Mixed views on the new CGT

The proposed capital gains tax has been touted as a good solution to the government's need to increase its revenue. However, those in opposition foretell grave consequences.

ECONOMY

Stories by YVONNE TAN
yvonne@thestar.com.my

THE proposal to introduce a capital gains tax (CGT) for the sale of private companies is a hot topic in the corporate world right now.

Discussions on the matter, first proposed under the revised Budget 2023 can even get heated and reveal divergent perspectives and philosophies.

The mixed views on the proposal are understandable.

Malaysia has never had a CGT in any form other than for the sale of properties and that too was introduced in the 1970s, only to be suspended later and reintroduced in 2010.

Hence, the idea of suddenly bringing in a CGT for the sale of private assets in Malaysia is quite a shock to the system.

To be sure, Budget 2023 states that the government intends to have consultations on the imposition of the CGT before a firm decision to roll it out is made.

Those opposing the idea speak of grave consequences.

"You will have yet another reason for entrepreneurs to leave the country, or to set up their companies abroad in countries like Singapore where there is no such CGT. Merger and acquisition (M&A) opportunities for companies like us will shrink," quips the head of a local private equity firm who declines to be quoted.

One public-listed company owner has this almost conspiracy-sounding theory – the reason for bringing in the CGT is to nudge more companies to go public this year, before the CGT kicks in.

His thinking is that this will boost the local market and make the current government regime look good.

There are others who have more tempered views on the matter.

M&A Securities managing director of corporate finance Datuk Bill Tan reckons that the proposed CGT will not impact initial public offerings (IPOs).

"It only makes sense for IPOs, which essentially is part sale of a private company, to be exempted from having to be taxed under the proposed CGT. This is the case in other regimes where CGT for private company sales exists," he says.

Tan is spot on about one aspect of the CGT – that there will be waivers granted in certain instances, if and when this CGT plan becomes law.

But what are those instances?

Datuk Alvin Tee of UHY, an accounting and consulting firm, reckons that the waivers for CGT would likely follow what is applied on the real property gains tax (RPGT) and stamp duties.

"There are exemptions or relief on stamp duties and the RPGT in instances such as the reconstruction and amalgamation of companies.

"The exemptions also cover transfer of properties or shares between associated companies. We expect the government to allow similar exemptions for the CGT with certain terms and conditions," he says.

Brahmal Vasudevan, the founder and head of home-grown private equity firm Creador, isn't overly concerned about the proposed CGT.

"India introduced a 10% CGT in the last few years. For investors, there was no big outcry because returns have been good in many private equity deals," he says.

He adds: "I think Malaysia's CGT will also be around 10%, so it is tolerable, especially if there are good companies for us to invest in.

"Larger companies can avoid the CGT by exploring an IPO. Since there are no capital gains on public investments so far, any capital gains of a public security should be tax-free. This is similar to the Indonesian model," he points out.

Meanwhile, one private investor notes that with the new proposed rules, there is a high chance that only local businesses will be impacted.

"If the local business is owned by an entity that is registered abroad, then the sale abroad doesn't get captured by the new Malaysian CGT," he says.

Asked if there can be ways to ensure such transactions do still get captured by the local tax structure, the investor says it will be challenging to do that.

"Imagine a situation where a holding company is registered by an owner abroad. That holding company happens to own one asset in Malaysia.

"If that holding company is sold in an overseas transaction, how can the Malaysian tax authorities then impose a CGT on the sale of that one Malaysian asset changing hands?"

Sim: New taxes are never popular and starting with a low rate will allow taxpayers to adjust to a CGT regime.

Tan: It only makes sense for IPOs, which essentially is part sale of a private company, to be exempted from having to be taxed under the proposed CGT.

Brahmal: India introduced a 10% CGT in the last few years. For investors, there was no big outcry because returns have been good in many private equity deals.

Need for government revenue increase

Those in support of the new proposed CGT say it is a good solution to the issue of the government needing to increase its revenues.

UHY's Tee says: "The CGT proposal is in line with best international practices. It is an important source of revenue for the government, although exemptions need to be given in situations such as internal restructurings of companies to achieve better efficiency.

"The new CGT should also not severely impact private equity deals as such deals are usually being done with rich valuations. It is only fair that some taxes are paid," he says.

KPMG Malaysia head of tax Soh Lian Seng, meanwhile, reckons that the CGT will certainly have an impact on companies intending to undertake a restructuring exercise, especially in the post-Covid era where the economy is recovering and many organisations are contemplating group restructuring exercises to increase overall efficiency.

"The idea of introducing the CGT has been floating around for many years, but the question is whether this is the right moment to implement such a tax, especially at a time where there are projections of an economic slowdown even as Malaysia is faced with challenges in attracting foreign investments," he tells *StarBizWeek*.

Soh points out that Malaysia has traditionally enjoyed a competitive advantage over other countries in the eyes of investors, in particular foreign investors, by not having a CGT regime.

"A disposal of shares is generally non-taxable in Malaysia, unless it involves shares in a real property company as defined under the RPGT Act, 1976; or if the disposer is principally engaged in the business of trading in shares.

"The introduction of this narrower CGT raises the question of equity as disposals of listed shares will not be subject to the CGT, which will likely create an uproar within the public domain," he says.

Deloitte Malaysia country tax leader Sim Kwang Gek concurs, saying that the imposition of the CGT would impact M&A activities in Malaysia and increase tax costs for corporate restructuring exercises of unlisted companies.

Like Soh, she reckons the question to ask is whether this is the right time to introduce the CGT and whether the CGT is the best way to broaden the country's revenue base.

"At a time when we want to have more vibrancy in the market and make Malaysia as competitive as it can be, the government needs to undertake a detailed cost benefit analysis before introducing the CGT.

"Malaysia, as an M&A market for private equity and strategic investors may (become) less attractive due to the increase in transaction costs," she tells *StarBizWeek*.

"Transaction costs will definitely go up. Whether Malaysia will remain attractive for the M&A and IPO markets would also depend on other factors such as access to resources and strong connectivity, competitive financing facilities, ease of doing business and economic stability that can outweigh the increase in transaction costs due to the CGT," Sim adds.

Soh: The idea of introducing the CGT has been floating around for many years, but the question is, is this the right moment to implement such a tax.

Williams: It might be that more could be raised from reducing wastage and leakages from the current system than from new taxes.

KPMG's Soh reckons the market needs to wait for further details before correctly assessing how wide the implication of this tax will be.

"More of interest will be the tax rate that will be imposed – whether it will be up to 30%, which is the current rate of the RPGT. If imposed, this will be a significant revenue stream for the government."

Soh points out at this juncture, it is also uncertain as to whether the rate will be a fixed rate or a progressive tax rate and whether it will be comparable to the RPGT rates currently in force.

"I would like to see the rate introduced as low as 5%, fixed rate," he says but adds that there are several considerations that have to be taken into account.

Deloitte's Sim notes that the government has said that it is considering a low rate as a start should the CGT be implemented.

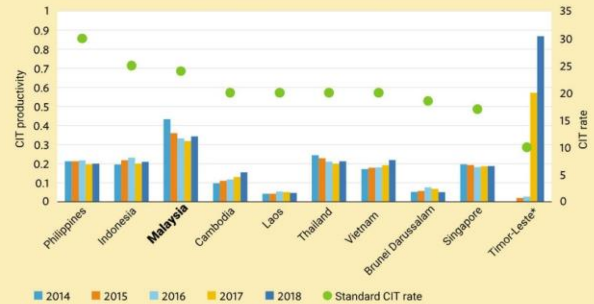
"This is understandable as new taxes are never popular and starting with a low rate will allow taxpayers to adjust to the CGT regime.

"The rate to be adopted would depend on whether the tax is to be applied on the net gain or on the sales proceeds. A comparison of the CGT adopted by countries in the region would be a good start so that Malaysia remains attractive and

"Most developed countries have some sort of CGT which in recent years have shown no reduction in deal flows."

Lavindran Sandragasu

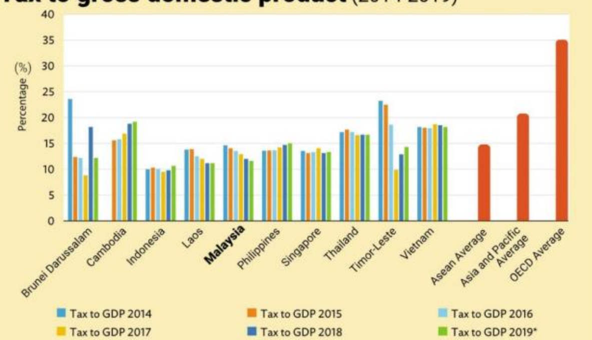
Corporate income tax productivity



CIT = corporate income tax
*2014 Figures for Timor-Leste not available
Note: Indonesia reduced the standart CIT rate from 25% for 2020 and 2021, and to 20% for 2022

Source: Aekapol Chongvilaivan and Annette Chooi, Asian Development Bank TheStargraphics

Tax to gross domestic product (2014-2019)



GDP= gross domestic product, Asean = Association of South-East Asian Nations,
OECD = Organisation for Economic Co-operation and Development
*2019 figures are estimates

Source: Aekapol Chongvilaivan and Annette Chooi, Asian Development Bank TheStargraphics

competitive for investors," she says.

"Another important point is to consider the interactions between the current RPGT and (proposed) CGT in order to avoid double taxation, as well as tax treatment on losses arising from the sale of unlisted shares. CGT exemptions should be given in certain situations such as internal group restructurings where stamp duty reliefs and RPGT exemptions are currently available for such transactions."

PwC Malaysia tax partner Lavindran Sandragasu also believes a single-digit rate would be acceptable as a starting point.

"Firstly we need to determine the size of the 'pot' that is being taxed while applying other filters such as reasonableness, administrative procedures and sustainability to the mix to influence the determination of the rate," he tells *StarBizWeek*.

He has a slightly different view compared to his counterparts on the impact of the CGT.

"Given what rate will be applied, hopefully being a reasonable one, we do not foresee a major impact to deal flows, as there are other commercially-driven aspects which are of greater importance to such determination," says Lavindran.

"This can be validated by the practices of other countries that have introduced similar taxes and the impact on their deal flows.

"Most developed countries have some sort of CGT which in recent years have shown no reduction in deal flows," he adds.

He says the CGT is a tax that has been discussed for many years, which means it is not new to the market.

"There are real gains to be derived from investors, who have the ability to bear such a burden, albeit at a reasonable level.

"Additionally, this introduction can be seen as a progressive tax as it reduces the inequalities of wealth distribution and taxes the speculation aspects of such gains," he adds.

A holistic view

Those less enthusiastic about the implementation of the CGT also say if it has to be implemented, it must be done with a holistic view in mind.

Malaysia University of Science and Technology (MUST) economics professor Geoffrey Williams believes that all tax changes must be conducted as part of a "holistic review of taxes and revenues".

"Ad hoc changes cannot be assessed properly in isolation. There must be a review of direct income taxes of individuals and companies, wealth and investment taxes, excise duties such as the new luxury goods tax as well as the implications of global taxes such as the global minimum tax.

"These must all be viewed in the context of other revenue sources such as Petroliam Nasional Bhd's oil royalty and the incomes of government-linked and government-linked investment companies," he says.

Williams says it makes no sense to ask what the rate of the CGT or indeed the rate of a goods and sales tax should be if they were to be introduced, unless the revenue needs and revenue potential from the current system are made known.

"It might be that more could be raised from reducing wastage and leakages from the current system than from new taxes."

This is certainly true of the luxury goods tax, also proposed under the revised Budget 2023, which Williams says will raise less than what existing waste cut off from the current system could yield.

"There is a lot of noise about tax reforms but in the absence of a full strategy and evidence-based study, we really cannot make a definitive judgement on this issue," he adds.