

Paying dividends in the long run: All eyes on Budget 2025

Compared with its predecessors, Budget 2025 was delivered on a very different note, amid expectations of gross domestic product (GDP) growth of up to 5.3%, reduction in unemployment rate, a reduced budget deficit and the ringgit outperforming its regional peers.

On the tax front, Budget 2024 already set a solid foundation with e-invoicing and progressive tax measures, such as the capital gains tax and increasing personal tax rates for the higher-income brackets.

Nevertheless, the Madani government did not shy away from addressing pressing issues around increasing revenues, alleviating the rising cost of living and tackling structural reforms in the government.

Although Budget 2025 continues a measured approach in its proposed tax reforms, there are still queries left unaddressed that may impact the success of these measures.

Dividend tax — a new approach?

Budget 2025 proposes to apply a dividend tax rate at the rate of 2% on chargeable dividend income above RM100,000 received by resident and non-resident individual shareholders, including those who hold shares through nominees.

Malaysia historically had an imputation system that effectively taxed dividend income at the shareholder level for the difference between their marginal tax rate and the corporate tax rate. This was replaced by the current single-tier tax system by Budget 2008, which treated the corporate income tax as the final tax, and exempted dividends in the hands of the shareholders.

Within the region, Hong Kong and Singapore adopt a single-tier system and do not impose further taxes on dividends. Thailand and Indonesia tax dividends by way of dividend withholding taxes that are imposed on domestic and foreign shareholders alike. Dividend withholding taxes, although comparatively simpler to administer, could have adverse effects on investor sentiment, and are indiscriminate in their application across all income groups.

Instead of applying the more broadly adopted dividend withholding tax, Budget 2025 opted for a dividend tax at the individual level that targets only high-income earners to collect the additional tax closer to the marginal tax rate applicable to these category of taxpayers, while avoiding the need to revert to an imputation system that has proven to be administratively burdensome. The latest approach is a well-considered move that could reduce the disparity between high-income earners, who generate a substantial amount of income

through stock investments, and the general population, ensuring that the latter is not subject to additional taxes.

Other countries have used a similar approach to tax dividends, particularly where corporate tax and the individual tax rate gap continues to widen. For instance, the UK moved towards taxing dividends received by individual shareholders at a tiered rate (up 39.35%), while also allowing a “dividend allowance” that exempts dividend income below a certain threshold.

Broader implications of the dividend tax

Although the details of its implementation are yet to be released, potentially wide-ranging implications of the proposed dividend tax need to be addressed.

(i) Malaysia's attractiveness as an investment destination

Currently, Malaysia has one of the highest corporate tax rates in the region, and with a dividend tax regime that imposes 2% on dividends received from local companies, while exempting foreign-sourced dividend income, investors may gravitate towards investing elsewhere. This may eventually increase costs of capital for Malaysian companies and place them at a disadvantage compared with their foreign competitors.

(ii) Alternative structures and investment options

The targets of the dividend tax are high-net-worth individuals who have access to various investment structures and options. Given these options, the efficacy of a dividend tax in terms of tax revenue generation needs to be considered in a broader context.

The fact that Malaysia does not tax capital gains derived by individuals could lead to a shift in investment behaviour in favour of capital gains over recurring dividend income. Companies may also offer investors dividend reinvestment schemes and individual shareholders may forego dividend payouts and thereafter realise exempt capital gains upon exit. Similar outcomes may also be achieved through redemption of loan stock at a premium.

(iii) Exemption considerations and compliance burden

The government exempts certain dividend sources from the 2% tax, which appears to



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be based on the tax attributes of the underlying source. For example, dividends from tax-exempt income due to incentives such as pioneer status and reinvestment allowance are excluded. Companies may distribute dividends out of accumulated past tax-exempt income balance first to avoid the 2% tax on the shareholder.

Additionally, under the current single-tier system, individuals do not need to report the single-tier dividend income in their tax returns. Moving forward, individuals need to start instilling discipline to keep track of their dividend receipts and the relevant attributes to compute the taxes appropriately.

(iv) Available deductions

Additional clarity is required on the deductions available to taxpayers subject to dividend tax. Costs associated with an investment could be substantial, and should accordingly be taken into account when determining chargeable dividend income. However, questions may arise around the apportionment of these costs between taxable and exempt dividend income.

(v) Taxing of non-residents

Although the dividend tax is not a withholding tax, a withholding mechanism may need to be considered at least for non-resident investors, who may otherwise not file a Malaysian tax return. This could lead to a substantial administrative tracking burden, particularly for large, listed companies.

An alternative would be to apply the withholding mechanism indiscriminately and provide the tax refund to the individual upon filing of the personal tax return. However, this option has its own drawbacks, as this would defer income receipts for taxpayers with dividend income that fall below the thresholds of the dividend tax.

Tax incentives and global minimum tax

Budget 2025 announces a New Investment Incentive Framework (NIIF) that is built upon the foundations outlined under the National Industrial Master Plan (NIMP). The NIIF outlines tax incentives that target high-value-add high-growth segments, state development and environmental, social and governance (ESG) drivers. Underpinning the NIIF is a Supply Chain Resilience Initiative that incentivises in-

vestments by multinational enterprises (MNEs) and domestic investors in the local supply chain and ecosystem through double tax deductions, special deductions, tax exemptions as well as matching funds for identified sectors.

The interplay between the NIIF and the global minimum tax (GMT), which imposes a minimum tax of 15% on in-scope MNE groups, will be a key area of interest for investors subject to the GMT. The NIIF appears to consider effective tax rates below the GMT, thus requiring modification to enhance its attractiveness to foreign investors.

Budget 2025 proposes consideration of strategic investment tax credits (SITC) to address GMT implications. To ensure that the SITC is capable of reducing the top-up taxes on incentivised activity, the SITC will need to satisfy requirements for a qualified refundable tax credit (QRTC).

A QRTC is a refundable tax credit paid in cash, or available as cash equivalents, within four years from the date the entity satisfies the conditions for receiving the credit.

To ensure that investments are directed to areas that drive the nation's agenda under the NIMP, we expect to see the SITC applied on identified expenditures, similar to how special deductions and allowances are traditionally applied.

Given its nature as a refundable tax credit, the SITC will require a certain level of funding commitment from the government and, therefore, may only be deployed selectively on very strategic investments.

The interactions between NIIF incentives and SITC should be considered holistically to ensure that there will be no “double dip” of benefits for the MNEs. From the MNEs' perspective, they should assess the options available (SITC or conventional special deductions or tax incentives) in deciding upon the optimal investment model for their Malaysian operations.

The right way forward

The interplay between the latest incentives and broader economic policies will be pivotal in shaping the nation's economic landscape.

As the saying goes, “the proof of the pudding is in the eating”. What remains certain is that Budget 2025 has set the stage for a dynamic and potentially transformative fiscal future, hinging on careful implementation of the proposed measures. ■

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