MEMORANDUM ON THE IMPROVEMENT OF INDIVIDUAL TAXATION

Prepared by:
Chartered Tax Institute of Malaysia

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Review of the Individual Taxation Regime and Proposals on the Improvement of the System

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1. Introduction

1.1 Background of Review

The reduction/depletion of natural resources has forced developing countries to restructure their economy to a service-oriented economy. From a global experience, it can be shown that advanced economies are service-oriented economy. The pre-requisite of a successful service economy is the availability of a vast supply of human resources. Malaysia's desire to shift towards higher value-add and knowledge-intensive activities necessitates specialization, in terms of having a critical mass and an ecosystem of firms and talent to drive economies of scale (per the Economic Transformation Programme). Thus, Malaysia is forced to engage in the battle for talent in the human resources market.

In addition, the rapid liberalisation of trade and services means that Malaysian service providers will be facing the influx and competition of foreign service providers. Hence, the ability to attract and retain the services of these talented individuals is crucial to Malaysia in achieving high income economy.

The private sectors have seen that Malaysia is losing out in the battle to attract talents. Industry leaders have been voicing their concerns on the difficulties in recruiting experienced and talented employees in the job market. Various commercial and industrial associations have urged the government to take measures to attract talents to stay with Malaysia or at least to prevent the brain-drain.

Malaysia should be more pro-active in attracting foreign direct investments, whereby more jobs can be created and therefore, increase the inflow of pool of talents into Malaysia. One method to do so is to provide a more competitive tax policy in Malaysia.

1.2 Purpose of the review

This review is a result of the representations made by CTIM in the various Budget proposals and other interested parties to the Ministry of Finance (MOF) and the meeting of CTIM with the MOF on 09 August 2010.

The purpose of the review is to study whether there is a need to revamp the individual taxation regime of Malaysia to attract and retain talents, which is pertinent to Malaysia in achieving a high income economy. If so, what are the areas that need to be changed and what kind of changes are needed to achieve the objective of attracting and retaining talents in today's competitive environment.

There is also the potential implementation of goods and services tax ("GST") in Malaysia to consider. As we know, there is urgency for Malaysia to build a stronger fiscal position by bringing GST in to the picture. For this to materialise, the Government has assured that the public must fully understand and be supportive of the consumption-based tax (*Minister in the Prime Minister's Department, Datuk Seri Idris Jala, at the seventh Economic Transformation Programme*).

One way for the public to buy in to make GST work is to introduce some form of compensating measures. Proposed changes, therefore, cannot be mere tinkering of

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income tax rate or introducing insignificant reliefs as in the past, but bold reform driven by the objective to get the contentious GST idea accepted, followed through and implemented successfully. Hence, a revamp of the personal taxation system, vis-à-vis the GST, should expectantly result in a more equitable distribution of income whereby, the income earner will be taxed at a progressive rate aligned with increase in earnings.

1.3 Rationale and scope of review

CTIM believes that the profit/income seeking behaviour is the main motivating factor that drives individuals to perform. Taxation is therefore generally considered as a disincentive to production and innovation. Nevertheless, the country needs fund to maintain and service the facilities and infra-structure of the country. The competitiveness of the taxation regime in attracting the talents lies on striking a balance between the two.

In view of the limited resources, CTIM has selected some representative countries from our trading partners for study. Indonesia, Thailand and Vietnam are selected because they are our competitors in the ASEAN region. Australia and United Kingdom are chosen because they are advanced economies in the Commonwealth countries which have similar revenue law structure as Malaysia. India and China are the emerging big economies which will be the main competitors and also major trade partners of Malaysia in the near future. As the most populous countries of the world, they may be a major supply of human resources in time to come. Singapore, South Korea, Taiwan and Hong Kong provide examples of how developing countries can uplift to advanced economies.

1.4 Scope of the comments

As a tax professional body, CTIM confines its review and comment to the relevant fiscal policy and the revenue laws. The review does not touch on other factors that will affect attraction of talents to the country, such as political environment, economic policy, the degree of freedom perceived by the individuals, the facilities and infra-structure available, etc.

Specifically, this review studies the following three areas from the countries mentioned above:
(a) The basis of assessment for individual
(b) The income tax structure on individual
(c) The individual compliance procedures

The review only summarises and discusses the relevant key factors and will not go into specific details of the tax law of each country. Some of the details for each country will be provided as appendices to this memorandum. The data has been collated by various parties over a period of the last one year. Therefore, for the purpose of this memorandum, it will be assumed that the information provided represents current applicable income tax law of each country.

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2.0 Simplifying and Consolidating Reliefs

2.1 Overview of the Malaysian Individual Taxation Framework

Income tax in Malaysia is imposed on a territorial/derivation basis in that only income that is accruing in or derived from Malaysia will be taxed in Malaysia. Employment income is regarded as derived from Malaysia and subject to Malaysian tax where the employee exercises an employment in Malaysia for any period of time. With effect from 1 January 2004, foreign income received in Malaysia is tax exempt regardless of the tax residency status of the individual.

Self-assessment for individuals was implemented from year of assessment (Y/A) 2004. Under the Self Assessment System (SAS), the responsibility for correctly assessing a person's tax liability is transferred from the Inland Revenue Board (IRB) to the taxpayer. Taxpayers' compliance with income tax rules and regulations under the SAS is governed through vigorous tax audits and investigations conducted by the IRB. With this, the IRB's former role of formally assessing taxpayers is relinquished.

2.2 Personal relief for individual

Upon arriving at the total income for a year of assessment, a person is allowed to set off the total income against personal relief to arrive at chargeable income, upon which income tax is levied. Currently Malaysia has approximately 20 reliefs available (excluding deposits for child into SSPN of RM3,000 due to the small group of participants and relief on housing loan interest of RM10,000 as this relief is only given for 3 consecutive years until 2010) for individual taxpayers to set off against total income and 2 rebates to set off against tax payable. These reliefs are introduced at different stages with specific objectives.

For each relief and rebate available, consequential compliance issue arise. Key questions that have surfaced over the years are as follows:-

a) What conditions are to be met to claim for the relief/rebate?
b) What amount to be claimed?
c) What documentations are required as a proof that the conditions are met?

The above, combined with the relatively insignificant quantum of some of the reliefs, demonstrate the complexity of the individual taxation system and raises the IRB's administration costs in carrying tax audits as well as taxpayer's compliance costs.

Therefore, it can be deduced that the lesser the types of relief available, the lower the administrative costs for the IRB and the lower the compliance costs for the taxpayers.

2.3 Comparison with Other Countries

Country	Number of Reliefs	Number of Rebates
Malaysia	20	2
Indonesia	6	N/A
Thailand	15	N/A
Vietnam	4	N/A

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Australia	16	14
United Kingdom	3	N/A
India	14	N/A
China	5	N/A
Singapore	15	2
South Korea	13	N/A
Taiwan	16	N/A
Hong Kong	15	N/A

Table 1: Number of reliefs and rebates for each country

2.4 Proposed Changes

From the Table 1 above, it is noted that Malaysia has the highest number of individual tax reliefs amongst the countries selected for this study. Hence, CTIM would suggest that the existing reliefs be rationalised and streamlined to 6 categories, i.e. personal relief, medical relief, disabled relief, spouse relief, children relief and relief for saving and retirement, similar to that of Indonesia and the United Kingdom [see Appendix 1].

It is proposed that the reliefs on acquiring qualifications, books, computers (once every 3 years), sports equipment and broadband subscription (totalling RM9,800 resulting in a total possible maximum individual tax liability reduction of RM2,548) be removed as these reliefs are insignificant and are not efficient to control. The removal of these reliefs will reduce the IRB's tax audit burden on the taxpayer, as well as on the tax authorities. However, the personal relief could be increased (for example, by RM3,000) to reflect the reduction in other reliefs and the increase in costs of living. Similarly, reliefs of savings and retirement totalling RM21,000 could be consolidated into one relief of say, RM12,000. Medical relief could be increased to RM6,000 to replace the various medical reliefs on parent, serious diseases, medical insurance premium, medical check-up, etc. totalling RM13,000. For simplicity, child relief could be combined into a single RM4,000 per child (limited to 5 children) and relief of RM6,000 given for each disabled individual in a family, whether it is for self, spouse or children. This will assists the middle and low income groups, as well as the disabled, to have a greater disposal income. The proposals have been summarised as follows:

Existing Reliefs	Current (RM)	Suggested (RM)
Personal		
Self/dependents	9,000	Self/dependants 12,000
Fees for acquiring qualification,etc	5,000	
Books, magazines, etc	1,000	
Computer (once in 3 years)	3,000	
Sports equipment	300	
Broadband subscription	500	
Medical reliefs		
- parent	5,000	Medical Relief 6,000
- serious diseases	4,500 – 5,000	
- Medical check-up (included in medical expenses relief)	500	

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- medical/education insurance premiums	3,000	
Disabled persons - self - spouse - child (each) - supporting equipment	 6,000 3,500 5,000 5,000	Disabled Reliefs Self 6,000 Spouse 6,000 Child (each) 6,000 Supporting equipment 5,000
Spouse	3,000	Spouse 3,000
Children - per child/with tertiary education - SSPN	 1,000/4,000 3,000	Children - per child 4,000
Savings and Retirement Life insurance/annuities/EPF/ retirement savings Medical/education premiums Interest paid on housing loans	 7,000 + 1,000 3,000 10,000	Savings and Retirement Relief 12,000

Table 2: Proposed categories of reliefs

It must be noted that individual tax does not constitute a significant part of the tax revenue, in particular the middle and low income groups. However, they are the major cost centre in enforcement. Hence it pays to reduce the costs of compliance in this respect.

In the long-term CTIM would suggest that personal reliefs to be automatically granted to an individual taxpayer as a percentage of his/hers taxable income depending to which category of taxpayer he/she belongs. However, the percentage would be lower for higher income bands. For example, an individual who is single and earning, for example, RM5,000 to RM7,000 a month could be granted reliefs equivalent to 25% of the taxable income and someone earning between RM7,000 to RM10,000 could get reliefs equivalent to 17% of the taxable income. The relief for the three designated categories i.e. a single person, a married person without children and a married person with children would be required to be capped to a maximum amount for each of the categories in future, similar to that of in the United Kingdom, whereby personal allowances are granted based on total income.

Alongside with other countries, with the exception of Australia and Singapore [see Table 1 above], we propose the removal of rebates so as to improve efficiency and effectiveness of the tax regime i.e. lesser incentives for taxpayers to evade tax in order to qualify for the rebate. As we are also proposing to increase the tax-free threshold [see section 3 below], it will be redundant to have in place any tax rebates which currently serves to achieve the same objective, i.e. to widen the tax-free threshold.

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3.0 Wider Personal Tax Bands

3.1 Overview of the Current Tax Bands

In Malaysia, a resident individual is taxed progressively with 8 bands of tax rates with the top marginal rate of 26%. With a chargeable income of RM100,000 (approximately US$33,109), the resident individual will be taxed at the top marginal rate of 26% [see appendix 2].

The tax bracket for individuals is too narrow compared with that of the developed nations. The bracket creep effect is inevitable as inflation may result in the increase of nominal income but the real income has remained unchanged. Besides, the highest marginal tax rate is applicable on income above RM100,000, which is inequitable as most professional individuals will hit the RM100,000 mark annually and will be taxed at a rate similar to other high income earners. If Malaysia intends to achieve a high income economy and attract talent to the country, this aspect should be looked into.

3.2 Comparison with other countries

Country	Tax Range	Number of Bands	Tax Free Threshold	Highest Marginal Tax Rate Applicable on Income Exceeding*
Malaysia	0-26%	9	RM2,500 (USD828)	RM100,000 (USD33,109)
Indonesia	5-30%	4	N/A	Rp.500,000,000 (USD57,567)
Thailand	0-37%	5	THB150,000 (USD4,953)	THB4,000,000 (USD132,084)
Vietnam	5-35%	7	N/A	VND 960,000,000 (USD46,882)
Australia	0-45%	5	AUD6,000 (USD6,249)	AUD180,000 (USD187,461)
United Kingdom	10-50%	4	N/A	GBP150,000 (USD242,640)
India	0-30%	4	Rs. 180,000 (USD3,967)	Rs. 800,000 (USD17,633)
China	3-45%	7	N/A	CNY100,000 (USD15,374)
Singapore	0-20%	9	S$20,000 (USD16,060)	S$320,000 (USD256,966)
South Korea	6-35%	4	N/A	W88,000,000 (USD80,628)
Taiwan	5-40%	5	N/A	TWD4,230,000 (USD145,696)
Hong Kong	2-17%	4	N/A	HKD120,000(USD15,414)

Table 3: Countries and the different tax bands

*Rounded up to the nearest USD

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Country		Effective Tax Rate on Chargeable Income (USD)			
		50,000	**100,000**	**200,000**	**300,000**
Malaysia	**Current**	16.72%	21.36%	23.68%	24.45%
	Proposed	0.00%	14.55%	23.64%	25.74%
Indonesia		16.83%	22.91%	26.46%	27.64%
Thailand		17.32%	23.66%	29.10%	31.74%
Vietnam		21.81%	28.41%	31.70%	32.80%
Australia		16.57%	24.45%	31.23%	35.82%
United Kingdom		15.81%	23.71%	33.95%	37.88%
India		22.24%	26.12%	28.06%	28.71%
China		15.95%	21.50%	29.40%	34.60%
Singapore		3.27%	6.81%	11.80%	14.15%
South Korea		8.06%	15.29%	24.27%	27.26%
Taiwan		7.75%	15.19%	24.86%	29.91%
Hong Kong		9.20%	13.10%	15.00%	15.00%

Table 4: Countries and the effective rates at different income bands

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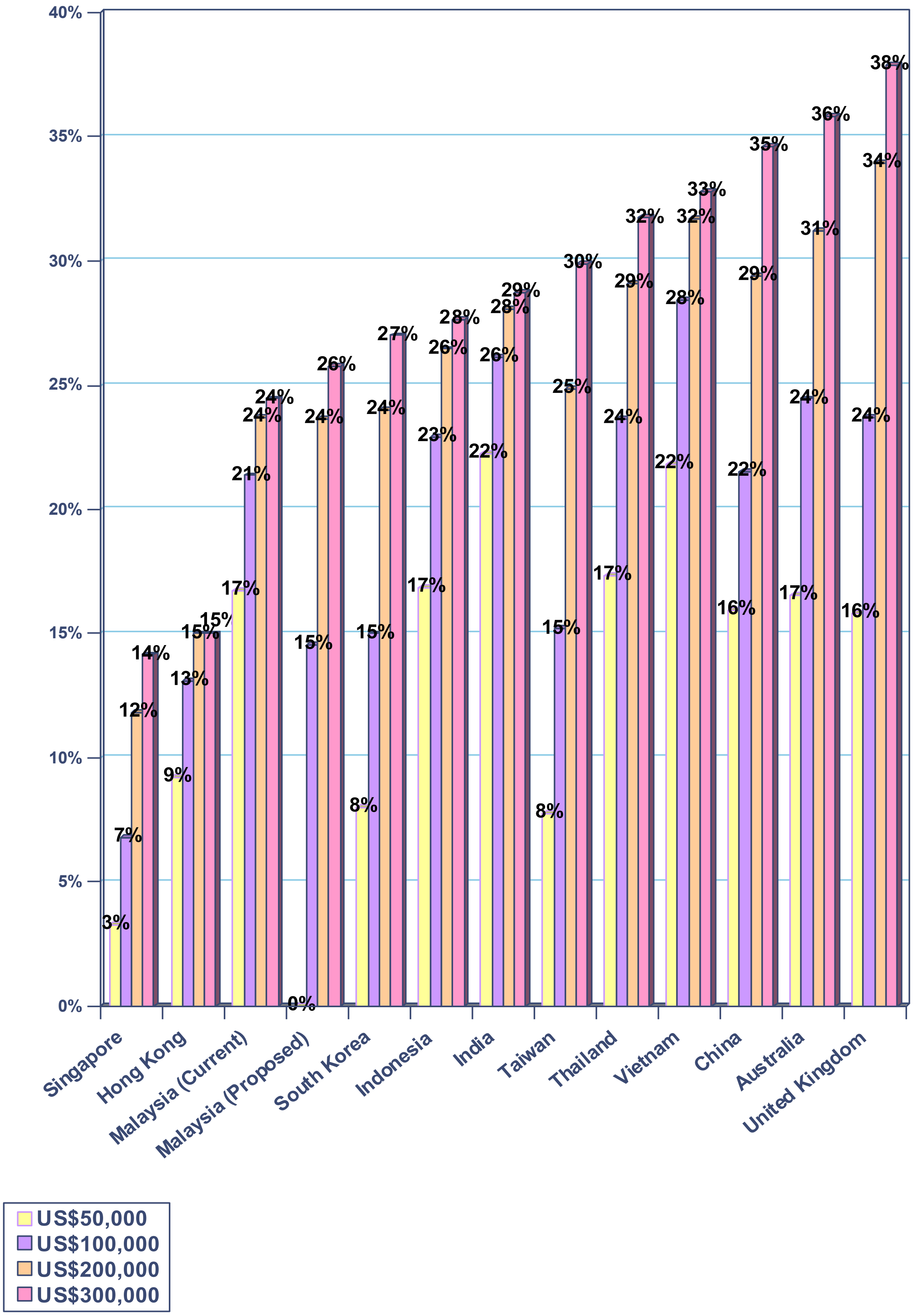

Figure 1: Comparison on the effective tax rates on different income bands in different countries

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3.3 Proposed Changes

Developed nations have sophisticated infrastructure and facilities to retain skilled labour. Malaysia should look into widening the current income bands wherein the relevant personal income tax rates apply. The suggestion is to widen the bands so that we lessen the 'bracket creep' effect and incentivize the work efforts of individuals. A wider personal tax chargeable income bands also avoid middle income trap for those at income level of RM100,000 and permits proportionate contributions by the higher income earners towards the growth of the country. This provides for a more economically efficient and equitable tax system.

Malaysia, as illustrated in Table 3 above, has one of the highest number of tax bands. What is more significant is the fact that the Malaysian chargeable income upon which the highest marginal income tax rate starts to take effect (i.e. US$33,109) is significantly low compared to most countries in the region.

As such, to strengthen our competitive edge similar to our neighbouring countries (e.g. Indonesia, Thailand and Hong Kong – see Appendix 3) and to simplify tax administration, the following individual tax bands are proposed:

First RM50,000	**0%**
RM50,001 – 150,000	**15%**
RM150,001 – 250,000	**24%**
RM250,001 and above	**26%**

Table 5: Proposed tax rates

From Table 4 and Figure 1 above, it can be noted that the current and proposed tax system promotes a more equitable tax regime. Compared to the current system whereby tax free threshold is RM2,500 (USD828), the proposed releases who earn income lower than RM50,000 (USD16,555) from paying taxes while middle income earners will no longer be burdened by the higher tax rate applicable on them, upon the increase of their income. High earners, i.e. those who earn exceeding RM250,000 (RM82,773) will be taxed at the highest tax rate of 25%, in oppose to RM100,000 (USD33,109) in the current tax system.

By increasing the basic exemption limit, administrative costs will be lower as high numbers of low income earners will be outside the taxable threshold. Any potential loss in revenue collection from the large numbers of low income earner, however, will be expected to offset against the potential savings in compliance and administration costs of IRB in order to provide a high quality service arising from this group. We also propose that the marginal tax rate should also align to the corporate tax rates so as to improve its competitiveness and to ease the financial burden of individuals. This will also facilitate capital accumulation for local entrepreneurs and facilitate the establishment of SMEs.

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4.0 Simplifying the Tax Compliance Process

4.1 Overview of the Current Tax Compliance Process

The prescribed Individual Annual Tax Return Forms (Forms B/BE/M) for a year of assessment is released to individual taxpayers in the beginning of the following year and will be due for submission not later than 30 April, except sole proprietors & partnerships (Form B) where the deadline is 30 June. The submission of the Form B/BE/M is deemed to be a notice of assessment for which tax is due and payable on the same date as the filing deadline. The policing by the IRB is accomplished through the process of field audits, which is an essential tool of the SAS.

For individual taxpayer (not self-employed), employer is required to deduct monthly payroll withholding via the Monthly Tax Deduction (MTD) system, whereby the employer is required to deduct the total amount of tax from the remuneration of its employees and remit to the IRB not later than the 10th day of the following month.

Penalties will be imposed on any non-compliance on the above.

4.1 Proposed Changes

The tax reform in relation to simplifying the tax compliance process should involve treating the Monthly Tax Deduction (MTD) as being the final tax for individuals with only employment source of income and thus not require them to file income tax returns. Alternatively, the tax authorities should increase the MTD rates a little so that there will be an incentive to submit tax file returns with the view to seek a refund of excess income tax paid.

Additionally, Malaysia should introduce a tax file number (TFN) for all those in the work force including business operators operating sole proprietorships and partnerships. The allocation of a TFN must be done speedily and with the minimum of administrative constraints. In the long term, the ability to generate a TFN could be allocated to all Government agencies. It is crucial to require all those receiving casual income or obtaining contracts to specify a TFN. Failure to provide a TFN will lead to an automatic withholding tax deduction by the payer from the casual income or contract payments.

5.0 In Closing

We hope that by revamping the tax system, Malaysia will attract more foreign investments and subsequently able to attract and retain experienced professional talent.

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Appendix I

Allowances available in Indonesia

Income Tax Relief	Rp.
Taxpayer	15,840,000
Spouse	1,320,000
Each dependant (max. of 3)	1,320,000
Occupational expenses (5% of gross income, max Rp.500,000/month)	6,000,000
Employee contribution to Jamsostek for old age security savings (2% of gross income)	Full amount
Pension maintenance expenses (5% of gross income, max. Rp.200,000/month)	2,400,000

Allowances available in the United Kingdom

Income Tax allowances	2011-12
Personal Allowance	£7,475
Personal Allowance for people aged 65-74	£9,940
Personal Allowance for people aged 75 and over	£10,090
Married Couple's Allowance (born before 6th April 1935 but aged under 75)	Not applicable
Married Couple's Allowance (born before 6th April 1935 and aged 75 and over	£7,295
Blind Person's Allowance	£1,980

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Appendix 2

Resident Individual tax rates for Assessment Year 2010/2011 in Malaysia

Chargeable income (RM)	Calculations (RM)	Tax Rate %	Tax Amount (RM)
0-2500	On the First 2,500	0	0
2,501-5,000	Next 2,500	1	25
5,001-10,000	On the First 5,000 Next 5,000	3	25 150
10,001-20,000	On the First 10,000 Next 10,000	3	175 300
20,001-35,000	On the First 20,000 Next 15,000	7	475 1,050
35,001-50,000	On the First 35,000 Next 15,000	12	1,525 1,800
50,001-70,000	On the First 50,000 Next 20,000	19	3,325 3,800
70,001-100,000	On the First 70,000 Next 30,000	24	7,125 7,200
100,001 and above	On the First 100,000 above 100,000	26	14,325

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Appendix 3

Tax rates of the Personal Income Tax –Indonesia

Taxable income	**Rate**	**Tax Rp**
On the first Rp. 50,000,000	5%	2,500,000
On the next Rp. 200,000,000	15%	30,000,000
On the next Rp. 250,000,000	20%	62,500,000
On the next amount of over Rp. 250,000,000	30%	30% of the relevant amount

Tax rates of the Personal Income Tax -Thailand

Taxable Income (baht)	**Tax Rate (%)**	**Marginal Taxable income (baht)**
0 - 150,000 (2008 onwards)	Exempt	150,000
150,001 - 500,000	10	350,000
500,001 - 1,000,000	20	500,000
1,000,001 - 4,000,000	30	3,000,000
4,000,001 and over	37	

Tax rates of the Personal Income Tax – Hong Kong

Taxable income	**Rate**	**Tax (HKD)**
On the first HKD 40,000	2%	800
On the next HKD 40,000	7%	2,800
On the next HKD 40,000	12%	4,800
On the next amount of over HKD 120,000	17%	17% of the relevant amount

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