after the date of receipt by the Ministry of Higher Education for the purpose of regulatory compliance. For regulatory compliance, the

deductions be allowed from the year of completion of the exercise.

Effective date: Y/A 2006

15. Extending the scope of incentives for private higher education institutions

Currently, PHEIs that provide science courses are not eligible for the Investment Tax Allowance of 100% for 10 years.

To increase the number of scientists in the country, it is proposed that the Investment Tax Allowance of 100% on qualifying capital expenditure incurred within a period of 10 years to be set-off against 70% of statutory income be extended to PHEIs in the field of science; and existing PHEIs in the field of science that undertake additional investment to upgrade equipment or expand their capacity.

The qualifying science courses are as follows:

- i. **Biotechnology** (Medical and Health Biotechnology, Plant Biotechnology, Food Biotechnology, Industrial and Environmental Biotechnology, Pharmaceutical Biotechnology, Bioinformatics Biotechnology)
- ii. **Medical and Health Sciences** (Medical Science in Gerontology, Medical Science in Clinical Research, Medical Biosciences, Biochemical Genetics, Environmental Health, Community Health)
- iii. **Molecular Biology** (Immunology, Immunogenetics, Immunobiology)
- iv. **Material Sciences and Technology**
- v. **Food Science and Technology**

The qualifying courses will be reviewed from time to time by the Ministry of Higher Education and submitted to the Ministry of Finance for approval.

The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 1 October 2005.

16. Incentive for unemployed graduates training scheme

Currently, companies in the capital market industry that conduct training programmes for unemployed graduates are not granted any tax incentives.

To further encourage the private sector to provide employment opportunities for unemployed graduates, it is proposed that double deduction be given to listed companies on the allowances paid to participants of Unemployed Graduate Training programme, endorsed by the Securities Commission, from 1 October 2005 until 31 December 2008 and the deduction is given for a period of 3 years.

Effective date: Y/A 2005

17. Tax incentive for industrialised building system

To promote the use of Industrial Building System (IBS) in the construction industry, it is proposed that Accelerated Capital Allowance (ACA) be given on expenses incurred on the purchase of moulds used in the production of IBS components. The ACA is to be fully written off within a period of 3 years.

Effective date: Y/A 2006

18. Review of tax incentives for generation of renewable energy

To further encourage the generation of renewable energy, it is proposed that Pioneer Status and Investment Tax Allowance be enhanced as follows:

- i. Pioneer Status with tax exemption of 70% be increased to 100% of statutory income and the incentive period be extended from 5 to 10 years; or
- ii. Investment Tax Allowance of 60% be increased to 100% on the qualifying capital expenditure incurred within a period of 5 years with the allowance to be set-off against 100% of statutory income for each year of assessment.

In addition, the incentive package of Pioneer Status and Investment Tax Allowance as well as import duty and sales tax exemption be extended for another 5 years until 31 December 2010. The company is required to implement the project within one year from the date of approval.

The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 1 October 2005. However, companies granted approval within one year prior to 1 October 2005 but have not implemented the project or applications are still under consideration are also eligible for the incentives.

19. Review of tax incentives for conservation of energy

Currently, there are prevailing tax incentives to encourage energy conservation. To further encourage the conservation of energy, it is proposed that:



A. Companies providing energy conservation services:

The application period for Pioneer Status, Investment Tax Allowance, import duty and sales tax exemption be extended for another 5 years until 31 December 2010. The company is required to implement the project within one year from the date of approval of the incentive.

B. Companies which incur capital expenditure for conserving energy for own consumption:

Investment Tax Allowance of 60% on the qualifying capital expenditure incurred within a period of 5 years with the allowance to be set-off against 70% of statutory income for each year of assessment. The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 1 October 2005 until 31 December 2010.

20. Review of requirement for gazette tax exemption order

Currently, exemption of income tax, real property gains tax and stamp duty given on a case-to-case basis or a class of income or a class of persons require gazette notification for such exemption to become effective.

To enhance the delivery system so that recipients benefit from such tax exemptions on time, it is proposed that exemption of income tax, real property gains tax and stamp duty given only on a case-to-case basis be effected without the requirement for gazette notification.

Effective date: 1 October 2005

21. Provision to allow tax assessment after six years

Currently, the Director General of IRB is only allowed to make assessments on income tax, petroleum income tax and real property gains tax within a period of six years.

To enhance tax administration and to prevent revenue loss, it is proposed that the Director General of IRB be empowered to make assessment on income tax, petroleum income tax and real property gains tax after a period of six years in cases where the assessment is determined by the court or withdrawal, revocation or cancellation of any exemption, relief, remission or allowance.

Effective date: Y/A 2006

22. Extending the scope of fund for tax refund

Presently, the Fund for Tax Refund was established under the Income Tax Act 1967 to provide for income tax refunds. This Fund came into operation on 1 January 2005.

However, refund payments of direct taxes, other than income tax, cannot be made out of this Fund.

To expedite the refund of payments of other direct taxes, it is proposed that the scope of the Fund for Tax Refund be extended to include refunds for petroleum income tax, real property gains tax and stamp duty.

Effective date: 1 January 2006

INDIRECT TAX & OTHERS

1. Tax incentives for mergers and acquisitions of listed companies

To encourage public listed companies to expand and compete globally, it is proposed that stamp duty and RPGT exemptions be given on Mergers and Acquisitions (M&A) undertaken by companies listed on Bursa Malaysia. This exemption is given to M&A approved by the Securities Commission from 1 October 2005 to 31 December 2007 and such M&A be completed not later than 31 December 2008.

2. Extending the scope of allowable expenses for Real Estate Investment Trusts

Currently, fees for accountancy, legal and valuation services incurred in the establishment of Real Estate Investment Trusts (REIT) or Property Trust Fund (PTF) are not allowed deductions for the purpose of income tax. It is proposed that the above fees be allowed as deductions for the purpose of income tax.

Effective date: Y/A 2006

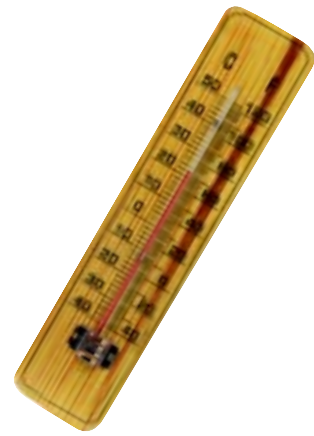
3. Remission of stamp duty on loan instruments for small and medium enterprises

To reduce the cost of borrowing, it is proposed that stamp duty remission of 50% (based on RM0.50 for every RM1,000) be given on instruments for a loan up to RM1 million taken by SMEs. However, for the balance of the loan above RM1 million, the prevailing stamp duty rate, i.e. RM5.00 for every RM1,000 or part thereof be applied.

Effective date: 1 October 2005

4. Reduction of road tax on private diesel vehicles

Currently, road tax for diesel vehicles is higher than petrol vehicles except in Sarawak. Effective from 12 September 2005, road tax on private and commercial vehicles using petrol and diesel was reduced as follows:



Were expectations **running high** for this year's Budget?

- private vehicles below 1000 c.c. was reduced to RM30;
- private vehicles between 1000 c.c. and 1600 c.c. was reduced by 50%; and
- commercial vehicles was reduced by 25%.

It is proposed that road tax on private diesel vehicles exceeding 1600 c.c. be reduced by 40%, except in Sarawak.

Effective date: 5 October 2005

5. Tax exemption on equipment for performing arts

It is proposed that import duty and sales tax exemption be given on equipment used in stage shows and performances provided such equipment is basic to the core activity and not produced locally. In addition, if such equipment is produced locally, sales tax exemption will be given.

The proposal is effective for applications received by Ministry of Finance from 1 October 2005.

6. Review of tax on beer and liquor

To curb social ills resulting from addiction to excessive drinking, it is proposed that the excise duty on beer and liquor be increased and the sales tax be standardised to 5%. In addition, the import duty structure on some liquor products be streamlined with the excise duty structure.

Effective date: 4.00 p.m. on 30 September 2005

7. Review of tax on cigarettes and tobacco products

To promote a healthy life style, it is proposed that the excise duty rates on cigarettes and tobacco products be increased and the sales tax be standardised at 5%.

Effective date: 4.00 p.m. on 30 September 2005

8. Additional incentives to encourage the use of natural gas for vehicles

It is proposed that Petronas be given import duty and sales tax exemption on conversion kits and related components for diesel buses and motor vehicles for transportation of goods to be converted to dual-fuel vehicles (diesel vehicles converted to use natural gas also); whereas local vehicle assemblers/manufacturers be given import duty exemption on chassis fitted with engines for NGV monogas buses/motor vehicles for transportation of goods and on NGV monogas engines to replace diesel engines for buses/motor vehicles for transportation of goods.

The proposal is effective for applications received by Ministry of Finance from 1 October 2005.

9. Review of import duty on selected goods

Currently, high import duty up to 30% is imposed on selected products in order to protect local producers. To enhance competitiveness of local producers, it is proposed that import duty on 51 goods be reduced from between 25% and 30% to between 20% and 25%.

Effective date: 4.00 p.m. on 30 September 2005

10. Enhancing the competency of tax agents

It is proposed that a person who wishes to perform tasks relating to taxation be required to obtain tax agent license. The proposal includes licensed auditors. However, a licensed auditor who has acquired an audit license prior to 1 January 2006, shall be allowed to continue to be a tax agent. Consequently, guidelines relating to granting of audit license will be streamlined.

Effective date: 1 January 2006

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

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