

Dividend Tax: A Threat to SME?

By Mohd Khairul Ramli

The recent announcement of a 2% tax on dividend income exceeding RM100,000 annually, introduced as part of Malaysia's Budget 2025, has sparked concern among SME owners and investors alike. Coming into effect on January 1, 2025, this policy is a departure from Malaysia's previous tax-free dividend environment, under which shareholders received dividends exempt from personal tax obligations. While ostensibly a minor change, this tax is poised to have a pronounced impact on small and medium-sized enterprises (SMEs) and their owners.

Burden for SME Owners

For years, Malaysia's dividend system has functioned under the Single-Tier System, which exempted shareholders from paying personal taxes on dividend.¹ This structure acknowledged the fact that dividends are derived from corporate profits, which are already subject to corporate income tax. Thus, the new 2% tax represents a fundamental shift, eroding a longstanding advantage for shareholders, particularly SME owners who rely on dividends, reducing the amount they get to keep from their investments.

For many SMEs, dividends represent not just profits but a reward for enduring the risks associated with managing smaller enterprises. Unlike larger corporations, SMEs often face limited access to financing, making dividend income a vital financial cushion and a financial tool to re-investment back to their business. Now, with the implementation of the 2% tax on dividend income over RM100,000, SME owners face a direct reduction in income share, which may, in turn, reduce their motivation to reinvest in their businesses and add challenges to SME owners' ability to balance personal financial goals with business growth objectives.

The Double Taxation Dilemma

One of the most contentious issues surrounding the new tax is the perception of double taxation. Corporate profits are taxed at the corporate level, and applying an additional tax on distributed dividends introduces a second layer of taxation. In effect, SMEs are taxed twice on the same earnings, first when they are generated as profits, and again when they are distributed as dividends to shareholders. For many business owners, this system feels punitive

¹ <https://taxsummaries.pwc.com/malaysia/corporate/income-determination>

and disproportionately affects smaller enterprises, which do not have the tax mitigation resources often available to larger corporations.

Furthermore, this tax has wider implications for high-income earners who depend on dividend income as part of their financial planning. This additional tax effectively reduces their returns, making other investment vehicles comparatively more attractive. For SME owners who have invested substantial time and resources into their businesses, the 2% tax adds another barrier, potentially leading them to reconsider the viability of retaining their investments in the local economy.

A Barrier to Profit Distribution

Malaysia's SME sector is home to many family-owned businesses, where succession planning is a key consideration and the 2% dividend tax introduces a new layer of complexity to these plans. Business owners seeking to pass their enterprises to the next generation must now consider the increased tax liability their successors may face on dividends. For many, this creates an additional financial strain, requiring careful tax and financial planning to ensure a smooth transition of ownership.

The additional tax burden may compel SME owners to consider alternative wealth transfer strategies, such as structuring their businesses to minimize dividend payouts or exploring other avenues for income generation. Yet, these approaches are often challenging for SMEs, which lack the sophisticated financial resources and tax planning expertise that larger corporations can afford. Consequently, the dividend tax complicates the future viability of family-owned SMEs, which play a significant role in the national economy and job creation.

Conclusion

Policymakers must weigh the potential consequences of this tax on SMEs, particularly as these businesses represent the backbone of Malaysia's economy. Revisiting this tax policy, perhaps by increasing the exemption threshold or exploring other SME-supportive measures, could mitigate its impact on small businesses and foster a more conducive environment for sustainable growth. Only by recognizing and addressing these concerns can Malaysia ensure that its tax system supports the resilience and dynamism of its SME sector.