Environmental, Social, Governance

ESG Compliance: Boon to a Sustainable Future

—

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KPMG in Malaysia

Overview and commentary

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Key Message

"In line with the Malaysian Government's goal to achieve carbon neutrality by 2050 and continued drive to push the green agenda, the Honorable Prime Minister and Finance Minister has announced in the 2025 Budget that carbon tax will be implemented in the year 2026 for iron, steel and energy industries. The new guidelines for green tax incentives (that were extended to 31 December 2026) have been issued by MIDA and MGTC respectively. Compliance with ESG may be tedious and costly in the short term, but in the long-run, the future for our next generation is secured."

Environmental, Social, Governance ("ESG") compliance: Boon to a sustainable future

As the ESG agenda continues to be in the spotlight and businesses (albeit not the majority) are starting to place greater importance in ESG practices, this area would no doubt be one of the key areas that every businesses should be looking into. Modern-day investors are seeking to understand how business operations would affect the environment and society, together with its governance structures, as generally good ESG values result in a stronger brand reputation, attracting customers and top talents. In this regard, a company's leadership should be fully committed to the ESG agenda by integrating good ESG practices into the company's vision, mission and strategy.

Green tax incentives

The long-awaited PU orders for the previous green tax incentives (which have expired on 31 December 2023) have finally been gazetted on 17 September 2024. As you may recall, various guidelines were issued by the Malaysian Investment Development Authority ("MIDA") and the Malaysian Green Technology and Climate Change Corporation ("MGTC") whereby approvals were also granted to the qualifying taxpayers. However, as the PU orders were not gazetted yet at that point in time, the taxpayers were not able to claim the said tax incentive in their tax returns.

As such, if taxpayers have previously obtained approval for the previous green tax incentives and did not make the claim in the tax returns, they have until 31 December 2029 to revise the tax returns provided that the prescribed conditions in the PU orders are met.

In the previous 2024 Budget, the qualifying activities for the previous green tax incentives [i.e. Green Investment Tax Allowance ("GITA") and Green Investment Tax Exemption ("GITE")] have been revamped and extended to 31 December 2026 as follows:

GITA Project (for business purpose) [Application to be made to MIDA]

Qualifying activities	GITA %	% of Statutory Income to be Set-Off	Incentive Period
Tier 1 i. Green hydrogen	100%	100% or 70%	Up to 10 years (5 + 5)
Tier 2 i. Integrated waste management ii. Electric vehicle charging station	100%	100%	5 years
Tier 3 i. Biomass ii. Biogas iii. Mini hydro iv. Geothermal v. Solar vi. Wind energy	100%	70%	5 years

GITA Asset (for own consumption purpose) [Application to be made to the MGTC]

<table>
<tr><th>Qualifying activities</th><th>GITA %</th><th>% of Statutory Income to be Set-Off</th><th>Incentive Period</th></tr>
<tr><td>Tier 1
i. List of qualifying assets approved by Minister of Finance
ii. Battery energy storage system
iii. Green building</td><td>100%</td><td rowspan="2">70%</td><td rowspan="2">Qualifying capital expenditure (“QCE”) incurred from 1 January 2024 to 31 December 2026</td></tr>
<tr><td>Tier 2
i. List of qualifying assets approved by Minister of Finance
ii. Renewable energy system
iii. Energy efficiency</td><td>60%</td></tr>
</table>

Please note that any unutilised GITA can be carried forward indefinitely until they are fully absorbed.

The new guidelines on GITA Project for business purposes have recently been issued by MIDA in October 2024 whereas the new guidelines on GITA Asset for own consumption have been issued by the MGTC on 23 April 2024.

The PU orders for the revamped GITA incentive have yet to be gazetted to-date and as such, businesses should be on the lookout in order to make the necessary claims in the tax returns.

ESG tax deductions

In addition, under the previous 2024 Budget, a tax deduction of up to RM50,000 for each year of assessment (“YA”) for ESG related expenditures were given to taxpayers. Some of the examples of allowable ESG related expenditures include the preparation of reports related to tax corporate governance framework, transfer pricing documentation, e-Invoicing implementation and ESG reporting by companies listed on Bursa Malaysia. The proposal is effective from YA 2024 to YA 2027.

Specifically for the implementation of e-Invoicing, it is proposed in the 2025 Budget that the expenses for the purchase of information and communication technology equipment, computer software packages and consulting fees be given an accelerated capital allowance that can be fully claimed within a period of 2 years in the form of an initial allowance of 20% and annual allowance of 40%. This proposal is effective from the YA 2024 until YA 2025.

These tax deductions and accelerated capital allowance should help to reduce some of the costs of ESG compliance, especially as more and more businesses strive to adhere to sustainability reporting requirements.

Carbon trading and carbon tax

The Bursa Carbon Exchange ("BCX"), Malaysia's official carbon trading platform, was launched by Bursa Malaysia in late 2022 for the voluntary trading of carbon credits between companies moving towards low-carbon and sustainability practices. It facilitates the continuous trading and off-market transactions of carbon credits, offering contracts for both nature-based and technology-based greenhouse gas reduction projects, and more recently renewable energy certificates. BCX had held its inaugural carbon auction in March 2023, with 15 buyers from various industries purchasing a total of 150,000 Verra-registered carbon credits. BCX had also carried out its first Malaysia nature-based carbon credit auction in July 2024 with carbon credits from the Kuamut Rainforest Conservation Project in Sabah, with another upcoming year end auction to be held in November 2024. The increased uptake or interest in the BCX by corporates would undoubtedly contribute towards achieving the objectives in Malaysia's National Energy Transition Roadmap.

As announced in the previous 2024 Budget, further tax deductions of up to RM300,000 will be given to companies that spend on the Measurement, Reporting and Verification ("MRV") process for the development of carbon projects which must be certified by MGTC. MRV refers to a defined multi-step process to measure the amount of greenhouse gas emissions reduced by a specific mitigation activity and report the findings to an accredited third party who will verify such report so that the results can be certified and carbon credits can be issued. The expenses incurred on such process can be deducted against the income from the sale of carbon credits traded on the BCX. Each qualified company is eligible for the tax deduction for one carbon project developed in Malaysia, where the incentive period is capped to three years. In addition, up to three related companies within the same group can apply. The applications must be received by MGTC from 1 January 2024 to 31 December 2026.

The Honourable Prime Minister and Finance Minister has also announced in the 2025 Budget that carbon tax is set to be implemented in the year 2026 for the iron, steel and energy industries. As such and in preparation for the impending implementation of carbon tax in Malaysia, these industries players should therefore start reviewing their carbon footprint and assessing the potential impact (both from financial and non-financial perspective) to their business. The revenue collected from carbon tax is intended to be used to fund research programmes and green technology. As a guide, the i-ESG Framework published by the Ministry of Investment, Trade and Industry is a useful starting point for companies as it aims to provide guidance on the adoption and enhancement of ESG practices including carbon footprint consideration.

In our neighbouring country, Singapore, their carbon tax currently covers 80% of the greenhouse gas emissions from roughly 50 facilities in the manufacturing, power, waste and water sectors. It covers seven types of greenhouse gases, namely carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulphur hexafluoride and nitrogen trifluoride emissions. The carbon tax rate was first set at SGD$5 per tonne of CO2 equivalent (tCO2e) and have been raised to SGD$25/tCO2e in 2024 and 2025, with an aim of reaching SGD$50-80/tCO2e by 2030.

Thailand is also planning to introduce carbon tax on energy, transport and industrial sectors in 2025 to achieve carbon neutrality by 2050, and net zero greenhouse gas emissions by 2065. The initial carbon tax proposal is to be at rate of 200 baht/tCO_2e and initially levied as part of existing taxes on oil products such as diesel and gasoline.

National Sustainability Reporting Framework (“NSRF) and Bursa Malaysia Listing Requirements

NSRF

In September 2024, the Advisory Committee on Sustainability Reporting (“ACSR”)* launched NSRF which addresses the use of the IFRS Sustainability Disclosure Standards issued by the International Sustainability Standards Board (“ISSB”), specifically the IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information, and IFRS S2 Climate-related Disclosures, as the baseline sustainability disclosure standards for companies in Malaysia, as well as the assurance requirements for sustainability reporting.

Applicable entities

Group 1	Group 2	Group 3
Main Market listed issuers with market capitalisation of RM2 billion and above.	**Main Market** listed issuers (**other than listed issuers in Group 1**).	• **ACE Market** listed issuers. • **Non-listed companies** with annual revenue of RM2 billion and above for two consecutive financial years preceding the current financial year **(Large NLCos)**.

*Note *: The ACSR is an inter-agency committee which comprise representatives from Securities Commission Malaysia, Audit Oversight Board of the Securities Commission Malaysia, Bank Negara Malaysia, Companies Commission of Malaysia, Bursa Malaysia, and the Financial Reporting Foundation.*

Implementation of the NSRF will be through a phased and developmental approach, supporting widespread adoption and continuous improvement in the quality of disclosures:

a) Adopting a climate-first approach;

b) Providing additional transitional reliefs to facilitate the use of the ISSB standards; and

c) Providing national driven programmes to help companies, large and small, to comply with the ISSB standards.

Bursa Malaysia Listing Requirements

In September 2022, Bursa Malaysia had enhanced the sustainability reporting framework for listed issuers under the listing requirements as part of its efforts to elevate the sustainability practices and disclosures of listed issuers. Under the enhanced sustainability reporting framework, listed issuers were required to include the following, amongst others:

i. A common set of prescribed sustainability matters and indicators that are deemed material;

ii. Climate change-related disclosures that are aligned with the Task Force on Climate-related Financial Disclosures Recommendations;

iii. At least 3 financial years’ data for each reported indicators, on a rolling basis (corresponding targets (if any) as well as a summary of such data and target(s) in a prescribed format); and

iv. A statement on whether the sustainability statement has been reviewed internally by internal auditors or independently assured.

To align with the NSRF, Bursa Malaysia has further reviewed its enhanced sustainability reporting framework and issued a consultation paper on 24 September 2024 to propose amendments to its listing requirements:

a) Listed issuers are required to prepare its sustainability statement in accordance with the ISSB standards;

b) To retain the key requirements of the enhanced sustainability reporting framework set out in (i), (iii) and (iv) above;

c) To disclose the percentage of employees and directors by ethnicity as part of the indicators for the common sustainability matter on diversity; and

d) Amendments (a) to (c) above to be implemented in phases, complemented by appropriate relief measures to facilitate and ease of compliance by listed issuers in additional to the proportionality mechanisms provided by the ISSB standards.

The proposed amendments to Bursa Malaysia's listing requirements issued in September 2024, as set out above, have not been approved by the SC and as such are not the final amendments.

In essence: ESG considerations are vital for the future

In summary, it is important to note that although the abovementioned tax incentives, tax deduction, carbon tax, NSRF requirements and Bursa Malaysia listing requirements may propel the country towards decarbonisation and to achieve net zero, the businesses (and the rakyat) have to start taking ESG more seriously and prepare to be ESG-compliant in the event that the relevant authorities impose a mandatory implementation.

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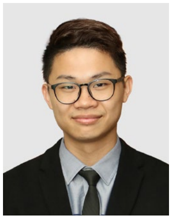

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