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## Capital Gains and Windfall Tax: Pros and Cons

Recently, the deputy finance minister mooted the idea of capital gains tax (**CGT**) and windfall tax in Parliament. The intention is to impose CGT, especially on share transactions, as well as a one-off higher tax rate on companies that have performed extremely well and obtained astounding profits amidst the pandemic. The increase in governmental revenue from such taxes can then fund recovery programmes for selected target groups who have been adversely affected by the pandemic.

The idea of CGT and windfall taxes is not new. CGT has previously been suggested as a means of broadening the tax base and increasing revenue to put Malaysia on par with other countries in the region. Nonetheless, the possible unintended consequences that this may have on Malaysia's economic competitiveness, especially in attracting foreign investments, remain unclear. It should be noted that the absence of CGT on the disposal of investments or capital assets is one of Malaysia's competitive advantages in the global investment market. Currently, the only form of capital gains that is taxable in Malaysia are gains arising from the disposal of real property or shares in real property companies.

## Approach adopted by other jurisdictions

Similar to Malaysia, Singapore and Hong Kong do not tax capital gains in general. Share disposals are not taxed, except when they result in a trading gain. In Singapore, the badges of trade such as frequency of transactions and holding period are considered in determining whether the taxpayer is trading.

Many other developed countries impose CGT on the sale of shares. For instance:

- (a) In Australia, the amount of gains on which CGT is imposed varies depending on how long the shares have been held.

Held for less than 12 months	Held for more than 12 months
100% of capital gain is taxable at the taxpayer's income tax rate	50% of capital gain is taxable at the taxpayer's income tax rate

(b) In the UK, taxpayers pay a CGT rate of 18%, which can go up to 28% if the total taxable gains and income exceed the income tax basic rate band. In respect of shares, CGT is imposed at a rate of 20% for higher and additional-rate taxpayers and 10% for basic-rate taxpayers.

Unlike developed countries like Australia and the UK, the focus of developing nations should naturally differ. One of the main priorities should arguably be to maintain our attractiveness to foreign investments to spur economic growth. Taxes on capital gains naturally lower returns on investments and create an additional risk burden, thus increasing the cost of capital and depressing overall investment in the economy. In the current economic environment, the risk of capital flight should be avoided.

### **What will this mean to the Malaysian economy and taxpayers?**

The imposition of CGT could be a boon or a bane for the Malaysian economy. On the one hand, CGT may arguably generate more revenue for the national coffers. On the other, whether it would actually do so after factoring in the unintended consequences remains uncertain. For instance, the introduction of CGT may lead to shareholders refraining and delaying from selling to avoid the immediate tax hit, resulting in a “lock-in” effect. In the short run, this will affect the fluidity and efficiency of the equities market.

In the longer run, if CGT is implemented and taxpayers are required to report and provide information to the Inland Revenue Board (**IRB**) on share disposals, increase in tax disputes with the IRB can be expected on the nature of such gains, i.e. whether they are trading gains or capital gains. Similar issues on the taxation of real property transactions have already resulted in many past and ongoing disputes with the IRB.

Proponents of CGT believe that investors should rightfully pay their fair share of taxes on the gains/profits they make. The risks undertaken by the very same investors should be equally weighed. Whether the stock market is a zero-sum game has been the subject of heated debate. However, what is indisputable is that share trading can also result in losses and not just gains to investors. Thus, if CGT is to be implemented, it is only logical to allow any taxable gains to be set-off against any losses made. This is the position in the UK.<sup>1</sup>

Similarly, for the vast majority of Malaysian taxpayers, the COVID-19 pandemic has not been the “windfall” event that it has been to the very fortunate minority. Thus, if windfall taxes are to

<sup>1</sup> ‘Capital Gains Tax’ (GOV.UK, a United Kingdom public sector information website) <https://www.gov.uk/capital-gains-tax/losses>

be imposed on companies that have gained tremendous profits through the pandemic, corresponding considerations should be given to companies in many industries that have suffered extraordinary losses during the pandemic.

Even if CGT and windfall taxes are to be imposed, the law is not expected to be passed immediately. The implementation plan could not be accomplished at the drop of a hat. For CGT, the government will need to consider carefully the method of implementation, taking into account factors such as its impact on the investment climate in Malaysia, and how it would fit in with existing legislation (in particular, for instance, the Real Property Gains Tax Act 1976). A detailed and comprehensive review of the legislation will be necessary so that it would not be overly complex to monitor and administer for the authorities, and to comply with for the taxpaying public and their advisers. For windfall taxes, it would be easier for the government to impose such taxes on specific products or industries.

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If you have any queries pertaining to the possible implications of capital gains tax and windfall taxes, please contact associate Chris Toh Pei Roo or team partners, [Dato' Nitin Nadkarni](#) and [Jason Tan Jia Xin](#), at [tax@lh-ag.com](mailto:tax@lh-ag.com)

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