SECTION 2

Federal Government Revenue

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Overview

The COVID-19 pandemic has led to the re-enforcement of containment measures which have affected the economy, business operations and social interactions. This has resulted in the provision of fiscal support among others via tax incentives and reliefs to cushion the impact of the pandemic. Hence, revenue is expected to underperform for the year, constraining fiscal space and effort to rejuvenate the economy.

However, the implementation of the National Recovery Plan (NRP) and acceleration of the nationwide vaccination programme are expected to boost recovery and revenue with the gradual reopening of the economy. High commodity prices coupled with revenue enhancement initiatives that were undertaken during the year have also provided some upside to revenue collection.

As part of the effort to improve inclusivity and transparency in preparing annual budget, the inaugural Pre-Budget Statement and four Public Consultation Papers were issued. One of the papers, namely Review of Tax Incentives, was published to solicit views on the proposal to review the overall tax incentive framework. This initiative signifies a fresh approach by the Government to engage business communities and the public to strengthen the overall tax administration and compliance.

Revenue in 2021

Federal Government revenue in 2021 is projected to register a lower collection of RM221 billion (14.6% to GDP) compared with RM225.1 billion (15.9% to GDP) in 2020. The 1.8% decline in total revenue is mainly due to the fall in proceeds from non-tax revenue as a result of lower investment income. In contrast, tax revenue, which constitutes 73.2% of total revenue (10.7% to GDP), is estimated to increase 4.8% to RM161.8 billion (2020: RM154.4 billion), while non-tax revenue is expected to record RM59.2 billion (3.9% to GDP), representing 26.8% of total revenue.

Direct tax is anticipated to turn around by 6.7% to RM120 billion, mainly contributed by higher companies income tax (CITA) collection of RM60.6 billion. The better performance is a consequence of a low base effect, supported by several factors such as higher tax instalment payments from the corporate sector in 2021 following tax deferments provided in 2020. Higher collection in CITA was also due to improved performance of the services and manufacturing sectors and higher collection from profit-making entities that were not affected by the pandemic, mainly in the banking, pharmaceutical and palm oil industries. However, individual income tax is estimated to decline by 6.6% to RM36.4 billion due to fewer taxable individual taxpayers following higher unemployment rate at 4.5%. Similarly, the petroleum income tax (PITA) is estimated lower at RM11.5 billion (2020: RM12.8 billion) attributed to higher extraction costs borne by petroleum companies, albeit increasing crude oil prices in 2021. Nevertheless, the collection of other direct taxes, mainly consisting of stamp duties and real property gains tax (RPGT), is estimated to increase to RM8.2 billion (2020: RM7.6 billion), supported by higher property market transactions following the rise in value and volume of properties sales from all market and price segments.[1]

[1] Valuation and Property Services Department. Retrieved from https://napic.jpph.gov.my/portal

TABLE 2.1. *Federal Government Revenue 2020 – 2022*

COMPONENT	RM MILLION			CHANGE (%)			SHARE (%)		
	2020	2021[1]	2022[2]	2020	2021[1]	2022[2]	2020	2021[1]	2022[2]
Tax revenue	**154,398**	**161,830**	**171,374**	***-14.5***	***4.8***	***5.9***	***68.6***	***73.2***	***73.2***
Direct tax	112,511	120,048	127,334	*-16.5*	*6.7*	*6.1*	*50.0*	*54.3*	*54.4*
of which:									
CITA	50,065	60,588	65,499	*-21.5*	*21.0*	*8.1*	*22.2*	*27.4*	*28.0*
Individual	38,953	36,400	37,510	*0.7*	*-6.6*	*3.0*	*17.3*	*16.5*	*16.0*
PITA	12,772	11,500	12,400	*-38.5*	*-10.0*	*7.8*	*5.7*	*5.2*	*5.3*
Indirect tax	41,887	41,782	44,040	*-8.6*	*-0.3*	*5.4*	*18.6*	*18.9*	*18.8*
of which:									
SST	26,773	26,528	27,560	*-3.2*	*-0.9*	*3.9*	*11.9*	*12.0*	*11.8*
Excise duties	9,855	9,760	10,200	*-6.2*	*-1.0*	*4.5*	*4.4*	*4.4*	*4.3*
Import duty	2,346	2,330	2,500	*-14.2*	*-0.7*	*7.3*	*1.0*	*1.1*	*1.1*
Export duty	746	1,406	1,610	*-33.7*	*88.5*	*14.5*	*0.3*	*0.6*	*0.7*
Non-tax revenue	**70,678**	**59,193**	**62,637**	***-15.7***	***-16.2***	***5.8***	***31.4***	***26.8***	***26.8***
of which:									
Licences and permits	10,932	10,252	10,958	*-24.6*	*-6.2*	*6.9*	*4.9*	*4.6*	*4.7*
Investment income	46,067	35,989	39,457	*-23.3*	*-21.9*	*9.6*	*20.5*	*16.3*	*16.9*
Total revenue	**225,076**	**221,023**	**234,011**	***-14.9***	***-1.8***	***5.9***	***100.0***	***100.0***	***100.0***
Share to GDP (%)	***15.9***	***14.6***	***14.3***						

[1] Revised estimate
[2] Budget estimate excluding 2022 Budget measures
Source: Ministry of Finance, Malaysia

Indirect tax collection is estimated to decline marginally by 0.3% to record RM41.8 billion (2020: RM41.9 billion), mainly due to lower collection from Sales Tax and Service Tax (SST) and excise duties. SST is expected to record RM26.5 billion, a slight decline by 0.9% attributed to the extension of the sales tax exemptions on passenger vehicles until 31 December 2021 and the impact of the containment measures on consumers and businesses. Similarly, excise duties are forecast to record a lesser collection at RM9.8 billion due to lower motor vehicle production following closures of plants in the entire value chain during the Movement Control Order (MCO) period. This is in line with downward revision of the projected total industry volume (TIV) for motor vehicles by 12.3% to about 500,000 units for the year.[2]

However, the lower collection from total indirect tax is cushioned by the increase in the collection from the windfall profit levy and export duty for crude palm oil (CPO). The windfall profit levy increased to RM0.9 billion in 2021 (2020: RM0.2 billion) on account of higher CPO prices of around RM4,000 per tonne, well above the threshold price of RM2,500 per tonne in Peninsular Malaysia and RM3,000 per tonne in Sabah and Sarawak. The windfall profit levy is collected from palm oil producers based on the output of fresh fruit bunches.

[2] Malaysia Automotive Association. Market Review First Half 2021. Retrieved from http://www.maa.org.my/news.html

In contrast, the export duty is collected from exporters based on CPO monthly gazetted market price, while for crude petroleum, export duty is charged at 10% of the exported oil profit. In this regard, the total export duty collection for 2021 is estimated at RM1.4 billion, of which RM0.7 billion is from CPO and RM0.6 billion is from crude petroleum.

Non-tax revenue is estimated lower at RM59.2 billion in 2021 (2020: RM70.7 billion), largely due to lower investment income, particularly dividends from PETRONAS amounting to RM25 billion (2020: RM34 billion). However, the Government received higher dividends from Bank Negara Malaysia (BNM) amounting to RM4 billion (2020: RM3.5 billion) and is expected to receive RM2 billion from Khazanah Nasional Berhad (2020: RM1 billion). Furthermore, the Government has received a special payment of RM5 billion from the Retirement Fund (Incorporated) (KWAP) to partly finance the current year's retirement charges. Receipts from licences and permits are expected to decline to RM10.3 billion (2020: RM10.9 billion) due to lower proceeds from petroleum royalties. Motor vehicle licences collection is forecast to be stable at around RM2.8 billion, taking into account the relief granted by the Government in renewals of new licences. Similarly, the levy on foreign workers is estimated to maintain around RM1.7 billion.

In 2021, the share of **petroleum-related revenue** is projected to be lower at 19.2% of total revenue (2020: 24.9%). Although its share is lower, the RM42.5 billion revenue is estimated to be higher compared to Budget estimates of RM37.8 billion, resulting from higher PETRONAS dividends in line with improving global crude oil prices. **Non-petroleum revenue** is projected to improve by 5.6% to RM178.5 billion (2020: RM169 billion), anchored by better collection from tax revenue that reflects a mild economic recovery in 2021 compared with the previous year.

FEATURE ARTICLE

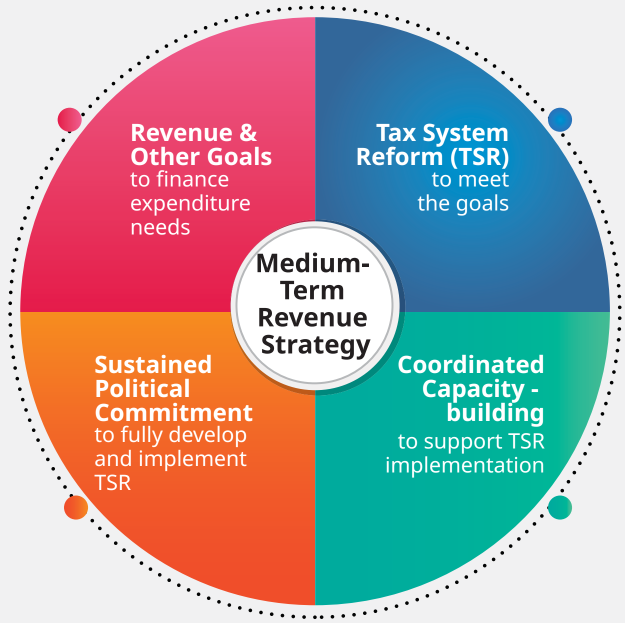
Medium-Term Revenue Strategy: A Call for Revenue Reforms in Malaysia

Introduction

Public finance management involves an efficient mobilisation of fiscal resources to achieve national development agenda. Thus, it is crucial to ensure stable revenue generation to support expenditure needs, particularly in meeting the country's socio economic objectives. The Government has embarked on fiscal reform initiatives, among others, to enhance its revenue base, as evidenced by the formation of the Tax Reform Committee (TRC) in 2018. The TRC is tasked to review the current tax system, propose new tax measures to address tax gaps and incorporate the informal economy into the tax net. As a policy continuation, the Government is formulating a revenue framework, namely the Medium-Term Revenue Strategy (MTRS), that will adopt and adapt international best practices in modernising Malaysia's tax system and administration.

The MTRS is a comprehensive approach in undertaking effective tax reforms to boost revenues and improve the tax system over the medium term through a country-led and whole-of-government approach. In general, there are four main aspects of an MTRS - defining revenue and other goals, reforming the tax system, sustaining political commitment and coordinating capacity building. The framework provides a high-level road map of tax reforms to establish a modern and robust system that is fair and equitable and provides an efficient revenue administration. Nevertheless, the successful implementation of an MTRS will require firm support from key stakeholders in our society.

FIGURE 1. *Main Components of the Medium-Term Revenue Strategy*



Source: The Platform for Collaboration on Tax

Rationale for MTRS

The introduction of MTRS is timely to address current issues relating to Federal Government revenue, mainly a narrow tax base, ineffective tax incentives, tax avoidance and tax evasion and untapped informal sectors. Total revenue as a percentage to gross domestic product (GDP) has declined from 21.4% in 2012 to 15.9% in 2020, which is relatively low compared with rating peer countries. In addition, a high reliance on direct tax, now constituting half of total revenue, renders the revenue collection susceptible to economic growth and business cycles. Thus, an effective and sustainable revenue collection for Malaysia is crucial to ensure sufficient financing of total expenditures.

MTRS requires a comprehensive reform plan for the tax system, which encompasses a clear policy setting framework, enhancement of revenue agencies, and strengthening the legal framework. The adjustment in policy setting will include detailed diagnoses of the economic and social impact of the tax reforms and a multi-year tax policy plan. These will lead to policy certainty and predictability, and in turn, boost investors' confidence. In addition, the adoption of a quality framework will avoid creating perverse incentives, excessive discretion of legal power and aggressive tax planning. Through the MTRS, Malaysia stands to gain not only in enhancing the potential of revenue collection but, more importantly, in having a more transparent and accountable tax system.

The MTRS Framework in Malaysia

The adoption of MTRS in Malaysia will be implemented based on these objectives:

a) To ensure sustainable revenue generation in the medium term in line with GDP growth;

b) To ensure better compliance through effective and efficient tax administration; and

c) To strengthen the legal framework in enhancing the tax system and policy formulation.

At the initial stage, the formulation will focus on the taxation system anchored on three main pillars as follows:

a) Tax Policy

The main factors influencing the tax policy direction include the business and macroeconomic environment, taxpayers' capacity, and the effectiveness of revenue agencies. The designing of tax policy will incorporate analysis of the socio economic impact and the sources of revenue generation, accompanied by a multi-year roadmap of tax policy options. The roadmap will be subjected to periodical reviews and updated according to national development policy objectives and priorities.

Measures to introduce new taxes or improve the existing system should be based on efficiency, fairness, simplicity, flexibility, transparency and effectiveness.[1] Currently, the Government is considering options to reduce the reliance on direct taxes and widen the revenue base by shifting to consumption-based tax. The latter can be further improved by reviewing the taxation and tax rate scope of the existing Sales Tax and Service Tax (SST). Alternatively, the Government can opt for a more reliable consumption tax base such as value-added tax (VAT). The VAT will be able to mitigate the tax-cascading impact of SST, manage the cost of doing business, and enhance compliance and transparency. MTRS also provides an opportunity for the Government to further reduce its dependency on petroleum-related revenue and introduce revenue initiatives that support its sustainable development agenda. In addition, the Government will intensify its efforts to improve tax incentives for investment and explore new sources of tax revenue, such as taxation on capital gains and the digital economy.

b) Tax Administration

Tax administration reforms should be focused on achieving higher compliance, minimising tax avoidance and tax evasion with minimum cost to the tax payers and the authorities, and managing tax incentives to optimise private investments. A multi-agency collaboration to streamline data sharing was initially introduced under the Collection Intelligence Arrangement (CIA), involving the Inland Revenue Board of Malaysia (IRB), the Royal Malaysian Customs Department (RMCD) and the Companies Commission of Malaysia (CCM). The collaboration is further enhanced with the formation of a task force involving several enforcement agencies including the Malaysia Anti-Corruption Commission (MACC). In addition, the existing National Committee Investment (NCI) was improved and is now being co-chaired by the Malaysia Investment Development Authority (MIDA) and the Ministry of Finance (MOF) to reduce bureaucracy, expedite investment approvals and ensure the effectiveness of the tax incentives administration.

For better tax administration, continuous efforts will be directed to enhance the revenue agencies' effectiveness while ensuring greater taxpayer compliance. Thus, resources will be allocated to build capacity, improve IT infrastructure and invest in big data analytics to modernise the relevant agencies. It is worth noting that advanced economies, such as Canada, have only a single revenue agency to collect and administer national revenues in their countries. This approach has enabled better data integration, resource management and enforcement.

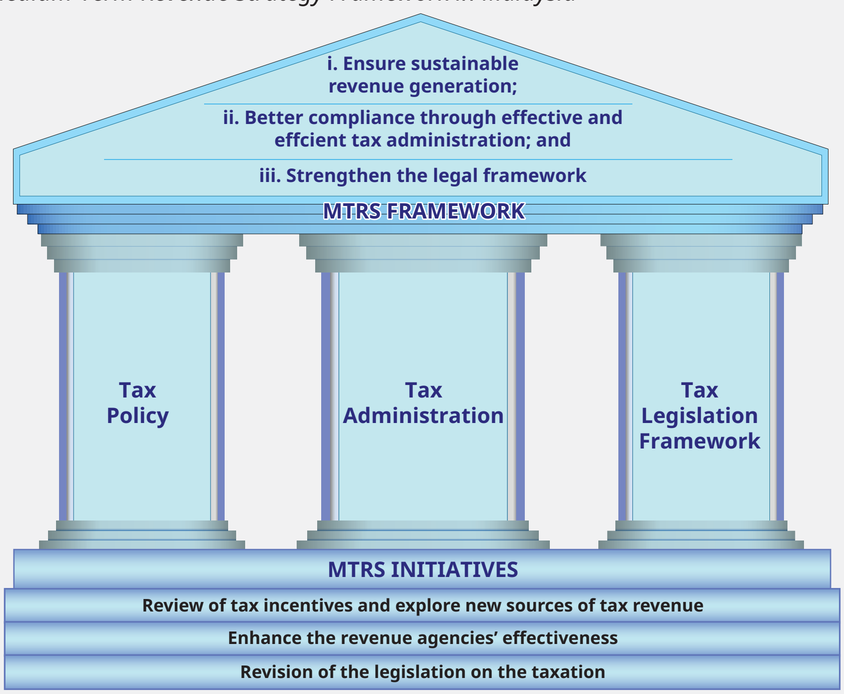
[1] Based on IMF criteria of good tax, revenue forecasting and analysis

c) Tax Legislative Framework

The tax legislative framework will be regularly reviewed and improved to ensure that provisions in the tax law and guidelines on processes and procedures are simplified, consistent, and in line with international best practices. For instance, in response to the new digital economy environment, the Government expanded the scope of services tax to cover digital content provided by non-resident providers. The Government is also considering several measures to strengthen its tax governance framework. These include a revision of the taxation legislation relating to insurance and takaful, and banking industry. In addition, the Government will provide guidelines or public rulings to facilitate the interpretation of the law for specialised industries, such as on Petroleum Act (Income Tax) 1967.

At the international front, Malaysia is a member of the OECD Base Erosion and Profit Shifting Action Plan (BEPS) under the Organization for Economic Co-operation and Development (OECD) Global Tax Initiative to address the issues of cross-border tax evasion. The action plan includes tax-related proposals on the digital economy through Pillar One and Pillar Two to ensure that Malaysia has the right to tax digital economy activities. Pillar One emphasises the determination of a country's tax rights based on BEPS' nexus. Meanwhile, Pillar Two will introduce a global minimum effective tax rate to ensure that tax element does not become the key factor for attracting foreign direct investments, thus addressing aggressive tax planning by multinational enterprises.

FIGURE 2. *The Medium-Term Revenue Strategy Framework in Malaysia*



Source: Ministry of Finance, Malaysia

Current Progress

In 2020, the MOF received technical assistance from the International Monetary Fund (IMF) to formulate an MTRS for Malaysia. Subsequently, Steering and Technical Committees on MTRS were established with representatives from MOF, the Economic Planning Unit, the Central Bank of Malaysia, the RMCD and the IRB. The committees are mandated to plan, administer and monitor to ensure the successful execution of the MTRS.

To date, the Technical Committee is formulating MTRS strategies and measures to be implemented in phases. Upon approval by the Steering Committee, engagement sessions with key stakeholders, industry players and professional bodies will be conducted. Feedback from the sessions will serve as value-added inputs in the final report. It will consist of new tax measures and recommendations for a better tax administration, supported by an improved legal framework. The final report is scheduled to be endorsed by the Government in 2022.

Challenges and the Way Forward

In this challenging pandemic crisis, the Government prioritises economic recovery measures to provide support for businesses and alleviate the burden of the *rakyat*. As such, the formulation of the MTRS will have to accommodate the nation's immediate needs while creating sufficient fiscal space post-crisis. Consensus building at various levels of stakeholders is also critical to managing expectation and compliance, which necessitates continuous engagement by the Government. It is also important to build knowledge and technical capacity to formulate and implement MTRS in an orderly and systematic manner.

The initiatives under MTRS are envisaged to complement the Fiscal Responsibility Act (FRA) initiative, which will further enhance the transparency of the tax system in Malaysia. In addition, the MTRS will be aligned with the Twelfth Malaysia Plan, 12 MP (2021 – 2025), particularly to ensure sufficient revenue generation to finance expenditure needs under the Plan. It will also consider findings from previous studies that have been conducted, such as recommendations from the TRC. Moving forward, Malaysia will extend the scope of the MTRS to non-tax revenue in the next phase of its implementation to further widen the revenue base.

Conclusion

Overall, to ensure sustainable revenue generation, it is time for Malaysia to undertake bold and effective reforms in its tax system and policy design comprehensively and inclusively through the adoption of the MTRS. A successful tax reform initiative will rebuild fiscal space, enhance economic resilience and ultimately return the country to its fiscal consolidation path. The reforms will also provide the Government with the flexibility for countercyclical measures to support economic recovery post-crisis while ensuring fiscal sustainability in the longer term.

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Outlook for 2022

The Federal Government revenue is projected to increase by 5.9% to RM234 billion, in line with better economic prospects. **Tax revenue** remains the major contributor to total revenue, consisting of 73.2% of the total share and is expected to increase to RM171.4 billion. However, as a percentage to GDP, it is estimated to decline slightly to 10.5% reflecting lower buoyancy during the economic recovery period.

Direct tax collection is projected to increase by 6.1% to RM127.3 billion, constituting 74.3% of total tax revenue, driven by better corporate earnings prospects resulting from the acceleration in the vaccination programme and anticipated economic recovery. Hence, CITA remains the largest contributor to the increase in direct tax at RM65.5 billion in 2022. This is followed by individual income tax, which is expected to improve by 3% to RM37.5 billion, consistent with expected improvements in the job market. Similarly, PITA is expected to record a higher collection of RM12.4 billion. Furthermore, revenue from other components of direct tax, namely stamp duties and RPGT, are expected to be higher at RM6.6 billion and RM1.8 billion, respectively, on expectations of higher value and volume of transactions from the property segment.

Indirect tax is forecast to improve by 5.4% to RM44 billion. This is mainly contributed by SST collection with a share of 62.5% to total indirect tax, registering RM27.6 billion or 1.7% to GDP, supported by improving consumer and business sentiments. Of this, RM14.6 billion are from sales tax while RM13 billion are from service tax, attributed to a higher projection of motor vehicle TIV as well as better outlook anticipated from telecommunications and insurance sectors. In consonance with the expected pick-up in motor vehicle production by 21% in 2022, excise duties collection is projected to improve to RM10.2 billion.[3]

Given the necessity to support growth, the expansionary fiscal spending will also need to be backed by improving revenue collection. Thus, the Government will continue to enhance tax auditing and compliance to ensure that tax dues are collected accordingly. These initiatives will be complemented by revenue administration enhancements such as simplifying tax procedures and reducing bureaucratic tape to improve clarity and certainties, leading to tax collection efficiency and effectiveness. In addition, to place Malaysia as a preferred investment destination, the tax incentive framework will be continuously enhanced to avoid distortions in resource allocations in line with international best practices.

Non-tax revenue is estimated to increase by 5.8% to RM62.6 billion, primarily due to higher proceeds from investment income. The annual dividends from PETRONAS and BNM are expected at RM25 billion and RM5 billion, respectively. As in 2021, a total of RM5 billion is expected from KWAP as a contribution to partly finance retirement charges. The collection from licences and permits is expected to increase slightly to RM10.9 billion, attributed to higher proceeds from petroleum royalties at RM4 billion. Other major components under licences and permits, namely motor vehicles licences and levy on foreign workers are estimated to be stable at RM3 billion and RM1.9 billion, respectively.

In 2022, **petroleum-related revenue** is forecast to register RM43.9 billion or 18.8% to total revenue, with PETRONAS dividends accounting for more than half of the total. **Non-petroleum revenue** is also projected to increase by 6.5% to RM190.1 billion, reflecting better revenue diversification on the back of a favourable economic outlook. The Government will continue to ensure sustainable non-petroleum revenue generation to meet expenditure commitments, particularly to serve the needs of the *rakyat*.

Conclusion

As a responsible revenue administrator, the Government is committed to enhancing its collection efficiency with the advent of technology and innovation. This initiative will improve service delivery and simplify procedures and thus, increase tax compliance. With the commitment to support fiscal reform initiatives, the adoption of the Medium-Term Revenue Strategy (MTRS) will help streamline its tax policy, improve tax administration and enhance the legal framework. In addition, the Government will continue to assess its revenue ecosystem holistically while engaging the business community in developing a good revenue policy in line with international best practices. These efforts will lead to sustainable revenue generation, which is crucial to rebuilding buffers for fiscal sustainability and debt affordability while facilitating counter-cyclical measures to mitigate any crisis.

[3] Malaysia Automotive Association. Market Review 1st Half 2021. Retrieved from http://www.maa.org.my/news.html

FIGURE 2.1. *Petroleum-Related and Non-Petroleum Revenue (% of total revenue)*

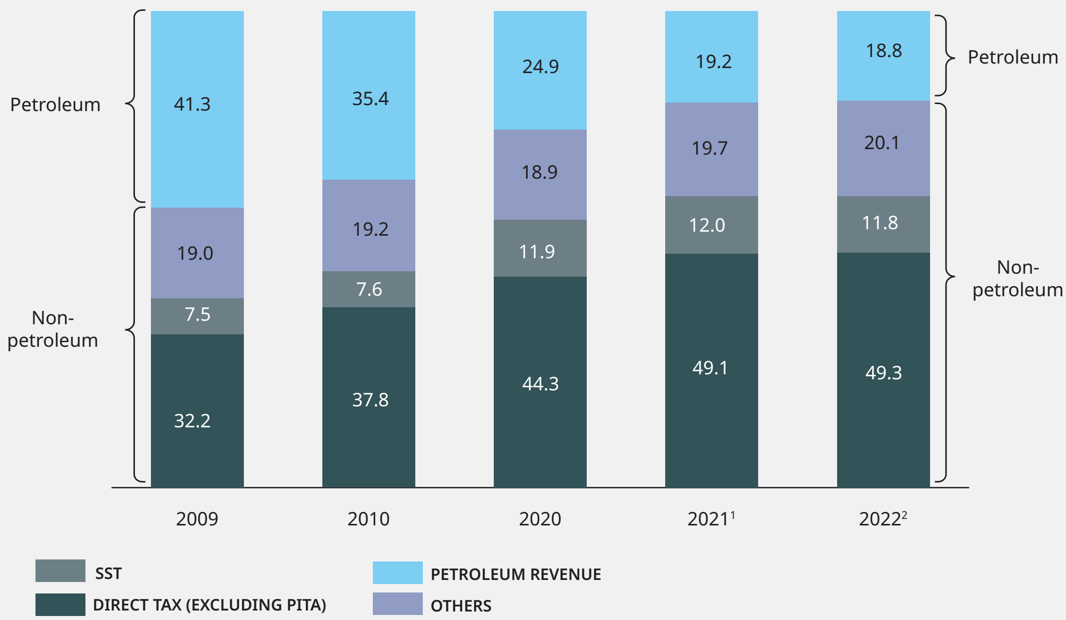
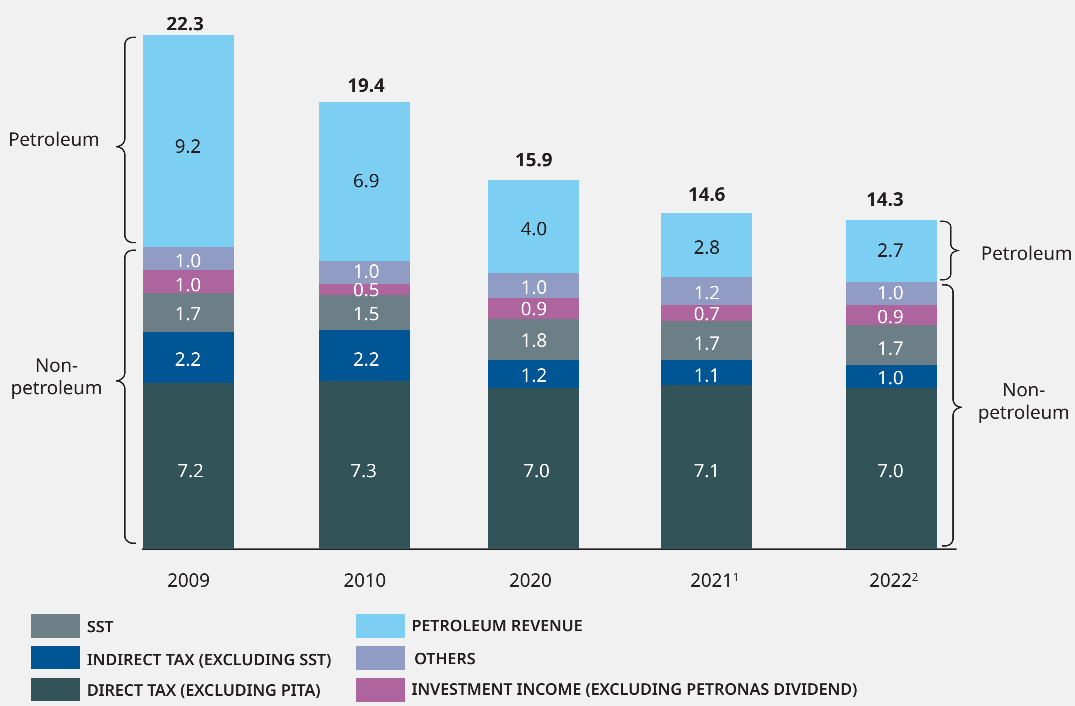


FIGURE 2.2. *Revenue as Percentage to GDP*



[1]Revise estimate
[2]Budget estimate excluding 2022 Budget measures

Source: Ministry of Finance, Malaysia