Hasilian Research Snapshot

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Tax Incentives: Tax Revenue versus GDP in Malaysia

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Abstract

- Malaysia is geographically blessed country, resourceful, conducive with established infrastructures, over other members of ASEAN. Lucrative Fiscal Incentives are value added feature in welcoming foreign investors.
- MNEs conduct business in low tax regime, with large business profits, and sustainable returns.
- Companies could diversify business profits into venture capitals and private equities, with extensive investment returns and capital gains upon realisation.
- Despite forgone tax revenue, Malaysia continues furthering tax incentives for FDI.

Problem Statement

The ASEAN Economic Community (AEC) did not incorporate rules on taxation in any of the regional/production market. Hence, members of ASEAN continue using Tax Incentives competing for FDI to boost GDP.

Research Question

The main issues of Tax Incentives are inequities and forgone revenue. To what extent of the effect of Tax Incentives on economic development and revenue forgone?

Objectives

To examine the economic effects of Tax Reforms and Tax Incentives on FDI and Corporate Taxes in Malaysia

Methodology

Correlating Tax, FDI and GDP statistics over a period of high to low tax reforms on direct taxes with growing Tax Incentives.

Tax Regime

Tax Cuts

- Our tax system has evolved historically through a series of reforms, from high to low tax regime. Tax reform is designed according to economic and political structures, mainly on improving equity and economic effects.
- The choice of tax instruments was a compromise between different points of view, mainly to spur economic development.
- Among significant tax reforms are:
  1. Taxation is on territorial basis, where repatriation money is exempt from tax.
  2. Severance Taxation, Excess Profit Tax, Development Tax and Estate Duty were repealed in the 1980s and 1990s.
  3. Corporate Statutory Tax Rate (STR) was largely reduced from 40% (1970s), 35% (1980s), 30% (1990s) and 17% or 24% by capital/profit size (2015 to 2022).
  4. Capital Gain Tax (CGT) in terms of Real Property Gains Tax (RPGT), is based on the realisation of real property assets. RPGT rate is in accordance with the holding period at marginal tax rate of 30%; regardless of the profit size.
  5. Self-assessment and current year basis assessment in the 2000-2004.
  6. Gift/Wealth/Surtax taxes are not applicable.
  7. Stamp duties, remain low with remission of charges and exemption orders, to support economic activities.

Tax Incentives

- Despite a narrow tax landscape, Tax Incentives remain the cornerstone of pro-growth fiscal policy.
- Tax Incentives are granted to companies in the form of tax exemption such as Pioneer Status, or Tax Credit relating to capital investment and Investment Tax Allowance (ITA) which is cost-based measure.
- Stimulus packages are available for companies: in the manufacturing sector; commercializing R&D findings of public/private research institutions; and dealing with promoted sectors in the economic zones and investment corridors.
- Companies in the Federal Territory of Labuan may be exempt or taxed at only 3%, or make an irrecoverable selection to be taxed under STR to be entitled for double taxation relief.

Analysis and Insights

Tax Reforms

- Current year basis assessment increases corporate tax revenue as share of GDP by 0.02 percentage point.
- Self-assessment-tax system increases corporate tax revenue as share of GDP by 0.01 percentage point.
- However, revenue positive effects, have been gradually suppressed by the reduction of STR and Corporate Effective Tax Rate (ETR), partly due to tax incentives.
- Line chart as in Table 1 indicates structural shift of Corporate Tax : GDP ratio by declining corporate tax growth.

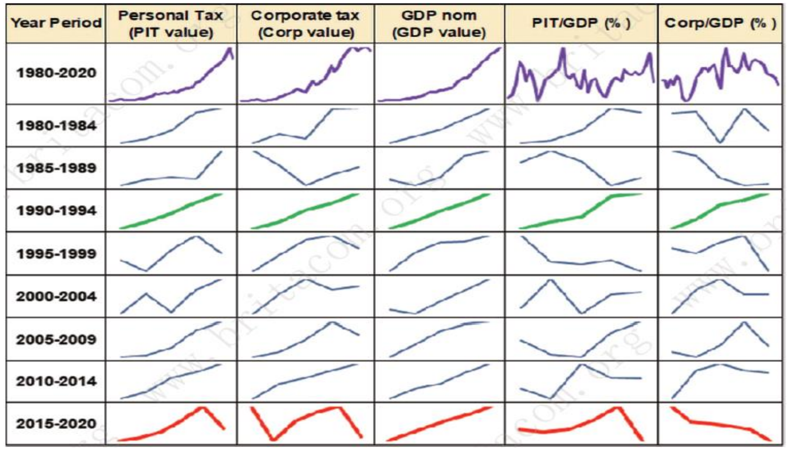


Table 1: Line chart for personal tax and corporate tax in absolute value and tax as share of GDP nominal in percentage point.

FDI and Tax Incentives

- Tax Incentives may have led to economic growth to a certain extent. FDI net inflow growth contributed to more than 10% foreign equity in Malaysia's companies, until 2008.
- FDI net inflow, then, decline, partly due to lower equity and investment shares, and higher loans extended to affiliates abroad.
- Over the period of 2013 to 2020, trend in both, Net FDI : GDP and Corporate Tax : GDP ratios declined, as in Table 2
- Downward trend in the macro ratios implies "partial and non linear role of tax incentives" in attracting FDI.
- Over two decades, the number of foreign companies remain at 5% of total, with turnover/sales between 25% and 35%, of the corporate tax base.
- Foreign companies pay lower taxes, by the proportion of tax to sales. Tax as share of sales in foreign companies; range from 0.84% to 1.25% versus local companies between 1.43% and 2.01%.
- In summary, the positive role of Tax Incentives on FDI and GDP is non linear, impacting corporate tax revenue and limiting government fund.

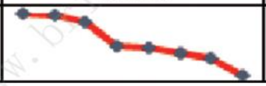
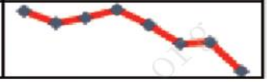
Year	Percentage ratio	
	Corporate tax : GDP	Net FDI : GDP
2013	6.39%	3.75%
2014	6.32%	3.19%
2015	6.13%	3.40%
2016	5.37%	3.84%
2017	5.29%	3.11%
2018	5.15%	2.25%
2019	4.98%	2.27%
2020	4.45%	0.98%
2013-2020		

Table 2: Trend in corporate tax and FDI net inflow in relation to GDP

Returns on Capital Investment

- Companies indicate strategies in retaining business profits into passive or active investing, earning capital returns, in the form of rental income and asset realisation.
- "Property Market Overview, Buying Guides, Rental Yields and Advice", highlighted the competitive property investment features of Malaysia in relation to other ASEAN members.
- Malaysia stood at 3.72%, 4.0% and 5.0% level, with regard to Gross Rental yield per annum, Buy to Let Rating and Effective Capital Gains Tax, respectively.
- In short, our fiscal policy promote cash flexibility and facilitates tax efficient investing, by allowing tax-loss harvesting and taxable investment returns at minimal rate.

Reform in Tax Administration

- Modern technology designed for use value and customer oriented, in administrative tax reforms, is imperative.
- Efficiency and effectiveness of tax operations and services, correlates with ICT budgeting, staffing and electronic/digital application.
- Electronic communication services have been enhanced digitally for better automation and opportunities, to facilitate service demand.
- Investors and taxpayers could obtain tax information and comply with tax law anytime and anywhere by using smart devices to access online facilities.
- The number of electronic usage increased from a single digit million in 2010 to more than 70 million in 2020. Filing corporate tax form is 100% electronic. Stamp duty service and payment is rising to more than 85% electronic.

Conclusion

- As for Malaysia, the positive role of Tax Incentives on GDP and FDI, has been contained until late 2000s. Fiscal Incentives gradually lost economic momentum over the last decade. The growing wave of Tax Incentives in our low tax landscape, impacted significant corporate tax growth and equities.
- Recent slow and low level of FDI net inflow, implies the limitation role of fiscal incentives, in attracting investment.
- Slow tax growth has distort government fund, adding to the growing government expenditure, both worsening fiscal deficits.
- It is timely to pursue a secure investment-revenue-future, emphasising on non-fiscal model, for inclusive growth of FDI. If in need Tax Incentives must be designed effectively with a comprehensive regularise formula.