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MALAYSIAN BUDGET 2008 SUMMARY

10 September 2007

Preface

On Friday, 7 September 2007, Malaysian Prime Minister and Finance Minister, Abdullah Ahmad Badawi, delivered his 2008 Budget Speech in Parliament, introducing the Supply Bill (2008).

In his Budget Speech, themed "Together Building The Nation and Sharing Prosperity", the Prime Minister moved the second reading of the Supply Bill with the intitulation, "An Act to apply a sum from the Consolidated Fund for the service of the year 2008 and to appropriate that sum for the service of that year".

Developmental expenditure continues to be a priority in the Budget, especially on human capital and the enhancement of quality. On the other hand, demand-side economics sees the liberalizing of the Employees Provident Fund Account II for monthly investment by a contributor in one residential property.

It is expected that stronger private investment and consumption will help drive the projected growth of 6.0—6.5 percent in 2008. The Prime Minister announced that the cuts in the corporate income tax rate announced in the previous Budget—to 27 percent in 2007, and 26 percent in 2008—will be followed by a further cut, to 25 percent in 2009.

No significant compensatory taxes elsewhere were signaled in Budget 2008, but individual income tax rates will remain unchanged.

In a year that has so far witnessed some significant off-budget measures, including the suspension of real property gains tax, the announcing of fiscal incentives for Iskandar Development Region companies, and large hikes in civil service salaries, the Prime Minister committed to a "focus on capacity building … through provision of infrastructure, public facilities, education and social services, including health and welfare of Malaysians", while promising enhanced revenue collection and prudent expenditure to continue reducing the fiscal deficit.

The following are some of the highlights and major proposals in the 2008 Budget Speech:

Budget Strategy

The 2008 Budget is again presented as an action plan within the National Mission, which (as set out in the Ninth Malaysia Plan) has the following five key thrusts:

> "First: To move the economy up the value chain;
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> Second: To raise the capacity for knowledge and innovation and nurture 'first class mentality';
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> Third: To address persistent socio-economic inequalities constructively and productively;
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> Fourth: To improve the standard and sustainability of quality of life; and
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> Fifth: To strengthen the institutional and implementation capacity."

To implement the above strategies the Government will appropriate RM176.9 billion (US$50.3 billion[1]) to the 2008 Budget (10.9 percent higher than 2007) comprising Operating Expenditure of RM128.8 billion and Development Expenditure of RM48.1 billion.

With Federal Government income continuing to increase mainly due to oil and gas revenues, the fiscal deficit is expected to reduce from an estimated 3.2 percent of GDP in 2007, to 3.1 percent in 2008.

Economic Performance[2]

- GDP is projected to grow at 6.0 percent in 2007 (2006: 5.9%) among others, due to stronger consumer sentiment, business confidence and higher Government spending

[1] US$1.00=RM3.5155

[2] To compile this summary, reference is also made to the Ministry of Finance's just-released Economic Report 2007/2008, as well as the periodic releases of the Economic Planning Unit, Department of Statistics and others

- The services sector—the largest sector of the economy, at 53.2 percent of GDP—is expected to grow 9.0 percent in 2007 (2006: 7.2%) driven by robust activity in intermediate services, which comprise finance and insurance, real estate and business services, transport and storage, and the communications industry. (Growth in the sector's contribution to GDP, from 3.7 percentage points in 2006, to 4.6, reflects a gradual re-weighting of the structure of the economy, from manufacturing to services.)

- The manufacturing sector, comprising 30.3 percent of GDP, is expected to expand 3.1 percent in 2007 (2006: 7.1%) following the gradual pickup in global electronics demand during the year

- The 2007 fiscal deficit is expected to duly reduce to 3.2 percent of GDP (2006: 3.3%)

- A key determinant of economic strength, Malaysia's international reserves remained strong at RM339.7 billion (US$98.4 billion) as at 15 August 2007 (end-December 2006: RM290.4 billion/US$82.5 billion) due to sustained repatriation of export earnings and steady inflows of foreign capital. International reserves were adequate to finance 8.9 months of retained imports and were 8.7 times short-term external debt

- The increase in the Consumer Price Index (CPI) eased significantly in the first seven months of 2007, to 2.0 percent (January-July 2006: 3.8%) due to "better supply conditions, keen competition, effective price monitoring as well as strengthening of [the] ringgit". The increase was largely (87.4 percent) due to higher prices of food and non-alcoholic beverages, transport, rental and utilities

- In the labour market, all sectors of the economy are expected to generate additional employment opportunities with total employment expanding 2.1 percent in 2007 (2006: 2.4%). The unemployment rate is expected to remain low at 3.3 percent of the labour force (2006: 3.3%) continuing the country's effective full employment position since 1992

- In the first quarter of 2007, total net foreign direct investment (FDI) grew robustly at 54.1 percent, to RM5,697 million (January-March 2006: 21.2%, to RM3,696 million). Manufacturing investments accounted for 52.2 percent of total FDI; wholesale and retail trade, 26.4 percent; financial intermediation, 16.8 percent; and mining and quarrying, 7.7 percent. Approvals for foreign investment in manufacturing projects increased strongly, by 114.1 percent, to RM14.5 billion in the first six months of the year (January-June 2006: 3.5%, to RM6.8 billion), mainly in E&E (53.3%), petroleum (20.5%), chemicals and chemical products (6.3%) and non-metallic mineral industries (6.1%)

Budget Proposals

Tax Reform

- Pursuant to the previous Budget, the basic income tax rate applicable to companies and trusts was cut to 27 percent, for year of assessment 2007, and 26 percent, with effect from 2008. It is proposed that the basic corporate income tax rate be further reduced to 25 percent, with effect from year of assessment 2009[3]

- With effect from year of assessment 2008, corporate income tax will be reformed by the introduction of a single-tier system of taxing profits only at the company level, with all dividends received by shareholders excluded from the tax net. This will eliminate a significant administrative and compliance overhead, as well as allow companies to pay dividends out of capital gains without an imputed tax charge. The Budget speech outlines a transitional period from 1 January 2008 to 31 December 2013 during which companies with dividend franking credits and exempt dividend accounts accumulated as at 31 December 2007 can continue to utilize the aforesaid tax credits under a somewhat complicated elective system

- To introduce more flexibility into the taxation framework of the Labuan International Offshore Financial Centre, with effect from year of assessment 2008, a Labuan offshore company (presumably, as widely defined in the Labuan Offshore Business Activity Tax Act 1990) will be able to elect, on a "final and irrevocable" basis, to be taxed exclusively under the Income Tax Act 1967. It appears that this measure is principally to enable Labuan entities to opt out of the offshore tax framework where disadvantageous foreign tax treatment, including the denial of tax treaty benefits, would otherwise ensue

- To expedite the registration of real property transfers, with effect from 1 January 2008, "private valuation" will be permitted as the basis of stamp duty assessment on the value of the property, pending "final valuation" by the Government. However, any payment of stamp duty based on a private valuation must be tendered with a bank guarantee for an amount of incremental duty computed on a 35 percent excess over the private valuation. When the final valuation is issued, any additional stamp duty will be payable within 30 days after the relevant notice, or the bank guarantee will be called upon

Manufacturing & Procurement Sectors

- Sums totaling more than RM15 billion are allocated to the implementation of various higher education projects and programmes, including to achieve Universiti Teknologi MARA's target of 200,000 students by 2010, and the upgrading of polytechnics,

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[3] Note that small/medium-scale companies with paid-up capitals not exceeding RM2.5 million continue to be taxed at only 20 percent on the first RM500,000 of chargeable income

community colleges and training centres throughout the country, as well as to various government agencies to align the quality of the workforce with market needs

- The Human Resource Development Fund will be expanded and liberalized (by way of amendment to the relevant legislation) to allow employers greater flexibility in the choice of training and advanced education programmes for their staff, especially in new and high technology areas

- With private sector security in mind, especially at factory premises, accelerated capital allowance will be available during the years of assessment 2008 to 2012, to enable the cost of approved security and surveillance equipment (likely to include anti-theft alarm, access control, CCTV and vehicle tracking systems) to be fully tax-depreciated in a year. To enjoy the incentive for equipment installed at factory premises, the taxpayer must be a licensed manufacturer under the Industrial Coordination Act 1975; while, in respect of vehicle surveillance equipment installed in container and general cargo lorries, carrier licenses A and C will be required

- With effect from year of assessment 2008, workplace renovation costs incurred by employers for the disabled will be tax-deductible

- The tax incentives for promoting the generation of renewable energy are enhanced with effect from 8 September 2007, until 31 December 2010, by allowing multiple companies generating renewable energy within the same group to enjoy Pioneer Status (income tax exemption) for 10 years, or Investment Tax Allowance of 100 percent of qualifying capital expenditure against 100 percent of statutory income for 5 years. In addition, the accelerated capital allowance for equipment used for generating energy for own consumption is replaced by Investment Tax Allowance of 100 percent of qualifying expenditure against 100 percent of statutory income for 5 years

- The tax incentives for promoting energy efficiency are also enhanced with effect from 8 September 2007, until 31 December 2010, by giving companies providing energy efficiency services Pioneer Status (income tax exemption) for 10 years, or Investment Tax Allowance of 100 percent of qualifying capital expenditure against 100 percent of statutory income for 5 years. In addition, Investment Tax Allowance for equipment acquired for the conservation of energy for own consumption is increased to 100 percent of qualifying expenditure against 100 percent of statutory income for 5 years

- For the years of assessment 2008 to 2010, income from the sale of Certified Emission Reduction (CER) certificates (Kyoto Protocol mandated credits for the reduction of greenhouse gas emissions) will be exempt from income tax

- With effect from year of assessment 2008, an expatriate employee of an International Procurement Centre or a Regional Distribution Centre will only be taxed on a portion of his Malaysian employment income based on a formula that takes into account the number of days he is in the country during the basis year (thereby aligning his tax treatment with that of expatriates under Operational Headquarters companies and Regional Offices who are also expected to travel frequently on regional duty)

- With effect from 1 January 2008, many Customs & Excise forms, including the sales tax return (CJ3) and inward/outward manifests (K4/5) will be streamlined and/or consolidated

Small & Medium-scale Enterprises (SMEs)

- With effect from year of assessment 2008, a company that is a Small/Medium-scale Enterprise (SME) and first commences business will be exempt for its initial two years of assessment from the provisional income tax regime wherein a tax estimate must be filed within three months after commencement of business and (if chargeable income is projected) monthly tax installments can be required to commence as early as the sixth month thereafter. Instead, the SME may settle its income tax for a year of assessment in a lump sum upon submission of the final return. Presumably, the relevant definition of SME will be that applicable to companies enjoying the 20 percent tax rate (i.e. paid-up capital not exceeding RM2.5 million)

ICT & Biotechnology Sectors

- To assist Malaysian ICT companies to link up with international players, promotion of the Multi-media Super Corridor (MSC) will be intensified through the sponsoring of World ICT Week in Kuala Lumpur in May 2008, as well as various international ICT conferences and exhibitions, such as the World Congress on Information Technology 2008, the conference on United Nations Global Alliance on ICT for Development, and the MSC International Advisory Panel Meeting

- Development projects will be undertaken in Cyberjaya to enhance its attractiveness as a business and residential location, including the construction of "affordable homes" and an international school, and the beefing up of security. Cyberjaya will also see the establishment of a Knowledge Workers Development Institute, to enhance the supply of ICT workers, and the MSC Malaysia Digital Animation Centre

- A sum of RM236 million is allocated to the biotechnology sector, among others, for the development of centers for biodiversity research and biotechnology commercialization, as well as for anti-cancer compound research and the acquisition of technology generally

Rakyat (The People)

- With effect from 2008, annual primary and secondary school fees, and some residual examination fees are abolished. The Text Book Loan Scheme will be extended to all students regardless of means. With these measures, the Prime Minister states that schooling in Malaysia will be completely free. In addition, to encourage co-curriculum activities in uniformed bodies and sports, one free uniform will be provided to any school student whose monthly family income does not exceed RM1,000

- A sum of RM12 billion is allocated (over the next four years) to improve the public transportation systems in Kuala Lumpur and Penang, and to public transportation-related projects in other major cities

- To improve public safety, RM6 billion is allocated to enhance police operations, including the recruitment of 60,000 new personnel over the next five years and the supply of cars, motorcycles and laptops. A Mobile Forensic Unit will be established in each police contingent and more CCTVs linked to police control centers will be installed

- As part of a programme to encourage more mothers to provide childcare services at home, an initial allocation of RM10 million is made to NGOs to provide training to women in such services, thereby creating job opportunities for housewives and assisting other women in the workforce

- With effect from year of assessment 2008, the individual tax relief of up to RM5,000 for education costs is extended to all post-graduate studies at "masters and doctorate level"

Further Information

Please contact any of the following partners at SCS Global Professionals for further information:

Jerome Davids (K. Lumpur)	+603-2093 1902	Jerome@scsglobal.com.my
Kenichi Shohtoku (Tokyo)	+81-3-5575-6701	Shohtoku@scsglobal.co.jp
Guat-Guat Lee (K. Lumpur)	+603-2093 1902	Guat_guat@scsglobal.com.my
Yaw-Choo Hee (K. Lumpur)	+603-2093 1902	Yaw_choo@poc.com.my
Sharman Arumugam (K. Lumpur)	+603-2093 1902	SA@scsglobal.cm.my

SCSG™

SCS Global Professionals

Kuala Lumpur:
15-1, Medan Setia 1
Plaza Damansara, Damansara Heights
50490 Kuala Lumpur, MALAYSIA
Phone: +603-2093-1902; 2093-1906
Fax: +603-2092-2101

Tokyo:
10th Floor, 2-16-2, Nishi-Shinbashi
Minato-ku
Tokyo 105-0003, JAPAN
Phone: +81-3- 5403-7117
Fax: +81-3- 5403-7118