THE STATE OF THE NATION A WEEKLY UPDATE

Fine balancing act between tax reforms and business sentiment

STORIES BY **SUPRIYA SURENDRAN**

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For the longest time, tax reform issues in Malaysia have centred on two main thrusts: the improvement of tax management, and whether new taxes should be introduced.

Recently, Finance Minister Tengku Datuk Seri Zafrul Aziz made it clear that Putrajaya would not be introducing any new taxes for now, given that the battered economy is in early recovery.

But tax reforms are obviously needed and *The Edge* has learnt that a public consultation has been commissioned by the Inland Revenue Board to seek feedback on a number of proposed changes from associations representing various industries and professional bodies.

These reforms have long been debated by tax experts, and include the introduction of a capital gains tax, the removal of the real property gains tax (RPGT), and a proposal for gains received from the disposal of real properties to be taxed under the Income Tax Act 1967 (ITA 1967).

The proposed reforms also touch on the withdrawal of income tax exemption under Paragraph 28, Schedule 6 of the ITA 1967, which pertains to income derived from sources outside of Malaysia. At present, Malaysia, like Singapore, practises a territorial tax system whereby residents and non-residents are taxed only on the income earned in Malaysia, while foreign-sourced income is not taxable.

However, no timeline has been stipulated, so it is unclear when these reforms are to be implemented, nor were proposed tax rates mentioned.

The Edge asked tax experts for their suggestions on how tax revenue could be boosted.

RPGT and capital gains tax

To say that Malaysia does not currently have a capital gains tax is not entirely true, according to Tricor Services (Malaysia) Sdn Bhd non-executive chairman Dr Veerinderjeet Singh, explaining that the RPGT is a limited form of capital gains tax.

"Many countries in Asia have started to merge capital gains with revenue gains, and what happens is they bring it within the current income tax act, and they call the combined legislation the Income Tax and Capital Gains Act, for example."

Veerinderjeet says that if we were to merge capital gains into the ITA 1967, the next question would be at what tax rate. For example, corporations currently pay an average 24% tax on their business income earned under the ITA 1967, but under Schedule 5 of the RPGT Act, they pay between 10% and 30% on gains from the disposal of properties — depending on the duration that they have held the properties, as the longer it is held, the lower the RPGT rate imposed.

"So if you bring in capital gains like sale of property into the ITA 1967, if you then treat it the same way as business profits, you will end up paying a flat 24% [in addition to paying 24% on business profits], so is that reasonable ... that is the question.

"I do support the merging of the Capital Gains Act into the ITA but the capital gains portion should be taxed at a lower rate, and for a start, it could be a flat 10% or 15%, and business profits at the normal 24% corporate tax rate."

The proposal to merge capital gains into the ITA would not just be limited to gains made on property disposals, but would also apply to any kind of capital gains made, which includes the sale of shares in listed or in private companies.

"For example, a high net worth individual would probably be paying the highest personal tax rate of 30% under the ITA 1967. Let's say he makes a gain in the stock market; he will again be taxed at 30% if capital gains were to come under the ITA 1967.

"Capital gains tax — be it for individuals or corporations — is not advisable at this point in time as it affects the stock market."

Baker Tilly Malaysia managing partner and Asia Pacific leader for tax services Anand Chelliah believes that introducing a new capital gains tax that will tax real property gains, as well as other gains that are capital in nature, is a better solution than taxing all gains under the ITA 1967.

"Taxing real property gains under the ITA 1967 will necessitate special taxing statutes to allow for certain reliefs and so on, on the gain made on disposal. It is highly complex, and likely to be subject to confusion in the administration of the tax.

"However, [the introduction] of the new capital gains tax will need careful drafting by the legislators to ensure that it provides the requisite allowances, reliefs and rates of tax that do not negatively impact on economic development, stock market attractiveness, property sector growth and so on."

Ernst & Young Tax Consultants Sdn Bhd (EY) Tax managing partner and Asean tax leader Amarjeet Singh says that if the objective is to tax gains made from trading in shares on the stock market, then the introduction of a capital gains tax is not the answer.

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Tax consumption, not employment and business income, says economist

Malaysia needs to shift away from taxing employment and business activities, and instead focus on taxing consumption, says Lee Heng Guie, executive director of the Socio-Economic Research Centre.

"For a start, when the economy has recovered from the pandemic, the government can consider reintroducing the Goods and Services Tax (GST), starting with a lower rate of between 3% and 4%, and raise it gradually over time when economic and business conditions permit.

"Malaysia's current level of entrepreneurship, income and capital market development does not warrant the implementation of capital income-related taxes, as in the rich developed countries. Capital gains tax and wealth tax run counter to the international trend of declining tax rates on capital income and wealth," he says.

Taxes such as capital gains tax reduce savings and investment incentives, he adds, and would thus greatly dampen the nation's long-term prospects for increased productivity and economic growth.

"Imposing taxes on wealth accumulation is counterproductive as it stifles innovation and entrepreneurship, and encourages avoidance, evasion and capital flight," Lee adds.

His view is that reducing corporate tax rates is more effective than providing special tax reliefs or incentives to enhance investment, especially for small and medium enterprises.

"Being a small and open economy, competing against other countries to attract high-quality foreign direct investments, capital resources and talented workforce will require Malaysia's tax system to be just as competitive and dynamic to compete in the global marketplace."

He says the appropriate timing and sequencing as well as scope of tax reforms must take into consideration the current state of economic and business conditions so as to manage the cost of adjustment.

"In this regard, a big bang tax reform approach is undesirable at this stage when the economy is still reeling from the Covid-19 pandemic."

The GST Act 2014 was repealed in 2018 under the Pakatan Harapan government. However, the Ministry of Finance has set up a committee to study its reintroduction. Some quarters say it should be brought back, but at a lower rate than the previous 6%.

Bringing back GST at a lower rate of 3% to 4% may still expand the country's revenue base as it is a broader base and more efficient system if implemented with the convenience of businesses and consumers in mind, says Chow Chee Yen, senior executive director of tax advisory and compliance at Grant Thornton Malaysia.

"This would mean to minimise the delay in refunds, to do away with exempt supply that was in GST 1.0, and to zero rate all essential goods and services.

"This will lead to higher investments and employment opportunities for the country. In addition, a lower GST rate of 3% to 4% [and with Sales Tax and Service Tax abolished] may result in a drop in prices of certain goods and services," Chow adds. E

IWH's listing might be delayed to 2H2021 amid aborted land deal with Ekovest

BY **LEE WENG KHUEN**

Plans by Iskandar Waterfront Holdings Sdn Bhd (IWH) to float its shares on the local bourse may not materialise in the near term.

The recent aborted land deal between IWH and Ekovest Bhd, in a related-party transaction, raises concerns that it may weigh on the former's ability to fetch a higher value for its land bank of more than 4,000 acres in Johor's Iskandar Malaysia, which has been plagued by the property glut.

A source says IWH's listing is now scheduled for the second half of this year, instead of the first half as planned.

"Work is in progress for IWH's listing. The first half is not possible; they are aiming for the second half," the source tells *The Edge*.

Analysts are not too optimistic about the listing of IWH, though. Says one: "I think IWH has postponed the listing because it is difficult to get interest for any property listing right now."

IWH had planned to raise at least RM5 billion from its proposed initial public offering.

Both IWH and Ekovest are controlled by tycoon Tan Sri Lim Kang Hoo, who has stakes of 63% and 32.4% respectively.

Unlike traditional property developers, IWH is not directly involved in property development but sells land to developers and co-invests with them in joint ventures (JVs).

An analyst stresses that when a listing takes place depends on the value of IWH's assets. The key factors taken into consideration are pricing, demand and location.

"The population density is low in Johor. If there is no demand, how can they sell the land?" she says.

Another analyst agrees, saying it may not be able to fetch good value for its land. "Yes, the market condition is better than six months ago, but you still can't maximise your value.

"While IWH can sell land and go into a JV with other developers, we have to see what kind of partners they are going to bring in. And there is the turnaround time — how fast they can enter into a JV or sell and monetise the land."

IWH recorded net losses of RM90.95 million and RM90.31 million for the financial year ended Dec 31, 2018 (FY2018) and FY2017 respectively, according to a company search on CTOS. Prior to that, it reported net profits of RM39.66 million, RM339.29 million and RM173.17 million in FY2016, FY2015 and FY2014 respectively.

On the land deal between IWH and Ekovest that was called off, the second analyst believes it has less to do with the outlook for Iskandar Malaysia. "I don't think it was due to the location of the land in Iskandar Malaysia. It is more of an internal issue in terms of the restructuring of all companies controlled by Lim."

Last Monday, Ekovest scrapped the proposed acquisition of 96.28 acres of freehold land in Pulai, Johor, from IWH for RM1.11 billion, as both parties were unable to reach an agreement on the transaction.

Ekovest's share price barely reacted to the news last week, closing at 49 sen last Friday, giving it a market capitalisation of RM1.32 billion.

Its net profit plunged 80% y-o-y to RM18.51 million for the first six months ended Dec 31, 2020, from RM92.35 million, owing to lower contribution from the property, construction and toll operations segments.

Land renegotiation with Ekovest in progress

The source says IWH and Ekovest are renegotiating terms on the land transaction. A new agreement will be announced in due course. "Ekovest is still keen on IWH's land. There should be an adjustment to the pricing, as it will be based on the new terms and conditions."

Nonetheless, the first analyst highlights that Iskandar Malaysia land has lost its shine, as developers have been shifting their focus back to the Klang Valley. For example, UEM Sunrise Bhd, which has huge exposure in Iskandar Malaysia, has been adding to its Klang Valley land bank.

"They [UEM Sunrise] are trying to limit their exposure in Johor with a bigger presence in the Klang Valley, where demand is still better despite competition from many developers.

"Even when the border closure is lifted, it will take some time for Iskandar Malaysia to be revived."

The analyst believes the oversupply will hinder property developers from actively expanding their presence in Johor.

"There are deals everywhere, but most of them are moving away from Johor," she says.

Teladan Setia Group Bhd is the newest property stock on Bursa Malaysia. Since its listing on March 16, its shares have risen 31.3% to close at 63 sen last Friday, valuing it at RM507.34 million.

The local stock market had seen no property listing since the flotation of Eco World International Bhd in April 2017.

Despite the weak sentiment in the property market, the analyst is positive on Teladan Setia's niche of focusing on the Melaka market and developing landed property.

"Melaka's population density is higher than that of Iskandar Malaysia. The oversupply in Iskandar Malaysia is due to massive high-rise development in the area," she says. E

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'We need to think long term and give tax reforms time to bear fruit'

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"The existing tax legislation already has sufficient provisions to tax gains made from the trading of shares in the stock market. We don't need to introduce a capital gains tax to tax trading gains.

"The real issue is enforcement. How can these gains from trading in the stock market be brought to tax, as there appears to be a gap in taxpayers declaring and bringing to tax the gains made from trading in the stock market? Perhaps there is a need for the tax authorities to work with the regulators of the stock market to identify how the system can be made more transparent."

Withdrawal of the income tax exemption under Paragraph 28, Schedule 6 of the ITA 1967

This tax exemption is for income sourced from outside Malaysia and remitted back to Malaysia, explains Baker Tilly's Chelliah.

"This can be in the form of royalties, interest, dividends and so on from offshore investments. The concept and application of 'source' rules is critical — Malaysia only taxes income arising or derived from Malaysia under its scope of taxation. This scope is known as territorial scope. The alternative to territorial is 'world' scope that is practised by many countries — this means one will be taxed in Malaysia on income derived or earned anywhere in the world.

"So, in a nutshell, we will need to decide on which scope we wish to ascribe to — territorial or world. If we stay in our current scope, then taxing income derived from overseas sources and remitted back to Malaysia may result in counterproductive attempts to not bring home such income and lead to loss of foreign earnings being repatriated," he says.

Chelliah adds that migrating to a world scope would require a "paradigm shift" on the entire basis and scope of Malaysian income tax.

"Malaysia needs to promote foreign direct investment and lure foreign multinationals to also site their regional or global operations in Malaysia — one of the attractions is a territorial scope that exempts income repatriated back to the Malaysian intermediate holding company, which can then be used to pay tax-exempt Malaysian dividends to the ultimate shareholders overseas. Some serious thinking must go into these factors," he says.

EY's Amarjeet says that currently, there is a credit mechanism in place for foreign tax suffered within the income tax legislation and tax treaties that Malaysia has signed with more than 70 countries.

"If we remove the tax exemption on foreign income, it is likely that tax credits will need to be provided on tax suffered in the foreign jurisdiction. The questions then are how much additional taxes can be realistically raised and will moving to the credit system result in additional complexity?

"There is no point withdrawing the foreign source exemption if the additional tax collection is not significant if this adds complexity, or if this impacts Malaysia's competitiveness. The withdrawal of this exemption will certainly reduce Malaysia's attractiveness as a hub location in Asia, especially if other countries maintain their foreign-sourced income exemptions.

"Investors looking to establish a holding company or principal hub type of set-up in Asia-Pacific are not likely to consider Malaysia given that dividends repatriated from their investee companies are likely to be taxed in Malaysia. There is also the additional burden of ensuring that treaty benefits are available to mitigate the tax," he says.

Expanding Malaysia's tax revenue base

From past Economic Reports issued by the government, in general, only about 21% of registered companies and 15% of employees were subject to income tax, says Veerinderjeet.

This puts into focus the extremely narrow base from which the government tries to extract its tax revenue. In addition, oil-related revenues generate around 25% of the total revenue of the government, he adds.

"As part of the move to draw foreign direct investment and remain competitive, Malaysia too needs to seriously consider lowering its corporate tax rate and, when the economy stabilises, we may want to consider a gradual 1% annual cut until the current corporate tax rate of 24% drops to 20%.

"As such, the government does face some serious constraints and the issue of tax evasion and underreporting of income is also an area that needs substantial research as the hidden and informal sectors, also known as the shadow economy, can generate substantial tax revenue. A robust fiscal framework, over say a 5-to-10-year time frame, to outline the way forward is what we need," he says.

Amarjeet says that in addition to broadening the tax base, we need to consider digitising our tax administration and tax framework.

"Automation, data sharing amongst tax authorities, agencies, regulators, taxpayers and financial institutions, and the use of big data and artificial intelligence will go a long way to improving compliance and reducing corruption or loss of tax revenue through the shadow economy, whilst allowing tax administrators to collaborate on an international level.

"Studies show that countries that have pursued digital tax administration have managed to significantly increase their tax revenue. In Mexico, tax revenue doubled in less than six years following the introduction of e-invoicing for all transactions. Correspondingly, the income tax evasion rate in Mexico reduced by 49% in just three years.

"We need to think long term and give tax reforms time to bear fruit. Studies have shown that between two and seven years may be required to fully realise the benefits of reforms. Sustained success requires institutional change, which happens only gradually. Proper pre-implementation consultation and transitional periods, where warranted, are also important," he says.

Given the impact that the Covid-19 pandemic has had on Malaysia and other countries, the government will have to perform a fine balancing act between implementing appropriate tax reforms to build its coffers and reduce debt levels, and ensuring that its actions do not erode business sentiment. E