Environmental, Social and Governance

Conundrum: Cost vs Benefit

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KPMG in Malaysia

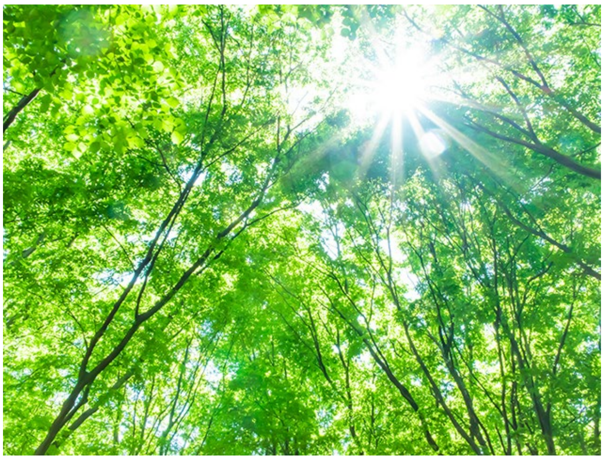
Overview and Commentary

Ng Sue Lynn
Partner
Head of Indirect Tax
suelynng@kpmg.com.my

Key Message

"In line with the Malaysian Government's goal to achieve carbon neutrality by 2050 and continued drive to push the green agenda, 2024 Budget prioritises ESG compliance and awareness. The existing green tax incentives that are currently available from MIDA have been revamped and extended to 31 December 2026. Tax deductions are also accorded for ESG related expenditures. ESG compliance may be an additional cost to business in the short term, but we all stand to benefit from a cleaner, more sustainable future in the long-run."

The Environmental, Social and Governance ("ESG") Conundrum: Cost vs Benefit



Imagine that you are a successful manufacturer of semiconductor materials that has been in business for the past 10 years, garnering hundreds of millions of annual turnover and profits, is planning to invest in technology (or green technology) and has multiple business operations/ subsidiaries in various countries.

With ESG practices increasingly playing a crucial role from a business perspective in recent years (e.g. in attracting new investors who place high importance in a company's ESG practices and reporting) and ESG reporting being implemented in various countries around the globe, what are the areas that you should be considering in order to enhance your business' value?

Green tax incentives

As an environmentally friendly manufacturing company, you may consider investing in qualifying green assets to take advantage of the green tax incentives that are currently available from the Malaysian Investment Development Authority ("MIDA"). This would help to reduce your carbon footprint and can potentially result in cost savings in the long-term.

In line with the Malaysian Government's goal to achieve carbon neutrality by 2050 and continued drive to push the green agenda, the qualifying activities for existing green tax incentives (i.e. Green Investment Tax Allowance ("GITA")) that are currently available from MIDA for investments in qualifying green assets have been revamped and extended to **31 December 2026** in the 2024 Budget as follows:

GITA Project (for business purpose)

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. Geo thermal v. Solar vi. Wind energy	100%	70%	5 years

GITA Asset (for own consumption purpose)

<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>

The unutilised GITA can be carried forward indefinitely until they are fully absorbed.

Other currently available green tax incentives include Green Investment Tax Exemption (“GITE”) for solar leasing which provides for a tax exemption of 70% on statutory income for solar leasing activities which have been extended to 31 December 2026. The incentive period depends on the capacity (MW) of the solar plant (e.g. >10MW to ≤30MW is 10 years).

It is worth noting that the date of first QCE incurred (for GITA) and the date of first invoice issued (for GITE solar leasing) must be on or after the date of application received by MIDA, otherwise you will not be eligible for the tax incentive.

In light of the revamped GITA tax incentives, if you are considering to purchase solar panels for purposes of increasing energy efficiency, you may qualify for GITA of 60% of QCE and to be offset against 70% of statutory income. However, if you currently have unutilised land space, you may consider undertaking a GITA project such as a solar farm in order to avail to GITA of 100% of QCE instead.

ESG tax deductions

Another measure proposed under the 2024 Budget to encourage taxpayers to comply with ESG practices is a proposed tax deduction of up to RM50,000 for each year of assessment ("YA") for ESG related expenditures such as preparation of reports related to tax corporate governance framework, transfer pricing documentation, e-Invoicing implementation, ESG reporting by companies listed on Bursa Malaysia, financial institutions regulated by Bank Negara Malaysia and companies to approved regulator. The proposal is effective from YA 2024 to YA 2027.

This additional tax deduction, albeit not a large amount, should help alleviate some of the costs of ESG compliance, especially as businesses progress from voluntary to mandatory sustainability reporting requirements.

Carbon trading and carbon tax

An option which companies may wish to explore and participate as part of their ESG adoption is the voluntary carbon market exchange i.e. Bursa Carbon Exchange ("BCX") launched by Bursa Malaysia. The BCX serves as a voluntary platform for the trading of carbon credits between companies moving towards low-carbon and sustainability practices, allowing the market to allocate resources to projects and solutions aimed at reducing, removing, or avoiding carbon emission. As announced in the 2024 Budget, the Government is proposing additional tax deductions of up to RM300,000 to be given to companies that spend on the Measurement, Reporting and Verification ("MRV") process for the development of carbon projects. 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.

Companies which are not involved in the development of carbon projects may also participate by purchasing carbon credits from climate-friendly projects and solutions as means to satisfy their ESG objectives. By purchasing carbon credits generated locally or internationally, companies can demonstrate their commitment to decarbonisation and sustainability by voluntarily offsetting some of their carbon footprint.

From a tax perspective, it remains to be seen where our tax authorities stand in terms of tax deductibility and indirect tax treatment of carbon credits in Malaysia. In Singapore, for income tax purposes, a company that purchases carbon credits to comply with regulatory obligations will be regarded as having purchased the carbon credits for use in its business and hence the expenditure incurred on carbon credits are tax deductible. On the other hand, the issuance, transfer and sale of carbon credits is currently treated as neither a supply of goods nor a supply of services (i.e. out of scope) and hence not subject to GST in Singapore. In Malaysia, albeit unlikely, whether Service Tax would be applicable depends on whether the provision of carbon credits would be included in the scope of taxable services.

Another consideration which companies may wish to take is the additional compliance costs with the implementation of carbon tax should this be announced in the near future in Malaysia. While the government is studying the feasibility of implementing a carbon pricing mechanism for the country, Malaysia is set to join a growing number of countries that are pricing carbon in an effort to achieve net zero carbon emission by 2050. While it is not mentioned in the 2024 Budget, companies should take the necessary steps to prepare themselves as the introduction of carbon tax is expected to be forthcoming in the near future.

Based on the direct emissions approach, the carbon tax is levied on the greenhouse gas emissions resulting from the production of goods and services. In Singapore, carbon tax currently covers 80% of the greenhouse gas emissions from roughly 50 facilities in the manufacturing, power, waste and water sectors. The carbon tax rate was first set at SGD$5 per tonne of CO2 equivalent (tCO2e) and will be raised to SGD$25/tCO2e in 2024 and 2025, with a view to reaching SGD$50-80/tCO2e by 2030. While this would bring additional costs to companies in the short run, this ultimately aims to push companies to lower their carbon emissions in the long-run by reducing the use of fossil fuels and switching to alternative fuels with lower carbon content and renewable energy.

In preparing for carbon tax in Malaysia, companies should start reviewing their carbon footprint and assessing the potential impact to their business. Companies may also wish to refer to the i-ESG Framework published by Ministry of Investment, Trade and Industry which aims to provide guidance on the adoption and enhancement of ESG practices including carbon footprint consideration within the manufacturing sector. When and if the carbon tax framework is announced, this would give companies a head start to implement a coordinated response to the new tax in a structured and efficient manner. By developing new strategies and moving to energy-efficient technologies, companies with sufficient foresight will have a competitive advantage if they plan and adapt ahead of their competitors.

Bursa Malaysia Listing Requirements and International Sustainability Standards Board ("ISSB")

Bursa Malaysia

Bursa Malaysia released the amendments to the listing requirements in September 2022 with the objective to elevate the sustainability practices and disclosures, and enhance comparability to enable benchmarking by stakeholders. Main market listed issuers are required to include a common set of prescribed sustainability matters and indicators that are deemed material and climate change-related disclosures that are aligned with Task Force on Climate related Financial Disclosures Recommendations in their Sustainability Statements. A statement of assurance is also required on whether the sustainability statement has been reviewed internally by internal auditors or independently assured, due to increasing expectations on companies to provide credible sustainability disclosures.

ISSB

In June 2023, the ISSB released two standards IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures. These standards are designed to meet the needs of all companies and provide a clear idea of what companies need to report to meet the needs of global capital markets – providing investors with globally comparable information.

These standards are effective from 1 January 2024, but it will be for individual jurisdictions to decide whether and when to adopt. Some public and private companies may choose to adopt them voluntarily, for example, in response to investor or societal demands.

In a nutshell: prioritising ESG today for a better tomorrow

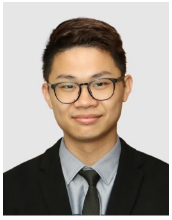
That being said, it is important to note that the abovementioned tax incentives, tax deduction, carbon tax and Bursa Malaysia listing requirements and ISSB disclosures do not only affect or apply to a particular industry (e.g. manufacturing), but it may also very well apply to a wider spectrum of industries (if not all) in time to come. In this regard, all businesses should start looking into adopting ESG initiatives early and be ready to be ESG-compliant in the event that the relevant authorities impose a mandatory implementation. It is also important to appreciate that the tangible (and intangible) benefits of an ESG-compliant business should outweigh the initial implementation costs in the long-run. We should all come together in playing an active role to conserve the environment as ultimately, our actions today will affect the world in which our future generation lives in.

Authors

Lim Wai Yin
Partner
Head of International & Domestic Tax Advisory
wylim@kpmg.com.my

Dany Oon
Executive Director
Indirect Tax
danyoon@kpmg.com.my

Koh Ree Nie
Partner
ESG Assurance Lead
reeniekoh@kpmg.com.my



Benjamin Ang
Director
International & Domestic Tax Advisory
benjaminang@kpmg.com.my

Christine Tan
Associate Director
Indirect Tax
zeeweitan@kpmg.com.my

Jenna Oh
Manager
Audit
jennaoh@kpmg.com.my

Contact Us

Petaling Jaya Office

Soh Lian Seng
Partner –
Head of Tax and Tax Dispute Resolution
lsoh@kpmg.com.my
+603 7721 7019

Long Yen Ping
Partner –
Head of Global Mobility Services
yenpinglong@kpmg.com.my
+603 7721 7018

Tai Lai Kok
Partner – Head of Corporate Tax
ltai1@kpmg.com.my
+603 7721 7020

Ng Sue Lynn
Partner – Head of Indirect Tax
suelynnng@kpmg.com.my
+603 7721 7271

Bob Kee
Partner – Head of Transfer Pricing
bkee@kpmg.com.my
+603 7721 7029

Outstation Offices

Penang Office

Evelyn Lee
Partner – Penang Tax
evewflee@kpmg.com.my
+603 7721 2399

Kuching & Miri Offices

Regina Lau
Partner – Kuching Tax
reglau@kpmg.com.my
+603 7721 2188

Kota Kinabalu Office

Titus Tseu
Executive Director – Kota Kinabalu Tax
titustseu@kpmg.com.my
+603 7721 2822

Johor Office

Ng Fie Lih
Partner – Johor Tax
flng@kpmg.com.my
+603 7721 2514

Ipoh Office

Crystal Chuah Yoke Chin
Associate Director – Ipoh Tax
ycchuah@kpmg.com.my
+603 7721 2714

KPMG Offices

Petaling Jaya
Level 10, KPMG Tower,
8, First Avenue, Bandar Utama,
47800 Petaling Jaya, Selangor
Tel: +603 7721 3388
Fax: +603 7721 3399
Email: info@kpmg.com.my

Penang
Level 18, Hunza Tower,
163E, Jalan Kelawei,
10250 Penang
Tel: +604 238 2288
Fax: +604 238 2222
Email: info@kpmg.com.my

Kuching
Level 2, Lee Onn Building,
Jalan Lapangan Terbang,
93250 Kuching, Sarawak
Tel: +6082 268 308
Fax: +6082 530 669
Email: info@kpmg.com.my

Miri
1st Floor, Lot 2045,
Jalan MS 1/2,
Marina Square, Marina Parkcity,
98000 Miri, Sarawak
Tel: +6085 321 912
Fax: +6085 321 962
Email: info@kpmg.com.my

Kota Kinabalu
Lot 3A.01 Level 3A,
Plaza Shell,
29, Jalan Tunku Abdul Rahman,
88000 Kota Kinabalu, Sabah
Tel: +6088 363 020
Fax: +6088 363 022
Email: info@kpmg.com.my

Johor
Level 3, CIMB Leadership Academy,
No. 3, Jalan Medini Utara 1,
Medini Iskandar,
79200 Iskandar Puteri, Johor
Tel: +607 266 2213
Fax: +607 266 2214
Email: info@kpmg.com.my

Ipoh
Level 17, Ipoh Tower,
Jalan Dato' Seri Ahmad Said,
30450 Ipoh, Perak
Tel: +603 7721 3388
Email: info@kpmg.com.my

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