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Ministry of Finance issues Pre-Budget Statement for Budget 2022

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On 31 August 2021, the Ministry of Finance (MoF) published a Pre-Budget Statement (Statement), ahead of Budget 2022 which will be tabled on 29 October 2021.

The Statement was issued to provide a preliminary view on the Budget 2022 direction, enhance the transparency of the Budget formulation process, and increase public and investor confidence. The publication of the Statement is in line with international best practices and going forward, a pre-Budget statement will be published annually.

The Statement discusses various tax-related measures. **The main measure which businesses should pay immediate attention to is the proposal for a Special Voluntary Disclosure Program (SVDP) for indirect taxes.** We discuss this and the other tax measures further below.

State of the economy

The Statement provides a brief recap of the implementation status of key measures announced in Budget 2021 as well as the various COVID-19 related stimulus packages announced by the Government. Further details on the implementation status can be found at <https://kewanganrakyat.com/>.



The Statement also provides a snapshot of the global economic climate, stating that the global economy is expected to grow by 6% and 4.9% respectively in the years 2021 and 2022, driven by wider vaccine coverage which will enable the reopening of economic sectors and the recovery of supply chains. International trade is expected to grow by 9.7% in 2021 and 7% in 2022, supported by increased external demand for goods.

Closer to home, Gross Domestic Product (GDP) growth for 2021 has been revised to between 3% - 4%, down from earlier forecasts of between 6% and 7.5%. This is because of the implementation of the Movement Control Order 3.0, due to the COVID-19 Delta variant. Overall, all major economic sectors are expected to grow in 2021, except for the construction and tourism sectors. The Budget deficit for 2021, originally expected to be 5.6%, is now expected to be between 6.5% and 7% of GDP, due to COVID-19 related spending.

Tax measures

With the country's tax revenue collections for the first half of 2021 being lower than expected and subsequent collections expected to decline further due to the COVID-19 pandemic, the Statement outlines various new measures the Government is looking into to enhance tax compliance and increase tax revenues. These include:

- ▶ The implementation of a Special Voluntary Disclosure Program (SVDP) for indirect taxes, which will be administered by the Royal Malaysian Customs Department (RMCD)
- ▶ The introduction of a Tax Compliance Certificate (TCC) as a pre-condition for tenderers to bid for government contracts
- ▶ The implementation of a Tax Identification Number (TIN) system and review of tax treatments which have resulted in revenue leakages or harmful practices

Some additional insights from the Statement include the following:

- ▶ Malaysia is committed to supporting the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) 2.0 initiative, which is designed to address cross-border tax leakages and aggressive tax planning. Pillar 1 of the BEPS 2.0 initiative proposes to reallocate a certain amount of taxing rights of large multinational businesses to the "market economies", i.e. the jurisdictions in which customers are located. This is a significant deviation from current direct tax rules, which generally only allow business profits of a multinational enterprise to be taxed in the countries where it has a fixed business presence. Pillar 2 of BEPS 2.0 proposes a global minimum tax rate (currently expected to be 15%), which will be particularly relevant to countries with low tax rates and those which offer tax incentives.
- ▶ As announced in Budgets 2020 and 2021, a comprehensive review of the tax incentive framework is underway, to ensure that the tax incentives offered to foreign and local investors remain relevant to the current business landscape, whilst continuing to maintain the country's competitiveness in attracting quality investments and providing positive returns to the country's economy and fiscal position. The incentives must also comply with Malaysia's international commitments, including to the BEPS 2.0 project. The Statement's acknowledgment that a conducive investment environment is made up of a multitude of factors, including economic and political stability, consistent and transparent policies, a sound labour market, good

infrastructure and others, is welcome, as all these factors will help Malaysia continue to attract foreign investments.

Areas requiring immediate action

► Indirect tax SVDP

This proposal follows an earlier SVDP which was administered by the Inland Revenue Board (IRB) between November 2018 and September 2019 with respect to income tax, petroleum income tax, real property gains tax and stamp duty. The IRB had collected RM7.877 billion from over 286,000 taxpayers during this earlier SVDP.

Under the indirect tax SVDP, taxpayers will be encouraged to voluntarily disclose any underpaid or unpaid indirect taxes, arising from errors or mistakes made during indirect tax filings or submissions, to the RMCD. Taxpayers who have failed to register and comply with indirect tax filing requirements are also expected to be eligible for the SVDP. Like the earlier SVDP, it is expected that the RMCD will grant a reduction in penalties to taxpayers participating in the indirect tax SVDP. Participating taxpayers may also face reduced audit scrutiny for the periods for which a voluntary declaration is submitted. After the SVDP ends, it is possible that the RMCD will enhance enforcement actions and increase penalties.

Some other relevant points include:

- i) The indirect tax SVDP period has yet to be announced.
- ii) The announcement does not appear to limit the indirect taxes to which the indirect tax SVDP will apply. As such, it could cover **all** indirect taxes, i.e. sales tax, service tax, import duty and excise duty. It is not clear at this stage whether Goods and Services Tax (GST) would also be covered, for taxpayers who have yet to obtain closure to their GST files.

Further announcements and guidance are expected in due course.

Who should take immediate action?

All registered persons or persons subject to indirect taxes in Malaysia should capitalize on this opportunity to regularize their tax positions and make voluntary disclosures where relevant. This would be particularly important for taxpayers who:

- Have adopted positions which may not be clear in law
- Have participated in unique transactions or business models for which the indirect tax position is ambiguous
- Have adopted positions which may, in retrospect, appear to have been aggressive
- Are providing services but have not registered for service tax
- Have been audited by the RMCD in the past for a particular period and have suffered additional taxes and penalties, but have not yet regularized the position for future periods
- Are enjoying or had previously enjoyed indirect tax exemptions or facilities. In an audit, the RMCD would scrutinize whether the exemptions or facilities should in fact have been available and whether the relevant conditions have been met.
- Have seen others in a similar industry being challenged by the RMCD on industry-specific issues

What should taxpayers do now?

Taxpayers should do the following:

- i) Undertake a “health check” exercise to identify contentious issues, errors in indirect tax submissions or underpaid or unpaid taxes. Taxpayers providing services but who have not registered a service tax file with the RMCD should validate whether or not they are in fact providing taxable services, as there have been various updates to RMCD’s technical and practical approach to service tax matters since service tax was re-introduced in Malaysia.
- ii) Obtain tax advice or rulings from the RMCD on the sustainability of potentially contentious tax positions which have been adopted or positions for which no advice was previously obtained
- iii) Strategize the overall approach to the SVDP submission

As the SVDP will likely be for a limited period only, it is crucial that taxpayers commence work on the above immediately. A well-administered voluntary disclosure will allow taxpayers to identify weaknesses and issues in their indirect tax compliance approach, regularize their positions with reduced penalties and move forward with a clean slate and a clear direction to indirect tax compliance. Participating taxpayers can also use this opportunity to develop a stronger working relationship with the RMCD.

► Tax Compliance Certificate (TCC)

Taxpayers who are undertaking Government contracts or who are planning to bid for such contracts should closely monitor developments in this space, including awaiting guidance on the TCC.

In the meantime, in anticipation that the TCC may require taxpayers to demonstrate that their tax payments and submissions are up-to-date and that taxpayers have put in place a proper governance framework with respect to their tax affairs, taxpayers could consider reviewing their approach to tax compliance and undertaking “health check” exercises across all taxes (and not just indirect tax as discussed above). This would allow ample time for the development of appropriate tax governance processes and rectification of errors, if any, prior to the introduction of the TCC.

► BEPS 2.0

Multinational enterprises should take pro-active steps to assess the impact which BEPS 2.0 may have on their businesses and their tax filing and payment footprints. Impacted businesses could include those:

- i) Operating in multiple jurisdictions, particularly those operating from central locations through virtual means
- ii) With tax incentives or low effective tax rates
- iii) Which are subject to Country-by-Country-Reporting (CbCR) requirements

Actions to take include:

- a) Monitoring the BEPS 2.0 announcements from the OECD and developments in each of the countries in which the group operates
- b) Modelling the potential tax impact of BEPS 2.0 and pro-actively updating senior management
- c) Reviewing global holding structures and operating models
- d) Assessing the approach to dealing with new compliance requirements and controversy matters, including developing appropriate outsourcing relationships where relevant

As domestic and international tax laws are moving at an ever-faster pace, it is important that taxpayers stay up-to-date on developments which could impact their businesses. Opportunities to regularize tax positions and improve the organization's approach to tax governance and compliance in a pro-active and cost-efficient manner should also be identified and maximized. Such opportunities include the indirect tax SVDP.

Please contact your EY engagement teams if you would like to discuss any of the matters covered in this alert.

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