

DON'T LET HIGHER SALARIES BE ONLY A GOVERNMENT-LED INITIATIVE | MY SAY | 42

A budget that tiptoes around difficult issues **42** | Brazil and Malaysia: Biofuels for a common future **43** | Towards a national ambition of becoming a leading economy **44** | Global minimum tax in 2025 – is there breathing space? **44** | A new dawn for global taxation in Malaysia **45** | Keep moving the needle on tax reforms **46** | Keeping an eye on the coming peak of global wealth inequity **46** | Boiling America's economy **48** | New Huawei phone raises questions about US quest to curb China's chip sector **49** |

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FORUM

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PFFR a firm step towards reform

Much reform is expected of this government, notwithstanding that it is a patchwork of political parties that have not worked together on either side of the aisle. The electorate did not give a clear majority and, therefore, a clear mandate on what the priorities are. But this unity government is a legislatively powerful government. It commands two-thirds of the Dewan Rakyat. The last time a government had that majority was in 2004. This is a powerful government that can act decisively.

This government is therefore well-poised to undertake the necessary reforms, reforms that have been ignored or delayed. Repealing or amending existing laws or enacting new laws that do not require constitutional amendments only require a simple majority in Dewan Rakyat. Whatever were the reasons for kicking the can, many cans, down the road, the problems have just got bigger, and the window to avert a crisis is getting smaller.

The state of government finances and therefore the effectiveness and efficiency of fiscal policy can be easily seen from the numbers. Fiscal policy has become a blunt policy instrument; it has lost much of its footprint and therefore its ability to influence the economy.

Back in 2000, the fiscal footprint – the sum of operating and development expenditures as a percentage of GDP – was over 26%.

Budget 2024 has it at 20.1% of GDP but it also contains debt-servicing expenditures of a whopping RM49.8 billion or 2.5% of GDP. That makes the footprint less than 18% of GDP. The development expenditure in the budget – public investments to build new capacities and induce private investments – has shrunk. Budget 2024 can only propose a development budget of RM89.2 billion in an economy that is nominally estimated to be RM1.9 trillion, or just 4.5% of GDP.

One can start looking at the fiscal picture from any end – expenditures, revenue or debt – and the case for reforms are obvious. They have been obvious for decades. It is also the case that despite all this spending and debt, the economy is not robust and neither are the distributional outcomes satisfactory.

There are two reasons for not changing things, for doing things differently, for reforms – it's either one is vested in the status quo or reforms are difficult and politically expensive. If there is a lesson from the last four general elections, it is that the electorate, perhaps from different departure points, wanted to get rid and got rid of those who benefited from the status quo. Malaysians of all stripes may not all understand the details of everything, but the majority knows



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Say

BY NUNGSARI A RADHI

that there are those whom they have given the trust to govern who have instead benefited from that trust. They do not want this any more.

It would be folly not to accept this lesson. The electorate may be fractured and the conversation can appear toxic, but there is that common disgust and rejection of corruption and abuse of power. In fact, the last government that had an elected two-thirds majority lost it in the following election.

So, there is only the other reason for not undertaking reforms – the fear of a backlash, that the pains from reform will turn into votes against the government.

This is again an underestimation of the electorate. If they understand the first reason, they can certainly understand the second one. Honest, reasonable people understand the depth of the problems the country is facing and they understand that the solution will not be painless. They are not dense. Yes, there are detractors of all kinds spreading lies and half-truths to cloud the issues from partisan perspectives but most people can see through these.

In this environment where politics is seemingly based on narrow partisan interests, the pursuit of furthering the common

national interest will provide a contrast that the electorate can observe. Contestants in this over-simplified world of identity politics seek support by offering divisiveness. The government should offer the opposite – the pursuit of common interests – and build trust, surely the scarcest and therefore the most valuable commodity in politics. Trust can only be obtained by action. Actions can fail, some will fail, but inaction is worse.

This parliamentary sitting is an opportunity for the government to legislate its reform agenda, and it has begun doing so. The most significant piece of legislation in the present sitting is the tabling and passage of the Public Finance and Fiscal Responsibility Act (PFFR). This is a landmark law – the most significant reform of the management of public finances that we have seen for many decades.

Our legislative tradition – perhaps a reflection of its colonial origins – has always given wide, sometimes discretionary, powers to the executive. Laws clearly stipulate the relevant minister responsible for them and that minister is given rather broad powers notwithstanding the letter of the law itself. Statutory entities, even regulatory and law enforcement ones, are not independent of the executive, and while the executive is subject to parliamentary scrutiny, the mechanism available for parliament to do so is limited.

The PFFR represents a break in this tradition and that is why it is a major reform

Tax reforms for sustained outcomes

initiative. The PFFR not only devolves the powers of the finance minister to parliament, it also subjects the government to fiscal metrics — budget deficits, debt ceiling and allocation for development spending — that are approved by parliament. It also requires disclosure of public finance information to parliament beyond what is typically done today. Such increased transparency to parliament is effectively making the information public.

Scandals such as 1MDB will no longer be possible under this new regime. If it does happen, it will be revealed much sooner as it will be revealed as a matter of process. The 1MDB experience taught the lesson of not only how it was possible, but also the various subsequent machinations to hide it which further undermined institutional integrity. The use of government guarantees and executive decisions to borrow and therefore incur liabilities to the government will also be made more transparent. Any decision to do that, and there are possibly instances where that may be required, will not solely be a decision by the executive. It will automatically be subject to parliamentary oversight.

There are many other existing laws that should follow the lead of the finance ministry in empowering parliament and increasing its oversight role. Indeed, the PFFR is simultaneously a part of parliamentary reforms. This government has introduced the weekly prime minister's Question Time, in addition to the regular daily ministerial Question Time. It has also created the various select committees which now require proper empowerment via changes to the standing orders of Dewan Rakyat to give the committees real teeth. There has been discussion on the re-enactment of the Parliamentary Services Act, which would make it administratively independent of the executive branch.

The recently tabled budget, Budget 2024, can also be seen as an early step towards fulfilling the parameters set in the PFFR. The government has embarked on preliminary steps to address the key issues in ensuring it fulfils the PFFR. Budget 2024 can be seen as putting in place the foundations towards further consolidation.

There is an emphasis on enforcement to close the gaps of leakages that is the result of highly distortionary and expensive blanket petroleum, diesel and electricity subsidies. There was also the announcement of subsidy rationalisation for diesel which can be seen as a prelude to the much larger problem of petroleum subsidies. A more targeted subsidy regime will enable the government to reallocate resources towards enhancing Malaysia's rather weak social safety nets.

There is also the glaring need to broaden the revenue side of the fiscal equation. The revenue side is too narrow, too dependent on Petronas and lacks buoyancy. Tax revenues as a percentage of GDP have been declining over the decades and this needs reversing. It is also very low compared to our regional peers or countries with similar levels of income. The goods and services tax (GST) or more generally, the value-added tax (VAT), is the tax that is universally acknowledged as efficient and buoyant and used in almost all countries. Of course, its implementation must be accompanied by the appropriate transfers to retain the purchasing power of the targeted group.

The announced implementation of e-invoicing can be seen as a prelude to building a system for the efficient implementation of such a tax. The VAT is not a four-letter word that is taboo. 1MDB is the four-letter word. In fact, the VAT will uncover all transactions, formalise every part of the economy, remove its grey part, capture the free riders and generate sorely needed revenues for the government to sort out the rather sorry state of government finances. ■

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As the popular saying goes, "A journey of a thousand miles begins with a single step."

In delivering Budget 2024, the prime minister was very firm and upfront about containing the challenges we face in balancing the fiscal position while recognising the need to drive growth and support the aspirations of the rakyat.

With our tax-to-gross domestic product (GDP) ratio (at 11.8%) trailing most of our neighbours and being short of the Asia-Pacific average of 19.8%, Budget 2024 continues to emphasise much-needed tax reforms.

To recap, to increase revenue, Budget 2023 signalled some bold moves — new taxes that are seen as progressive such as the capital gains tax (CGT) and luxury goods tax and even increasing personal tax rates for the higher-income brackets.

The more straightforward measures were implemented in 2023, such as the increase in personal tax rates for those with chargeable income of RM100,001 and more, and the imposition of excise duties on liquids and gels containing nicotine.

However, a number of the proposed reforms require a greater understanding of implications and consultations with stakeholders. What we see in Budget 2024 is a reaffirmation of the reforms to a large extent, and a measured approach in introducing these proposals commencing 2024.

Capital gains tax

CGT is a long-discussed significant reform to the tax system, with Malaysia being one of a few remaining jurisdictions that do not tax capital gains save for real property. With the lines between capital gains and revenue becoming increasingly blurred and less meaningful, there is definitely a need to consider taxing capital gains to expand the tax base equitably.

Budget 2024 announced CGT at 10% on net gains from the sale of unlisted shares by companies starting March 1, 2024, for shares acquired prior to March 1, 2024, where there is an option to pay CGT based on 2% of the gross sales value. Sale of shares in approved initial public offerings (IPOs) by venture capital companies and in internal restructuring exercises within the same group will be exempted.

The limited implementation of the CGT is understandable and appropriately cautious given the desire to avoid dampening interest in shares listed on Bursa Malaysia, or investments into certain focus areas such as digital start-ups. Nevertheless, if the intention is to broaden the tax base in an equitable manner, the current restricted scope of CGT should be seen only as a first move in the implementation of a comprehensive CGT regime. Many countries in the region already do not distinguish between capital gains and revenue, and manage to remain competitive via gradual reductions in corporate tax rates — a medium-term agenda that we should pursue.

Service tax reforms

Any attempt to significantly broaden the scope of service tax or increase service tax rates will prove challenging, given its nature as a single-stage tax without an input tax mechanism. Budget 2024 again treaded carefully in widening the scope of taxable areas to new areas that will not directly burden the lower-income groups, such as logistics services (specifically excluding services provided by freight companies), brokerage, underwriting services and karaoke.

A similar approach is taken in the service tax rate increase, with the increased rate of 8% applying to taxable services other than food and beverages (F&B), telecommunications and parking. The increase in rates and expansion in scope is expected to deliver RM3 billion in revenue, while avoiding a visible impact on sectors that deliver their services directly to the consumers.

Nevertheless, given the inherent shortfalls of our sales and service tax (SST) regime, any increase in rates or expansion in scope that impacts businesses will lead to a cascading effect down the value chain and potentially translate



TRUST IN Resilience

BY JAGDEV SINGH



As the global playing field in attracting FDI through tax incentives is increasingly levelled through initiatives such as the global minimum tax, there is an urgent need for a comprehensive reform of our incentive framework to attract the investments we want."

to a final price increase to the consumer.

Over the longer term, reforming to a broad-based consumption tax brings significant advantages not only in terms of revenues to the government, but in creating a tighter ecosystem that will increase the level of tax compliance and reduce leakages through non-compliance and the shadow economy.

Incentive framework

As the global playing field in attracting foreign direct investments (FDI) through tax incentives is increasingly levelled through initiatives such as the global minimum tax, there is an urgent need for a comprehensive reform of our incentive framework to attract the investments we want. The introduction of an outcomes-based incentive regime is designed to attract investments in high-growth, high-value segments and eventually create new economic clusters, expand the domestic network and establish a balance between economic growth and our environmental, social and governance commitments.

Although tax incentives remain important in attracting investors, there are myriad other factors that are placed before tax incentives, from the availability of trained human capital, differentiated local infrastructure and strength of local research and development capabilities to the reach and breadth of the local supporting ecosystem.

As we move to an outcome-based approach to incentivising investors, experimenting with a couple of incentives such as the Global Services Hub is a good move, as it enables refinement to better align investor objectives and the nation's requirements, while not creating an unnecessary level of uncertainty. However, the elephant in the room still needs to be addressed, as our pioneer incentive and investment tax allowance frameworks definitely need to be assessed and reformed to be in line with this outcome-based approach with the impending introduction of the global minimum tax and/or a qualifying domestic minimum top-up tax.

It is heartening that Budget 2024 demonstrates awareness of the urgent need for reform not only to the tax incentive regime, but to enhance competitiveness through investments in other areas to attract FDI.

A structured approach in establishing industrial parks, such as the Kerian Integrated Industrial Park established specifically for the electronics and electrical (E&E) cluster is a good example of a well-designed initiative catered for the specific needs of a targeted industry. Similarly, the emphasis placed on seeing through investments so that they meet the nation's desired outcomes is a move that should be applauded, with the Ministry of Investment, Trade and Industry and Malaysian Investment Development Authority now being tasked not only with the approval of investment incentives, but to see through FDI and domestic direct investments until their realisation.

Conclusion

Budget 2024 takes measured first steps in the introduction of new taxes such as the CGT and luxury goods tax, and increasing the rate and scope of service taxes to generate the additional revenues necessary for the nation's development while reducing our fiscal deficit. Although we should be prudent in undertaking any kind of reform, bolder, more wide-reaching measures are required to actually move the needle in revenue generation, absent more significant cost-saving measures such as a holistic subsidy rationalisation exercise.

Careful implementation of bolder measures is feasible, provided initiatives are in place to minimise the impact on lower-income groups. Increased allocations of specific and targeted handouts should be considered to alleviate the impact from increased costs of living, alongside more sustainable measures to move the B40 up the social ladder. ■

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