CHAPTER 1

INTRODUCTION

1.1. Introduction

Tax is a major source of revenue for the government. In formulating tax policies the government has to take various factors into consideration such as the socio-economic conditions of its citizens, new investments, protection of local industries, etc. Taxation is also needed to control the direction of the economy.

Taxation in Malaysia is imposed by federal legislation passed by Parliament. The main tax legislation are the Income Tax Act, 1967, Real Property Gains Tax Act, 1976, Promotion of Investments Act, 1986 and Petroleum Income Tax Act, 1967. Offshore companies carrying on an offshore business activity are subject to a preferential tax regime under the Labuan Offshore Business Activity Tax Act, 1990.

A number of tax incentives have been introduced by the Government to promote foreign investments and priority industries, particularly projects which are capital intensive, with high value added content and involving new and emerging technologies. These incentives are available to investors under the Promotion of Investments Act, 1986.

1.2 Tax System

Malaysia used to operate a territorial and remittance basis of taxation i.e. income arising in or deriving from Malaysia, and income remitted into Malaysia from outside Malaysia are subject to Malaysian tax. Certain taxpayers are taxed on special bases e.g. banks are taxed on world income basis.

Malaysia has the following direct and indirect taxes[1]:

a. Direct taxes

- Income tax - this is levied on individuals, companies and other taxable entities.
- Petroleum income tax - this is levied on upstream petroleum companies.
- Real property gains tax - this is levied on capital gains arising from disposal of real estate, rights over real estate and shares in real property companies where the real estate is situated in Malaysia.
- Stamp duty - this is imposed on certain documents e.g. agreements for transactions such as transfer of real estate.

---

[1] Howarth, Mok & Poon; HMP News: Malaysian Taxation; 2001, Kuala Lumpur

b. Indirect taxes

- Sales tax - this is imposed on the sale of manufactured goods. The tax is collected at the point of importation (in the case where the goods are imported for consumption) or when the goods are sold by a Malaysian manufacturer to a non-manufacturer e.g. trading company.
- Service tax - this is imposed on prescribed services provided by hotels, restaurants and certain prescribed professional establishments. The service tax rate is 5%.
- Import duties - these are tariffs imposed on import of goods.
- Export duties - these are duties imposed on export of goods
- Excise duties - this is imposed on selected range of goods manufactured in Malaysia such as beer, stout, cigarettes and motor vehicles.

Income in Malaysia is taxed under 6 heads:

- business income;
- employment income;
- dividends, interest and discounts;
- rents, royalties and premiums;

- pensions, annuities and other periodical payments; and
- all other income not falling into any of the above. This is a "sweep all" provision.

1.1.2 Rate of Tax

The rates of tax are as follows:

- Resident and non-resident companies - 28%; *effective Year of assessment 1998;*
- Non-resident individuals - 28%; based on a graduated scale commencing from 0% to 28%; *effective Year of assessment 2002;*
- Resident individuals - based on a graduated scale commencing from 0% and rising to 28%; *effective Year of assessment 2002.*

1.1.3 Withholding Taxes

Withholding taxes are usually imposed on income paid to non-residents. Certain income paid to residents may also attract withholding tax. Some withholding taxes are final whilst others are not and may be refunded by the tax authorities upon the submission of the tax returns by the taxpayer.

1.1.4 Tax year

Prior to the year 2000, income tax was assessed on the income earned in the preceding year and was assessed by the Inland Revenue Board (IRB) according to the Official Assessment System.

In order to modernize and streamline the tax administration system, the assessment of income tax based on the income received in the preceding year was changed to that of the current year. Further, Official Assessment System was changed to the Self-Assessment System in stages as follows:

Table 1 - Tax Year

Group	Year Of Implementation
Companies	2001
Businesses, partnerships and co-operatives	2003
Salaried individuals	2004

Self-Assessment is the manner in which a taxpayer works out and pays his own income tax. It is not a new tax but a system whereby the taxpayer is given the responsibility to compute his own tax liability.

Self-Assessment is a total process change from the previous formal assessment system. Under the formal assessment system, taxpayers are required to declare their incomes in the Return Form, submit the Return

Form to the Inland Revenue Board (IRB) and the IRB will then raise the assessment. The Notice of Assessment is sent to the taxpayer and based on the tax raised in the Notice of Assessment, payment must be made accordingly. Under the Self-Assessment System, taxpayers are still required to complete and submit the Return Form by the required dates.

In the case of an employee, the Scheduler Tax Deduction Scheme will continue to apply - i.e. tax will be deducted from their monthly salary and remitted to the IRB by the employer[2].

1.1.5 Individuals

This depends on the tax residence of the individual. Resident individuals are subject to income tax on income arising in or derived from Malaysia, and on income remitted into Malaysia from outside Malaysia.

Non-resident individuals are only taxed on income arising in or derived from Malaysia. Foreign sourced income is not subject to Malaysian tax.

1.1.6 Property Tax

Property Tax is a tax on all immovable properties, including apartments/condominiums, houses, offices, factories and shops. It is payable half yearly in advance by the owner in the months of January and

[2] www.hasilnet.org; Lembaga Hasil Dalam Negeri; April2003

July each year. The property tax payable per year is computed based on a percentage (tax rate) of the Annual Ratable Value of the property. The property tax rate varies from 2 percent to 8 percent depending on the land use (residential, industrial, commercial or agriculture) and the city/town or district council within which the property is located in.

Annual Ratable Value is the estimated annual rent the property can fetch if it were rented out and is assessed by the collecting agency normally once every five years. Property tax is payable irrespective of whether a property is vacant or occupied.

Owners may claim for a refund of the tax paid for the vacant period if a property is vacant for a continuous period of at least 30 days or a calendar month provided the property is fit for occupation and cannot be let at a reasonable rent despite efforts to do so, or the property is unfit for occupation and is undergoing repairs to render it fit for occupation.

a. Real Property Gains Tax

Chargeable persons - Every person whether or not resident in Malaysia is chargeable to Real Property Gains Tax (RPGT) in respect of any gains accruing on the disposal of real property in Malaysia.

b. Chargeable gains or losses

A chargeable gain arises if the disposal price exceeds the acquisition price, and an allowable loss is incurred if the disposal price is less than the acquisition price. Losses at a specified rate are available to be carried forward for relief against future RPGT liabilities.

c. Exemption from Real Property Gains Tax (RPGT)

i. an amount of RM5, 000 or 10 percent of the chargeable gain, whichever is greater accruing to an individual;

ii. a gain arising on disposal as a result of compulsory acquisition of property under the law;

iii. a gain accruing to the Government, State Government or a local authority;

iv. a gain accruing to an individual who is a citizen or permanent resident in respect of the disposal of one private residence;

v. a gift made to the Government, State Government, local authority or approved charity;

vi. the transfer of assets for the purpose of asset securitisation.

1.1.7 OFFSHORE FINANCE

Labuan is a tax free and also low tax alternative environment for non-resident entities. There are no withholding, capital gains, and transfer wealth, gift or income taxes.

As a Federal Territory of Malaysia, the Federal Government administers Labuan. On 1st October 1990, Labuan was established as an International Offshore Financial Center (IOFC). The Federal Government has taken steps to develop Labuan as an IOFC by providing and constantly improving its infrastructure.

a. Tax Incentives

Labuan offshore entities are exempted from withholding tax, stamp duty and any indirect taxes such as sales tax, import duties, excise duties and export duties. The Labuan Offshore Business Activity Tax Act, 1990 provides for special tax incentives for offshore companies carrying on offshore business activity such as banking, insurance or leasing in or from Labuan. An offshore company has the option of paying 3% tax on net audited profits or a lump sum of RM20, 000 per year of assessment. The election to pay at 3% or RM20, 000 is on an annual basis.

On the other hand, an offshore company involved in offshore non-trading activity, such as investment holding is exempt from tax.

b. **Preferential Tax Treatment Accorded Under Income Tax, 1967 and Stamp Act, 1949**

i. **Treatment on Dividends**

Dividends received by an offshore company from a Malaysian resident company are not subject to income tax and no refund or set-off is given in respect of tax deducted from such dividends. Dividends paid by an offshore company out of income derived from an offshore business activity or out of exempt income is not subject to income tax in the hands of the recipient.

ii. **Treatment on Royalty**

Distribution made by an offshore trust is not subject to income tax in the hands of the beneficiary.

iii. **Treatment on Interest**

Interest paid by an offshore company to a non-resident person or another offshore company is not subject to income tax. Interest paid by an offshore company to a resident person, other than a person carrying on a banking, finance company or insurance business in Malaysia, is not subject to income tax.

iv. Treatment on Technical or Management Fees

Technical or management fees paid by an offshore company to a non-resident or another offshore company is not subject to income tax.

v. Exemption from Stamp Duty

All instruments made in connection with an offshore business activity by an offshore company are not subject to stamp duty under the Stamp Act 1949.

vi. Abatement of Tax for Professional Services

Income derived from qualifying professional services rendered to an offshore company in Labuan is exempted from tax up to an amount equivalent to 65% of the statutory income from that source.

vii. Abatement of Tax for Employment

Income derived by a non-citizen individual from an employment exercisable in a managerial capacity of an offshore company in Labuan and a non-citizen trust officer in a Labuan Trust Company is exempted from tax up to an amount equivalent to 50 percent of the gross income from that employment until year of assessment 2004 and 2005, respectively[3].

[3] Economic Report 2001/2002; Ministry of Finance Malaysia; pp218&219

Table 2

GROSS NATIONAL PRODUCT BY EXPENDITURE CATEGORY, 1995 – 2000

(In current prices with 1978 prices in italics)

	RM million			*Average annual Growth Rate (%)*				
				7MP Target				
Category	*1995*	*1998*	*2000*	*Original*	*Revised*	*1996-1997*	*1998*	*1999-2000*
Consumption	132331 *73856*	144546 *72871*	167034 *79393*	10.3 *7.4*	4.8 *1.5*	8.1 *4.9*	-6.5 *-10.3*	7.5 *4.4*
Private	104695 *56288*	114338 *54757*	131034 *58582*	10.8 *7.4*	4.6 *0.8*	8.8 *5.4*	-7.7 *-12.4*	7.1 *3.4*
Public	27636 *17568*	30208 *18114*	36000 *20811*	8.3 *7.0*	5.4 *3.4*	5.4 *3.3*	-1.5 *-3.5*	9.2 *7.2*
Investment	94120 *55715*	71921 *36561*	91766 *44185*	7.5 *5.6*	-0.5 *-4.5*	11.9 *9.1*	39.0 *-44.9*	13.0 *9.9*
Private	66577 *39411*	40209 *20440*	48963 *23575*	9.7 *7.8*	-6.0 *-9.8*	13.7 *10.9*	-53.3 *-57.8*	10.4 *7.4*
Public	27543 *16304*	31712 *16121*	42803 *20610*	2.4 *0.6*	9.2 *4.8*	7.5 *4.8*	-0.3 *-10.0*	16.2 *13.1*
Change in Stocks	974 *644*	86 *47*	760 *404*	- -	- -	- -	- -	- -
Export of Goods	208699 *128827*	324677 *151890*	335839 *160640*	14.4 *10.9*	10.0 *4.5*	11.9 *9.0*	24.3 *-0.7*	1.7 *2.8*
Import of Goods	217453 *138770*	262506 *130111*	289542 *145477*	12.5 *9.5*	5.9 *0.9*	8.8 *7.1*	2.0 *-18.3*	5.0 *5.7*
GDP at Purchasers' Value	**218671** ***138770***	**278724** ***130111***	**305857** ***145477***	**11.0** ***9.5***	**6.9** ***0.9***	**12.2** ***7.1***	**1.2** ***-18.3***	**4.8** ***5.7***
Net Factor Payments	-10377 *-6568*	-16230 *-6752*	-17256 *-7229*	- -	- -	- -	- -	- -
GNP at Purchasers' Value	208294 *113704*	262494 *124476*	288061 *131916*	11.2 *8.1*	6.7 *3.0*	12.0 *8.1*	0.5 *-6.3*	4.9 *2.9*
GNP Per Capita at Purchasers' Value (RM)	10068	11835	12421	8.6	4.3	9.4	-1.8	2.4

Source: Mid Term Review of the Seventh Malaysian Plan.

.3 Scope of the study

'his study is conducted by analyzing data collected from 1996 to 2000. 'he research strategy will involve in analyzing the Malaysian Budget and ıe Bank Negara Economic Reports for the last 5 years. Data were ;pecifically collected from the Mid-term Review of the 7th Malaysian Plan, 3ank Negara Annual Report 2000, Economic Reports from 1998 to 2000 vith regards to GDP growth, government revenue, and the contribution by he manufacturing, tourism, property and the construction sector towards he Malaysian economy.

Comparison is made against previous years growth in the manufacturing, tourism, property and the construction sector to identify the significance of taxation on the economic growth.

1.4 Limitations of study

This study is confined to manufacturing, tourism, Multimedia Super Corridor, property and free trade zone. However, due to limited data were available on the free-trade zone, no analysis was done on this area.

1.5 Organisation of study

This thesis will be divided into five chapters.

Chapter 1 will be the introduction, discussing the various types of taxes in Malaysia. It will discuss the types of tax incentives given by the government to promote investments in various sectors.

Chapter 2 will discuss studies previously conducted on the subject matter. The chapter is divided into 2 parts. The first part covers introduction, followed by the findings of previous studies related to the impact of taxation on Malaysian economy.

Chapter 3 presents the method employed to identify the impact of taxation.

Chapter 4 presents an analysis of the findings and the results obtained.

Chapter 5 provides the conclusion and a summary of the research findings. The suggestion for future research is presented at the end of the chapter.