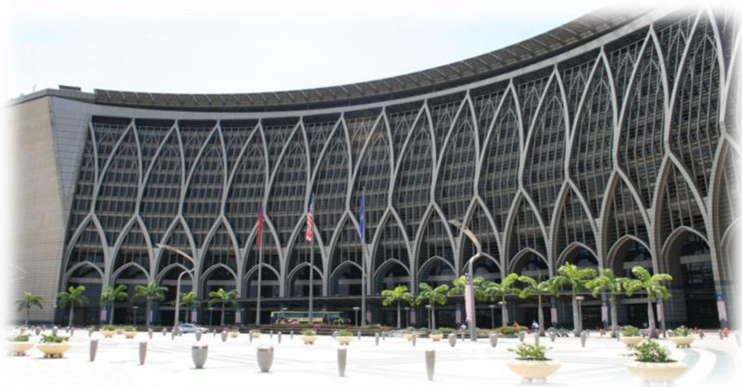
NATIONAL TAX CONFERENCE 2014



TAX INCENTIVES - WAY FORWARD

Tax Division,

Ministry of Finance

INTRODUCTION

- No business prefers to pay tax & investment projects have to **maximize returns** to investors;
- Thus, taxation affects decision on where & how to invest;
- Principle of taxation on right to tax by any jurisdiction is based on where the **real economic activities** are taking place:
  - ❖ having business presence;
  - ❖ value is created, eg. employment, transfer of technology etc.

- Many jurisdictions especially the developing & less develo countries **waive their taxing rights** in order to promote domestic direct investment (DDI) as well as foreign direct investment (FDI);
- When taxing rights are waived, the jurisdictions are **forgoing tax revenue** in order to incentivise the targeted economic activities.

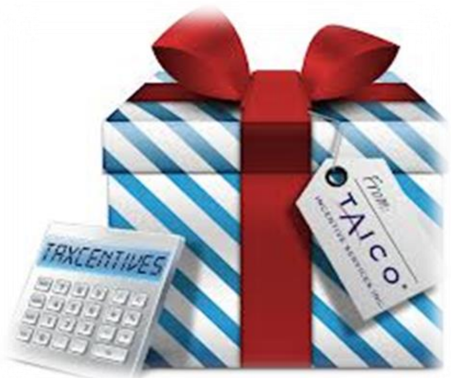
INTRODUCTION

- **Objective of tax incentives is to promote direct investments for sustainable economic development**

- **Currently, Direct and Indirect Tax Incentives are provided under the following Acts:**

  A. Direct Taxes
  - **Promotion of Investments Act 1986**
  - **Income Tax Act 1967**

  B. Indirect Taxes
  - **Customs Act 1967**
  - **Sales Tax Act 1972**
  - **Excise Act 1976**
  - **Free Zones Act 1990**



INTRODUCTION

Tax incentives are available for targeted sectors as follows:

- **Agriculture;**
- **Manufacturing ;**
- **Aerospace industry;**
- **Biotechnology ;**
- **Multimedia & ICT ;**
- **Manufacturing related services;**
- **Education services;**
- **Healthcare services;**
- **Tourism (including hotels);**
- **Green technology and environmental management (eg. Renewable enery);**
- **R&D and training;**
- **Selected services sectors such as Telecommunication & Logistics, IPC, RDC, OHQ, TMC**

IMPLEMENTATION OF TAX INCENTIVES

Under Official Income Tax Assessment System (prior to YA 2001 for companies)

- Companies eligible for incentives based on **specified** criteria;
- Formal applications submitted to the Investment Promotion Agencies e.g. MIDA, MDEC, BioTech;
- After obtaining the approval of tax incentives, the companies must **implement** the project as soon as possible;
- Companies can enjoy the incentives provided that all conditions imposed are **fully complied** with;
- Companies are required to apply for **approvals of specific incentives** under the Income Tax Act 1967, Investment Incentives Act 1968/Promotion of Investment Act 1986.

IMPLEMENTATION OF TAX INCENTIVES

Under Self Assessment System (Effective from YA 2001 for companies)

- Income tax assessment system has been changed from official system to **self assessment system**;
- As regard to incentives, income tax exemption can only be claimed in **the annual tax return forms** provided that all the conditions of tax incentives are **fulfilled**;
- Income Tax Compliance Audit is conducted by the Inland Revenue Board in ensuring the **fulfillment of all conditions** of tax incentives.

DEVELOPMENT OF TAX INCENTIVES

- Tax incentives have been offered since early stage of industrialization in **1960s**;
- Tax incentives are made available at the **initial stage** of business operation:

  - ➢ to promote **sustainable economic development** especially in the targeted sector;
  - ➢ brings **higher level of future revenue** to the country to finance more modern & efficient infrastructure facilities;
  - ➢ helps in **reducing cost of doing business** in order to be competitive in the global market.

DEVELOPMENT OF TAX INCENTIVES

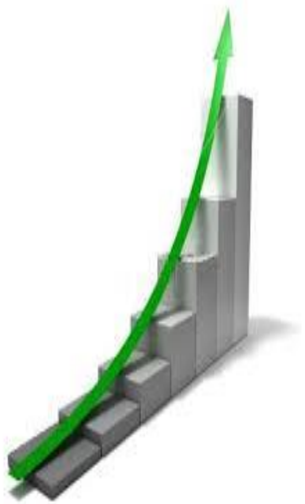
- Under the Investment Incentive Act 1967, pioneer industries in the assembly of electronic and electrical products were eligible for **Pioneer Status incentive**;

- Prior to YA 1992, incentives in the form of income tax exemption was given fully **(100% of statutory income)** for a specified period **(5 years + 5 years)**;

- From YA 1992 onwards, incentives in the form of income tax exemption has been granted partially **(70% of statutory income)** for a specified period **(5 years + 5 years)**;

- Indirect tax incentives come in the form of exemptions from **import duty, sales tax and excise duty** for raw materials and inputs which are basic, directly used in the manufacturing of finish products and not locally manufactured.

TAX INCENTIVES – WAY FORWARD



- Tax incentives are categorized as **subsidies**;
- In ensuring subsidies bring economic benefits without distortionary impact, tax incentives have to be targeted to **identified sectors** which have **long term viability** to support sustainable growth;
- In line with the aspiration of becoming high income nation by 2020, income tax incentives should be targeted to **promoted economic activities** which are contributing to sustainable **long term economic growth**;
- Equal importance between domestic direct investments (DDI) and foreign direct investments (FDI) through **higher productivity level** and **innovation**.

TAX INCENTIVES – WAY FORWARD

- Tax Incentives can also be provided in the form of a **pre-packaged incentive** to attract **huge investment** in promoted products and activities which are of **high technology** that would bring high economic impact and further development.

- Inline with **optimization** of limited resources, the granting of incentives should be more **selective** & based on the comparative advantage of the certain locations/ corridors (e.g. Northern Corridor targeted for agriculture, Eastern Corridor targeted for oil and gas, Iskandar Malaysia targeted for selected services)

TAX INCENTIVES – WAY FORWARD

- Tax Incentives are more **focused** to new areas of growth e.g. Biotechnology, Green Technology, Renewable Energy and development of corridors.
- As resources and factors of production are limited in nature, **efficient** operation of economic activities is crucial.
- Tax incentives are to **facilitate** private sector-led-growth by helping at the **initial stage** of business operation. The business must be **resilient** and able to proceed after the expiration of income tax incentive and contribute to Government revenue.
- Right sequencing of tax incentive is very important. In this light, **labor intensive** industry such as simple manufacturing activity with low level of technology are no longer incentivised.

TAX INCENTIVES – WAY FORWARD

Effective Administration Of Incentives

- Granting of tax incentives in line with **The Economic Transformation Program (ETP)**:
  - a) meeting the identified objectives of **specific sectors** and areas of economy within stipulated time frame;
  - b) **transparent** and **efficiently** executed;
  - c) mutually exclusive of each incentive;
  - d) only at the **beginning stage** of the operations (not perpetual);
  - e) contribution to Government's revenue in order to obtain **financial resources** for the Government to upgrade facilities and infrastructure for industrial and socio economic development e.g. partial exemption from income tax (exemption on 70% of statutory income)

TAX INCENTIVES – WAY FORWARD

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Effective Administration Of Incentives

f) Maintaining long term **economic competitiveness** for sustainable growth;

g) Significance of the Gross National Income (GNI) contribution by the **New Key Economic Areas (NKEA)** ;

g) 12 NKEAs are identified (eg. Oil, gas & energy, electronic & electrical, education, health care, communication content and infrastructure, agriculture)

TAX INCENTIVES – WAY FORWARD

Promoting Win-win Environment

- Tax incentive (eg. reinvestment allowance-RA) for sectorial diversification has contributed to **economic growth**.
- Today's globalize economy leads to greater regional **integration**.
- New areas of growth have to shift to **higher value added** and **knowledge intensive activities** for achieving economies of scale.
- All conditions of incentives including level of value added, technology & capital investment must be fully complied:
  - ❖ must establish a system to monitor on gradual basis using ICT
  - ❖ red flag mechanism to ensure strict monitoring by tax payers under self assessment system
  - ❖ oversights on compliance to conditions of tax incentives cannot be tolerated

TAX INCENTIVES – WAY FORWARD

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Promoting Win-win Environment

- In supporting sustainable growth, profit obtained and exempted from income tax in Malaysia, should be use for **reinvestment** in Malaysia.

- Reinvestment incentive should be targeted for **further upgrading** to higher level of technology and modernization.

- KPI measurement be based on quality of key indicators in knowledge intensive/high technology, high value added, expansion of export market & creation of high income job.

- Tax incentives are aimed to **promote economic activities** of global scale in Malaysia as our domestic market is rather small in size.

- Period of slower world economic growth has been impacting investment (DDI & FDI). This situation renders rationalisation of tax incentives a **difficult task**.

- Rationalisation of tax incentives need to be **carefully considered** as other jurisdictions are also providing incentives to attract quality FDI.


Thank
you!