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Cover Story: Reviewing tax incentives to attract quality investments

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"WHEN foreign investors come to Malaysia, our government gives them tax credits and incentives, pioneer status and investment tax allowance. But when local companies invest here, what do we get? Not much. And when we go overseas and ask for similar treatment from other countries' governments, what do we get? Nothing."

Rightly or wrongly, this perception has been commonly held among local corporates and investors over the years, although the view is not held by the Malaysian Investment Development Authority (Mida).

Suffice it to say, Malaysia has been a welcoming host to global investors as many multinational corporations (MNCs) have chosen the country as an investment destination, be it for brownfield or greenfield investments, and for business expansion.

Some Malaysian corporates hold the view, however, that the government has been "too generous" or "too kind" to foreign investors, such that local businesses sometimes feel "discriminated against". They feel the authorities appear to be favouring foreign direct investment (FDI) over domestic direct investment (DDI).

Is that really the case, though? It depends on who you ask and there is no straight answer to this question.

"This is not true at all," says a former top official of Mida. "All investors are considered equally, based on the same criteria. We do not discriminate. We used to have the Domestic Investment Strategic Fund (DISF), which catered for only Malaysian companies. The allocation is currently exhausted, but Mida is requesting for more.

"Ask the Penang companies. Many have benefited from the DISF. This topic of incentive is long and difficult to understand. We need to correct this misconception, otherwise we will be criticised for favouring foreign investors."

A check on Mida's website shows that the DISF focuses on accelerating the move of Malaysian-owned companies in targeted industries into high value-added, hi-tech, knowledge-intensive and innovation-based industries.

Unlike Indonesia, Malaysia does not have a sizeable domestic market; so, tax breaks and policy incentives will help ensure the country remains on the radar screens of investors." - Goh

"The fund aims to harness and leverage outsourcing opportunities created by MNCs operating in Malaysia, intensify technology acquisition by domestic companies, and enable them to obtain international standards or certifications in strategic industries," says the government's principal investment promotion agency.

According to Mida, Malaysian companies with 60% equity that are in operation are eligible for a matching grant to upgrade machinery and equipment, increase R&D activities, upskill talent through training initiatives and obtain international certification of their products, among others.

Unfortunately, owing to overwhelming interest in Mida's High Impact Fund (HIF) and the DISF, the programme has reached the fund's capacity and has been temporarily put on hold. As it is, Mida is no longer accepting new applications as registrations were closed on Dec 17, 2021.

Notably, between January and September 2022 (9M2022), Malaysia attracted RM193.7 billion (US$41.7 billion) of approved investments, including RM130.7 billion in FDI and RM63 billion in DDI. China dominated the foreign investments, with RM49.2 billion, followed by the US (RM16.9 billion), the Netherlands (RM16.5 billion), Germany (RM9.2 billion) and Singapore (RM8.7 billion).

In a press statement dated Dec 14, 2022, International Trade and Industry Minister Tengku Datuk Seri Zafrul Abdul Aziz stated that Malaysia's success in attracting almost RM194 billion in approved investments in 9M2022 is "a testament to its established standing as a gateway to Asean and an investment destination of choice in Asia".

He added: "Our robust supply chain network, competitive cost structure, simplified business processes, cutting-edge innovation and technology capabilities, and good talent base are key ingredients in attracting investments and driving sustainable growth in this country. Moving forward, Miti (Ministry of International Trade and Industry) and its agencies will ensure that new investment opportunities will also build the appropriate capacity and talent base in targeted industries to develop the nation's economy in a sustainable manner."

Look beyond headline investment figures

While the debate over the fairness of the tax incentives given for FDI and DDI is a never-ending one, market experts with whom The Edge spoke did agree on one thing — Malaysia should look beyond headline investment figures by attracting quality investments to move up the value chain.

Clearly, the absolute amount of FDI alone would not be enough if the investments were of low quality and there was little technology transfer or creation of higher-skilled or high-paying jobs for Malaysians.

"Generally, many foreign investors are footloose. They move around freely among Southeast Asian countries. After taking advantage of the pioneer status or tax incentives offered by one country, they move their operation to another country to enjoy the new benefits," the former top official of Mida observes.

"Let's face it, most civil servants with government agencies don't have sufficient knowledge to understand the technicality of certain business industries. But it's not fair to suggest that Malaysia is being too generous with FDI. Every country offers various forms of incentives. Even the developed countries do that. Perhaps some of them offer state incentives, not federal ones," he points out.

The amount that Malaysia spends on R&D annually is low — a fraction of what global leaders like South Korea spend every year. But, while there is a target to increase Malaysia's R&D spending to 2.5% of gross domestic product (GDP) by 2025, is enough being done to ensure that this happens?

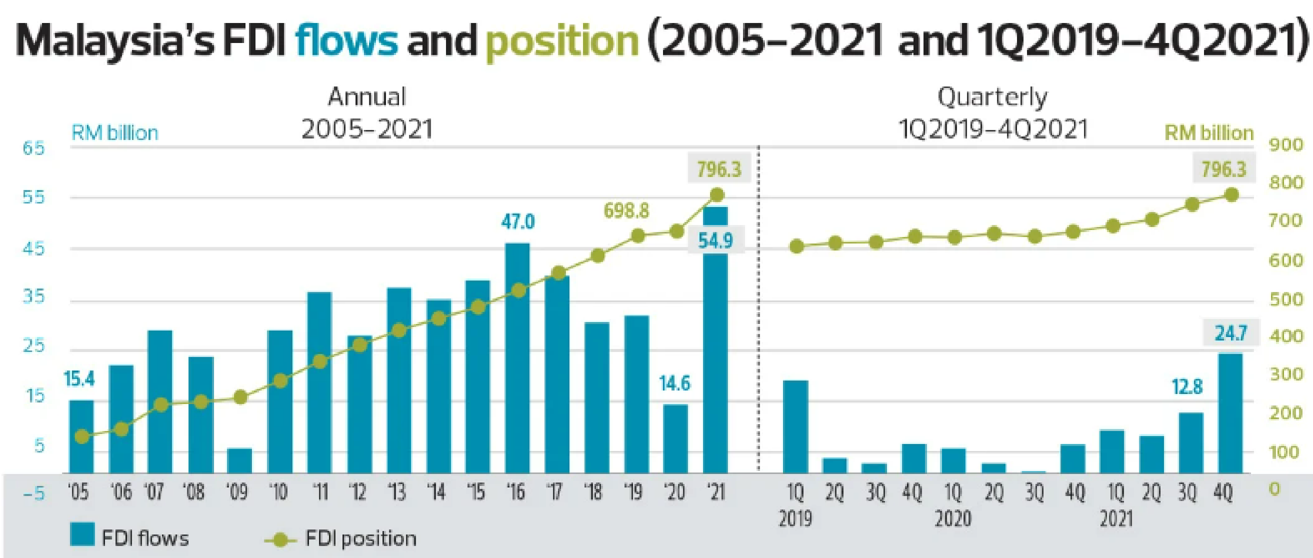
Baker Tilly Malaysia managing partner and Asia Pacific leader for tax services Anand Chelliah acknowledges that the issue of incentives — when tied to technology, R&D and talent — is ubiquitous. The tax expert points out that the country is already offering tax incentives for technology and R&D, so the issue is whether these are sufficient and tailored enough to be meaningful to spur domestic investment.

"The current incentives and grants that these industry players can turn to are mostly already in place and, at most, needs some finetuning. The talent factor is the problematic one as we have lost quality talent overseas and now need to pay a high price to lure them back to Malaysia," he says.

To promote growth and attract investment and skilled talent, you need to get the architecture of politics, public sector support, as well as private sector investment and expansion coming together to form cohesive and well-thought-out growth policies to take us into the next two to three decades." – Chelliah

On the potential downside risks of overdependence on FDI, Chelliah admits that foreign investors can be fairly mobile, while large investments can be moved once there is a feeling that costs are increasing or talent cannot be sourced as easily any longer. "We must be aware of those risks and balance things out by developing our SMEs (small and medium enterprises), growing and strengthening our local industry, as well as boosting the quality and resilience of DDI," he notes.

Chelliah highlights that sound and pragmatic leadership in some countries in the region has resulted in many of their peers forging ahead with FDI and DDI. "To promote growth and attract investment and skilled talent, you need to get the architecture of politics, public sector support, as well as private sector investment and expansion coming together to form cohesive and well thought out growth policies to take us into the next two to three decades," he remarks.



Education and training are crucial

UOB Global Economics & Markets Research senior economist Julia Goh believes incentives are necessary, given that the regional competition to attract FDI is intense. MNCs and corporates, however, will continue to shop around while being guided by other local factors.

"Particularly for new growth areas where expertise is scarce and the local supply chains lack the right capabilities, offering incentives and tax breaks to develop local suppliers is necessary. Unlike Indonesia, Malaysia does not have a sizeable domestic market; so, tax breaks and policy incentives will help ensure the country remains on the radar screens of investors," Goh says.

She adds that investment incentives are offered, not just to foreign but also local companies, to drive strategic investments.

"For local companies, credit guarantee schemes and funds are allocated by Bank Negara Malaysia to SMEs in tourism, agriculture, digitalisation, automation and low-carbon activities. As there is no local expertise in these new areas, however, much of it has to be sourced from abroad," she elaborates.

While incentives are available to both local and foreign companies, certain issues — such as a lack of transparency in how the incentives are offered, which agencies to connect with and what the eligibility criteria are — need to be ironed out to make it easier for investors, says Goh.

"Without investments and FDI, there is no demand and we won't be able to develop the talent, and there is no growth. To attract MNCs, Malaysia has to show that we have a sufficient supply of engineers and technical workers. Therefore, education and training are also important," she adds.

Baker Tilly Malaysia's Chelliah concurs that various government ministries need to have a common approach to spurring DDI to build trust, commitment to private sector growth and validity in the system. "This includes the role of the taxing authorities in building trust among investors that, provided they embrace good tax governance, they will not be unnecessarily subjected to scrutiny and disruption," he says.

The economy evolves, so should incentives

Chelliah points out that, essentially, Malaysia offers incentives for qualifying activities or the manufacture of qualifying products, whether for FDI or DDI, but primarily for Malaysian resident companies. There are certain earmarked incentives designed to attract high-end FDI and to have the MNCs relocate their operations in Malaysia.

For instance, concessionary income tax rates of 0% to 10% for a period of 10 years are available to companies in manufacturing and selected services that relocate their operations in Malaysia, subject to certain conditions set by the government.

The tax incentive period could be extended to 15 years, particularly for new companies that are relocating their manufacturing operations in Malaysia and undertaking new investments in fixed assets of more than RM500 million in the country.

On top of the concessionary income tax rates, which are targeted more towards certain sectors with high-quality investments, other tax incentives given are capital expenditure-based — such as investment tax allowance and reinvestment allowance — or profit-based, including income-tax exemption or a pioneer tax holiday of up to five years, or even 10 years in some cases, for companies in hi-tech and selected industries.

Chelliah says Malaysia has traditionally tried to attract FDI by granting such tax incentives, particularly in the 1970s and 1980s, when industrialisation was key to the country's growth and economic plans. But as Malaysia's economy evolves and matures, the incentives offered will need to be more targeted to lure the relevant FDI, and the tax incentives used as a means to attract higher-end and hi-tech-type industries.

"Many countries still offer such 'sweeteners', and one needs to look at the overall economic development plans to understand better what each country offers to competitively attract FDI or DDI to fit into its economic agenda," he points out.

The US, for example, may not offer outright tax breaks but will perhaps offer alternative forms of support and grants, while certain countries in Europe and many in Asia still offer various forms of fiscal and non-fiscal incentives to make them competitive in attracting FDI, says Chelliah.

"I have long held the view that tax incentives in this day and age are the icing on the cake. What is primarily needed is a strong governance culture and ethics, stable government, strong judicial system, good infrastructure and connectivity, strong intellectual property protection laws and, last but not least, little or no tolerance for corruption," he adds.