Memorandum on 2016 Budget Proposals (Summary)

[Theme: *Strengthening Growth, Enhancing Inclusiveness, Ensuring Fiscal Sustainability]*

No.	Issues	Proposals
I	***STRENGTHENING GROWTH*** Unstable oil prices, the introduction of Goods and Services Tax (GST), regional competition from emerging economies, coupled with the impact of the ASEAN economic community has permanently changed the business landscape in Malaysia. Malaysia must constantly evolve to strengthen economic growth and ensure a resilient economy. Measures to facilitate investment should be upgraded to maintain competitiveness in attracting investors. However, in the long run, domestic investments should be the main thrust for our economic growth to ensure a resilient economy. The small and medium enterprise (SME) sector is a key player in this context and measures must be implemented to grow and strengthen this sector particularly in the wake of additional compliance costs given the introduction of GST, the need to reduce reliance on foreign labour, etc. As Malaysia aspires towards establishing a high income service economy, the building of human capital is also crucial to the success of our service economy. **Strategy 1: Facilitation Of Investment** **Strategy 2: Development Of Domestic Investments** **Strategy 3: Building Human Capital**	
	Strategy 1: Facilitation Of Investment Malaysia should review its incentives regime, which was largely designed for a traditional industrialised economy. Over the years the incentive regimes has evolved to include the services sector, and various other areas targeted for growth. However, there are many incentives which have a low take-up rate, and many other incentives which may be out-dated. A revamp of the incentive regime is encouraged, with a clear focus on key incentives which may even be grouped to cover a particular sector, similar to the combination of the operational headquarters, regional distribution centre and international procurement centre incentives which have been combined into the Principal Hub Incentive. Aside from incentives for investment, a sound infrastructure, a clear and solid corporate governance framework and transparency is critical for investors. Such non-fiscal matters are increasingly important to attract and retain investment, both foreign and domestic. .	

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	(i) Review of Incentives Regime **(ii) Facilitation of Development in Infrastructure**	
i)	**Review of Incentives Regime** From a national perspective, tax incentives result in a loss of direct revenue for the Government in the short term, with the aim of promoting and achieving growth and national objectives in the longer term. The Promotion of Investments Act 1986 and the Income Tax Act 1967 are the two pieces of legislation governing the Malaysian incentives regime. Both these Acts were enacted based on the national economic situation more than more than 25 years ago. Over the years, amendments to the Acts have been introduced in accordance with the changing needs of the national economy. These amendments are piecemeal updates and have made the incentives legislation and administration very complicated. CTIM has submitted *Feedback on the Review of PIA 1986* to MITI, setting out some broad views on the PIA specifically and on the incentives regime as a whole with a recommendation that a holistic review of the tax incentives regime in Malaysia is required. In addition, the Institute has also submitted *Feedback on Issues Relating to Incentives administered by MIDA* to MIDA commenting on issues relating to the administration of incentives. Both documents are attached for your reference.	Incentives were granted to achieve certain fiscal objectives. In this respect, we need to constantly review our incentives regime to ensure that the tax revenue foregone has achieved its fiscal objectives. The current incentives mechanism may be modified to enhance its effectiveness. For instance, incentives with low/no take-up rate should be reviewed or removed. Foreign direct investments (FDIs) have been the main thrust for our economic growth. Many of our incentives therefore focus on attracting FDIs. With the shift to domestic investments for economic growth, many incentives may need to be reviewed and adjusted to the needs of domestic investors. [Please also refer to Strategy 2(ii) below]. In addition, the incentive legislation should be simplified and streamlined to create an investor friendly environment. Consideration should be given to consolidating similar incentives into one for ease of administration. Guidelines indicating the eligibility and special conditions for granting incentives, should be issued to provide better clarity and transparency, which would in turn result in certainty and uniformity, thus avoiding the withdrawal of incentives subsequent to approval. This would improve the effectiveness of incentives granted and prevent abuse. Many agencies are involved in granting tax incentives, e.g, the Malaysian Investment Development Authority ("MIDA"), the Multimedia Development Corporation, Biotech Corporation, and the MOF where incentives are sought directly under Section 127(3A) of the Income Tax Act, 1967, etc. Investors are often confused and are unable to get clear responses from the relevant agencies. The incentive framework must be reviewed and clear and transparent guidelines must be made available to

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		all potential investors.
ii)	**Facilitation of Development in Infrastructure** There is a need to improve the country's infrastructure; e.g. transportation system to enhance connectivity between urban areas, access roads to rural areas, etc. to promote economic activities. Such infrastructure projects entail high investment in labour, machinery and equipment and technology. **(i) Tax relief for interest expense incurred during construction** Infrastructure projects are highly capital intensive and require long term financing. However, no tax relief is available for interest expense incurred during the construction phase of infrastructure projects under existing tax laws on the premise that the company has not commenced operations. Such interest which is capitalised as part of the cost of the asset does not qualify for capital allowances as it is considered to be the cost incurred on the provision of finance rather than on plant and machinery. The non-deductibility of the interest costs and the fact that capital allowances cannot be claimed increases the cost of such infrastructure projects. **(ii) Deduction for pre-commencement expenses** Expenses which are incurred prior to commencement of business are not deductible for tax purposes. In the construction of infrastructure, such pre-commencement expenditure is very sizeable including expenditure incurred on planning, conducting feasibility studies, etc.	We propose that a special deduction be given for the expenses below to reduce the cost of engaging in construction of key infrastructure projects. **(i) Tax relief for interest expense incurred during construction** A special tax deduction is to be given for interest expense incurred during construction for companies undertaking key infrastructure projects. **(ii) Deduction for pre-commencement expenses** A special tax deduction is to be given for pre-commencement expenditure for key infrastructure projects.

Strategy 2: Development Of Domestic Investments

Malaysia should assist local businesses to build a resilient economy and minimise the impact of global economy fluctuations. Reducing the costs of doing business will help to facilitate the development of the domestic economy, to grow larger local conglomerates over time. SMEs still form the major bulk of local businesses and any strategy to strengthen our economy will be futile if the SMEs are neglected. We have outlined below some key issues impacting SMEs from a tax perspective:

(i) Reducing Costs of Doing Business

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	(a) Filing of Tax Return Form for Dormant Company **(ii) Development of Local Conglomerates** **(a) Restriction on eligibility of Group Relief** **(b) Facilitating Exploration of Export Markets by Entrepreneurs** **(iii) Facilitation of SME** **a) Reintroducing Rules on Carry Back Of Current Year Losses**	
i)	**<u>Reducing Costs of Doing Business</u>** **(a) Filing of Tax Return Form for Dormant Company.** The LHDNM has recently announced that a dormant company is required to file a tax return (Form C) and employer return (Form E). This is pursuant to Section 77A of the Income Tax Act, 1967. Although this section requires every company to file a return, the practice of the LHDNM until recently was to relax this requirement for dormant companies. The change in practice has resulted in increased costs of operations for investment /holding companies which may have some dormant companies within the group.	**(a) Filing of Tax Return Form for Dormant Company** We are of the view that the requirement to files returns for dormant companies is not revenue generating activity but only an information collection process for the LHDNM While we understand that this requirement is aimed at countering the use of dormant companies by some taxpayers for tax avoidance purposes, implementing this requirement across the board to genuine dormant companies increases the tax compliance costs to such companies/groups. It is not cost effective as such information may have already been made available to other authorities. CTIM therefore recommends a review of this new practice and/or a change to the legislation to limit the requirement to file returns to companies which have commenced activities or subject to certain other criteria, e.g where such companies have assets in excess of a certain threshold, with a view to exploring other alternatives to address the issue of tax avoidance.
ii)	**Development of Local Conglomerates** **(a) Restriction on eligibility of Group Relief** Currently. a company may surrender not more than 70% of its adjusted loss in the basis period for a year of assessment to one or more related companies, resident and incorporated in Malaysia. The shareholding of the claimant and surrendering companies in the	**(a) Restriction on eligibility of Group Relief** To simplify the application of Group relief, we propose that the definition of related companies be amended in line with the definition provided under the Companies Act, 1965 and the requirement of a 70% shareholding be removed. The losses to be surrendered should be restricted only by the

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	group, whether direct or indirect, must not be less than 70%. **(b) Facilitating Exploration of Export Markets by Entrepreneurs** Malaysian businesses need to go out and explore regional and global markets and seize opportunities to strengthen their competitive position. Such business opportunity seeking activities involve high costs and in many instances, these will be sunk costs, if a business opportunity is not fruitful. At present, the costs incurred in exploring new business opportunities are not deductible unless these costs relate to an existing business source of the company concerned. Hence holding companies which engage in such activities on behalf of group companies will not be entitled to a deduction for such costs.	aggregate income of the claimant company (and not in relation to the amount that can be surrendered by the surrendering company) **(b) Facilitating Exploration of Export Markets by Entrepreneurs** To encourage the growth of local conglomerates and to encourage outbound expansion, a deduction should be given to the holding company for costs incurred in exploring new business opportunities to grow Malaysia's export markets, irrespective of whether the exploration results in a successful expansion of business. This should be subject to clear guidelines and criteria to prevent abuse.
iii)	<u>**Facilitation of SME**</u> **Reintroducing Rules on Carry Back Of Current Year Losses** In the Second Stimulus Package 2009, the Government allowed a taxpayer to irrevocably elect to carry back its current year business losses of up to RM100,000 to the immediately preceding year of assessment to reduce its tax liability for the said year of assessment. However, this incentive was only applicable for the years of assessment 2009 and 2010 and the carry back only benefitted a taxpayer with a current year loss in one year and chargeable income in the immediately preceding year. The stringent qualifying conditions have limited the number of taxpayers who benefitted from the incentive. For SMEs, financial resources are critical and if tax losses were allowed to be carried back, this would provide greater flexibility and relief for SMEs, particularly during economic downturns.	**In this respect, CTIM proposes that:-** • The carry back of losses be allowed as a permanent feature in the Malaysian tax system • There should not be a cap on the quantum of losses that may be carried back, but instead, the amount of loss utilised may instead be determined based on a certain percentage of the chargeable income in the preceding year. • The loss carry-back period be extended from one year to at least 3 preceding years; •
	Strategy 3: Building Human Capital Based on the economic master plan, Malaysia is moving towards a high income service economy. The success of a service economy is	

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	dependent on the capacity of human capital. In this respect, enhancing the supply of quality human resources is essential. In addition, measures should be taken to reduce the dependency on foreign labour which has an adverse impact on wage levels for the domestic market. **(i) Enhancing The Supply Of Quality Human Capital** **a) Continued employment of retirees** **b) Enhanced deduction for training costs** **c) Promoting the Spirit of Lifelong Learning** **d) Promoting the Establishment of an Education Hub**

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i)	<u>**Enhancing The Supply Of Quality Human Capital**</u> **a) Continued employment of retirees**	**a) Continued employment of retirees** To encourage retirees to remain in the pool of workforce, we propose that retirees be given a tax relief of, say 50%, on their employment income. This will also lessen the burden on escalating healthcare costs, etc. which will eventually be borne by the Government.
	b) Enhanced deduction for training costs Currently, a double deduction is available in respect of expenditure incurred by companies on the training of employees under approved training programmes conducted by training institutions.	**b) Enhanced deduction for training costs** We propose that the double deduction be extended to costs incurred in conducting in-house training courses to enhance and upgrade the skill levels of staff.
	c) Promoting the Spirit of Lifelong Learning Currently only limited courses for specific fields of study are allowed for deduction under Section 46(1) of ITA. This is not conducive to promoting a lifelong study spirit and will not enhance the development of human capital.	**c) Promoting the Spirit of Lifelong Learning** We propose that the restriction on the type of courses and the field of study be removed. The relief under S.46(1) should be extended to cover costs incurred in pursuing any professional/ vocational/academic courses paid to any institution of learning registered in or recognized by Malaysia. Government should not be too concerned with the loss of revenue as for every deduction claimed, there is a corresponding income to the education providers which would be taxable.
	d) Promoting the Establishment of an Education Hab	**d) Facilitating the establishment of educational institutions by** • allowing deductions on donations made to private schools, provided the schools are run as not-for-profit organizations; • allowing owner of buildings who do not operate the educational institutions to claim IBAs on the buildings used as educational institutions.
II	***ENHANCING INCLUSIVENESS*** Besides focusing on the serious structural challenges in our economy and we must not neglect to address the issue of enlarging wealth disparity and our commitment to environmental sustainability. We should seek sustainable growth that meets the ongoing needs of the	

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	population without compromising future generations by effective stewardship and preservation of the natural environment and resources. **Strategy 1 – Reducing the Tax Burden of Individuals** **Strategy 2 – Strengthening the Social Safety Net** **Strategy 3 – Promoting A Caring Society**	
	Strategy 1 – Reducing the Tax Burden of Individuals **(i) Improving Medical Relief On Taxpayer** **(ii) Treatment of Basis Year Loss for Individual** **(iii) Reviewing Personal Relief of Individual**	
i)	**Improving Medical Relief On Taxpayer** Currently relief of up to RM5,000 is allowed for medical expenses incurred by taxpayers for serious diseases. However, the relief is only allowed for serious diseases or major operations. It does not include chronic long term medical conditions such as diabetes, high blood pressure (Systemic blood pressure), etc. In addition, the claim must be certified by medical practitioners registered with the Malaysian Medical Council.	In view of the rising medical costs, we propose the deduction be extended to expenses incurred on the following: • common chronic medical conditions such as high blood pressure, diabetes, etc. • cost of treatment by certified alternative medical practitioners
ii)	**Treatment of Basis Year Loss for Individual** In view of the limited resources and highly competitive business environment, sole proprietorships or partnerships often struggle. Under the existing tax law, basis year business losses cannot be set off against income of a spouse. This can hinder entrepreneurship particularly for start-up businesses, etc.	To encourage entrepreneurship among the rakyat, the Institute would suggest that **Section 45 of the ITA** be amended to allow a husband and wife to utilise the basis year business loss of spouse to be offset against the income of the other.
iii)	**Reviewing Personal Relief of Individual** Based on the 2012 World Bank cross-country tax-to-GDP ratio, Malaysia has a score of 16.1%. Compared to a ratios of 14.5% for OECD members, 14.3% for High Income OECD and 14.3% for World, it appears that there is room for further reduction in the effective tax rates of individuals	**Reviewing Personal Relief of Individual** We are of the view that the current income taxation of individuals needs to be reviewed. CTIM has submitted a *Memorandum on the Improvement of Individual Taxation* on 30 November 2011. Additionally, in view of the introduction of the new consumption tax, Goods and Services Tax (GST), individuals, we would

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	Currently, an single individual with monthly income of RM2,870, claiming only personal relief (RM9,000), contribution to EPF (upto RM6,000), and Section 6A individual rebates (RM400) will not have to pay income tax. However, RM3,000 monthly income is the threshold for city poor.	propose the following: • An increase of personal relief to RM15,000 • An increase of contribution to approved fund and life insurance premium to RM 15,000 The effect of the above will result in an individual earning RM3,750 a month will not have to pay income tax (on assumption that he only claim personal relief, contribution to EPF and individual rebate of RM400).
	Strategy 2 – Strengthening Social Safety Net **(i) Donations to Approved Institutions**	
(i)	**Donations to Approved Institutions** Under the current law, a small company which made a small profit say, RM100,000 wishes to donate say RM25,000 to an approved institution, the deduction of donation will be restricted to RM10,000. The deduction on donation to an approved institution by an individual will be restricted to 7% of his aggregate income.	Consistent with the objective of developing a caring society, we propose that the law be repealed to remove the restriction on donations made to charitable organisations.
	Strategy 3 – Promoting A Caring Society **(i) Parent healthcare relief.**	
(i)	**Parent/ grandparent healthcare relief** As the average life expectancy increases, more individuals are supporting their parents/ parents-in-law and grandparents/ grandparents-in-law, particularly in the absence of Government funded facilities for the aged. These elderly generally needs assistance with their daily routine while some may have to be placed in nursing homes or residential care for the aged due to their physical condition to ensure that they receive the appropriate care.	To relieve family from the escalating cost of caring for the aged, we suggest that a **"parent/ grandparent/dependent" relief** of RM8,000 each for parent/grandparent/dependent of the individual taxpayer, where the parent/grandparent/dependent resides with the individual. "Parent/ grandparent/dependent" includes parent-in-law/ grandparent-in-law, natural or legally adopted. This will complement I Strategy (iii) (Enhancing The Supply Of Quality Human Capital) and alleviate the shortage of skilled labour, particularly the female workers, increase the capacity of

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	As the costs of care givers is very high, some individuals have to relinquish their jobs to stay at home to provide the necessary care to their parents/grandparents/parents in-law.	human resources.
III	***ENSURING FISCAL SUSTAINABILITY*** ***Strategy 1 – Improving Tax System Efficiency***	
	Strategy 1 – Improving Tax System Efficiency The Malaysian Income Tax Act 1967 (ITA) was enacted almost 50 years ago under the official assessment system based on the preceding year basis. Over the years, piecemeal amendments to the ITA had been introduced with the introduction of self-assessment system of taxation and to cater to the ever changing developments of the country. Currently, there are gaps between the law and the policy and practice which demand a full revamp of the law. In this respect, CTIM has submitted a *Memorandum on the Review of the Income Tax Act 1967 under the Self-Assessment System of Taxation* on 4 September 2014. **i) Enhancing The Efficiency Of Tax Compliance** **ii) Review of legislations to address gaps and flaws** **iii) Section 4B Income**	
i)	**Enhancing The Efficiency Of Tax Compliance** **(a) Consolidating the reliefs available to individuals for personal income tax purposes**	**(a)** To simplify the reliefs available to individuals for personal income tax purposes, we propose that the reliefs be consolidated into few items. This will reduce the amount of administrative work undertaken by the tax authorities and consequently reduce their operating costs and opportunity costs annually.
ii)	**Review Of Legislation To Address Gaps And Flaws** The key to quality of tax compliance is closely related to the efficiency and effectiveness of tax information dissemination. In this respect, the Institute has observed the following issues and would like to make some recommendations for the consideration of the Ministry. **Self-amendment of tax computation** Under the current self-assessment regime, a taxpayer who wishes to	**Self-amendment of tax computation**

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	revise his tax returns may do so within 6 months after the due date. Under Section 77B of the ITA, it appears that the taxpayer lost the right to self-amend if he has not submitted the tax return on the due date. Further, the law does not provide for self-amendment to be submitted before the due date or 6 month after the due date. In addition, the law allows self-amendment only if there is an understatement of tax. However, in practice, there could be cases where amendment results in a reduction of tax. Currently the only avenue for this is via section 131 which involves an 'application'. However, Section 131 and Form CP15C (*Application for Relief in respect of Error or Mistake*) for appeal under Section 131 of the ITA, indicates that such a relief is available for a tax payable case. Where a computational error is made in a loss case or where there are losses carried forward, or unabsorbed capital allowances carried forward, or investment tax allowances carried forward, have been stated wrongly, etc, there appears to be no avenue for amendment of the tax computation.	In the spirit of self-assessment, we propose the following: • the right to amend a tax return under Section 77B be widened to allow amendments for a reduction in tax and loss making situations. • the time frame for self-amendment be extended to 24 months from the close of the financial year. • self-amendment of a tax return before the due date without imposing penalty be allowed. • Section 131 be amended to allow for relief in error or mistakes to be made in tax reduction and loss making cases
iii)	**Section 4 B Interest Income** Section 4B goes against the fundamental tax principle of "badges of trade". Trade debts are financed by working capital and businesses charge overdue interest to reduce financing costs. With the introduction of Section 4B, there will be a mismatch. While interest expense incurred on financing the trade debts is a business expense, the overdue interest income on trade debt is now treated as passive income rather than business income and has no corresponding costs to offset. This will be detrimental to a company having huge unutilised capital allowances or unabsorbed business losses The amendment also appears to give preferential tax treatment to foreign groups of companies compared to the local conglomerates, whose treasury activities within a group of local companies, such as monitoring cash flows and funding requirements, making financial arrangements, making loans to subsidiaries, etc. are not recognised as business	The Institute strongly suggest that Section 4B and amendment to Section 24(5) be removed.

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	activities, whereas those of the multinationals are (via OHQs or TMCs) With technological advancement and globalisation of markets, businesses are forging towards integration of their activities and services to improve their competitiveness. In this connection, the proposed measures may hamper the efforts being made by local companies towards integration for competition.	
IV	**ISSUES FOR INCLUSION IN FINANCE BILL 2015.**	
	Non-deduction of Expenses for failing to furnish relevant information Subsection 39(1A) of the Act, introduced by the Finance Act 2014, stipulates that failure to furnish information on any item of expense (which has been claimed as a tax deduction by the taxpayer) as requested by the authority under Section 81 of the Act, within the time specified, will result in a tax deduction being disallowed for that expense. Section 81 and its related penalty provision under Section 120 already provides for penalties to be imposed on taxpayers for failure to furnish information to the IRB within the specified time frame. There is no necessity for a separate provision in the law to completely deny the tax deduction which is effectively tantamount to barring the taxpayer from exercising his right to appeal on the matter.	We recommend that the new provision be repealed.

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