COVER STORY

Needed: A budget for UNCERTAIN TIMES

BY CHERYL POO AND ESTHER LEE

Much rests on Budget 2021, which will be revealed on Nov 6, as it will be a budget under a new government, under the 12th Malaysia Plan (12MP) and during the unprecedented global health crisis wrought by Covid-19.

The year has thus far seen the rollout of four economic stimulus packages — the first on Feb 27, the Prihatin Stimulus Package on March 27, Penjana on June 5 and Kita Prihatin on Sept 25 - collectively amounting to a mammoth RM315 billion.

Will the government introduce further stimulus packages to address the immediate problems stemming from Covid-19 or a longer-term plan to spur the country's economic growth?

It goes without saying that Budget 2021 will be an expansionary one with the aim of addressing immediate and medium-term issues, which will be in line with the finance minister's earlier indication that the budget would have four broad themes - caring for the people, steering the economy, sustainable living, and enhancing public service delivery.

Most expect to see some of the stimulus measures announced so far this year, especially those that assist the vulnerable income groups and affected businesses, extended in the upcoming budget.

In a report by United Overseas Bank (M) Bhd, senior economist Julia Goh foresees earlier stimulus measures — such as wage subsidies, cash aid, automotive sales tax exemption and property-related measures — being extended into 2021 alongside new measures to support consumption, stimulate investments, accelerate digitalisation, improve job creation and wages, and promote environmental sustainability.

Nevertheless, it is pertinent to assess how effective the measures are before extending them.

"In crafting Budget 2021, it is important for the government to take stock of the impact of the various measures announced in Penjana and Prihatin to determine their effectiveness and continue with what works," says PwC Malaysia tax leader Jagdev Singh.

As much as addressing the nation's most immediate concerns must take precedence, the budget will also have to prepare for the country's fiscal sustainability and sustainable growth going forward as the economy moves into recovery mode.

"Looking at the medium and long term is equally important as we position ourselves to take advantage of the economic recovery. This would include reshaping the government revenue side of the equation, growing and increasing the competitiveness of our small and medium enterprises (SMEs), strategic inbound and outbound investments as well as stepping up to be a high income nation," says Jagdev.

Another critical aspect of the economy that should be given priority in the budget is investment growth.

"The government is expected to continue to support the SMEs that are still struggling from the impact of the pandemic through favourable tax schemes and, at the same time, ensure a stable and conducive environment for potential foreign investments. Furthermore, incentives for new sources of growth — including Industrial Revolution 4.0, digitalisation, green technology and sustainability — could be further enhanced in the budget," opines RHB Research economist Peck Boon Soon in his report.

It is no surprise that many have been calling for more support for the SME industry. KPMG Tax Services Sdn Bhd corporate tax executive director Lim Wai Yin highlights that the category represents about 98% of Malaysian businesses, and as such, their survival is critical to the overall growth of the Malaysian economy.

Another aspect of expenditure that is likely to take precedence is development expenditure, which is expected to remain high in 2021.

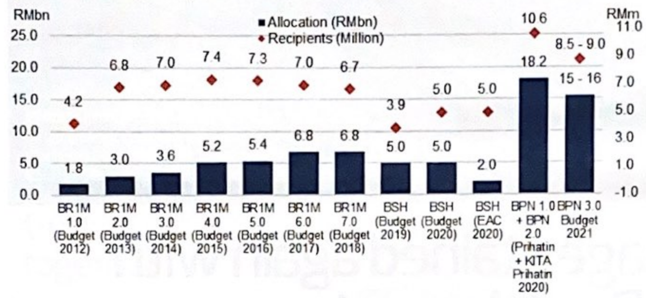
Peck says it could remain a priority for the government in light of weak private investment prospects as well as Malaysia's need to remain economically competitive.

"We believe the allocation will be focused on the economic sectors, especially transport due to the ongoing large rail and highway infrastructure projects, as well as digital and communications infrastructure to accelerate the shift to a digital economy," he explains.

According to AffinHwang Capital Research, development expenditure is projected to be around RM60 billion per annum for the next five years.

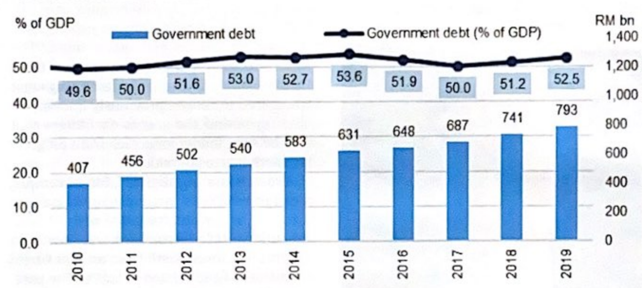
MOF

Cash assistance disbursed by government (with 2021 forecast)



Government debt

MOF, AFFIN HWANG



"Based on our estimate, we believe the allocation for the development expenditure ceiling over the five-year period from 2021-2025 in 12MP may be raised to a target of about RM280 billion, which will translate to average spend of between RM56 billion and RM60 billion per annum.

"We believe that development expenditure plays an important role in sustaining the country's economic growth, thereby preserving the revenue source generated by economic activities," notes the research house.

KPMG's Lim also calls for the government to enhance its public service delivery to ensure that every ringgit disbursed from the budget is utilised efficiently, with minimum wastage and leakage.

Fiscal deficit: Justified, but government must spend wisely

According to UOB's Goh, the measures taken to contain the pandemic have weighed heavily on the economy, labour market, households, SMEs and large companies, particularly in the most affected industries. The economy contracted 8.2% year on year in the first half of 2020 and although economic indicators have improved since May, conditions are far from near pre-pandemic levels.

The government targets economic growth of between 5.5% and 8.0% in 2021, from a deficit of 3.5% to 5.5% in 2020.

"The pace of recovery hinges on the distribution of an effective and safe Covid-19 vaccine, geopolitical risks and US-China relations. Barring any negative surprises, we expect policy rates to remain on hold in the near term," she says.

The health crisis has widened the fiscal deficit amid lower government revenue, which fell 22% year on year from January to August. Ongoing expenditures, comprising 148% of revenue, and the direct fiscal injection of RM55 billion amounting to 3.7% of GDP is projected to widen the nation's fiscal deficit to 6% of GDP in 2020.

Meanwhile, RHB Research's Peck says that while revenue is expected to improve with better economic growth next year, it could well be weaker than the level seen in 2019. Similarly, expenditure is expected to narrow in the absence of one-off extensive support measures, he adds.

It is clear to experts that although there have been attempts by the government to lower the fiscal deficit since the Asian financial crisis (AFC) of 1997 and 1998, the widening gap is justified since the pandemic's impact on fiscal sustainability is deeply felt by governments around the world. No nation is spared. As such, any negative repercussions from higher budget deficits or public debt should not apply in this cycle, economists say.

Amarjeet: Malaysia needs to formulate its own view on the right balance for our country today, and take care of those in need

As Malaysia was recovering from the AFC, its fiscal deficit expanded to -5.5% in 2000, after which it improved to -3.5% in 2007 before sinking to a record -6.7% during the global financial crisis in 2009. In 2019, it stood at -3.2%, having hovered between -3.1% and -3.9% since 2013.

"Malaysia will not be singled out — as long as our growth number is recovering," Institute for Democracy and Economic Affairs (IDEAS) Malaysia research manager Lau Zheng Zhou says.

He points out that what is more pressing are the areas of spending and whether they will be effective in stimulating growth and spurring recovery, rather than disbursing funds on "wasteful items such as indiscriminate subsidies on petrol".

"Also, emoluments take up a huge share of the government's operational spending, so is there any room to rationalise the public sector size?" he asks.

Lau explains that the current low interest rates provide fiscal space to borrow and invest in capital-intensive items such as public infrastructure in rural areas as well as nurture the renewable energy industry. He adds that investors in Malaysian government bonds will need to be assured that spending on this is not made for unsustainable short-term gains but, rather, for growth impetus in the long run.

COVER STORY

In order to sustain the pace of economic recovery, economists expect the government to continue to spend on targeted areas such as trade and industry, communications, healthcare, education and training, as well as infrastructure projects such as renovating, rehabilitating and restoring old government buildings, which are in the pipeline.

According to UOB's Goh, the overall federal government revenue for 2020 is projected at RM215 billion amid the absence of additional revenue contributions from government-linked companies and government-linked investment companies as well as lower petroleum-related revenue.

Higher government borrowings may be required to close the fiscal gap for potentially larger allocations for trade and industry, communications, healthcare, education and training, as well as infrastructure projects.

"As the fiscal trajectory widens in 2020, the government may provide a revised medium-term fiscal consolidation plan as part of prudent fiscal management. This would provide greater clarity and conviction on the government's plans to lower the budget deficit to 3% to 4% of GDP in the medium term while keeping the debt-to-GDP ratio under 60% of GDP," she says.

Sources of revenue

With companies struggling to survive, the outlook for tax collection next year is set to be weak. Compounding the economic weakness are the elevated unemployment levels and reduced workers' compensation, which further diminish any potential increase in income taxes. One possible avenue for an increase is the better outlook for commodity prices, which may benefit revenues tied to these commodities.

Lau: Prepare for a potential slowdown in the global economy by beefing up our social welfare system

"In light of the challenging economic outlook, tax revenue, which makes up a substantial part of overall government revenue, is expected to decline. As such, it would not be surprising if the government decides to tax some income or gains which are currently not taxable," Jagdev of PwC Malaysia says.

Most tax consultants believe this, or higher taxes, will not be the case in the near term although the government has indicated that it will consider every avenue for an increase in the revenue base, which has been forecasted to grow 8.8% year on year to RM248 billion in 2021 from RM228 billion in the current year.

"Although there is talk of bringing back GST (Goods & Services Tax), this may not be the right time for immediate implementation, but a reasonable timeframe for the implementation may be announced," says Deloitte Malaysia country tax leader Sim Kwang Gek. While globally, more countries are adopting the broad-based GST, tax consultants believe what would be more likely is an expansion of the scope of taxable services under the Sales and Services Tax (SST) regime and lowering of the registration threshold for SST to cast a wider net to include more business segments.

Tax authorities may intensify tax audit activities to beef up tax collection. With the adoption of the Common Reporting Standard (CRS) and Malaysia's commitment to automatic exchange of information, taxpayers can expect higher scrutiny on their sources of income, she adds.

In addition, there may be a review of the existing scope of tax to include online transactions and cross-border activities so as to reduce tax leakages from the shadow economy and profit- shifting activities.

This may include taxing the informal sectors of the economy such as unregistered online businesses and online purchases by individuals. Data analytics and technology tools could be used to detect anomalies in sources of income versus spending as a proxy for underreporting of income for tax purposes, as well as enhancements in information sharing across different regulatory agencies, and with foreign tax administrators, to identify possible non-reporting of offshore income, says KPMG's Lim.

A digital service tax of 6% on foreign digital service providers in Malaysia with an annual turnover of more than RM500,000, which came into effect on Jan 1, is expected to bring in approximately RM300 million this year. While this is positive for government coffers, it is well below the RM2 billion to RM4 billion previously estimated by the market, RHB's Peck says, attributing the lower collection to special treatment, including group relief facilities and exemptions, to local service providers amid overall weaker economic growth.

He forecasts the digital tax collection to grow by 9% this year in response to the strong and steady growth of Malaysia's digital economy.

"To accelerate investments in digital transformation, a special tax incentive package can be considered in the form of a capital allowance claim equivalent to two times the capital expenditure incurred and double tax deduction on professional fees incurred in implementing such projects subject to a certain investment limit and within a specific time frame," Deloitte's Sim proposes.

As for the likelihood of a widening of the income tax bracket for individuals or a reduction in income tax for individuals and corporates, KPMG's Lim says that a reduction in income tax rates for SMEs — by way of a direct rate cut or a tax rebate — would be beneficial as Penjana's provision of a tax rebate of up to RM20,000 for SMEs is currently limited to newly established businesses.

SMEs are currently taxed at 17% on their first RM600,000 of chargeable income and 24% on the remaining chargeable income, hence a reduction of up to 20% on the remaining chargeable income would be welcomed as SMEs across the board are experiencing significant disruptions.

Tax consultants also point out that a review of the SST regime to address the weaknesses in the system would be helpful, such as eliminating the cascading effects of the SST that ultimately increase business costs, and providing clarity on the scope of taxable services.

"It is timely to revisit the GST system and enhance the framework, such as facilitating GST refunds and stringent enforcement of the Anti-Profiteering Act to ensure the GST system is not abused for unreasonable gains," says Deloitte's Sim.

For context on the consumption-based tax, Ernst & Young Asean and Malaysia tax leader Amarjeet Singh notes that imposing tax on the rich with the hope of sufficiently managing the fiscal position of the country will not meet that aim as the high-income group in Malaysia is relatively small.

"Our GDP per capita income today is about US$11,000 per annum compared with Singapore's US$64,000 per annum. Are we a high-income nation? Not yet. Hence, we do need to broaden the tax base. However, it is a delicate balance as we need to also find ways to encourage businesses to operate in Malaysia and generate jobs. Today, there is a heavy reliance on government investments to sustain and spur the economy. Therefore, we must encourage private businesses to participate in the growth of the economy, which will improve Malaysia's fiscal position."

Within the region, Malaysia's corporate tax rate stands at 24%; Indonesia's prevailing 25% will be reduced to 22% by the end of 2020, and to 20% by 2022; the Philippines' 30% is slated for a preliminary reduction to 25% and, thereon, an annual reduction of 1% until it reaches 20% by 2027; Singapore's is 17%; Thailand's is 20%; and Myanmar's is 30%.

According to Amarjeet, the implementation and broadening of consumption-based taxes have been trending globally, with many nations correspondingly reducing corporate tax. However, critics have slammed this as being "regressive" as such taxes impact the lower income group proportionately harder than the wealthy.

"Malaysia needs to analyse this carefully and formulate its own view on what the right balance is for our country today."

He provides the illustration of two people, one with an income of RM2,000 and the other, RM10,000, buying a can of Coke for RM1.

Based on a GST of 6%, the six sen will be more of a pinch to the lower-wage earner than the rich. Therefore, the right support must be in place for the lower-income group, who will have to pay consumption tax when the time comes.

He explains that the support measures may even supersede the tax contribution paid by the poor.

"We also need to tweak the broader consumption tax base to ensure that those who are in need are taken care of in the right way."

For reference, Singapore's Budget 2020 will defray the cost of consumption tax for lower to middle income citizens with the S$6 billion Assurance Package, through which adult citizens will receive a cash payout of between S$700 and S$1,600 over five years. The scheme will come into effect when the GST rate rises to 9% from 7% by 2025. ■

Stimulus packages recap

Since the start of 2020, the government has doled out over RM300 billion in stimulus to support the nation's economy in light of the global health pandemic. Here, we recap the highlights from each stimulus plan.

FIRST STIMULUS PACKAGE

(Under former PM Tun Dr Mahathir Mohamad)
Date announced: Feb 27, 2020
Package size: RM20 billion

Spending highlights:

Direct government spending: RM3.5 billion
- Small scale projects — RM2 billion
- Other initiatives (including tax measures) — RM1.5 billion

Others: RM16.5 billion
- Loan funds — RM3.5 billion
  - Funds provided by BNM to provide soft loans mainly to SMEs
- Other sources – RM13 billion
  - Contribution arising from reduction in Employee Provident Fund (EPF) contribution rate

PRIHATIN STIMULUS PACKAGE

Date announced: March 27, 2020
Package size: RM250 billion

Spending highlights:

Direct government spending: RM25 billion
- Bantuan Prihatin Nasional – RM10 billion
- Wage subsidy programme – RM5.9 billion
- Small infrastructure projects – RM2 billion
- Healthcare (Covid–19) – RM1.5 billion
- Food Security Fund – RM1 billion
- Micro Credit Scheme – RM500 million
- Assistance for Tertiary Students – RM270 million
- Others – RM630 million
- Economic Stimulus Package (Feb 27) – RM3.2 billion

Public and Private Institution: RM225 billion
- Loan moratorium – RM100 billion
- Danajamin: Financing Guarantee Scheme – RM50 billion
- EPF: i– Lestari Scheme – RM40 billion
- EPF: Employer Advisory Services – RM10 billion
- BNM: Facilitation Fund – RM4 billion
- Others – RM4.5 billion
- Economic Stimulus Package (Feb 27) – RM16.5 billion

PENJANA STIMULUS PACKAGE

Date announced: June 5, 2020
Package size: RM35 billion

Spending highlights:

Direct government spending: RM10 billion
- Wage subsidy programme extension — RM5.3 billion
- Hiring and training assistance for businesses — RM1.5 billion
- Training and upskilling programmes — RM2 billion
- Penjana SME financing — RM2 billion
- Social protection and training for gig economy workers – RM75 million
- Childcare assistance — RM200 million
- My30 public transport subsidy – RM200 million
- Social assistance for vulnerable groups — RM110 million
- PEKA B40 healthcare support – RM50 million
- "Shop online Malaysia" – RM70 million
- E–Dagang campaign for SMEs and microenterprises – RM70 million
- MyAssist SME – RM5 million

Public and Private Institution: RM25 billion
- Internet connectivity for education & productivity – RM3 billion
- Penjana Tourism Financing – RM1 billion
- SME Go–Scheme – RM1.6 billion

KITA PRIHATIN STIMULUS PACKAGE

Date Announced: Sept 25, 2020
Package Size: RM10 billion

Spending highlights:

Direct government spending: RM10 billion
- Targeted wage subsidy Programme – RM2.4 billion
- Prihatin special grant – RM600 million
- Bantuan Prihatin Nasional 2.0 – RM7 billion

COVER STORY

How to revitalise private investments

"Revitalise private investments in the country" has been a common refrain over the last few years. And now, with the Covid-19 pandemic affecting almost every facet of the economy, it is even more crucial for policymakers and regulators to address this issue, especially with most businesses refraining from making new investments or putting further funds into existing businesses.

The year 2020 is seen as a "lost year" for private investment, as evident from the total approved investments of RM65 billion recorded for 1H2020, as recorded by the Malaysian Investment Development Authority. Even at an annualised figure of RM130 billion, it is only slightly more than half of the RM211.3 billion total approved investments recorded in 2019.

But, it is worth noting that the growth of total approved investments had been slowing down in the past five years, although it grew from RM106 billion in 2010 to RM211.3 billion last year. Total approved investments grew 120% from RM106 billion in 2010 to RM235.9 billion in 2014, but from 2015 to 2019, it only registered a growth of 13% from RM186.7 billion to RM211.38.

What is also noteworthy is that domestic direct investment (DDI), which makes up the bulk of total approved investments, has been on a decline since 2014, falling from RM171.3 billion to RM129.03 billion last year.

Meanwhile, foreign direct investment (FDI) increased 27.5% to RM82.3 billion from RM64.6 billion over the same period.

At a recent economic briefing organised by the Associated Chinese Chambers of Commerce and Industry of Malaysia's (ACCCIM) Socio-Economic Research Centre, the latter's executive director Lee Heng Guie said investors are looking forward to the upcoming budget for some form of catalyst to revive business sentiment.

However, Amarjeet Singh, Ernst & Young Tax Consultants Sdn Bhd (EY) Asean and Malaysia tax leader, is hoping for more. At the top of his wish list for Budget 2021 is seeing the government continuing to refine and improve its existing policies and philosophy to be business friendly and to encourage businesses to set up shop in Malaysia. This will lead to the creation of new jobs and the improvement of livelihoods of Malaysians, he says.

He believes that Malaysia has all the right attributes, with the government putting in place many measures to attract foreign businesses. However, the competition for foreign investors in the region is stiff.

"Hence, to distinguish Malaysia, it is important that the government's measures are clear and easy to implement and that these measures as well as Malaysia's positive attributes are made known to the world. Our neighbours are good at getting the right publicity and attracting attention from investors. We need to continue to improve on this front."

Amarjeet also highlights that it is crucial to look after existing businesses and investors, adding that the expectation of investors today has gone beyond incentives.

"Investors want to operate within a supportive ecosystem, including an efficient operating environment with a high degree of certainty and consistency. They want the government to stand by their side and support them throughout their stay in Malaysia. For example, if an investor is given a tax holiday and has followed through on its commitments to Malaysia, the investment promotion agencies should support the audit process when the investor is audited by the tax authorities to ensure that the spirit of the incentive is upheld," Amarjeet says.

Others agree that foreign investors are not only drawn to incentives.

"While tax incentives are a key factor in attracting FDI, it is not the only consideration. I expect to see continued investments in infrastructure development to ensure that Malaysia is an attractive hub for high-value functions and larger components of the regional or global supply chain," says PwC Malaysia tax leader Jagdev Singh.

He adds that what could encourage businesses, with many expected to make losses during this period, to continue investing is a reversion to the previous position where businesses could carry forward their losses indefinitely.

Prior to the year of assessment (YA) 2019, unutilised business losses could be carried forward indefinitely to be set off against income from any business source. However, this has been capped at a period of seven YA.

ACCCIM's SMEs committee chairman Koong Lin Loong believes that while FDIs are important to countries like Malaysia, which is an open economy with a small population, emphasis also needs to be put on DDI, of which the SME (small and medium enterprise) industry is a part of.

"Now that borders are closed, there are no FDIs coming in. But even when they reopen, it would take some time before foreign investments flow into the country again. So, it is really important to encourage local investments now," he says.

Notably, the SME industry represents about 98.5% of companies in Malaysia — in 2018, it contributed 38.3%, or RM500 billion, to the country's gross domestic product.

Koong says the government can encourage local investments, especially among the SMEs, by getting financial institutions to offer soft loans with favourable terms.

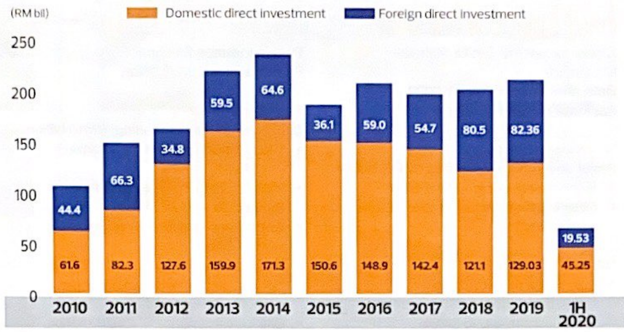
He points out that policies need to be revised to give local businesses a business-friendly environment as well. "Local businesses must be treated well too, like how we treat foreign investors. We must allow SMEs to grow freely. We often are told of how [local businesses,] SMEs especially, go through a hard time with authorities, often over minor issues.

"Don't get me wrong, I'm not against the authorities going after those who violate the law, but what is important is for them to go after the 'genuine' wrongdoers," says Koong.

Malaysia currently ranks No 12 in the World Bank's Doing Business 2020 rankings. Can the country improve further and attract more DDIs and FDIs in the years ahead?

MIDA

Approved private investments in the last decade



Healthcare expenditure likely to be in focus

With the resurgence of the Covid-19 virus and rising anticipation over Covid-19 vaccines being available sometime next year, it would be no surprise if the allocation for healthcare expenditure is increased this time.

In the last three years, the healthcare budget has grown by high single digits year on year. Budget 2020 allocated RM30.6 billion in healthcare spending, a 7% increase from the 2019 Budget of RM28.7 billion.

AffinHwang Investment Research says in its report that it believes the government is likely to spend on the social services sector, especially on building new public hospitals and upgrading healthcare facilities to meet the rising demand for public healthcare services amid the pandemic.

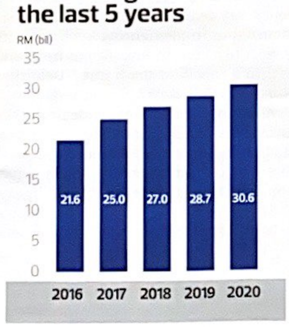
"We also expect the government to allocate funds for a vaccine. The Minister of Science, Technology and Innovation recently noted the proposal to the finance minister for RM3 billion to be allocated in Budget 2021, mainly for the purchase of a vaccine. Malaysia is not expected to receive any subsidy or financial assistance from the World Health Organization's (WHO) global Covid-19 vaccine access plan as Malaysia is categorised as a middle- to high-income country," adds the research house.

In terms of the vaccine, United Overseas Bank (M) Bhd believes the top concern will be the cost, especially upfront payments. The cost is said to be set at a ceiling price of US$20 (RM83) per vaccine or dose for committed purchases under the Covid-19 Vaccine Global Access (COVAX).

"Using that as a base price, the down payment to immunise 10% of the country's population could go up to RM90 million," says the research house.

MOF

Healthcare expenditure in the budget over the last 5 years



Budget wish lists

Sim Kwang Gek
DELOITTE MALAYSIA COUNTRY TAX LEADER

1. **Holistic review of current tax regime**
   - Ensure framework is current, relevant and competitive
   - Streamline tax incentive provisions under the Promotion of Investment Act 1986 and Income Tax Act 1967
   - Review Sales and Services Tax regime to address weaknesses in the system
2. **Incentives to encourage digital adoption**
   - Accelerate investments in digital transformation via a special tax incentive package
3. **Reduce penalties for voluntary disclosures made by taxpayers**
   - Reduce penalties to 5% from 10% to 35%, and no penalties on voluntary disclosure on genuine errors
4. **Relax current group relief rules**
   - Allow all companies including small and medium enterprises to access the group relief facility and removal of the 70% restriction

Jagdev Singh
PWC MALAYSIA TAX LEADER

Lower corporate and personal tax rates. Reduce headline rate to 22%, with firm plan to further reduce beyond that target in the coming years.

Lim Wai Yin
KPMG TAX SERVICES SDN BHD EXECUTIVE DIRECTOR FOR CORPORATE TAX

Government to reintroduce previous group relief regime
- Allow 70% of adjusted losses to be shared among companies in the same group, without limiting it to surrendering companies in their first three consecutive years of assessment
- Introduce a loss carry-back provision to allow taxpayers to carry back current year losses for a limited period to recover income taxes paid previously
- Temporary moratorium from paying tax instalments for taxpayers with good tax records to encourage more self-compliance in the long term