

IDEAS POSITION PAPER: MAKING SHARED PROSPERITY A REALITY IN BUDGET 2020

The Government has put Shared Prosperity at the centre of its vision for the future of Malaysia's economy. With the planning for the 12th Malaysia Plan now underway and Budget 2020 due to be tabled shortly, many are asking how to achieve the goal of Shared Prosperity. For the working people of Malaysia, the problems are well known: low wages and high cost of living. Businesses are struggling too, with increasing uncertainty in the global economy and rising costs. This at a time when the Government's fiscal room for manoeuvre is limited. In light of these challenges, we offer the following proposals as a contribution to the policy discourse on Shared Prosperity.

We know that the minimum wage is insufficient to maintain an acceptable standard of living, but also that businesses have concerns over further increases in the minimum wage. Therefore, we propose a new **Living Wage Tax Credit (LWTC)**, under which employers are incentivised – but not required – to increase wages up to a new Living Wage, proposed to be RM2,500 per employee.

We also know that many Malaysians are unable to save enough to put towards retirement or unexpected events. Therefore, we propose **Employee Equity Schemes (EES)** to ensure that employees can share in the wealth of the country. Under this scheme, employers will be incentivised to allocate shares to employees and employees will be encouraged to hold on to these assets rather than sell them on for easy cash. We propose both these policies be introduced in the forthcoming Budget and recommend they be paid for through rationalisation of existing investment incentives.

More broadly, we recognise that the government is struggling to bring the deficit under control. The abolition of GST has narrowed the tax base in Malaysia while the SST is insufficient to replace the lost revenue. Therefore, in the longer term, we believe the Government should introduce a **Capital Gains Tax (CGT)**. We would propose an initial rate of 5% with a tax-free allowance of

RM50,000. The Government should launch a consultation on the introduction of this new tax in Budget 2020.

We recognise that the introduction of tax on capital gains will have implications for investment and there are also questions over the future sources of economic growth in Malaysia. We believe there are actions the Government can take to encourage investment and local business development. The Government's shareholding among Publicly Listed Companies remains over 40% of total market capitalisation with majority stakes in over 70 companies. This high Government presence creates concerns over competition and the lack of liquidity in Malaysia's capital markets. We believe that the time has come to transition from this model, and we propose a **Government Divestment Strategy**, under which the Government targets a gradual divestment of its holdings to 10% of total market cap by 2030 with no majority shareholdings. The proceeds of this divestment should be reinvested in new markets to generate returns for the Malaysian people. Divested shares can be channelled to employees through the Employee Equity Schemes. The Government should initiate a review of GLCs in Budget 2020 to form the basis of this Divestment Strategy,

We believe these proposals can contribute to a bold new economic strategy in Malaysia and help to make shared prosperity a reality: an innovative approach to reaching a Living Wage and higher ownership of Malaysia's corporate equity by Malaysia's workers, combined with liberalisation of Malaysia's capital markets leading to new opportunities for investors to stimulate growth in the economy, at the cost of a modest tax on the profits they make from doing so.

For more information on these proposals, please visit www.ideas.org.my

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PROPOSAL I: Living Wage Tax Credit

Current Situation

The Minimum Wage nationally is currently set at RM1,100. The Pakatan Harapan manifesto promised further increases in the Minimum Wage to RM1,500 in response to widespread concerns over stagnant wages and the rising cost of living. Indeed, Bank Negara has estimated that the living wage, required to “afford a minimum acceptable living standard”, is significantly higher than RM1,500¹. However, the business community has warned of the risks to economic growth and employment of further increases in the minimum wage and are therefore likely to react negatively to such increases. In response to these concerns, the Pakatan Harapan manifesto promised that half the cost of increases in the minimum wage would be subsidised by the Government, but so far this has not been implemented, presumably due to affordability constraints.

Proposal

This proposal is intended to promote increases in income for low paid workers through an approach which seeks to balance the needs of the Government, workers and businesses.

We propose that corporate tax incentives be introduced to encourage employers to increase pay beyond the minimum wage. The precise parameters of this policy will need to be subject to further consideration. Indicative parameters are proposed as follows:

- » Companies would be able to deduct 50% of the value of pay rises for full time permanent employees earning between RM1,100 and RM1,500 per month from their annual corporate taxable income up to a maximum of RM200 per month, per employee; and
- » Companies would be able to deduct 25% of the value of pay rises for full time permanent employees earning between RM1,500 and RM2,000 per month from their annual corporate taxable income up to a maximum of RM200 per month, per employee.
- » These incentives would be in place for 5 years from the date of enforcement. The thresholds of the incentives should be updated in light of any changes in the minimum wage during this period.

¹ Chong, E. & Khong, F.A. (2018) The Living Wage: Beyond Making Ends Meet. Bank Negara Malaysia, Monetary Policy Department. Accessed from: http://www.bnm.gov.my/index.php?ch=en_publication&pg=en_work_papers&ac=62&bb=file

Issues

The intention of this policy is to share the cost of pay rises for low paid workers between the Government and the private sector. In contrast to the minimum wage, these incentives are optional. The cost to the Government of these incentives will therefore depend on the uptake of the incentives. We estimate at 100% uptake, these incentives could cost over billions of ringgit annually. We anticipate that this level of uptake is highly unlikely but also that any anticipated rise in spending should be accounted for. We propose the costs be met through rationalisation of existing investment incentives, including a range of corporate tax exemptions.

This policy does not cater to those working in the informal sector, which in 2017 accounted for 1.36 million working people in Malaysia.

PROPOSAL 2: Employee Equity Scheme

Current Situation

Many companies in Malaysia operate employee share schemes as a tool to retain and motivate employees. Under Malaysian law, a benefit derived from a share scheme is considered to be part of gross employment income in the relevant period in which the rights are exercised. There are no published statistics on the total value of shares in Malaysia held by employees under these schemes, and Publicly Listed Companies are under no legal obligation to disclose the value of shares held by employees. It is likely that these schemes are generally used to remunerate senior management.

Proposal

This proposal is intended to encourage employee share schemes targeting all employees, not just senior management. We propose that personal income tax incentives are introduced to encourage the transfer of shares to employees as part of remuneration. The precise parameters of this policy will need to be subject to further consideration. Indicative parameters are proposed as follows:

- » Companies can give each employee up to RM10,000 in shares each year, tax free²; and
- » In addition, each employee can buy shares out of their salary, before tax deductions, up to RM5,000 or 10% of the employee's taxable income for the tax year, whichever is lower.
- » For every share purchased through the method above, the company can choose to match with an additional share, above the RM10,000 limit;
- » Shares acquired through either method will not be subject to tax if they are retained for at least 5 years.
- » Companies that have 10% of equity held by employees will be entitled to a 1% reduction in their corporate tax rate.

² Shares given in this way are currently counted as part of gross taxable income

- » Publicly Listed Companies will be required to disclose in their annual report the level of equity held by employees.

Issues

Employee share schemes are typically associated with the remuneration of senior management. This proposal is deliberately constructed to encourage broad allocation of shareholding through annual per employee limits, however the decision on how to allocate shares will be for the individual company. This proposal is partly designed to address the low level of savings among many working Malaysians. There is a risk that employees benefiting from the scheme choose to sell their shares for easy cash. Ultimately, this is their choice, but we seek to discourage this by predicating the tax-exempt status on the requirement that shares be held for at least 5 years. The corporation tax incentive is intended to promote broad employee shareholding, however there is a risk that the conditions are met on the basis of a relatively narrow number of employee shareholders, this requires further consideration.

PROPOSAL 3: Capital Gains Tax (CGT)

Current Situation

Currently in Malaysia capital gains from the disposal of real properties including residential homes, commercial buildings and share in real property companies are subject to the Real Property Gains Tax (RPGT). However, profits on the disposal of other assets, notably shares, are not subject to tax. The Introduction of a broader Capital Gains Tax has been mooted as a possible option to expand the tax base in Malaysia but has not hitherto been adopted, in part due to the potential impact on the economy.

Proposal

We propose the introduction of Capital Gains Tax (CGT) exclusively on the profit from the disposal of shares. The precise parameters of this policy will need to be subject to further consideration. Indicative parameters are proposed as follows:

- » CGT would be payable on disposal of assets, excluding shares in real property companies covered by RPGT; and
- » CGT will apply at a rate of 5% with an annual tax-free allowance for corporations and individuals of RM50,000.
- » Shares held via Amanah Saham Nasional Berhad would be exempt from CGT.
- » The Government is advised to introduce a consultation on the introduction of CGT at the earliest opportunity.

Issues

The introduction of Capital Gains Tax should be preceded a comprehensive consultation to address concerns and issues with the scope and implementation of such a tax, including the coverage of non-residents. We recommend that the Government introduce a consultation at the earliest opportunity. We recognise that the introduction of Capital Gains Tax could have a negative impact on business activity in Malaysia. We have sought to address this to some extent by proposing a tax-free allowance. Nonetheless, we recognise that the introduction of a CGT could have a negative impact on investment in Malaysia. However, we argue that this can be offset through liberalisation of Malaysia's capital market, including a reduction in Government shareholdings, which will encourage higher levels of investment.

PROPOSAL 4: Government Divestment Strategy

Current Situation

Government Linked Investment Companies (GLICs) own significant numbers of shares in Publicly Listed Companies (PLCs) in Malaysia. IDEAS estimate that over 40% of the market capitalisation of the Bursa is owned by Government Linked Investment Companies (GLICs) including majority shareholdings in over 70 companies. Investors have noted that this reduces the liquidity in Malaysia's capital markets, disincentivising investment. The perceived risk of expropriation and unfair competition has also acted as a disincentive for other private businesses in Malaysia.

The most notable shareholders include Khazanah, the Employers Provident Fund (EPF) and PNB. The objectives of these different entities vary and include promotion of strategic industries, return on investment and redistribution of equity.

Proposal

We propose reform of the Government domestic investment position, with the goal of gradual disinvestment from Malaysian PLCs. The precise parameters of this policy will need to be subject to further consideration. Indicative parameters are proposed as follows:

- » The Government would undertake a systematic review of its current investment position and specify clear objectives, including for each different GLIC. This review should be overseen by a new Parliamentary Select Committee.
- » The Government would commit to annual publications of performance against specific objectives for GLICs, including on Bumiputera equity as promised in Buku Harapan.
- » Consistent with the review and agreed objectives the Government would target a gradual disinvestment from Malaysian PLCs targeting a maximum of 10% of market cap by 2030 and no majority shareholdings in any Malaysian PLCs without a clear public interest justification.
- » Funds raised from divestment should be reinvested in line with specific objectives and subject to the conditions above and GLICs should give due need to diversify in different international markets and to avoid controlling stakes.

- » Publicly Listed Companies (PLCs) should be encouraged to participate in Employee Equity Schemes (EES).

Issues

Government Linked Companies (GLCs) play a very significant role in the Malaysian economy, so any efforts to fundamentally restructure the role of GLCs should be conducted with due care. Furthermore, previous attempts at divestment have resulted in sub-optimal outcomes, partly due to lack of transparency. However, we argue there is a clear need to address the role of Government intervention in the economy, and that higher levels of sustainable growth can be achieved with a reduced Government footprint. Therefore, the first step should be a comprehensive review of the current investment position of GLCs and GLICs. In addition, other proposals contained in this paper aim to improve the level of shareholding by private citizens. The overall objective is that equity that is currently held in trust for the people (in GLICs) should be gradually transferred so that it is directly held by the people, whilst at the same time creating opportunities for private investors, who will now be subject to tax via the CGT. We recognise that this is a significant change in current Government policy and could also lead to some volatility in Malaysian capital markets. The programme of disinvestment should therefore be carried out gradually over a period of 10 years such that the impact can be monitored, and any necessary action taken.