



MALAYSIAN BUDGET 2009 SUMMARY

2 September 2008

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Preface

On Friday, 29 August 2008, Malaysian Prime Minister and Finance Minister, Abdullah Ahmad Badawi, delivered his 2009 Budget Speech in Parliament, introducing the Supply Bill (2009).

In his Budget Speech, themed “A Caring Government”, 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 2009 and to appropriate that sum for the service of that year”.

Driven by high global oil and food prices, and mounting inflationary pressures, this year’s Budget strategy sees the fiscal deficit widening to 4.8 percent of GDP in 2008. Subsidies, including for fuel and food, will account for nearly 22 percent of operating expenditure. Targeted personal tax cuts and reliefs are sprinkled in; and civil servants will receive a one-month bonus in 2008, subject to a minimum of RM1,000.

The Prime Minister says, “the high fiscal deficit is a one-off necessity and [the Government] is committed to reducing the deficit to 3.6 percent in 2009”.

With domestic demand contributing to GDP growth of 6.7 percent in the first half of this year, the Government is “confident that Malaysia’s economy will remain stable” despite the external challenges, and will grow 5.7 percent in 2008. Growth of 5.4 percent is then projected for 2009, with consumption and private investment increasing by 6.5 and 5.8 percent, respectively.



Laced with caustic remarks directed at those making “populist claims” and seeking “to destabilize the country”, the Prime Minister argued that this Budget reflects “measures to lighten the burden of all Malaysians, particularly the lower income group ... focused towards support and assistance, which not only improves the quality of life but also enables all Malaysians to enhance their productivity”.

A discussion of some of the highlights and major proposals in the 2009 Budget Speech follows.

Budget Strategy

The 2009 Budget is again presented as an action plan within the National Mission, focusing on the following specific strategies:

- “First: Ensuring the Well Being of Malaysians;
- Second: Developing Quality Human Capital; and
- Third: Strengthening the Nation’s Resilience.”

To implement the above strategies the Government will appropriate RM207.9 billion¹ to the 2009 Budget (5.1 percent higher than the revised allocation for 2008) comprising Operating Expenditure of RM154.2 billion and Development Expenditure of RM53.7 billion.

Economic Performance²

- GDP is projected to grow at 5.7 percent in 2008 (2007: 6.3%) due mainly to firm commodity prices and growth in the emerging and developing markets ameliorating the slowdown in the United States, especially the latter’s demand for our electrical and electronics (E&E) exports
- The services sector—the largest sector of the economy, at 54.3 percent of GDP—is expected to grow 7.1 percent in 2008 (2007: 9.7%) supported, among others, by higher consumer spending, sustained domestic investment, including steady real estate activity, and higher tourist arrivals

¹ RM3.3895=US\$1.00

² To compile this summary, reference has also been made to the Ministry of Finance’s just-released Economic Report 2008/2009, as well as the periodic releases of the Economic Planning Unit, Department of Statistics and others



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- The manufacturing sector, comprising 29.8 percent of GDP, is expected to expand 4.7 percent in 2008 (2007: 3.1%) driven by higher production in domestic-oriented industries such as transport equipment, construction-related products and food, as well as strong growth in output from the petroleum, rubber, and machinery and equipment sectors
- The fiscal deficit will increase in 2008, to 4.8 percent of GDP. The previous Budget had estimated a deficit of 3.2 percent in 2007, reducing to 3.1 percent in 2008. With oil prices breaching US\$130 per barrel last May, the Government radically increased the pump prices of petrol and diesel, and then the electricity tariffs, ostensibly to alleviate future deficits. However, this Budget allocates RM17.0 billion for fuel subsidies and RM3.1 billion for food subsidies, among other expansionary measures
- In the context of global inflation where crude oil prices rose 79 percent, and food commodities, 30—130 percent, in the 12 months to June 2008, domestic headline inflation, as measured by the increase in the Consumer Price Index (CPI) rose 4.4 percent in the first seven months of 2008 (January-July 2007: 2.0%). (The inflationary surge of 8.5 percent in July, due to the increase in pump prices and electricity tariffs, was the highest since December 1981.) The main contributors to the CPI increase were the food and non-alcoholic beverages, housing, water, electricity, gas and other fuels, and transport groups. On the other hand, declining prices in the clothing and footwear, and communications groups, due to stiff domestic competition, were a mitigating factor
- The Producer Price Index (PPI) which measures changes in the commodity prices charged by domestic producers or those paid by local importers, rose 11.1 percent in the first six months of 2008 (January-June 2007: 5.3%) due to higher prices for commodities like rubber, CPO and crude oil. The increase in the local production component of the PPI was driven mainly by the prices of mineral fuels, lubricants, and animal and vegetable fats and oils. The increase in the imported component of the PPI was mainly due to machinery and transport equipment prices
- A buoyant services sector accounting for 52.1 percent of total employment, and an improving manufacturing sector (29.0%) are expected to keep the labour market stable in 2008. Employment will increase 1.7 percent in 2008, to 11.6 million workers (2007: 2.2%; 11.4 million). However, jobs created will decline from 250,600, in 2007, to 196,200, due to “increased utilization of new technology and ICT as well as improvements in work processes”. The labour force is expected to increase 1.7 percent, to 12.0 million persons (2007: 2.0%; 11.8 million). Unemployment is expected to remain at the 2007 level of 3.2 percent



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- Total retrenchments decreased 37.7 percent, to 5,218, in the first six months of 2008 (January-June 2007: -18.2%; 8,382). The manufacturing sector, particularly the apparel, radio, television and communications equipment, and furniture sectors, accounted for 67.0 percent of retrenchments (January-June 2007: 75.8%). Mainly affected were “plant and machine operators and assemblers, [and] general workers, as well as those in craft and related trades”
- In the first six months of 2008, foreign direct investment (FDI) approvals in the manufacturing sector surged to RM23.3 billion (January-June 2007: RM16.4 billion) mainly in the basic metal products, and E&E industries. Total investment in the manufacturing sector increased to RM32.5 billion (January-June 2007: RM31.6 billion) substantially in the basic metal products, E&E, transport equipment and chemicals industries
- A key determinant of economic strength, Malaysia’s international reserves remained strong at RM403.9 billion (US\$123.7 billion) as at 15 August 2008 (end-December 2007: RM335.7 billion/US\$100.7 billion) due to the strong trade surplus underpinned by robust commodity exports, as well as FDI flows. International reserves were adequate to finance 9.7 months of retained imports, and represented five times short-term external debt

Budget Proposals

Tax Reform

- Purportedly “to minimize the brain drain”, the highest marginal tax rate paid by individuals, on chargeable income in excess of RM250,000, and the flat tax rate paid by non-resident individuals are reduced from 28 percent, to 27 percent, with effect from year of assessment 2009. The marginal rate applicable to a resident individual’s chargeable income exceeding RM35,000, but not exceeding RM50,000, is also reduced from 13 percent, to 12 percent
- The 20 percent tax rate applicable to the first RM500,000 of chargeable income of a resident company with paid-up ordinary share capital not exceeding RM2.5 million will no longer be available to a company that directly or indirectly owns more than 50 percent of, or is more than 50 percent owned by, another company with paid-up ordinary share capital exceeding RM2.5 million at the beginning of the relevant basis period. When considering the scope of this provision, which takes effect from year of assessment 2009, it is interesting to note that the Finance Bill does not stipulate as to the tax residency of the latter company



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- Group tax relief available to locally incorporated, tax-resident companies (subject to various conditions) is increased from 50 percent of the current-year tax losses of the surrendering company, to 70 percent, with effect from year of assessment 2009
- To encourage Corporate Social Responsibility programmes, the scope of charitable and community projects eligible for tax deduction is extended to projects for “conservation or preservation of environment” and “enhancement of income of the poor”, with effect from year of assessment 2009. At the same time, the limit on tax deductions claimed for charitable and other qualifying donations is increased from 7 percent of aggregate income, to 10 percent
- Transfer pricing refers to the system of pricing goods or services transferred between associated or related enterprises. This can involve transfers or financings across or within borders, but usually refers to the cross-border variety. Where such transactions do not reflect market dynamics, especially market pricing, there is potential for the ordinary incidence of tax to be altered, such as through the artificial shifting of profits. Tax authorities invariably are empowered to adjust transactions (and impose penalties) to ensure that the counter-parties are paying their “fair shares” of tax. As in many jurisdictions, Malaysia adopts the OECD’s Arm’s Length principle of benchmarking transfer prices to those between independent enterprises in similar circumstances. The benchmarking process involves applying one or more of a range of commonly accepted pricing methodologies. In theory, the Malaysian Inland Revenue could effect tax adjustments to controlled transactions under widely framed anti-avoidance provisions in the income tax legislation. However, with effect from 1 January 2009, specific provisions will be enacted to empower the Inland Revenue to adjust the tax effect of any transaction between associated (i.e. related or controlled) persons involving “the acquisition or supply of property or services”, so as to reflect arm’s length pricing. In the case of a financial transaction between associates, tax deduction of interest and other finance costs by a resident borrower may be disallowed if “the value or aggregate of all financial assistance ... is excessive in relation to the fixed capital of such person” (i.e. thin capitalization)
- Concomitant with the new tax provisions dealing with transfer-pricing practices (and in line with administrative practice in many other countries) a mechanism to provide for an Advanced Pricing Arrangement (APA) in relation to cross-border transactions will be enacted with effect from 1 January 2009. The APA between a taxpayer and the Malaysian Inland Revenue (or between the competent authorities under the auspices of one of Malaysia’s tax treaties) will predetermine the transfer prices between associated persons for a specified period. To date, Inland Revenue practice guidelines have expressly excluded APAs from the scope of existing advance ruling procedures



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Industrial Sector

- Double (tax) deduction currently available to employers for the cost of putting employees through specified courses is extended to postgraduate studies in information and communication technologies (ICT), electronics, life sciences, post-basic courses in nursing and allied care, and aircraft maintenance engineering for the years of assessment 2009 to 2012
- Foreign experts coming to Malaysia to provide training in ICT, electronics, life sciences, post-basic courses in nursing and allied care, and aircraft maintenance engineering are exempted from non-resident withholding tax, from 30 August 2008 to 31 December 2012
- Accelerated capital allowance is given for expenditure incurred on ICT equipment during the years of assessment 2009 to 2013, enabling such equipment to be fully tax-depreciated within the year
- Accelerated capital allowance is given for all plant and machinery acquired during the years of assessment 2009 and 2010, by a resident company with a paid-up capital not exceeding RM2.5 million and not related to another company whose capital exceeds that amount at the beginning of the relevant tax basis period, thereby enabling such assets to be fully tax-depreciated within the year. In addition, the RM10,000 limit on 100 percent capital allowance claims by such companies, for “small value assets”, is removed with effect from year of assessment 2009
- Accelerated capital allowance, enabling the cost of specified security and surveillance equipment to be fully tax-depreciated within the year, is extended beyond licensed manufacturers to all businesses during the years of assessment 2009 to 2012
- So as to extend some tax breaks for the use of energy from renewable sources to non-generating companies, exemptions from import duty and sales tax on solar photovoltaic systems equipment, high efficiency motors and insulation materials, and from sales tax on locally manufactured solar heating systems equipment and energy efficient consumer goods, will be available to any importer or purchaser, by application to the Ministry of Finance from 30 August 2008 to 31 December 2010



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- A sum of RM2.4 billion is allocated to enhance training and skills programmes, among others, by upgrading and increasing the enrollment of 28 existing polytechnics and community colleges, as well as constructing new campuses for the Industrial Training Institute, at Marang, Terengganu and for the Advanced Technology Training Centre, at Taiping, Perak. In addition, the Construction Industry Development Board is directed to provide at least 100,000 industrial training opportunities in 2009, and to fund the training and accrediting costs of local workers

Capital Markets

- Income tax exemption for 10 years is presently available to any venture capital company (VCC) that invests not less than 50 percent of its funds as “seed capital”, or not less than 70 percent as “start-up or early stage financing”. To further assist the venture capital industry, a five-year tax exemption is available to any VCC that invests not less than 30 percent of its funds as seed-capital, start-up or early stage financing, by application to the Securities Commission from 30 August 2008 to 31 December 2013
- Withholding tax rates on dividends paid by Real Estate Investment Trusts (REITs) listed on Bursa Malaysia are reduced from 20 percent, to 10 percent for foreign institutional investors (as defined) and from 15 percent, to 10 percent for non-corporate investors, with effect from 1 January 2009 to 31 December 2011
- To alleviate the high costs faced by corporate advisors in marketing Bursa Malaysia to foreign issuers, advisory fees earned in connection with local listings of foreign based corporations, exchange traded funds and REITs, or of foreign securities, are exempted from income tax for the years of assessment 2009 to 2013
- With the objective of re-weighting Malaysia’s sukuk market to non-ringgit denominated instruments, fees earned by institutions approved by the Securities Commission from arranging, underwriting and distributing approved non-ringgit sukuk issued in Malaysia and distributed overseas, as well as profits derived from the trading of such securities, will be exempt from income tax for the years of assessment 2009 to 2011

Rakyat (The People)

- To enhance the people’s disposable income, “households which incur monthly electricity bills of RM20 or less, will not have to pay for electricity” from 1 October 2008 to 31 December 2009. In addition, interest income received by an individual from any deposit with a licensed institution is exempted from tax with effect from 30 August 2008



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- Employees who are not directors of controlled companies are exempted from tax on a range of benefits, with effect from year of assessment 2008, including (subject to prescribed limits) allowances for commuting, meals, childcare, telephone and internet bills, and maternity and traditional medicine expenses, as well as staff discounts and loan interest subsidies, whether or not stipulated in the service contract
- Import duties on consumer durables, and electrical goods and components, such as voice recorders, generators, washing machine components, blenders, rice cookers, microwave ovens and electric kettles; and textiles, such as carpets and glassware; as well as food items, such as ground nuts, sardines, coffee paste, tomato sauce, MSG, vermicelli, biscuits, fruit juices and canned sweet corn are reduced or eliminated with effect from 4.00pm, 29 August 2008
- Buyers of low cost houses are not subject to stamp duty on their sale & purchase or loan documents, while buyers of medium cost houses (worth up to RM250,000) are exempt from 50 percent of the *ad valorem* stamp duty normally payable on the instrument of transfer of one property during the period 8 September 2007 to 31 December 2010. To further reduce the people's cost of home ownership, Malaysian citizens are exempted from 50 percent of the *ad valorem* stamp duty normally payable on a loan agreement for the purchase of one medium cost house during the period 30 August 2008 to 31 December 2010
- As in previous Budgets, sums are allocated to long-term public transportation projects, including extending the reach and capacity of the Kelana Jaya and Ampang lines of the LRT system, as well as building a 42km Kota Damansara-Cheras line, to be completed in 2014. The reach and capacity of the KTM commuter rail service will also be extended, including completing a 7.5km Sentul-Batu Caves line in 2010, and double-tracking electric rails for Seremban-Gemas in 2012, and Ipoh-Padang Besar in 2013. Inter-urban bus and taxi terminals are planned to link central to northern and southern regions, and reduce congestion in the heart of Kuala Lumpur. A Public Land Transportation Commission will be established under the Prime Minister's Department by mid-2009, "to plan, integrate, regulate and improve the overall public transportation services ... as well as improve enforcement"
- Investment is made in public amenities to enhance the quality of life of rural communities, especially in Sabah and Sarawak. A sum of RM3 billion is allocated to Sabah for various infrastructure projects, including constructing or upgrading 266km of federal and rural roads, replacing dilapidated bridges in the interior, implementing tourism and eco-tourism projects, and providing hospital and health facilities. Sarawak receives a sum of RM3.3 billion, among others, for constructing 230km of federal and rural roads and an integrated waste water management system in Kuching, as well as for tourism and eco-tourism projects, and hospital and health facilities



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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

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

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