Dividend Tax on Individual Shareholders

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KPMG in Malaysia

Overview and commentary

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Key Message

The Prime Minister and Finance Minister YAB Dato' Seri Anwar Bin Ibrahim announced in the 2025 Budget the introduction of dividend tax at the rate of 2% on chargeable dividend income received by individual shareholders which consist of resident and non-residents, as well as individuals who hold shares through nominees, from 1 January 2025 onwards. However, the dividend tax should only impact a small portion of Malaysian taxpayers as only individuals who have annual dividend income exceeding RM100,000 would be subject to dividend tax.

Introduction of Dividend Tax

The imposition of a dividend tax is a topic of considerable debate among economists, policymakers and investors. While some argue that it introduces an additional layer of taxation on corporate earnings, others contend that it is a necessary measure to ensure tax equity.

Presently, earnings distributed to shareholders is free from further taxation. By taxing individual shareholders who derive large amounts of dividend income, the government's move ensures that a portion of such wealth can be redistributed to the rakyat who are much more in need.

Dividend payments are often concentrated among wealthier individuals and households, who own a larger share of corporate stock. Implementing a dividend tax can help to address this disparity by redistributing the tax collected through various government assistance programs.

Dividend tax from a global perspective

Japan taxes dividends at both the national and local levels, and dividend income is subject to a flat tax rate. In the United Kingdom, dividend income is taxed under a progressive system. Investors receive a tax-free dividend allowance, after which dividends are taxed at varying rates according to the taxpayer's income band.

On the other hand, Hong Kong and Singapore do not impose dividend tax, making it an attractive destination to attract global business and investment.

The impact on individuals

The primary and most direct impact of dividend tax on shareholders is the reduction in their disposable income. When dividends are taxed, shareholders receive a reduced net amount compared to the gross dividend declared by the company. This reduction can diminish the attractiveness of dividend-paying stocks, especially for income-focused investors, such as retirees, who rely on dividend income as a significant portion of their earnings.

The introduction of dividend tax may also affect the strategy of business owners, typically the majority shareholders, who may rethink their dividend payment strategies to minimise its tax impact. This could have an impact on minority shareholders who could ultimately derive less income from their investments.

Reporting of taxable dividend income

For individuals with a diversified investment portfolio, it can be challenging to track and ensure that all dividend income is accurately reported in their personal income tax returns. Additionally, to ensure correct reporting, individuals must be familiar with the types of dividend income that are exempt from tax. The government will need to look into ways to assist affected individuals in reporting their dividend income. For example, companies need to ensure that they provide full details of dividend payments to enable individual taxpayers assess whether their dividend income meets the taxable threshold.

To smoothen the implementation of the dividend tax, further guidance should be provided on the deductibility of expenses against dividend income. For instance, clarification is required for the following:

- If the interest expense from a personal loan is used to purchase shares that are exempt from dividend tax, can it be deducted from taxable dividend income?
- Would the exempt dividend income be considered when calculating the RM100,000 threshold for determining taxability?

A wider outlook

The impact of this new tax on dividends needs to be considered not only from the perspective of individuals, but also how it will impact Malaysian companies. In this regard, there are at least three key areas of impact.

a) Impact on the investment attractiveness of Malaysian companies

At 24%, Malaysian corporates already pay a relatively higher corporate income tax rate than several other competitor jurisdictions such as Singapore (17%), Hong Kong (16.5%), Indonesia (22%), Vietnam (20%) and Thailand (20%). With the impact of an additional 2% tax on dividends, this in many senses increases the overall tax on profits and their distributions when derived by individual investors (both local and foreign).

Curiously, or some may say negatively, Malaysians themselves may be exempted on foreign sourced dividends that were subject to tax in the country of origin, while paying 2% on dividends received from Malaysian companies. This creates an incentive for investors to prefer investments in foreign companies over Malaysian companies.

b) The additional administrative burden to Malaysian companies

The budget release doesn't yet make clear the administrative aspects of this new tax on individuals. However, we can immediately see a few areas that would need to be addressed with respect to the Malaysian companies paying the dividends.

The primary concern is whether any withholding obligation would be placed on Malaysian companies. Prior to the introduction of this tax, Malaysian companies have not had to concern themselves as to the residence status of the individuals being paid the dividends nor the amounts being paid. In respect of Malaysian resident individuals it may be straightforward enough for them to include such income in their personal income tax returns, but for foreign residents the only feasible means of applying the tax would be to require Malaysian companies to withhold the 2% on dividends upon making payment. For private companies with limited shareholders that are well known to the company this may be straightforward enough, but larger companies, particularly listed companies (or their financial custodians) would potentially need to put in place mechanisms for tracking the residence status of their individual shareholders for withholding tax purposes. Then there is the added complication of how to effectively track the annual dividend income threshold of RM100,000 of the non-resident individual if the company makes more than one dividend payment per year or if the individual receives multiple dividends from different sources.

It is crucial for the Malaysian government to provide further guidance on the appropriate enforcement mechanism and due care should be taken in doing so, so as not to overly burden Malaysian companies that are already grappling with a number of new tax driven system adjustments.

c) **Driving a change in investment behavior and structuring strategies**

The imposition of a Dividend Tax may lead to significant shifts in how the high-net-worth (HNW) and ultra-high-net-worth (UNHW) individuals manage their investments. More sophisticated, wealthy investors may seek to use more complex corporate investment structures and / or make changes to their investment approach in order to mitigate their tax burden. Some of these may include:-

(i) **Shift toward tax-efficient structures:** To miminise tax liability on dividends, wealthy individuals are likely to explore alternative investment vehicles or structures to hold dividend-paying assets. Given that capital gains tax does not apply to individuals we may also see an increased use in redeemable preference shares by individuals who choose to extract profits through redeeming these shares at a premium as an alternative to paying dividends.

(ii) **Emphasis on high-growth stocks and alternatives investment:** Wealthy individuals may pivot away from dividend-paying stocks and shift towards growth companies or those that re-invest dividends or undertake stock buy-backs, alternative investments and foreign investments.

Conclusion

While a targeted dividend tax at wealthy individuals aims to address income inequality, it is essential to consider the broader implications for investment behavior and economic health. As wealthy investors adapt by creating more sophisticated structures and exploring alternative investment strategies, the landscape of capital allocation will shift. Policymakers should recognize these potential consequences for both individuals and the Malaysian companies they impact and strive for tax policies that foster investment while promoting fairness in the tax system. Balancing these objectives is critical to ensuring a robust and dynamic economy that benefits all stakeholders.

To ease taxpayer's administrative burden (especially for those with diversified portfolios), the Inland Revenue Board should establish clear guidelines and efficient mechanisms to streamline compliance. Ensuring that information on exempt dividends is readily available will aid individuals in accurately reporting their dividend income.

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