

## THE 1986 BUDGET PROPOSALS

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BY

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#### A. Amendments to the Income Tax Act, 1967

Last year with effect from the 19th of October 1984, section 13(1)(b) (ii) of the Income Tax Act, 1967 (hereinafter referred to as the "1967 Act") was amended to provide that in order to claim exemption in respect of overseas leave passage given by an employer to an employee, the leave passage must be undertaken with a ticket issued by a Malaysian national carrier and on board a national carrier. Clause 8 of the Finance (No. 2) Bill 1985 seeks to remove this requirement and will take effect from the 25th of October 1985. The reason for the removal of this requirement could be attributed to allegations made by other airlines of discrimination by the Malaysian government in respect of air travel.

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The 1986 Budget strategy, as outlined by the Finance Minister in his speech in the Dewan Rakyat, is two-fold, namely, to strengthen the country's balance of payments position and the government accounts through restraints on public sector expenditure and to revitalize and stimulate private sector investment. It is proposed to highlight in this paper only the more topical aspects of the 1986 budget proposals under the following subheadings. This paper does not address itself to any contentious points in the Finance (No. 2) Bill 1985 which seeks to implement the various proposals outline in the 1986 Budget. This is left to the question and answer session.

### A. Amendments to the Income Tax Act, 1967

Last year with effect from the 19th of October 1984, section 13(1)(b) (ii) of the Income Tax Act, 1967 (hereinafter referred to as the "1967 Act") was amended to provide that in order to claim exemption in respect of overseas leave passage given by an employer to an employee, the leave passage must be undertaken with a ticket issued by a Malaysian national carrier and on board a national carrier. Clause 8 of the Finance (No. 2) Bill 1985 seeks to remove this requirement and will take effect from the 25th of October 1985. The reason for the removal of this requirement could be attributed to allegations made by other airlines of discrimination by the Malaysian government in respect of air travel.

With regard to separate assessment, the position at present is that a married woman is allowed to elect for separate assessment only in respect of her income from employment or profession. Clause 11 of the 1985 Bill seeks to provide for the income

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of a married woman from pension derived upon optional retirement from employment before she reaches the age of 55 to be separately assessed upon her election. This amendment effective from the year of assessment 1986, will go some way in helping to reduce the amount of tax which would otherwise be payable if the pension income is also lumped together with the other income of the husband. It may also be noted that at present a married woman who is assessed separately on her income from employment or profession and who derives no other income is not allowed a deduction in respect of any allowable cash donation made by her. Clause 10 of the 1985 Bill seeks to ensure that such a deduction is allowed to her in respect of any gift of money made to the government or an approved institution or organization. This amendment is effective from the year of assessment 1986.

As for the tax exemption on interest payments to non-residents accruing to long-term loans Clause 4 and 24(b) of the 1985 Bill seek to withdraw the exemption. The rationale for the withdrawal is to discourage foreign borrowing in the private sector in view of the high incidence of debt servicing resulting from excessive external borrowing. Clause 20 also seeks to increase the rate of income tax leviable on interest derived by non-resident persons from 15% to 20%. However, as the country still needs foreign loans, tax exemption on interest payments accruing to approved loans will be retained with the definition of "approved loan" made more restrictive. Clause 4 of the 1985 Bill limits "approved loan" to only loans or credits made to the Federal Government, State Government, local authority or statutory body (including any loan or credit guaranteed by the Federal Government or State Government) by a non-resident person and the interest from such loan will be exempt from income tax provided that the loan or credit agreement is executed in Malaysia or if executed outside Malaysia with the prior approval of the Minister of Finance.

With a view to encouraging long term savings and to facilitate a better system of collecting tax on interests earned, Clauses 6(b), 7(c), 18 and 22 of the



1985 Bill seek to introduce a withholding tax of 5% on gross income in respect of interest ( other than interest which is exempt under the Income Tax Act or any order made thereto ) paid to resident individuals by banks, financial institutions, cooperative societies, Bank Pertanian Malaysia, Lembaga Urusan dan Tabung Haji, Malaysia Building Society Bhd. or other institutions approved by the Minister of Finance. Such banks, institutions and bodies will be required to deduct such tax from payments of interest to individuals and forward them to the Inland Revenue Department. The tax will be final and such interest income will not be subject to further tax. Such withholding tax which will come into force on the 1st of January 1986 will not apply to long-term deposits of more than 12 months with the commercial banks and financial institutions or with the National Savings Bank.

#### B. Amendments to the Real Property Gains Tax Act, 1976

With regard to supplementary taxes such as tin, timber and excess profits taxes on the incomes of companies, they are to be rationalised and standardized into one excess profits tax. Clause 5 of the 1985 Bill seeks to apply a single franking limits of \$2 million to all companies, resident and non-resident, for the purposes of excess profit tax. Accordingly, the current franking limits of \$200,000 or 25% of the shareholders funds whichever is the greater will no longer apply effective from year of assessment 1986. In addition Clause 21 of the 1985 Bill seeks to reduce the rate of excess profits tax for companies from 5% to 3%. It is hoped that with the abolishment of tin and timber profits taxes, the industries concerned will be able to expand more rapidly and provide the lead for more dynamic growth of the economy. Moreover, the doing away of tin and timber profits taxes seems justified in the light of the current low prices for the commodities.

To provide additional funds to finance the socio-economic development of the country, the government cannot afford to put more strain on the balance of payments situation by excessive external borrowing. Accordingly, the government proposed to attract funds owned by Malaysians abroad into the country by granting an amnesty on commission income which has been paid abroad to Malaysians for

services performed in the country. 50% of the income will be exempted from tax and no penalty will be imposed on those who declare and bring back this income. Tax payers in order to enjoy this amnesty and exemption must declare the commission they have received earlier in their tax returns for the year of assessment 1986. As for business and investment income earned abroad, full exemption from tax will be granted if they are brought back to Malaysia between 25th August 1985 and 31st December 1986. Taxpayers must declare such income in the relevant years of assessment and to obtain the exemption, the relevant income must be brought back to Malaysia before or at the time the taxpayer submits his returns. The exemption, however, does not include income of banks, airlines and shipping lines.

B. Amendments to the Real Property Gains Tax Act, 1976

At present, when a person disposes of a chargeable asset he is required to submit a notification of the disposal and after the end of the year of assessment, to submit a return of all disposals made in the year of assessment. When the Department of Inland Revenue receives the notification, it will issue a requisition for tax. Following the submission of the return a notice of assessment will be issued. In view of the fact that this procedure has caused some confusion to taxpayers and created additional work for the Department of Inland Revenue, clause 30 and 31 of the 1985 Bill propose to do away with the present system and instead substitute for it a system whereby a taxpayer is only required to submit a return upon every disposals and will be issued with an assessment upon the receipt of the return. These amendments will be effective from the 1st of January, 1986.

At present, a wife who is married to a non-citizen is not entitled to enjoy tax exemption on the disposal of her own residential house. Accordingly, clause 40 of the 1985 Bill seeks to introduce a provision so that a wife who is a Malaysian



citizen or a permanent resident but married to a non citizen or a person who is not a permanent resident will now be entitled to exemption from tax in respect of the disposal by her of her private residence. This provision is effective from the 1st of January 1986.

Another amendment to the Real Property Gains Tax Act, 1967 effected by clause 41 of the 1985 Bill seeks to allow a co-proprietor to claim exemption from tax of an amount of \$5,000 ringgit or 10% of the chargeable gain whichever is the greater when he disposes of his share of the property.

In the case of an asset gifted on death or received by a legatee, the present position is that the acquisition date is taken to be the date of transfer of ownership to the recipient or legatee whereas the acquisition price is the estate duty value of the asset. Clause 39(i), (j) and (k) of the 1985 Bill, which will be effective from the 1st of January 1986, seeks to provide that the acquisition price in such a case will be the market value at the date of transfer of ownership of the asset.

#### C. Amendments to the Share (Land Based Company) Transfer Tax Act, 1984

In view of the numerous ambiguities and difficulties of interpretation arising from the introduction of the 1984 Act last year, several amendments to the 1984 Act have been brought about by the 1985 Bill with the aim of streamlining its implementation.

One of the changes brought about by the 1985 Bill relates to the definition of "land based company" with the intention of narrowing the scope of the existing definition. Under the new definition effected by clause 43(d) of the 1985 Bill, a company will be considered as holding an interest in a land based company if it has more than 20% of voting shares of the land based company or if it has a subsidiary

are to be granted an export allowance of 5% on the export value of the products which has voting shares of more than 20% of the land based company. Under the new provisions, a company owning land which is used for its hotel building (including ancillary recreational facilities) and which is not excessive to normal requirements will not be considered as land based. The provision also disregards land in an industrial estate which is used for a factory, office or business premises for purposes of determining whether the company owning such land is land based or not.

Clause 45 of the 1985 Bill seeks to introduce a new provision whereby any transfer of shares if it is effected as part of a scheme of reorganization, reconstruction or amalgamation where the transferee company is resident in Malaysia and is being restructured in compliance with the NEP will not be regarded as a disposal provided such scheme has the prior approval of the Director-General of Inland Revenue.

As regards disposals of chargeable assets in a land based company between nominees or trustees, clause 50 of the 1985 Bill provides for their exemption from share transfer tax. This is also the position in the case of the disposal of chargeable assets in a land based company by the Federal Government, a State Government or a local authority.

These amendments will be effective from the 19th of October 1984.

#### D. Agriculture and Manufacturing Tax Incentives

In view of the high priority given by the Government to reduce poverty amongst those involved in agriculture, it has been proposed under the 1986 budget to extend the pioneer status incentive to cover all activities and industries encouraged under the National Agriculture policy. Certain agricultural exports



are to be granted an export allowance of 5% on the export value of the products provided these are exported through local ports or airports.

Investment tax credit will be given to a maximum of 100% on qualifying capital expenditure incurred during the first five years of operation. Agricultural development allowance will be given when the five year pioneer status period or investment tax credit period has been exhausted or when the activities or crops do not qualify for those incentives. This initial allowance is up to 60% on plant and machinery.

These incentives will be effective from 1986.

Incentives for the manufacturing sector will be streamlined to make them more effective especially in developing export oriented industry. Amongst the revised incentives proposed are that pioneer status of five years will be given on the basis of priority instead of on the amount of capital invested. New projects approved will not be given pioneer status for a period exceeding five years. Investment tax credit will be retained as an alternative to pioneer status. The maximum rate given is 100%. Accelerated Depreciation Allowance and the Reinvestment Allowance will be extended for a further period of three years to encourage existing manufacturers to undertake expansion and modernisation of their plants. However, the extended accelerated depreciation allowance will be worked out within two years instead of one year as at present. The 1986 Budget proposed to introduce the abatement of adjusted income as an incentive. The abatement based on the manufacturer's actual performance varies from 5% to 10% depending on location, the value added in exports and the value of local manufactured or indigenous materials used in the exports. Small scale manufacturers will be given special abatement of 5% of adjusted income for 5 years and another 5% if they comply with the criteria under the NEP.

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