

Tax Incentives and Strategies for the Circular Economy to Improve ESG Performance in Malaysia

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ABSTRACT

This article discusses the impact of tax incentives on the promotion of a circular economy to improve Environmental, Social, and Governance (ESG) performance in Malaysia. The strategy provides a thorough plan that includes economic, policy, administrative, social, technological, and environmental components. Malaysia intends to promote sustainable corporate practices, stimulate innovation, and align with global sustainability objectives by utilising targeted tax reductions, credits, and exemptions. The study highlights the significance of incorporating comprehensive policy frameworks, enhancing organisational capabilities, engaging relevant stakeholders, and establishing rigorous monitoring systems to ensure the efficient execution and enduring prosperity of the shift towards a sustainable circular economy.

INTRODUCTION

Malaysia's goal of achieving Net Zero status by 2050 demonstrates its dedication to the United Nations' Environmental, Social, and Governance (ESG) principles and Sustainable Development Goals (SDGs). Malaysia's commitment to reducing greenhouse gas emissions, improving resource efficiency, and promoting economic resilience aligns with global initiatives to address climate change and encourage sustainable development. Malaysia seeks to promote significant changes in various industries, foster sustainable innovation, and facilitate a fair transition that benefits all segments of society by incorporating ESG criteria into national policies and corporate practices. ESG represents a framework and set of criteria used by businesses and investors to evaluate a company's management of non-financial risks and opportunities, assessing its broader impact beyond traditional financial metrics (Salin & Ali, 2025). Attaining Net Zero by 2050 will not only make a significant contribution to meeting global climate objectives but also bolster Malaysia's competitiveness and sustainability on the international stage (MIDA, 2024; Parente, 2024). The growing importance of ESG stems not only from its ethical underpinnings but also from its profound implications for financial performance, firm resilience, and systemic risk (Abdullah et al., 2026) as these elements will contribute to better performance of the organisation (Salin et al., 2025; Rahim et al., 2025; Salin et al., 2024).

One effective approach to accomplishing this is to fully embrace the principles of the circular economy in business operations (Murray et al., 2017). A circular economy is an economic system that seeks to minimise waste and pollution by maximising the lifespan of products and resources. It represents a significant departure from the existing linear economy, which follows the take-make-consume-dispose framework (Kirchherr et al., 2017). The circular economy is founded upon three fundamental ideas. The first step is to eliminate waste and pollution through design. Products and materials ought to be developed with the intention of being reused, repaired, or recycled, rather than discarded. The second step is to ensure that products and materials are continuously utilised. Products should be designed to facilitate disassembly and recycling, and there should be market demand for recycled materials. The third step is to rehabilitate natural ecosystems. The circular economy aims to restore and rejuvenate natural ecosystems, such as forests and oceans (Geissdoerfer et al., 2017; Kirchherr et al., 2017; Murray et al., 2017).

Examples of circular economy techniques include repurposing food leftovers to generate compost, refurbishing damaged items rather than replacing them, renting products rather than purchasing them, transforming old

materials into new products through upcycling, and designing products that facilitate disassembly and recycling. The circular economy is in its nascent phase but is rapidly gaining traction. Governments, businesses, and consumers are increasingly embracing circular economy methods. The expansion of the circular economy has the potential to revolutionise how we produce and consume products and services.

There are numerous advantages to implementing a circular economy. Firstly, minimise waste and pollution. Implementing a circular economy can effectively mitigate waste and pollution by prolonging the use of products and materials. This can be achieved through long-lasting design, maintenance, repair, reuse, remanufacturing, refurbishing, and recycling (Geissdoerfer et al., 2017) (Stahel, 2016; Korhonen et al., 2018; Velenturf & Purnell, 2021).

Secondly, a more optimal allocation of resources. The circular economy facilitates resource conservation by minimising the need to extract new raw materials and supports a more efficient and responsible use of resources. Instead of relying heavily on extracting new raw materials, it encourages the reuse, repair, recycling, and sharing of products and materials. This helps to reduce the need for mining, logging, and other resource-intensive activities that can damage the environment. By keeping materials in use for longer, the circular economy lowers waste, saves energy, and reduces greenhouse gas emissions. It also helps businesses become less dependent on the uncertain prices of raw materials and more resilient to supply disruptions. Research has shown that countries and industries that apply circular economy practices can use fewer natural resources while also reducing pollution and improving long-term economic sustainability (Kazakova & Lee, 2022; Lingaitiene & Burinskiene, 2024) (Aguilar-Hernandez et al., 2021; Bibas et al., 2021; Deserno & Sterk, 2024).

Thirdly, implementing a circular economy can create new jobs, especially in industries such as recycling, product repair, refurbishment, and remanufacturing (Aguilar-Hernandez et al., 2021). Unlike the traditional linear economy, which often ends with products being thrown away, the circular model focuses on extending the life of products and materials. This shift requires more workers to collect used goods, sort materials, repair damaged items, redesign products, and operate recycling technologies. As a result, the transition to a circular economy can create more local jobs and support small and medium-sized enterprises (SMEs). It can also provide new skill development and job training opportunities, particularly for youth and workers in regions affected by the decline of traditional manufacturing or fossil-fuel industries. Several studies have shown that countries adopting circular practices could see net job gains, while also reducing environmental damage (Korhonen et al., 2018; Murray et al., 2017; Stahel, 2016) (Murray et al., 2017; Aguilar-Hernandez et al., 2021; Parente, 2024).

Finally, there is an economic stimulus. Implementing a circular economy can enhance economic growth by fostering the creation of new enterprises and markets. The circular economy is an emerging economic paradigm that has promise in tackling the pressing issues of climate change, resource depletion (Heshmati, 2017), pollution and environmental sustainability (Barreiro-Gen & Lozano, 2020). This situation benefits both the environment and the economy (Heshmati, 2017; Barreiro-Gen & Lozano, 2020; Ivanková et al., 2025).

However, in the Malaysian context, the circular economy is still new and receives little attention from businesses. This can be due to many factors, such as a lack of technical expertise, the high cost of transitioning to a circular economy, limited public and industry awareness, and a lack of support from the current government to promote a circular economy as part of the Malaysian way of life. As a result, government intervention is needed to support the adoption of the circular economy in Malaysia. Fernando et al. (2022), for example, find that the circular economy has a significant influence on the manufacturing industry in Malaysia, particularly on supply chain disruptions. There are many ways the government can help, such as providing grants, subsidised loans, technical assistance through government agencies, and tax incentives. Arguably, tax reform is one of the powerful incentives that can influence industry players to embark on the circular economy, as this can help companies to reduce the transition cost of their operation from current practices into circular economy practices (Fernando et al., 2023; Ting et al., 2023; Rehman et al., 2022; Mohd Ali et al., 2024).

However, there are also disadvantages to using tax incentives to support the circular economy. First, the government will lose potential tax revenue. Second, the taxpayer may commit tax evasion and abuse the incentives given. Finally, it is possible that the tax incentives that are offered are not as needed by the taxpayer (Milios, 2021; Vence & López Pérez, 2021).

Thus, the purpose of this paper is to evaluate the role of taxation in supporting the growth of the circular economy and to ascertain the current tax incentives available in Malaysia, together with recommended tax strategies for policymakers to enhance the expansion of the circular economy. In short, this paper wishes to answer this research question,

“How can tax incentives be used to enhance the circular economy?”

This paper contributes in several ways. Firstly, it highlights current tax assistance and recommends tax strategies that policymakers, such as the Inland Revenue Board, the Customs Department, and relevant government agencies and ministries, can adopt to support improvements to the country's circular economy. Secondly, it provides industry players and businesses with more information to lobby the tax authority to align fiscal incentives with a circular rather than a linear economy and to address more pressing environmental issues, such as climate change. Finally, for researchers and academicians, it enhances the existing body of literature and theoretical foundation on the tax framework and strategy, which is essential for the long-term viability of the circular economy.

THE ROLE OF TAX IN SUPPORTING CIRCULAR ECONOMY

Taxation can have a crucial impact on fostering the expansion of the circular economy by encouraging sustainable habits, discouraging wasteful behaviours, and financing efforts that promote circular activity (Vence & López Pérez, 2021; Milios, 2021; Parente, 2024; Ljubičić, 2025).

Encouraging the adoption of sustainable practices can be achieved through tax credits and deductions. Governments can offer tax credits and deductions to enterprises that actively implement circular economy principles. This encompasses investments in renewable energy, waste-reduction technologies, and the design of sustainable products. For instance, implementing tax credits for the use of recycled materials in manufacturing can effectively reduce costs and incentivise more enterprises to adopt these sustainable methods (Milios, 2021; Genc, 2024; Shergina & Zhemba, 2017).

Taxation can also serve to discourage and penalise inefficient or extravagant behaviour. Landfill taxes can be implemented to levy or raise taxes on the utilisation of landfills, thus creating a financial deterrent for trash disposal. This promotes the inclination of firms and consumers to explore alternative methods such as recycling, composting, or waste-to-energy technologies. Alternatively, carbon taxes can be implemented to levy charges on carbon emissions from manufacturing and disposal processes, thereby incentivising enterprises to adopt cleaner, more efficient methods. Carbon taxes establish a clear connection between the financial burden of pollution and economic activities, thereby incentivising industries to adopt sustainable alternatives (Klymenko, 2019; Huttmanová & Mikča, 2024; Deserno & Sterk, 2024).

Taxation can also serve as a means to finance the implementation of a circular economy. Authorities can distribute income generated by environmental levies, such as taxes on waste disposal and carbon emissions, to support initiatives promoting a circular economy. Examples of such support measures include research and development funding, subsidies for sustainable enterprises, and public awareness campaigns. Tax funds can be allocated to the construction and expansion of essential infrastructure for the circular economy, including recycling facilities, waste collection systems, and renewable energy installations. Enhanced infrastructure enables enterprises and consumers to engage seamlessly and economically in the circular economy (Bibas et al., 2021; Parente, 2024).

TAX INCENTIVES ADOPTED GLOBALLY

Tax is a powerful tool that can influence the behaviour of businesses and consumers. By strategically using taxes, governments can accelerate the transition to a circular economy. There are many ways in which tax is used to support the circular economy worldwide (Govindan & Hasanagic, 2018; Vence & López Pérez, 2021; Munonye, 2025).

In Europe, countries like the Netherlands impose a tax on the disposal of waste from construction and demolition sites. This tax has helped to reduce the amount of waste sent to landfills and incinerators. In France, a tax is imposed on single-use plastic bags. This tax has led to a significant reduction in the use of these bags. In Norway, a tax is imposed on the sale of new cars. This tax is higher for less fuel-efficient cars. This has helped to encourage consumers to buy more fuel-efficient cars (Milios, 2021; Parente, 2024).

In China, the government is investing in research and development of new technologies for recycling and reuse. This investment is helping to create new jobs and businesses in the circular economy sector. These are just a few examples of how taxes can support the circular economy. As the circular economy gains momentum, we can expect more governments to use tax policy in this way (Chang et al., 2022; Genc, 2024).

A few ASEAN countries have also started using taxes as an effective tool to encourage their circular economies. Thailand, for example, provides a tax deduction for businesses that invest in waste management projects, such as recycling and composting facilities. The government also provides tax exemptions for electric and other environmentally friendly vehicles. Indonesia, on the other hand, provides a tax deduction for businesses that use recycled materials. The government also provides a tax exemption for businesses that operate waste treatment facilities. In Vietnam, the government provides tax deductions for businesses that invest in renewable energy projects, such as solar and wind power. The government also provides a tax exemption for businesses that operate energy-efficient buildings. In the Philippines, the government provides tax deductions for businesses that invest in energy-efficient technologies. The government also provides a tax exemption for businesses that operate zero-waste facilities (Lestari et al., 2025; Govindan & Hasanagic, 2018).

Singapore can be argued to be the frontrunner among ASEAN countries in adopting the circular economy. This country introduces several tax initiatives, including a green investment allowance that provides a tax deduction for businesses that invest in green technologies, including those that support the circular economy, as well as a green income tax rebate. This incentive provides a tax rebate for businesses that derive income from green activities, such as recycling and waste management. In addition, the government imposed tax exemptions on electric and other environmentally friendly vehicles, exempting them from import and excise duties. An investment tax allowance for waste management projects was also introduced to provide businesses with a tax deduction for investments in projects such as recycling and composting facilities. Finally, a sustainable energy fund is created to provide financial assistance to businesses that invest in sustainable energy projects, including those that support the circular economy.

These are just some of the tax incentives for the circular economy in ASEAN countries. The specific incentives vary from country to country, but they all aim to encourage businesses and individuals to adopt circular economy practices. The ASEAN Framework for Circular Economy (ASEAN FCE) was adopted in 2021. The FCE provides a roadmap for the transition to a circular economy in ASEAN. The FCE includes several recommendations for tax incentives, including tax breaks for businesses that invest in circular-economy technologies and practices, tax deductions for businesses that use recycled materials, tax exemptions for businesses that operate waste treatment facilities, and tax credits for businesses that reduce their environmental impact. The ASEAN FCE is a significant step forward for the circular economy in ASEAN. The tax incentives recommended in the FCE can help to accelerate the transition to a circular economy in the region (ASEAN Secretariat, 2021; Lestari et al., 2025).

THE CURRENT TAX INCENTIVES FOR CIRCULAR ECONOMY IN MALAYSIA

The Malaysian government has recognised the importance of the circular economy and introduced several tax incentives to encourage businesses to adopt circular practices. Several government agencies, such as the Malaysian Investment Development Authority (MIDA) and the Malaysian Green Technology and Climate Change Corporation (MGTC), have offered several incentives, such as the following:

Green Investment Tax Allowance (GITA)

This incentive provides a tax deduction for the cost of acquiring or installing green technology equipment or assets. Green technology is defined as technology that reduces the environmental impact of a product or process.

The Green Investment Tax Allowance (GITA) is a Malaysian government tax incentive designed to encourage businesses to adopt green technology. The GITA provides a 100% tax deduction for qualifying capital expenditure incurred on approved green technology assets. The GITA can be claimed in the year of assessment in which the qualifying capital expenditure is incurred. The allowance can be offset against 70% of the company's statutory income. Unutilised allowances can be carried forward for up to five years.

The GITA is a valuable incentive for businesses that are looking to reduce their environmental impact. By providing a tax deduction for the cost of investing in green technology, the GITA can help businesses to make the switch to a more sustainable future. Some examples of green technology assets eligible for the GITA include solar panels, wind turbines, energy-efficient lighting, water-saving devices, wastewater treatment systems, recycling equipment, and electric vehicles. The GITA is a great way for businesses to save money while protecting the environment.

Green Income Tax Exemption (GITE)

It is a tax incentive offered by the Malaysian government to encourage businesses to provide green technology services. The GITE provides a tax exemption for the income generated from qualifying green technology services. The GITE can be claimed in the year of assessment in which the income is generated. The exemption is available for a period of three years, starting from the year of assessment in which the first qualifying income is generated.

The GITE is a valuable incentive for businesses that are looking to provide green technology services. By providing a tax exemption on income generated from these services, the GITE can help businesses make the switch to a more sustainable future. Examples of green technology services eligible for the GITE include waste management, recycling, energy efficiency consulting, water conservation, air pollution control, noise pollution control, and green building design and construction.

Import Duty Exemption.

This incentive exempts businesses from paying import duty on machinery and equipment used in circular economy activities. The import duty exemption can be claimed in the year of assessment in which the machinery and equipment are imported. The exemption is available for a period of three years, starting from the year of assessment in which the first qualifying machinery and equipment is imported. The import duty exemption is a valuable incentive for businesses that are looking to invest in circular economy activities. Exempting businesses from import duty on machinery and equipment can help them reduce the cost of investing in circular technologies. Examples of machinery and equipment eligible for the import duty exemption include equipment used for waste management, recycling, energy efficiency, water conservation, and air and noise pollution control (MIDA, 2024; MGTC, 2026).

STRATEGIES OF TAX INCENTIVES IN THE MALAYSIAN CIRCULAR ECONOMY

There are several approaches the Malaysian government can implement to advance the circular economy in the country. The first aspect to consider is the economic and financial strategy. The objective is to meticulously strategise and evaluate the financial consequences arising from tax incentives. Although these incentives are crucial for encouraging circular processes, they can inevitably result in a temporary decrease in government revenue. Hence, it is essential to conduct comprehensive impact assessments to gauge the potential financial consequences. An incremental strategy can be implemented to phase in the introduction of these incentives, enabling the government to adapt according to economic circumstances. Effective tax incentive design entails implementing targeted tax reductions, credits, and exemptions for enterprises that engage in circular-economy activities, such as recycling and remanufacturing. Moreover, providing tax credits for research and development (R&D) in circular technologies and sustainable product design can foster innovation. In China, for example, Chang et al. (2022) find that tax rebates and subsidies positively interact with the R&D efficiency of green firms. Therefore, a commitment to substantial infrastructure investment, especially in establishing crucial administrative and monitoring systems, is important. Effective collaborations between public and commercial

sectors can facilitate the development of recycling and waste management infrastructure, therefore promoting the principles of a circular economy (Vence & López Pérez, 2021; Milios, 2021; Bibas et al., 2021; Chang et al., 2022).

Secondly, there is the policy and regulatory approach. A comprehensive policy framework is necessary to ensure that tax incentives specific to the circular economy align with current environmental, industrial, and economic regulations. This degree of coherence establishes a unified policy framework that promotes sustainable activities. It is imperative to establish explicit norms and eligibility criteria to prevent abuse and ensure that incentives effectively focus on circular-economy activities. Securing enduring policy stability is essential to incentivising enterprises to invest in sustainable initiatives. The frequent fluctuations in tax regulations may create ambiguity and discourage enterprises from committing to circular economy initiatives. This is because tax literacy is one of the important determinant to tax compliance and hence, reduce the possibility of tax evasion by the tax payer (Agusti & Rahman, 2022) Adopting enabling legislation is crucial as it strengthens the government's dedication to a circular economy and establishes a legal structure for implementing tax incentives (Govindan & Hasanagic, 2018; Kazancoglu et al., 2020; Milios, 2021).

Thirdly, there is the administrative and operational strategy. The successful application of tax incentives relies heavily on the essential capacity-building function within government institutions. Allocating resources to training programs for officials improves their comprehension and administration of circular economy practices. Establishing dedicated teams within relevant government departments to oversee the implementation and monitoring of tax incentives ensures optimal efficiency and the achievement of desired outcomes. Establishing robust mechanisms for checking compliance with tax incentive conditions is crucial. For example, the government can expand the functions of its auditing department beyond financial audit to include tax auditing. Government auditing is an important mechanism for supervising the use of fiscal funds, preventing official corruption, and improving governance performance (Cao et al., 2022). Precise data-gathering and analysis methodologies are essential to assess the efficacy of the incentives and to implement required modifications. Initial implementation of pilot projects can facilitate the evaluation of the efficacy of various tax incentives, thereby providing valuable insights to enhance and expand successful endeavours (Cao et al., 2022; Milios, 2021).

The fourth strategy is sociological in nature. The effective promotion of the advantages of a circular economy and tax incentives relies heavily on public awareness and education initiatives. It is imperative to educate businesses and the general public on how they might exploit these benefits and embrace circular processes (Valencia et al., 2023). Effective stakeholder engagement is essential, including industry groups, corporations, and civil society organisations in the development and execution of the incentives. This collaborative strategy fosters support and guarantees that the incentives align with the requirements of all parties involved. Facilitating the transition of enterprises from linear to circular models requires substantial changes in both attitudes and business processes. Recognition prizes and public endorsements are examples of behavioural incentives that can inspire firms to exhibit leadership in circular economy practices (Valencia et al., 2023; Ting et al., 2023; Mohd Ali et al., 2024).

Technological strategy ranks fifth. Fostering innovation, research, and development is crucial to advancing and adopting circular-economy technologies. Velenturf and Purnell (2021) documented that a circular economy focused on technology can generate economic gains while alleviating pressure on the environment, and that it enjoys a positive reception from organisations across the public, private, and civic sectors. Thus, granting tax credits and cash incentives to enterprises that invest in research and development for circular technology and sustainable product designs can effectively foster innovation. The establishment of innovation hubs and research centres specifically dedicated to circular-economy technologies more effectively reinforces this objective. Implementing technology transfer from industrialised nations can also enable Malaysia to acquire cutting-edge circular economy technologies. Promoting partnerships between local enterprises and multinational corporations fosters knowledge exchange and facilitates technological progress. Facilitating the implementation of sophisticated recycling, remanufacturing, and waste management technologies through tax incentives and subsidies can effectively demonstrate their practicality and advantages (Velenturf & Purnell, 2021; Kazakova & Lee, 2022; Genc, 2024).

Finally, there is the environmental and sustainability strategy. Developing sustainability metrics to quantify the environmental impacts of circular-economy operations is of utmost importance. As a prerequisite for obtaining tax benefits, businesses should be obligated to disclose their circular economy activities and advancement status. Thorough environmental impact evaluations ensure that circular-economy methods, encouraged by tax incentives, do not result in unforeseen adverse effects. Incorporating the findings of these evaluations to enhance and optimise the tax incentive programs is crucial. Implementing procedures for periodic evaluation and adjustment of tax incentives ensures their ongoing effectiveness and alignment with evolving sustainability objectives. The involvement of independent auditors in evaluating the environmental and economic consequences of the tax incentives ensures transparency and accountability. DeSimone et al (2021) find that the internal audit function correlates with the release of sustainability reporting, while Arif et al (2021) provide a relationship between audit committee attributes with a more pronounced effect on environmental disclosure (DeSimone et al., 2021; Arif et al., 2021; Velenturf & Purnell, 2021).

CONCLUSION

Implementing tax incentives to promote a circular economy in Malaysia requires a comprehensive, multifaceted approach. By effectively addressing economic, policy, administrative, social, technological, and environmental issues, Malaysia can create a conducive environment for enterprises to embrace sustainable practices. In addition to fostering environmental sustainability, this all-encompassing strategy will stimulate economic growth and innovation, establishing Malaysia as a frontrunner in the shift towards a circular economy. Incorporating financial incentives to promote the circular economy can propel Malaysia towards sustainable growth, but it necessitates a meticulously planned approach (Milios, 2021; Vence & López Pérez, 2021; Ting et al., 2023; Rehman et al., 2022).

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