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Five strategies for success

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ON FRIDAY SEPT 12 2003, PRIME Minister Dato' Seri Dr Mahathir Mohamad put all speculation on the country's next strategic direction to rest when he presented the federal Budget for year 2004. The occasion took place against a backdrop of an uncertain world environment. Indeed, the uncertainties of the external world were factored into the Budget which targeted the domestic private sector as the engine of growth - rather than foreign direct investment - as one of the five Budget strategies.

The other four strategies are:

- fiscal consolidation towards a balanced Budget;
- monetary policy to support private consumption and investment;
- enhancing the nation's competitiveness; and
- strengthening the social agenda and a caring society.

These strategies are to be achieved through a combination of direct and indirect tax measures as well as stimuli targeted at corporates and individuals. Let us take a look the key tax changes associated with each strategy.

Domestic private sector to lead the way

This strategy is aimed at promoting Malaysian products directly to a wider international market. On the commercial level, it will be facilitated by the corporatisation of MATRADE which would get an RM100 million launching grant. A further RM100 million are to be allocated to a fund for the Development and Promotion of Malaysian Brands.

Domestic investment, particularly by way of small and medium industries (SMIs), is to be encouraged. In this respect, the level of chargeable income eligible for the concessional 20% income tax rate (for companies whose share capital does not exceed RM2.5million) is to be extended from RM100,000 to RM500,000.

To further strengthen the role of the private sector, a number of existing fiscal incentives have been enhanced. Pioneer status (PS) or Investment Tax Allowance (ITA) is to be given for a further five years to companies manufacturing machinery and equipment. PS will get exemption of 70% of increased statutory income; alternatively 60% of additional qualifying capital expenditure will qualify for ITA.

For companies in Sabah, Sarawak and the Eastern Corridor of Peninsular Malaysia, the rate of income tax exemption under PS is to be increased from 85% to 100%; while ITA is to be increased from 85% to 100% of eligible expenditure and can be fully offset against statutory income.

The rates of PS and ITA available to companies using oil palm biomass to produce value-added products have also been enhanced.

Venture capital companies (VCCs) continue to be a source of funding for SMIs. Given this, tax incentives currently available to VCCs are to be made more accessible with a relaxation of the qualifying conditions. Proposals include an income tax exemption which will extend to income of a venture capital management company arising from profit-sharing agreements with a VCC.

Enhanced fiscal incentives are also targeted at the services sector. Companies enjoying the preferential Labuan tax regime will be allowed to establish marketing offices in Johor Bahru. The tax incentives for operational headquarters (OHQs) are to be enhanced by a tax exemption for income derived from the provision of services to related companies in Malaysia - provided the income does not exceed 20% of the OHQ's income from qualifying services.

Towards a balanced Budget

The government aims to achieve a balanced Budget in the near future by implementing fiscal consolidation measures. Expenditure will focus on the

provision of more efficient infrastructure facilities to reduce the cost of doing business and support economic growth as well as to improve the socio-economic well being of Malaysians.

As part of this strategy, employers are encouraged to hire unemployed graduates (registered with the Economic Planning Unit) through a proposed double tax deduction for salary costs.

Research and development are given increasing prominence, particularly that which emphasise value-added or value creation. Towards this end, relevant income received by researchers from the commercialisation of their research findings will be awarded tax exemption of 50% for five years. Relevant income received by lecturers for services rendered for the purpose of validation, moderation or accreditation of franchised education programmes in higher education institutions will be exempted from income tax.

To help combat the effect of the Iraq war and the outbreak of SARS, a second round of PS or ITA is proposed for hotel and tourism operators who invest in expansion, modernisation or renovation.

On the 'receipts' side, import and excise duties on cigarettes and other tobacco products will be increased by 20% and on liquor, by 10%.

In support of private consumption and investments

On the monetary policy side, the Prime Minister's proposals are focused on the capital market.

The government intends to introduce a comprehensive framework governing the tax treatment of Asset Backed Securities (ABS). Currently issuers of ABS are hampered by a lack of comprehensive tax rules.

Similarly, the Prime Minister has proposed that rules will be introduced to govern the tax treatment of Islamic securities. In essence the objective is to place ABS and Islamic financing on a similar tax footing to more conventional forms of finance.

Pensioners holding Merdeka Bonds will be exempted from income tax on the interest.

A more competitive Malaysia

To reduce the cost to the private sector of doing business, a number of tax deductions have been proposed. Interestingly, a full deduction is to be given on entertainment expenses incurred in sales promotions while a deduction of 50% will be given on other entertainment expenses. Deduction on incorporation expenses will be extended to companies with an authorised capital of up to RM2.5 million.

Further cost reductions will see the indefinite extension of the exemption for import duty and sales tax on spares and consumables for the manufacturing and approved services sectors. Import duties on selected goods such as computer batteries, wooden and plastic goods will be reduced or abolished.

Social goals

Efforts will be intensified to combat social ills and the family and society will share this responsibility. Towards this end, the government has proposed an increase in tax relief from RM800 to RM1,000 to reduce the cost of bringing up children. Also proposed are reductions in road taxes for certain lower income groups.

Small investors will be able to participate in the real property sector through the proposed introduction of Real Estate Investment Trusts as well as Property Trust Funds.

Conclusion

As expected, the Budget strategy contains discrete but diverse stimuli rather than across-the-board tax cuts. Indeed, the Budget was aptly defined by the Prime Minister as 'Building o Success, Investing for the Future.'