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Ministry of Finance (MoF) issues 2023 Pre-Budget Statement

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On 3 June 2022, the MoF published a Pre-Budget Statement (Statement), ahead of the Budget 2023 announcement. This is the second time such a Statement, which is consistent with international best practices, has been issued in Malaysia. The Statement was issued to provide a preliminary view on the direction of Budget 2023 and enhance the transparency and governance of the Budget formulation process.

The theme of Budget 2023 is "Strengthening Recovery, Facilitating Reforms Towards Sustainable Socio-Economic Resilience of *Keluarga* Malaysia". The Statement highlights the three areas that will be focused on in Budget 2023, specifically:

(a) Formulating people-centric initiatives, particularly those that generate job opportunities, raise income, strengthen social protection and enhance the *rakyat*'s socio-economic wellbeing
(b) Creating a conducive business environment, especially enhancing the competitiveness and productivity of small and medium enterprises, boosting the recovery of tourism and other pandemic-impacted sectors, leveraging on Malaysia's leadership in Islamic finance, as well as catalyzing new growth areas
(c) Driving a more inclusive and sustainable development model to support economic growth, particularly narrowing the disparities between regions and communities, as well as promoting sustainable development and strengthening food security

The Statement included various tax-related announcements, which are discussed below.

Malaysia's commitment at the international level

Malaysia is committed to the Organization for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) initiatives to combat perceived aggressive cross-border tax planning. Malaysia has always been responsive to the current changes in internationally agreed tax standards to ensure a competitive environment to attract foreign and domestic direct investments, as well as prevent cross-border tax evasion activities. Malaysia is part of the BEPS Inclusive Framework (IF)[1] and participates in BEPS-related discussions internationally.

As multinational enterprises (MNEs) rely heavily on digitalization, it is noted that existing tax policies will need to be reviewed to prevent revenue leakages and profit-shifting. The Government and OECD are currently discussing the implementation of taxation of the digital economy under BEPS Action Plan 1 and have agreed to implement the Two-Pillar approach, which is expected to be implemented from 2023. The Pillars are as follows:

- Pillar 1: Development of new nexus and profit allocation rules that assign a greater share of the taxing rights to market jurisdictions, i.e., the jurisdictions in which goods and services are consumed
- Pillar 2: New global minimum tax rules to ensure in-scope MNE groups pay a minimum level of tax of 15% on income arising in each of the jurisdictions where they operate

The Statement concludes its BEPS 2.0 discussion to say that Malaysia is currently reviewing the technical details of the two Pillars, including the possibility of introducing the Qualified Domestic Minimum Top-Up Tax (QDMTT) under Pillar Two. The QDMTT would allow Malaysia to impose a 15% minimum tax, using Pillar Two principles, on in-scope groups which have an effective tax rate of below 15% in Malaysia. This would prevent Malaysia from ceding taxing rights (over profits earned in Malaysia) to other countries and could also simplify compliance for in-scope MNE Groups.

Observation

Malaysia has sent a clear message in the Statement that the implementation of BEPS 2.0, including the QDMTT, is being closely studied. The authorities will want to ensure that Malaysia's tax system is in line with international best practices and that Malaysia protects its taxing rights over profits generated here, whilst ensuring that our country continues to be attractive to foreign investors. More details may become available in Budget 2023, which is expected to be tabled on 28 October 2022. Most other countries are also evaluating the impact of implementing BEPS 2.0, especially Pillar Two (see for example the Officials' Issues Paper which has been issued in New Zealand on this matter, which is discussed in the Overseas Developments section of Tax Alert No. 12/2022).

Taxpayers will need to ensure that boards of directors and senior management are aware of the potential financial impact of BEPS 2.0 and that systems are capable of generating the data and calculations needed to

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[1] The IF was established to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS related issues, while reviewing and monitoring the implementation of the BEPS Project

comply with Pillar Two requirements. The Two Pillars also include various exclusions, the applicability of which would need to be carefully assessed by relevant taxpayers. For example, extractives and regulated financial services are excluded from the scope of Pillar One, whilst international shipping income is excluded from the scope of Pillar Two. However, the details of the exclusions must be carefully studied, to determine whether these apply. Companies which have not yet begun assessing the impact which BEPS 2.0 will have on their businesses should commence work on this immediately, as the analysis can be complex, the implications to the tax position can be significant and changes to the systems to enable compliance can take a considerable amount of time.

Strategy to increase tax revenue: Implementation of e-Invoicing

To support the growth of the digital economy, the Government intends to implement e-Invoicing, in stages, to enhance the efficiency of Malaysia's tax administration management. This initiative is in line with the 12th Malaysia Plan to strengthen the digital services infrastructure and digitalize tax administration.

This initiative is anticipated to improve the quality of services, reduce compliance costs for taxpayers and increase the efficiency of business operations. The initiative will also support the use of the Tax Identification Number (TIN), which is implemented from Year 2022, as a measure to expand the income tax net.

E-invoicing is in line with international best practices. It streamlines and strengthens the national tax system, increases tax transparency and provides a more accurate assessment of compliance risk.

Strategies to strengthen the tax system

The Government will continue to implement the tax reform initiatives proposed by the Tax Reform Committee. The initiatives include:

i) measures to broaden the tax base, such as the review of broad-based incentives, reliefs and deductions
ii) measures to improve tax administration, such as the comprehensive registration of taxpayers, better training of tax personnel, improved registrations of cross-border trades, strengthened audits and investigations, and enhanced legal certainty for taxpayers.

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The MoF will begin its engagement and consultative sessions with various stakeholders to ensure a comprehensive and holistic Budget 2023. Feedback on issues and recommendations to be considered for Budget 2023 can be submitted through the official portal until 5.00 p.m., 24 June 2022.

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