

# Tax e-Alert

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## Is Capital Gains Tax A New Budget Surprise?

Recently, Prime Minister Tun Dr Mahathir Mohamad, addressing an investors' conference themed "Malaysia: A New Dawn", remarked that the government may have to introduce new taxes to address the nation's debt issues. Incidentally, Bursa Malaysia saw a bloodbath the next day, with the FBM KLCI shedding 39 points — its worst performance in recent months. The biggest concern, of course, was the possible implementation of a tax on gains made from stock market transactions. Known as capital gains tax, it has become a subject of speculation, although there is no clear indication from the government whether such a move would take place.

So, what is capital gains tax then? As the term connotes, it is a tax on capital gains, namely the gains realised on the sale of a non-inventory asset that was purchased for investment purposes. The most common capital gains are realised from the disposal of real estate, stocks and intangible assets.

Currently, there is no capital gains tax in Malaysia for gains arising from investment in equity other than real property gains tax on disposal of real property and shares of real property companies.

### The position elsewhere

In the US, capital gains are considered as income and thus have been taxed since the introduction of the individual income tax in 1913. Long-term capital gains are taxed at a preferential rate. Similar to the US, the UK imposes tax on capital gains as well. Likewise in Australia, which has capital tax whereby gains on assets held by individuals for at least 12 months are considered as long-term investment.

In Thailand, capital gains are taxed the same as regular income. However, if an individual earns capital gains from his investment in the Stock Exchange of Thailand, such gains are exempted from personal income tax. Meanwhile, Hong Kong and Singapore do not impose capital gains tax.

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## OECD's observation

The Organisation for Economic Co-operation and Development (OECD) has observed that in countries where capital gains may be realised tax-free, taxpayers can be expected to take steps to convert taxable income into exempt capital gains in order to avoid taxation. For example, Australia observed that prior to the introduction of its capital gains tax legislation, it was alleged that there were tax planning activities to convert income receipts or characterise them as capital gains.

While taxation of capital gains counters tax avoidance incentives, it may not eliminate them, depending on the tax rate structure applied to capital gains and other income. For example, in some countries, while short-term capital gains are taxed as ordinary income and subject to progressive tax rates, long-term net capital gains are taxed at a lower rate. As a result, tax-sheltering activities are reported as being observed on a regular basis with the creation of financial instruments designed to transform income taxed at progressive rates into long-term capital gains.

Further, capital gains tax policy may influence the level of investment that Malaysia may attract. Reducing the tax rate on equity returns including capital gains, for example, may lead to increased investment to the extent the reform lowers the cost of capital used to finance additional investment.

## Conclusion

The introduction of capital gains tax is likely to cause capital outflows while stifling the Malaysian entrepreneur's spirit of creating wealth and corporate elites' desire to innovate and prosper. These taxes would dampen economic growth in many ways as it would stifle the growth expansion of small medium enterprises and family businesses. This is especially when neighbouring countries like Singapore and Hong Kong do not implement capital gains tax. Neither do they have any plans to introduce this tax.

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Various studies have shown that the introduction of capital gains tax is likely to dampen economic growth as it would discourage capital formation and savings. Businesses and investors are likely to move their assets and investments abroad to tax-friendly jurisdictions to avoid capital gains tax.

We should further study the possible implications of a capital gains tax to our economy before introducing such a measure. Our government should give priority in enhancing corporates' competitiveness and boosting their business growth and profits as it would lead to more revenue collected.

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If you have queries on what amounts to capital gains or trading gains, we are available to assist you. Please contact our tax partners Datuk D P Naban or S Saravana Kumar at tax@lh-ag.com.

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