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EXIT TAX

Introduction

On 1 September 1998, Bank Negara Malaysia ("BNM") introduced new regulations in exchange control rules, mainly aimed at curbing speculative foreign dealings in the ringgit overseas. The new regulations in exchange control rules focuses on the following four key features:

(1) The official fixing of ringgit at RM 3.80 to the US dollar;

(2) All export and import transactions are to be conducted in foreign currencies;

(3) Funds transfer abroad by Malaysian residents for import payments, foreign debt servicing, or transactions related to foreign direct investment in Malaysia remain free of control but transfers of currency between offshore accounts or external accounts are not allowed without BNM's approval; and

(4) Assets acquired with funds from external accounts held by non-residents must be held in Malaysia for a period of at least one year. Withdrawal from external accounts require approval by BNM except for the purchase of ringgit assets.

The import and export of ringgit is now limited to RM1,000 per person with effect from 1 October 1998. The currency notes of RM500 and RM1,000 are scrapped. Residents are allowed to export foreign currencies abroad up to the equivalent of RM10,000. No limits on the import of foreign currencies by resident and non-resident travellers. The export of foreign currencies by non-resident travellers is allowed up to the amount of foreign currencies brought in[(1)].

On 4 February 1999, the Malaysia government announced a new policy with respect to the repatriation of portfolio capital. The one year freeze on repatriating proceeds from the sale of equities by foreigners was replaced with an exit tax system. “These new measures are aimed to encourage existing portfolio investors to take a longer term view of their investments and to attract new funds, while at the same time discourage destabilising short-term flows,” said Tun Diam Zainuddin, the Malaysian Finance Minister[(2)].

Concept of Exit Tax

For funds brought into Malaysia before 15 February 1999, it will be allowed to be repatriated subject to a graduated levy which is based on the duration of the investment. For funds brought into Malaysia after 15 February 1999, it will not be taxed on the principal amount. However, it will be subject to capital gain tax (See table 1).

Table 1-Imposition of Repatriation Levy[3]

Fund brought in : Before 15 February 1999			On/after 15 February 1999
Principal	Repatriated	Levy	Levy
1 September 1998 (Up to 7 months)	31 March 1999	30%	No
1 September 1998 (Over 7 months, less than 9 months)	31 May 1999	20%	No
1 September 1998 (Between 9 and 12 months)	31 August 1999	10%	No
1 September 1998 (Exceeding 12 months)	1 September 1999	0%	No
Profit			
Repatriated before 12 months From date they are made		No	30%
Repatriated thereafter		10%	10%

The exit tax introduced on 4 February 1999 focus on equity investments. The levy will be payable based on the market value of the portfolio investments as at 1 September 1998 and not on the amount originally paid for the investments. This means that if a foreign investor has brought in RM10 million in principal sum before 1 September 1998 and the value of that investment on the stock market had fallen to RM2 million on 1 September 1998 but is now worth RM5 million, he could withdraw RM3 million without paying the exit tax(4).

On 5 February 1999, BNM clarified that the new exit tax includes repatriating profits from the sale of property and bonds, which means that any gains over the original amount brought in excluding dividends, interest and rental earnings. The profit taxed is based on realised profit after sales, and will be levied only when the ringgit proceeds are converted to foreign exchange and taken out of the country(5).

On 18 February 1999, BNM revised its exit tax that all investments in properties are excluded from the levy to further relax of the exchange control rules(6).

Conclusion

The concept of exit tax is new. Overall the funds managers and analysts are unsure if the exit tax will attract new foreign funds to offset any major outflow of funds trapped in Malaysia(2). As for the investors, it is only when the curtain of exchange controls rules is fully lifted that Malaysia will be regarded as being on the main highway of recovery. The removal of restrictions on the repatriation of portfolio capital amounts to just parting a little of that curtain(7). Since 18 February 1999 to April 1999, there is no further clarification from BNM.

References

(1) Institut Akauntan Malaysia, Circular No 16/98, 23 September 1998.

(2) "KL's exit tax plan gets mixed reception", The Business Times, 5 February 1999.

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(4) "KL clarifies exit tax; bourse selldown seen", The Business Times, 9 February 1999.

(5) "KL exit tax to cover bonds and property", The Straits Times, 6 February 1999.

(6) "No KL exit tax now for property", The Straits Times, 19 February 1999.

(7) "M'sia parts the curtain - a little" by Vikram Khanna, The Business Times, 5 February 1999