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Comment

Tax incentives: Is Malaysia ready for the next leap?

Run-up to Belanjawan 2025 MALAYSIA MADANI

MALAYSIA has started the year on a high note in the first quarter of 2024 having secured RM83.7bil in approved investments across various sectors, with foreign direct investment (FDI) contributing RM47.0bil (56.2%).

Yet, amid this success, the complexity of Malaysia's tax incentives presents a challenge for investors, underscoring areas that still require further improvements.

As South-East Asian nations ramp up their efforts to secure FDIs – capitalising on the trade diversions from the US-China trade war and global uncertainties – Malaysia must enhance its strategies to attract higher-value investments and distinguish itself from rival markets.

The upcoming Budget 2025 proposals present another pivotal moment for the country to introduce measures to strengthen its global standing and enhance the ease of doing business.

In Malaysia, investors are offered with a wide range of tax incentive packages when considering investments in the country, such as the general pioneer status and investment tax allowance incentives for promoted products and activities.

In addition to these, there are fiscal incentives such as digital, training and research and development grants, as well as import duty and sales tax exemptions, alongside non-fiscal benefits.

Malaysia's five economic corridors – the East Coast Economic Region, Northern Corridor Economic Region, Iskandar Malaysia, Sabah Development Corridor and the Sarawak Corridor of Renewable Energy – also offer sector-specific tax reliefs such as income tax exemption and investment tax allowance, as well as non-fiscal incentives.

Additionally, within these corridors, there are various industrial parks that target specific sectors with tailored incentives, such as the Malaysia-China Kuantan Industrial Park, Chuping Valley Industrial Area, Kerian Integrated Green Industrial Park and Forest City Special Financial Zone.

To further promote digital investments and foster digital economy growth, federal and state agencies such as the Malaysia Digital Economy Corp, the Selangor Information Technology and Digital Economy Corp and Sarawak Digital Economy Corp provide specialised incentives and support to attract investors in the digital sector, further enhancing Malaysia's appeal as a burgeoning digital hub.

Fine-tuning required: People taking part in a marathon event in Kuala Lumpur. The complexity of Malaysia's tax incentives presents a challenge for investors, underscoring areas that still require further improvements. — Bernama

While all these may sound very attractive, in practice, navigating the multitude of options can be overwhelming for investors.

The incentive frameworks are administered by various ministries and agencies, which may result in duplication and necessitating engagement with multiple agencies before deciding on the optimal investment location.

Investors may also face simultaneous outreach from different ministries, investment promotion agencies and state agencies, all vying to attract them to their respective states or projects.

To address this, Malaysia must adopt a more consolidated and integrated approach to investment incentives.

Ideally, a one-stop regulatory authority that spans across states, ministries and agencies, can be established to guide investors throughout the process – from selecting a location to securing licences and receiving both fiscal and non-fiscal incentives. This would streamline the investment journey and improve the ease of doing business in Malaysia.

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Red tape and inefficiencies can also be reduced to shorten processing time and expedite approvals, ultimately positioning the country as an investor-friendly destination.

Talent development is equally critical to Malaysia's ambition to move up the value chain.

To build a skilled workforce in engineering, science and technology, targeted incentives should focus on attracting top-tier international universities renowned for these disciplines, along with foreign companies willing to transfer knowledge, provide training and support skill development within the local workforce.

Furthermore, preferential income tax rates could also be extended not only to returning expatriates but also to local talents, ensuring their retention and long-term contribution to our country's growth.

Another critical area in need of focus is research and development (R&D).

While multinational corporations (MNCs) often leverage Malaysia as a manufacturing hub, Singapore frequently serves as their R&D base.

Although tax incentives for R&D are available in Malaysia, there is room to fine-tune the definitions, qualifying conditions and approval processes.

Expanding the scope of these incentives would allow more companies engaged in R&D and innovation activities to benefit.

Offering more attractive R&D credits could entice investors to establish their R&D hubs in Malaysia.

Malaysia also needs to adopt more forward-looking, strategic tax incentives.

For instance, while we have successfully attracted billions in data centre investments, these facilities consume vast amounts of energy and water.

Future incentives should focus on moving up the value chain by encouraging more sustainable data centre investments and attracting foreign companies that provide high-quality digital economy jobs and develop artificial intelligence talents and capabilities.

Additionally, fund incentives could be introduced to encourage regional and global data centre fund platforms to establish their presence in Malaysia.

With the imminent implementation of the base erosion and profit shifting (BEPS) Pillar Two rules through the Income Inclusion Rule and the Domestic Top-up Tax in Malaysia by 2025, traditional tax incentives in the form of tax breaks would no longer be effective as a tool to incentivise MNCs impacted by the global minimum tax rate of 15%.

To stay competitive, Malaysia's tax incentive regime must evolve. Budget 2025 presents an opportunity to reform these incentives, ensuring that they remain relevant and competitive in the post-BEPS globally connected world.

However, attractive tax incentives can only be effective if accompanied by certainty and clarity in tax policies.

In the past, premature announcements of tax incentives have led to delays, leaving investors waiting months for detailed guidelines.

There is collective hope that future tax incentives and initiatives, especially those in Budget 2025, will involve greater stakeholder engagement, with clear details and guidelines from the outset to avoid unnecessary delays and confusion.

Malaysia as a progressive nation is well positioned to take the necessary leap forward to rethink and refine its tax incentive strategies.

By addressing current inefficiencies, fostering quality specialised talents, promoting innovation, and ensuring clarity in tax policies, Malaysia can strengthen its position as a premier destination for high-value investments in the region.

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