A COMPARATIVE ANALYSIS OF TAX INCENTIVES IN ASEAN COUNTRIES

INTRODUCTION

RECENT developments have revealed the rapid emergence of several developing countries, (among them members of ASEAN),[1] as important components of the world economy. They stand in contrast to the many industrialized countries which have experienced low growth rates, for they have succeeded in maintaining a high level of economic activity despite an economic crisis of global dimensions (managing to sustain GDP growth rates averaging between 6% to 9% from 1970 to 1980).[2]

This article seeks to compare the strategies employed by these countries in the development and promotion of their economies, with particular reference to the use of tax as an incentive to foreign investors. Although this project was begun with the aim of undertaking a comprehensive study, this was later found to be too colossal a task and well beyond the scope of a paper of this nature. As far as the author could ascertain, a comprehensive study of the abovementioned topic has yet to be attempted. The scope of this paper therefore is necessarily much more modest.

A. *Fiscal Policy And Tax Incentives*

Fiscal policy has often been used as a developmental instrument directly to find the necessary funds for public investments or indirectly to channel private savings to productive sectors as well as to prevent development-impeding spending.[3]

While typically no distinction is made between domestic and foreign capital, most laws giving effect to the fiscal policy are aimed at the attraction of foreign capital[4] (especially foreign exchange), entrepreneurship and managerial know-how, technology and facilities, export market-access and experience and stimulation of the local business and industrial environment.

Since it is well known that taxes can have a substantial impact on the rate of return of an investment,[5] most developing countries employ some (sometimes many) tax concessions which are believed to influence private activity. Thus, tax incentives of one form or another are part of the arsenal used to mobilize and direct capital for new investments.[6]

[1] This paper was written in 1983 and as such does not include Brunei and amendments made to incentive legislation after that date.
[2] B. Warua, *The Economies of the ASEAN Countries* (1982).
[3] S. Djojohadikoesoemo, "Fiscal Policy, Foreign Exchange Control and Economic Developments", Majallah Ekonomi dan Keuangan Indonesia (April 1954).
[4] G. Lent, "Tax Incentives in Developing Countries", in *Readings on Taxation in Developing Countries* (eds. R.M. Bird and O. Oldman) (3rd ed. 1975).
[5] *Aspects of Philippine Tax Law* (ed. M.M. Megallona) (1965), pp. 129-131.
[6] Lent, *ibid.* at 363.

The most common examples of development-oriented tax legislation are those that reduce taxes for persons engaged in economically and socially desirable activities. These are found in many countries, either as integral aspects of a development programme, or as special measures operating independently. In some countries tax incentives may represent the major legislative effort to hasten development; in others, they may represent only one among a variety of measures undertaken for this purpose. These 'tax subsidies' may take a variety of forms. The most common are partial or complete exemptions, ordinarily for a limited period of time, from one or several taxes, and special allowances for accelerated depreciation or reinvestment.[7]

B. *Economic Policies in ASEAN*

A government's attitude and policy towards foreign investment must surely be conditioned principally by its perception of its country's goals and needs. Within the broad goal of economic development, objectives shared by the five ASEAN countries include:

(1) industrial expansion and diversification, to reduce dependence on imports for both balance-of-payment and non-economic nationalistic reasons;

(2) export of manufactured products, mainly but not only based on local raw materials, to offset declining or unstable terms of trade for some unprocessed primary products;

(3) development and sophistication of local entrepreneurship;

(4) increased skill levels of their workforces, as a means and complement of raising living standards and aspirations.

The last objective is most firmly expressed in Singapore, which however does not share the aims of:

(5) generating employment opportunities to provide jobs for large under-employed work-forces and facilitating increased agricultural mechanisation; and

(6) regional development within each country to create "growth poles" alternative to its main metropolis.

In the case of Malaysia, there is also the further purpose of improving the economic role of non-Chinese Malaysians. In Singapore, there is the purpose of developing the city-state into a centre for know-how, finance and banking.

Although, with the exceptions mentioned, these objectives are common to the five countries, the emphasis placed on them differs, even in terms of general policy. For example, until very recently, Thai governments have paid less heed to regional development than their Malaysian neighbours who, in turn, have placed less emphasis on manufactured exports than Singapore. Different emphasis in industrial policy is one of the factors determining a country's policies towards foreign investment. Other factors are particular social goals (such as Malaysia's Bumiputra policy); different appreciations and ways, of dealing with the threat of foreign domination; and different degrees and standards of economic planning, management and detailed administration. A country's policy towards foreign investment has a direct bearing on its tax policy concerning foreign investors.

[7] Lent, *ibid,* at 365.

This paper will now examine each of the ASEAN countries in alphabetical order, beginning with Indonesia. For each country, the following matters will be discussed:

(1) growth strategy;

(2) incentives offered;

(3) effectiveness of the incentives offered;

(4) the future of tax incentives.

I. INDONESIA

After the abortive coup of October 1965 when the government led by General Suharto took over power from President Sukarno, it was met by an economy on the verge of collapse, unable to meet payments due on external debts of well over US$2 billion; the cost of imports of goods and services far exceeding export earnings; inflation of 20-30% a month; far-reaching breakdown of budget control and tax collection; a rundown infrastructure and much diminished productive capacity in the industrial and export sector.[8]

A. *Growth Strategy*

In 1966, the new government developed a new approach to economic policy, which included a two-year stabilization programme to rehabilitate and resume development, decontrol foreign trade and payments, restore orderly price relationships and increase reliance on market forces.[9]

Among the government's first pieces of legislation was a Foreign Investment Law ("FIL"), passed by Parliament early in 1967. With foreign bilateral aid going to balance of payments support and food aid, it was believed that new capital and technical and managerial know-how for natural resource development and industrialization would have to come from private foreign investment. The FIL was designed to attract such investment by providing fiscal incentives, transfer guarantees, legal security against nationalization, procedures for settlement of disputes and assurance of management autonomy.[10]

Because of the nationalistic tones of general state policy, foreign investment was accorded a 'supplementary' role. It was not to be the mainstay of the economy. The major pillars of the economy should be domestic firms and the indigenous business class. Foreign investment was, and still is, conceived as filling gaps and deficiencies, which the authorities hope will not be permanent, in the array of domestic factors of production. Foreign investment should be 'domesticated' or integrated into the national economy.[11] Foreign capital, technology and know-how were to be used only to realize the abundant natural and manpower potential.

Thus, in her attempt to attract foreign capital, Indonesia employs two basic strategies:

[8] *Direct Foreign Investment in Asia and the Pacific* (ed. Drysdale), Mohammad Sadli, section on Indonesia (1972), pp. 201-226.

[9] Sadli, *ibid.*

[10] *Id.*

[11] *Id.*

1. foreign capital owners are enticed with various attractive regulatory assurances if they do business in Indonesia; and
2. they are strictly controlled by the development practitioners.

For maximum utility of manpower, government policy stresses technologically labour-intensive investment rather than capital-intensive investments. To exploit abundant potential economic resources, private investment in their exploitation is encouraged. Also, to lift the regions outside Java from their presently depressive state, one of the government's objects is their development since concentrating investments in only one or two areas will create economic, social and political distortion.

In sum, therefore, the policy of the government and its role in the promotion of this policy can be seen as being:[12]

1. to provide a monetarily stable, commercially viable and inexpensive investment climate;
2. to provide direction and assistance to business undertakings through investment priority scales, the promotion of sharing of ownership of companies and fiscal and monetary regulatory policies;
3. to promote the role of indigenous weak economic groups by providing programmes such as credits, participation funds, marketing assistance, vocational training, and the promotion of cooperatives.

B. *Incentives Offered*

In detail, the incentives offered by the FIL are:

1. *Tax Holiday Periods*[13]

These are selectively granted to new enterprises that invest their capital in priority fields of production, that is, such production as is in accordance with the stage of economic development. In this respect, the Ministry of Finance will periodically issue regulations concerning the types of business acknowledged as having priority status activities in the Investment Priority List (DSP).[14]

The basic period is two years, beginning from commercial production of the enterprise, and it may be extended up to six years, provided certain conditions are met. The extension granted is dependent upon the number of conditions fulfilled. One year is given for each condition met. The conditions are:

(1) if the investment contributes to a significant increase or saving of foreign exchange;

(2) if the investment is located outside Java;

(3) if the project requires a large investment in infrastructure and/or involves other extraordinaiy risks;

[12] *Id.*
[13] A. Warsita, "Policy on Foreign Investment in Indonesia", (1978) 20 Mal. L.R. 362. This was a paper presented at the Workshop on Foreign Investment and Joint Enterprises sponsored by the International Law Centre and held in Jakarta in April 1978.
[14] Art. 16, FIL, as amended in 1970.

(4) if the investment coincides with other special priority objectives of the Government.

2. *Investment Allowances*

For new enterprises in lower priority sectors falling within the "facility" category in the DSP and existing enterprises expanding their investment in a priority or lower priority sector, the investment allowance [15] is available. This allowance aggregates 20% of the sum of capital invested to be spread evenly over 4 years, beginning with the year in which the investment is made. They are only granted to capital investments selected and approved by the Government. Initial investments are excluded.

In granting incentives for investments the government has regard to the various stages of investment activities. This is expected to enhance the function of incentives granted.[16] Four stages have been selected — the period of preparation, the period of construction, the period of operation or production and the period of development. Incentives for each stage differ.[17]

In the preparation period, the incentives may consist of exemption from capital stamp duty payable on equity capital and/or exemption from previous taxes and investigations for domestic investors participating in a joint enterprise.

In the construction period, the incentives may take the form of exemption from or reduction of import duties and sales tax for capital goods.

In the operation or production period, the incentives may be:

(1) exemption from or reduction of import duties and sales tax for raw materials and supplies for the first two years of operation;

(2) tax holiday or investment allowance, depending on the scale of priority of the investment;

(3) provision of accelerated rates of depreciation of fixed assets;

(4) provision of carry forward of losses; and/or

(5) exemption from dividend taxes.

In the development period for the expansion of production capacity, there may be:

(1) exemption from capital stamp duty payable on additional equity capital required;

(2) exemption from previous taxes and investigations for domestic investor participation in expanding the equity capital of a joint enterprise;

(3) exemption from or reduction of import duties and sales tax for additional capital goods;

[15] Suharsona Hadikusomo and Sajid Budidji, *A Guide to the Indonesia Taxation.*
[16] Art. 15, FIL, as amended in 1970, read together with Art. 4b of the 1925 Corporation Tax Ordinance
[17] Warsita, *ibid.*

(4) investment allowance;

(5) exemption from dividend taxes;

(6) provision of accelerated rate of depreciation; and/or

(7) provision of carry-forward of losses.

3. *Accelerated Depreciation*[18]

Besides the normal rate of depreciation, enterprises may apply for an accelerated rate of depreciation, at the option of the enterprises, within a period of four years, beginning with the year in which the investment is made.

4. *Carry-Forward of Losses*[19]

Losses incurred may be carried forward for four successive years. But if the loss was incurred during the first six years, there may be indefinite carry-forward, until the loss is fully set off.

5. *Dividend Tax Exemption*[20]

In certain cases, dividend tax may also be exempted for a period equal to the period of corporate tax exemption or for two years in the case of investment allowances.

6. *Capital Stamp Duty Exemption*[21]

Capital stamp duty payable on equity capital may also be exempted.

7. *Exemption from or Reduction of Import Duties and Sales Tax*[22]

In the priority sector, exemption from or reduction of import duties and sales tax may also be given for the importation of capital goods required for initial operation as well as raw materials or supplies to be processed for the first two years of the operation. There is, however, a proviso that these must not yet be manufactured or produced domestically and that they are not used, rebuilt or reconditioned goods.

Because of the nature of foreign investment policy and the related laws, much discretion is left to the government and the Foreign Investment Board, which is the administrative body of the FIL. Unlike investment legislation in other states like Malaysia and Singapore, no clear guidelines are laid down in the Act. Incentives are simply awarded to "priority" industries. What constitutes a priority industry is left to the Board, which publishes the DSP biannually, to decide. In this way, leeway may be given or restrictions imposed whenever it is felt to be necessary.

C. *Effectiveness*

In terms of the industrialization process, foreign capital produced two kinds of industries conforming to the strategies of the first two five-year development plans:[23] secondary and resource industries. Secondary

[18] *Id.*
[19] *Id.*
[20] Art. 15, FIL read with Art. 4 para. (4) of the 1925 Corporation Tax Ordinance.
[21] Art. 15, FIL.
[22] *Id.*
[23] *Id.*

industries generally manufacture consumer and import-substitution products. As a result, Indonesia has become self-supporting in the manufacture of textiles, electronics, household appliances, building materials, electric cables, bricks, cement and iron rods. In fact, their export is encouraged. Resource industries are primarily those in oil, mining and forestry.

In view of such apparent progress, the results achieved by foreign investment so far have been described as spectacular by Dr. Sunaryati Hartono of Pajajaran University.[24] However, with this observation came a warning of the shortcomings in government policy. These warnings were borne out by statistics and other such evidence. For example, between January 1967 and December 1979, actual investment amounted to only 42% of the intended investment.[25] Because of this, the required growth rate was not achieved. Also, from 1975, Indonesia experienced a dramatic drop in foreign capital investment, in dollar amount as well as in the number of projects financed.[26] Between 1972 and 1977, only 40% of foreign investment projects approved were implemented.[27]

It is thus seen that results fell short of expectations by a large margin. Not unexpectedly, this caused much concern and consternation among Indonesian development practitioners. At the beginning of the decline in 1975, the cause of the decline was identified as the then existing world recession. Because of this, the initial alarm subsided as everyone prepared to wait it out. Yet, when the world economy began to recover in 1976 and the inflow of foreign capital which had been designated an important element in the acceleration of national economic development failed to materialize, a very serious perspective was taken. Three fundamental causes were then isolated:

1. Regulations, though well formulated, were poorly implemented and this caused concern and uncertainty among foreign investors.[28]
2. "Red tape" and endless bureaucratic channels frustrated foreign investors who had to wait extremely long before approval for investment was granted. Even then, there were other hurdles such as delay in the clearance of imported machinery.
3. The foreign incentives and facilities also seemed to be inappropriate for the current stage of development.

As a whole, the Indonesian economy performed rather badly from 1972 to 1975. Be that as it may, were the goals of the economic policy in any way met?

Taking as examples of labour-intensive industries the textile industry and the tourism, hotel and real estate industry, between 1970 and 1974, these industries did in fact experience exceptional growth. The number of approvals granted took such an enormous leap that the value of input increased about a hundredfold.[29] That such approvals

[24] *Id.*
[25] C. Himawan, *The Foreign Investment Process in Indonesia* (1980).
[26] See the seminar paper entitled "Notes on the Improvement of the General Policy on Foreign Capital Investment", Himawan, *ibid.*
[27] Himawan, *ibid.*
[28] *Id.*
[29] Bank Indonesia.

were granted shows that aside from the enthusiasm shown by the authorities, there were also interested investors. Whether or not these approvals were utilized is another matter, but notionally, there was growth. Implementation may have been hindered by outside factors such as the recession but it can at least be said that the new measures taken were effective enough to attract the investors. As for the number of jobs created, the tourism industry itself accounted for 102,075 as of August 1974.[30]

Therefore, as far as the promotion of labour-intensive industries is concerned, the measures taken as a whole were, in fact, effective.

Such was also the case in the exploitive industries though the growth was not as dramatic. A reason for the smaller increase may be traced to the nature of the industry itself. Exploitive industries call for large capital outlay which may ultimately yield no gains. This would be sufficient to account for any greater caution that may be evident. In any case, these industries accounted for an average growth of 57.98% as compared to the total foreign investment approvals.[31] In terms of employment creation, when the exploitive industries are taken as a whole, they account for an enormous 59.9% of the jobs created as of August 1974.[32]

In terms of regional development, the number of approvals was on the upswing between December 1971 and May 1973. In terms of job creation, a total of 1,014,241 were directly created.[33]

However, a note of caution should be taken which is equally applicable to investment data used in this section. It is necessary to bear in mind that the investment data used are those concerning approvals and not actual implementation. Taking into account the long procrastination of investors, the slow gestation period of investment and those companies that had second thoughts about committing their capital to Indonesia even after approval by the authorities, a more realistic figure of total job creation may be half of the figure estimated.

D. *The Future Of Tax Incentives*

Viewed cumulatively, it may be concluded that the measures were effective to a certain extent in attracting foreign investment. However, this is insufficient, especially with the sharp decline after 1975. The measures taken may be beneficial for the individual industries sought to be promoted, but this does not improve the condition of other industries.

Because of the general atmosphere of uncertainty and an above average amount of red tape and bureaucracy, foreign investors are increasingly wary of investing in Indonesia, despite the availability of natural resources and other plus factors. Further, within the ASEAN region itself, Indonesia faces much competition. Recent research indicates that within ASEAN, Indonesia is the least favourite host country. *Vis-a-vis* all other countries in the world, including developed countries,

30 Himawan, *op. cit.*
31 Warua, *op. cit.*
32 *Id.*
33 Palmer, *The Indonesian Economy Since 1965* (1978), p. 110 Table 5.3.

Indonesia ranks 35 out of 45 countries investigated.[34] Clearly, a serious reform is needed.

Yet, the cause of the downswing was not the measures themselves but rather their implementation and promotion. Hence, the prevailing view is that tax should continue to be a regulator of the economic structure. However, its administration needs to be revamped. There must be overall clarity in government policy. Otherwise, the incentives alone will not do the job.

Amidst the flurry of foreign investment promotion, domestic investment has taken a surprising upsurge. Up to March 1973, the total number of 'domestic' projects approved far exceeded that of 'foreign' projects. Whether this was planned or not, no one can really tell but it is welcome just the same, especially if we recall the nationalistic tone of Indonesian economic policy which is reflected in the suggestion of Dr. Charles Himawan[35] that tax may also be used to "change the economic structure of Indonesia from a 'foreign-dominated' country to a 'nationally-dominated' one". .

Perhaps the bet was placed on the wrong horse. True enough, initial foreign capital investment is necessary to introduce the required technology and entrepreneurship. But, it would seem that Indonesia has fallen prey to the obstacle all developing economies face: over-ambition. Large scale industries were generally preferred.

The emphasis on foreign investment may also be attributable to the large amount of publicity in the Indonesian press. To some, spellbound it seems by the giant nickel and copper projects, foreign investment is, like oil, seen as the panacea for all the ills of unemployment, underemployment and low per capita income.[36]

No one can justifiably begrudge Indonesian policy, but with the caution of foreign investors and the amount of active promotion, a better solution may be to promote domestic investment, especially since a domestic investor would be more familiar with local conditions. With the initial introduction of technology more or less complete, the field is ready for the 'locals' to come in. Most importantly, this would further the primary objective of encouraging domestic investment.

II. MALAYSIA

Since attaining independence in 1957, Malaysia has stepped up its development efforts through four successive five-year plans to accelerate economic growth and diversify the economy.[37]

The agricultural sector (which includes forestry and fishing) continues to be the mainstay of the economy, accounting for 22% of the Gross Domestic Product of the country and about 40.6% of its employment in 1980. While rubber is still the most important crop, efforts

[34] Warua, *op. cit.*

[35] Himawan, *op. cit.* Pola-pola Kerja Sama Patungan Dalam Rangka Pananaman Model Asing, Patterns of Joint Ventures in regard to Foreign Capital Investment (1979).

[36] Lynch, *Indonesia: Problems and Prospects* (1977).

[37] *Investment in Malaysia: Policies and Procedures,* Malaysia Industrial Development Authority (MIDA), (1982).

have been made to diversify the agricultural base of the country. More than 30% of the world's tin production also comes from Malaysia, and more recently, the country has also been emerging as a producer and exporter of crude petroleum.[38]

A. *Growth Strategy*

Despite the economic importance of the agricultural sector, increasing emphasis is being placed on industrial development to diversify the economy and provide employment for a growing labour force. Manufacturing has developed into an important sector in the economy contributing about 21% of the GDP in 1980. It is also the fastest growing sector. Not surprisingly, therefore, the government has designated manufacturing as the key sector in its long-term economic development plans.

Hence, foreign investment in the manufacturing sector is much welcomed. However, in keeping with the objective of ensuring increased Malaysian participation in manufacturing activities, it is also government policy to encourage projects to be undertaken as joint ventures.

B. *Incentives Offered*

Malaysia's investment incentives under the Investment Incentives Act 1968[39] ("MIIA") are designed to provide relief from the payment of income and development taxes to companies manufacturing new products or undertaking modernization, expansion and/or diversification. The relief is granted in various forms, and investors may select the type of tax incentives most beneficial to them. Basically, eight major forms of tax incentives are offered under the MIIA.

1. *Pioneer Status*

In order to qualify for pioneer status, the industry must not be carried on in Malaysia at all or not on a commercial scale suitable to economic requirements. There must also be favourable prospects of further export development. Also, it must be expedient in the public interest to encourage its development or establishment of the industry in Malaysia by the granting of such pioneer status.[40]

The benefit is total exemption from income and development taxes of two to eight years, depending[41] on the level of the company's qualifying capital expenditure, type of product produced, extent of local content and location of the factory.[42]

Initially, the period of exemption will depend on the degree of capital investment.[43] When deciding whether the initial period will be extended for a further year, regard will be had to its location, the

[38] *Id.*
[39] Act No. 13 of 1968.
[40] S. 3(1), MIIA.
[41] *The* initial period of two years, however, does not depend on the capital expenditure incurred: IBFD.
[42] *Taxes and Investment in Asia and the Pacific,* Vol. 3, International Bureau of Fiscal Documentation, Amsterdam (1982).
[43] S.13, MIIA.

priority products produced or the specified local content.[44] The relief period can only be extended for a further three years.

2. *Investment Tax Credit*

A credit of not less than 25% is given if a non-pioneer company has incurred capital expenditure on a factory, or on plant, machinery or other apparatus used in Malaysia for the purposes of any approved project. An additional credit of 5% of the expenditure will be granted for each of the following conditions fulfilled:

(1) where the company has a factory in operation in a declared development area;

(2) where the company produces in marketable quantities any priority manufactured product or products or establishes any priority industry;

(3) where the company incorporates in its manufactured products the required percentage of Malaysian content.[45]

3. *Labour Utilization Relief*[46]

This relief is granted to a company which will be or is employing 51 or more employees in any project in Malaysia.[47] The relief given is a tax relief of two to eight years based on the number of full-time paid employees, type of product produced, level of local content and location of the factory. The establishment or promotion of the project must be desirable in the interest of the industrial development of Malaysia.

The initial period of relief will depend on the number of employees employed presently or in future. It ranges from two to five years.

Once again, the granting of yearly reliefs will depend on the development area in which the company is located, the priority of products produced and compliance with the specified local content. As with pioneer industries, there may be an extension of a total of three years only.[48]

4. *Export Incentives*

These consist of three specially designed incentives for companies exporting their Malaysian manufactured products —

(1) *Export Allowances:*[49] Export allowances are only granted to resident companies and do not cover the export of primary products. Subject to this, the business of the company should include the production in Malaysia of manufactured products. The calculation of the export allowance depends on whether the local content of the export exceeds 50% in value. If so, the allowance is 8% of the

[44] At least 50% of the value of the manufactured product must come from Malaysian raw materials and/or parts and components manufactured in Malaysia, excluding wages, salaries and the domestic inputs: IBFD.

[45] *Id.*

[46] S. 12A, MIIA; inserted by s. 2 Investment Incentives (Amendment) Act No. A89 of 1971. This relief was introduced to encourage labour-intensive industries.

[47] *Id.*

[48] S. 13(2), MIIA, Act 199, as revised in 1978.

[49] S. 29, MIIA, Act 199, as revised in 1978.

difference between the value of the exports in the current year and the value of the average export of the five immediately preceding years. If not, it is 5%.

(2) *Accelerated Depreciation Allowance:*[50] Only resident companies may qualify for an accelerated depreciation allowance. The company must export 20% (by value) of its products, and the allowance is only for capital expenditure incurred to modernize production techniques at an existing factory or to set up a modernized factory. The allowance is 40% of the residual expenditure relating to the assets at the end of the basis period for that year and is a substitute for an annual allowance given under the Income Tax Act 1967.

(3) *Deduction of Outgoings And Expenses:*[51] To enhance further the export of Malaysian products, the Minister of Finance prescribed deductions for outgoings and expenses incurred in the promotion of exports from Malaysia such as expenses for overseas advertising, supply of free samples overseas, export market research, preparation for overseas tenders, negotiation and conclusion of contracts overseas, and supply of technical information overseas.

5. *Increased Capital Allowances*[52]

This allows a company to depreciate its assets at a greater rate of depreciation.

6. *Locational Incentive* [53]

Projects in "less developed areas" may be granted a locational incentive if their establishment or promotion is desirable for Malaysia.[54] The period of relief, from five to ten years, depends on the level of qualifying capital expenditure or number of full-time workers employed, type of product produced, location of the company and the level of local content. The relief period begins on production day and continues for five years, and thereafter for such further period or periods of extension.[55] In deciding whether an additional year of tax holiday will be granted, the priority of the product and whether it meets the specified local content is relevant.[56]

The locational incentive differs from many of the other incentives offered under the Act in that besides tax holidays, it also exempts dividends in the hands of shareholders from tax. Where the shareholder is a company and pays dividends out of tax-free dividends received, such dividends are also exempt from tax in the hands of the shareholders of such shareholder company.[57] Also, any capital expenditure incurred on existing assets is deemed to have been incurred on

[50] S. 28, MIIA, Act 199, as revised in 1978.
[51] S. 27, MIIA, enacted by Act No. A473.
[52] S. 30M, MIIA: inserted by s. 5 and 1st Schedule, Investment Incentives (Amendment) Act, No. A89 of 1971.
[53] S. 12B, MIIA: inserted by s. 2 Investment Incentives (Amendment) Act, No. A89 of 1971.
[54] S. 12B, MIIA: inserted by s. 6 Investment Incentives (Amendment) Act, No. A265 of 1974.
[55] S. 13A(2), (3), MIIA: inserted by s. 6 Investment Incentives (Amendment) Act, No. A265 of 1974.
[56] S. 13(1)(b), MIIA proviso: amended by s, 3 Investment Incentives (Amendment) Act, No. A167 of 1973, read with s: 14(2) as revised in A199 of 1978.
[57] S. 22 read with s. 25A, MIIA, as revised in A199 of 1978.

the day following the end of the tax relief period so that capital allowances may be calculated accordingly. Where losses have been incurred during the tax relief period, the net amount of such losses can be carried forward and offset against income in the post tax relief period.[58]

7. *Malaysian Content Incentives*[59]

If a company incorporates in its manufactured product at least 50% (by value) of Malaysian raw materials and/or parts and components manufactured in Malaysia, it can qualify for further incentives.

8. *Hotel Incentives*[60]

In order to promote the potential in the hotel industry, the MIIA was amended in 1971 to allow for grants of pioneer status, abatement of chargeable income, accelerated depreciation allowances, industrial building allowances and hotel tax credits. Any company other than a pioneer company or a company granted utilization relief resident in Malaysia may apply for an abatement of chargeable income derived from a hotel business carried on in a hotel building or in an extended or modernized hotel building. The company may either establish itself in the future or merely seek to extend present operations.[61] The amount of abatement granted depends on the location of the hotel.[62] Where the present hotel is extended or modernized, the amount of the chargeable income to be abated depends on the fixed capital expenditure incurred on the new building. Abatements are effective for twelve years of assessment.[63] Where the company has incurred qualifying plant expenditure [64] for an asset to be used for hotel business carried on in a hotel building or any extended or modernized part of it, and is of the approved standard, a hotel accelerated depreciation allowance is given for that year of assessment and subsequent years of assessment.

9. *Approved Agricultural Industries*[65]

In 1979, the MIIA was further amended to provide special incentives for approved agricultural industries. A company engaged in a project in such an industry may seek approval from the Minister in respect of that project. After approval is given, the company is given an investment tax credit amounting to 50% of the capital expenditure incurred for the clearing of land, planting of crops, the provision of plant, machinery or other apparatus and the construction or purchase of various agricultural facilities.

[58] S.25 read with s. 25A, MHA, as revised in A199 of 1978.
[59] MIDA.
[60] S. 30B, MIIA: inserted by s. 5 and First Schedule of Investment Incentives (Amendment) Act, No. A89 of 1971.
[61] S. SOD, MIIA: inserted by s. 5 and First Schedule of Investment Incentives (Amendment) Act, No. A89 of 1971.
[62] S. 30D, MIIA: inserted by s. 5 and First Schedule of Investment Incentives (Amendment) Act, No. A89 of 1971.
[63] S. 30D(3), MIIA: inserted by s. 5 and First Schedule of Investment Incentives (Amendment) Act, No. A89 of 1971.
[64] S. 30H, MIIA: inserted by s. 5 and First Schedule of Investment Incentives (Amendment) Act, A89 of 1971.
[65] Part IIIC, MIIA, as amended in 1979.

To conclude this section, it should be noted that these incentives are not mutually exclusive. Subject to its qualifications for the various categories, a company may make full use of all incentives. For example, Yamaha may decide to set up a plant to manufacture musical instruments in the Johore Tenggara Area. In such a case, it would qualify for pioneer status as well as the locational incentive

C. *Effectiveness*

1. *Private Sector*

The Second Malaysian Plan (1971-1975)[66] recognized the need for high levels of public and private investment to sustain the rapid growth of production, employment and incomes sought under the Plan. It envisaged an increase of almost 50% in total investments. Of the aggregate level of planned investment fixed at M$12,150 million or 16.6% of projected GNP in 1971-75, private sector capital formation was set at M$7,843 million while public investment was fixed at M$4,307 million. With regard to the target set for the private sector, it should be noted that the greater part of it is made up of investment in West Malaysia.[67]

During 1971-75, the overall performance of the private sector was strongly influenced by external circumstances which affected the growth of income and production in the economy. In real terms, private investment grew by 7.2% per annum, as compared to the Mid-Term Review of the SMP target of 8.9%. The shortfall was due mainly to the decline in investment activity in 1975 because of world-wide recession and the unexpectedly large effect on the investors.[68] Between 1970 and 1974 however, private investment grew by 10.1% per annum. It can thus be concluded that had it not been for the recession, the growth rate would have far exceeded that which had been predicted.

The disappointing performance was not due to any failure on the part of the government to take action nor was it due to the inefficiency of the measures taken. In fact, the converse is true. This view is shared by the government since, as part of its promotional efforts, particular attention was paid to the provision of a wider range of tax incentives, especially in the electronics and hotel industries.

The Labour Utilization Relief was introduced to provide tax incentives for labour-intensive industries, traditional examples of which are the textile and clothing industry and the electrical industry. These industries experienced above-average growth despite adverse conditions. 1970 to 1972 saw 24 new establishments in the textile manufacturing industry set up with an added value of M$29.252 million and which created 7,564 jobs. Between 1972 and 1975, a further 68 establishments were set up.[69]

When the Third Malaysian Plan (1976-80) was formulated, the government once again placed much reliance on the private sector. It was summed up thus:

[66] Hereinafter called "SMP". Discussion will begin, with the SMP as this is the period that is closest to the enactment of the MIIA.
[67] SMP.
[68] Third Malaysian Plan, hereinafter called "TMP".
[69] TMP, p.279.

> Economic development in Malaysia and the prospects for achieving the socio-economic objectives of the New Economic Policy within the context of growth depend largely on dynamic expansion of the private sector.[70]

Private investment was projected as contributing the major source of capital formation during the TMP since despite the adverse economic conditions worldwide, "private investment had a positive impact on industrial development" with manufacturing growing by 10.9% per annum on the average.[71]

2. *Manufacturing*

All aspects of the manufacturing industry experienced positive growth. When total growth is averaged out among all the various sub-units, the whole industry[72] grew by an average of 11.85% per annum, a figure exceeding that projected by the TMP. Surveying the growth in the sub-units, the highest growth was recorded in the manufacturing of electrical machinery, which is one of the pioneer industries. Another pioneer industry, the production of industrial machinery, also experienced comparatively high growth with 13.9% per annum. The second highest growth was experienced in the textiles and clothing industry, one of the traditionally labour-intensive industries.[73]

3. *Dispersal of Industries*

As mentioned, one of the objectives of the industrialization policy of the SMP was the promotion of industrial activities in less developed areas to achieve more balanced regional industrial growth. Thus, we have the Locational Incentive Scheme. Of the total projects approved by the Government during 1971-75, 1,234 were located outside industrially developed areas. The percentage of approved projects located in less developed areas increased from 43.1% in 1971 to 67.7% in 1975. Some progress has been made in the dispersal of industries to the less developed states. Under the TMP, further efforts will be made to accelerate the programme, such as the setting up of more FIDA regional offices in the less developed areas.

4. *Indigenous Participation*

Although the ownership of share capital in public and private limited manufacturing companies by the Malays and other indigenous people continues to be low, there has been some improvement in their share.[74] In 1970-1973, it increased from 1.8% to 2.4%. A sum of MS814.7 million or 29.2% of proposed called-up capital in approved manufacturing projects was reserved for the Malays and other indigenous people.[75] Of the actual called-up capital of MS980.3 million, about 20.1% of MS196.9 million were subscribed by Malay individuals and Malay interests.[76]

[70] TMP.
[71] TMP, Table 15-1 on p. 174.
[72] *Id.*
[73] Unfortunately, figures for the period 1976 to 1980 are as yet unavailable.
[74] A 5% tax reduction of the company income tax is allowed to any company conforming to the equity restructuring requirement of the NEP ("New Economic Policy"). The tax rate is thus 35% instead of the usual 40%. This incentive is offered on a yearly basis upon annual certification by the Foreign Investment Advisory Committee.
[75] TMP, p. 277.
[76] Fourth Malaysian Plan.

D. *The Future of Tax Incentives*

It must be evident from just a glance that the Malaysian industrialization programme has been a success. However, how much of this success can be attributed to the tax incentives offered?

Though there is no direct link between the growth recorded and the incentive programmes, the latter must logically be one of the contributory factors. It must be more than a mere coincidence. In any case, the Government itself seems to hold the incentive programmes partly responsible at least. In the TMP it is stated that:

> Tariff protection and tax concessions are important instruments which have stimulated the rapid development of industrialization in the country.

As such, similar measures were continued. However, it would be unfair to all parties concerned if the tax programme alone received credit. The Malaysian success can also be attributed to the clarity of Government policy and the smaller degree of administrative discretion. Industrial priority lists were drawn up or revised regularly and given statutory force. To the investor, this must surely be a great consolation as it shows a positive commitment to investment promotion. Further, with these as bases for projection, longer-term plans could be made. Moreover, it may be said that with the ascent of Dr. Sri Mahathir Mohammed to the post of the Prime Minister in 1981 came a more aggressive approach to "Malaysia selling". In fact, he has taken a strong personal interest in this. This in turn has led to greater confidence by both foreign and domestic investors.

It can thus be safely said that the success of the Malaysian strategy cannot be solely attributed to the tax incentives offered. Though the extent is uncertain, other factors certainly played a part.

(*To be continued in Vol. 27 No. 2*)

ANNA OEI *

* LL.B. (Sing.), Advocate and Solicitor, Supreme Court of Singapore.