

Tax Deduction For ESG Expenditure

23 July 2025

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Recently, the Minister of Finance issued the Income Tax (Deduction for Expenditure in Relation to Environmental Preservation, Social and Governance) Rules 2025, which are applicable from the year of assessment (YA) 2024 to 2027.

The main purpose of the Rules is to encourage businesses to invest in Environmental, Social and Governance (ESG) practices, where tax deductions are made available for specific expenses related to sustainability, good governance and digital transformation.

This move to issue the Rules is welcomed as it aligns with the national strategies under Budget 2024 and Budget 2025, which aim to make ESG a core part of long-term economic competitiveness and environmental responsibility.

A Strategic Opportunity For Businesses

The introduction of ESG-related tax incentives marks a significant milestone in Malaysia's sustainability agenda. The Rules not only offer financial benefits but also reinforce the importance of integrating environmental stewardship, social responsibility and governance best practices into business operations.

For Malaysian enterprises, the message is clear: now is the time to act. Investing in ESG is no longer just about compliance or reputation—it is a strategic imperative for resilience, competitiveness and long-term value creation.

Eligibility

To qualify, a business must be resident in Malaysia and must be actively generating income from business operations within the country. The entities eligible to claim these tax deductions include:

- Financial institutions licensed under the Financial Services Act 2013, Islamic Financial Services Act 2013 or Development Financial Institutions Act 2002.
- Public listed companies and Labuan entities.
- Micro, small, and medium enterprises (MSMEs) as defined by SME Corp Malaysia.

Types Of ESG Expenses Deductible

The Rules divide the types of allowable expenses into three main categories depending on the type of business:

(a) Financial Institutions & Listed Companies

- Costs of ESG certification or verification, such as for greenhouse gas (GHG) emissions.
- Subscriptions to ESG software used for tracking carbon emissions, compliance and sustainability data.
- Training and upskilling of staff in ESG knowledge and practices.
- Consultant fees for ESG experts to assist with technical or regulatory compliance.

(b) Companies & Labuan Entities

- Preparing reports under the Tax Corporate Governance Framework (TCGF).
- Appointing independent reviewers to verify TCGF compliance.
- Preparing transfer pricing documentation under the Income Tax (Transfer Pricing) Rules 2023.

(c) MSMEs

- Fees paid to external consultants to help develop and implement custom e-invoicing systems.
- Charges from third-party service providers for integration and setup (except for costs related to the MyInvois portal or initial planning stages).

Limitations & Important Conditions

The total deduction that a business can claim under the Rules is capped at RM50,000 per year of assessment, regardless of how many categories they qualify for.

It is important for businesses to note that expenses eligible under the Rules 2025 cannot be double claimed under other provisions of the Income Tax Act 1967 (ITA), specifically if:

- (a) The expense has already been deducted under Section 33 of the ITA.
- (b) The company has already been given a tax exemption under Section 127(3)(b) or 127(3A) of the ITA
- (c) The expenses are claimed under other rules made under Section 154 of the ITA.

Practical Guidance

The Rules are not limited to large corporations—they also apply to employers and businesses of all sizes. In particular, this tax incentive encourages enhancements in human resource practices, digital systems and internal governance structures. Additionally, this presents a valuable opportunity for employers to formalise ESG processes, strengthen documentation and embed sustainability into day-to-day operations.

Recordkeeping

Businesses intending to claim ESG-related expenses must maintain comprehensive records, including:

- Contracts and invoices
- ESG certification documents
- Greenhouse gas (GHG) tracking reports
- Staff training attendance records
- Details of software purchases or subscriptions

This documentation is essential, as the Inland Revenue Board (IRB) may require evidence to verify that the expenses are genuinely ESG-related and compliant with legal requirements.

Insights

Although the ESG tax deduction was first announced under Malaysia's 2024 Budget, the Rules were only gazetted on 23 June 2025. By this time, most taxpayers may have already filed their income tax returns for the year of assessment 2024, while others may be in the final stages of doing so.

For those who have submitted their returns without claiming the ESG deduction, a revision may still be made under Section 131(1) of the ITA.

Businesses intending to claim this deduction are encouraged to assess their eligibility in detail and, where appropriate, take steps to amend their tax filings in accordance with statutory requirements.

Recommendations

1. Map Existing ESG Initiatives Against Deductible Categories

Conduct a thorough review of current and planned ESG activities; such as sustainability reporting, carbon emissions tracking, employee training or the adoption of ESG-compliant digital tools and evaluate how these initiatives correspond with the eligible expense categories outlined in the Rules. This proactive alignment will help ensure that qualifying efforts are properly documented and optimised for tax relief.

2. Align With The Tax Corporate Governance Framework (TCGF)

For companies and Labuan entities, alignment with the TCGF is a prerequisite for claiming deductions related to tax governance reporting. This includes implementing internal tax risk controls, appointing an independent reviewer and obtaining a Certificate of Compliance from the Inland Revenue Board.

3. Engage ESG Professionals For Technical Accuracy And Compliance

Given the complexity of certain ESG areas such as greenhouse gas (GHG) emissions monitoring or third-party assurance of sustainability disclosures; businesses are advised to engage qualified ESG consultants. Professional support can help ensure alignment with recognised standards, improve reporting quality and support audit readiness in case of Inland Revenue Board queries.

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