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How Budget 2011 broadens the tax base

Budget crafted to suit current economic situation

By YEO ENG PING

WE had a steady Budget 2011, crafted carefully to suit the current economic circumstances, where Malaysia is experiencing a recovery amidst a global recovery that is said to be uncertain.

There are a few things Malaysia can be pleased about: expected GDP growth of about 7% in 2010 (compared to a contraction of 1.7% in 2009), and reduction in the budget deficit from a high of more than 7% in 2009 to 5.6% in 2010. The plan to reduce the budget deficit further to 5.4% in 2011 is directionally correct and delivers on the commitment made last year to address the budget deficit that Malaysia has experienced since the 1998 Asian financial crisis.

Looking back the last few years, governments around the world, Malaysia included, have implemented various stimuli to sustain growth and prevent a recession.

A slower economy would impact income tax revenues – the tax statistics show a reduction of total direct taxes from 2008 to 2010 (see Table 1). Despite the slower economy from 2008 to early-2009, Malaysia enjoyed the benefit of higher petroleum income taxes in 2009, mitigating the contraction in corporate and individual income taxes in 2009.

In 2010, however, there was a sharp reduction in petroleum income taxes as petrol prices returned to more normal levels.

It is also interesting to observe the overall mix of direct taxes (income taxes) and indirect taxes (duties, sales and service tax), where direct taxes contributed to 74% of total taxes in 2009, and are expected to decline to 71% in 2010.

The increasing proportion and importance of indirect taxes are a phenomenon that has been also observed in other countries, as countries shore up revenues through increases in indirect taxes such as value-added tax in the last couple of years following the financial crisis and stimulus spending (see Table 2).

In Malaysia, the emphasis on indirect taxes took the form of a somewhat surprising move – an increase in the service tax rate from 5% to 6%, effective from Jan 1, 2011 and also the expansion of the scope of service tax by including payments for paid television broadcasting services.

Malaysians currently pay service tax on a variety of goods and services, for example, hotel rooms, food in restaurants, services of professional services etc. Last year, we saw the introduction of service tax on credit cards that is said to generate RM270mil in taxes.

Table 2: Worldwide VAT/service tax rate

	Old (%)	New (%)
Finland *(Standard rate)*	22	23 (w.e.f 1/7/2010)
Geece *(Standard rate)*	19	21 (w.e.f 15/3/2010)
New Zealand	12.5	15 (w.e.f 1/10/2010)
Romania	19	24 (w.e.f 1/7/2010)
United Kingdom	17.5	20 (w.e.f 4/1/2010)

Source: Ernst & Young — Star GRAPHICS © 2010

A rudimentary quantification based on service tax collection of RM3.33bil in 2009 indicates that the 1% increase may yield about RM680mil in service tax, not taking into account the expected growth in 2010 and 2011.

Based on data from the 2009 audited accounts of Astro All Asia Networks plc, service tax on paid TV broadcasting services could possibly generate an additional RM148mil in revenue for the Government.

Together with the vision to make Malaysia an even more attractive tourist destination as a shopping haven, through the proposed abolishment of duties on tourist-preferred goods (such as handbags, clothing, jewellery etc), the service tax base and collections should also increase in tandem with tourist consumption.

Notably, many infrastructure and development projects were proposed in Budget 2011, including the development of the KL International Financial District (RM26bil), the MRT for greater KL (RM40bil), the Nexus Karambunai integrated eco-nature resort (RM3bil), greater number of hotels in remote areas (RM85mil for infrastructure), shaded walkway in the Bukit Bintang area (RM50mil), the Warisan Merdeka 100-storey tower (RM5bil), increase in number of hospitals/clinics/equipment (about RM15bil), schools (RM6.4bil) and low-cost housing (RM568mil).

Development and construction activities are known to provide a multiplier effect in the economy through increased employment, services and trade through the supply chain. Assuming a multiplier of 2, and an average tax rate of 20% (corporate and individual taxe the potential additional income tax from the projects (using a high-level computatic could be about RM38bil over time.

On stamp duties, the Government's reven base will likely be increased from Jan 1, wh the stamp duty reprieve on services agre ments expires on Dec 31, 2010..

Stamp duty of 0.5% on services agreemer was introduced from Jan 1, 2009. Servic agreements can be interpreted widely a include construction contracts (and sub-co tracts), and various instruments pertaining provision of services.

To the credit of the Government, it has qu effectively broadened the tax base in the budget proposals, without unduly burdeni the public. In particular, it was pleasant tl despite some speculation, the real proper gains tax rate was unchanged – retained at for gains on disposal of real property a shares of real property companies held for r more than five years.

● *This article was written by Yeo Eng Ping, t National Tax Leader of Ernst & Young T Consultants Sdn Bhd. The information contair in this article is intended for general guidar only. It is not intended to be a substitute detailed research or the exercise of professioi judgment. On any specific matter, referei should be made to the appropriate advisor.*