# REINVESTMENT ALLOWANCE (RA)

- w.e.f. YA 1998
- Given to Co
- ≠ qualifying project
- No need prior approval from IRB/MIDA

RA

Mutually exclusive

PS/IAA/ITA/Sch 4A (Expenditure on approved agricultural project) (Pg 29-30, PR 10/2020)

Malaysian resident company not falling under the excluded activities in Appendix A

Agro - based co-operative society
+ Area/Federal/State Farmer's Asso.
+ Area/National/State Fishermen's Asso.

Agricultural sector

w.e.f. YA1999

In operation 36 months

No

≠ RA

Yes

Incur QCE on

HP = capital portion
P & M = capable of being used ie date of commencement of the commercial production ie after trial run
B = Date of completion / purchase

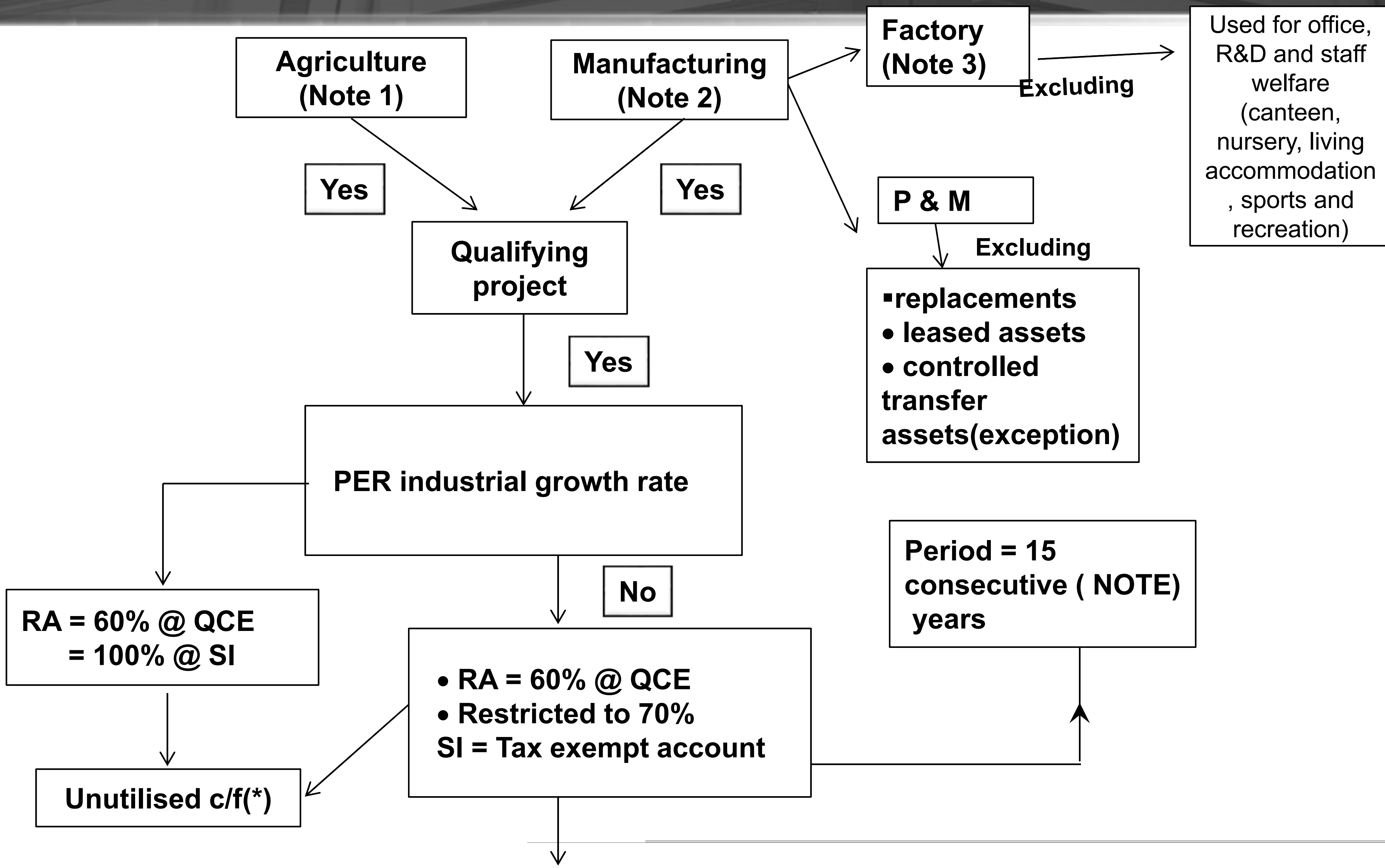
Yes

Agriculture

Yes

Manufacturing

# REINVESTMENT ALLOWANCE (RA) (Cont'd)




(*) Next Slide

# Special RA

| YA in which the existing 15 consecutive YAs incentive period ended | YA in which the capital expenditure is incurred that qualifies for the Special RA claim |
|---|---|
| YA 2019 or prior YAs | YAs 2020 to YA 2024 |
| YA 2020 | YAs 2021 and YA 2024 |
| YA 2021 | YA 2022  to 2024 |
| YA 2022 | YA 2023  to 2024 |
| YA2023 | YA2024 |
| | |

# Unabsorbed RA b/f (*)

Must utilize within a period of 7 consecutive YAs (pg 329) Eg 39-40, PR10/2020

| RA 15 consecutive YA expired in | YA in which unutilised RA will be disregarded |
|---|---|
| Up to YA2018 | 2026 |
| 2019 | 2027 |
| 2020 | 2028 |
| 2021 | 2029 |
| 2022 | 2030 |

# Unabsorbed RA b/f (*)

Must utilize within a period of 7 consecutive YAs ,Eg 41-42, PR10/2022

| Special RA 5 consecutive YA expired in ( PENJANA) | YA in which unutilised RA will be disregarded |
|---|---|
| YA 2024 | YA 2032 |
| | |

# REINVESTMENT ALLOWANCE (RA) (Cont'd)

- RA = 60% @ QCE incurred
- Restricted to 70%

SI = Tax exempt account

↓

QCE disposed(*) of ≤ 5 years

→ Alienated / Sold / Conveyed / Transferred / Assigned — With or without consideration, if there is a change in the floor area- deemed ceased to be used

→ Ceased to be used ( including assets classified as AHFS(wef YA2016)

Yes ↓

RA withdrawn in that YA deemed disposed of

↓

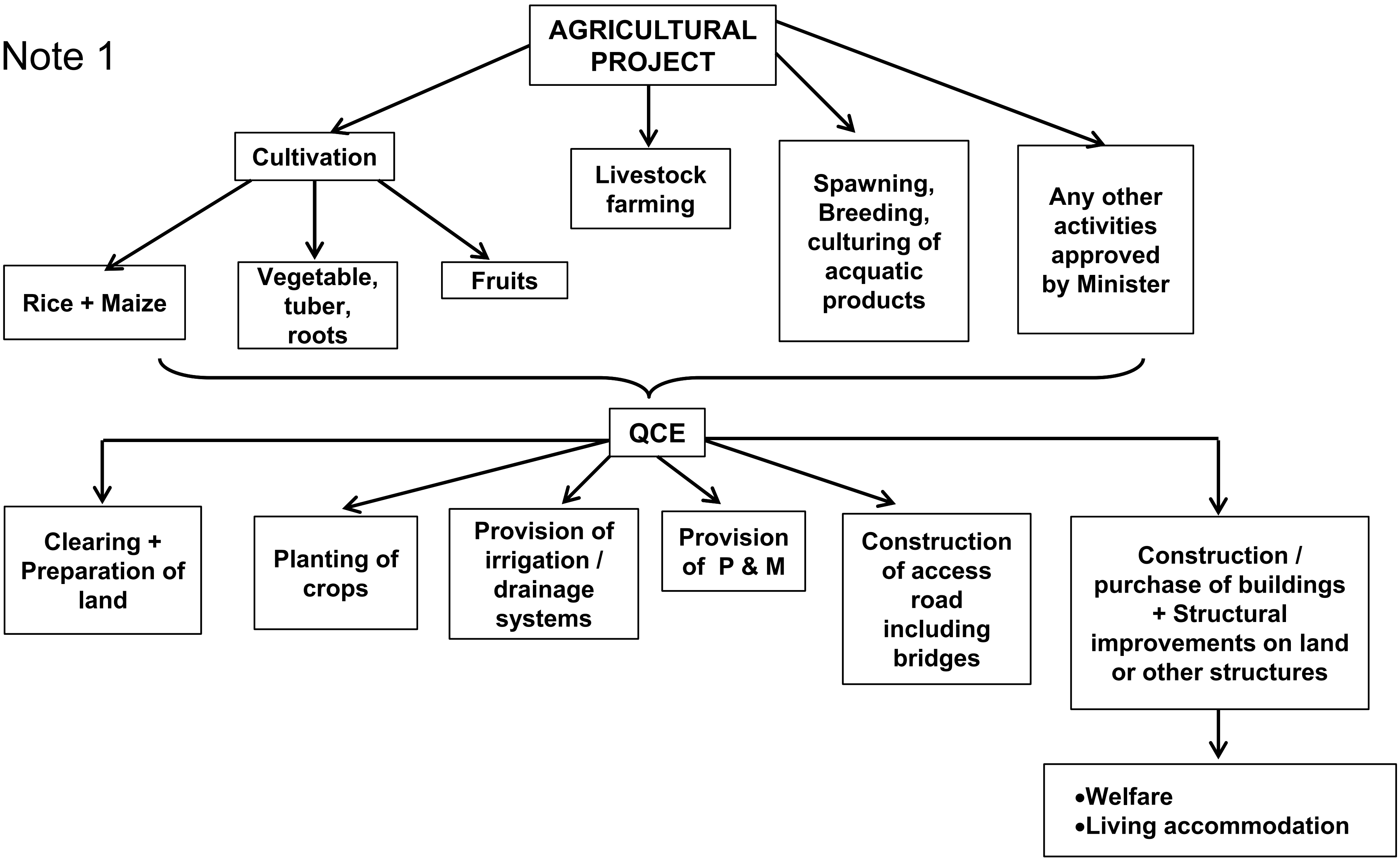
Tax exempt account = companies ≠ society / asso.

*Eg 30, 31 PR 10/2020*

**(*)** *does not include destruction by fire, flood or any other such disasters. RA claimed for the assets which are destroyed under such circumstances would not be withdrawn.*

# REINVESTMENT ALLOWANCE (RA) (Cont'd)

Note 1



# REINVESTMENT ALLOWANCE (RA) (Cont'd)

- **Note 1 ( Cont'd)**

*The activities described above are to promote the production of food. Hence,*
*-spawning, breeding or culturing of ornamental fish, culturing of pearls and cultivation of flowers are not included and <u>do not qualify for RA.</u>*
*-Cultivation of oil palm, coffee, cocoa, coconut and other similar crops are not included as cultivation of fruits and therefore are <u>not eligible for RA.</u>*

# Definition of factory building

- **capital expenditure incurred on a building or an extension of the building used for the purposes of qualifying project if it is used to place plant or machinery or to store any raw material, or goods or materials manufactured prior to sale;**
- **where part of the building or extension is used for the storage of raw material, goods or materials, the part of the building or extension used for such storage must not be more than one-tenth of the total floor areas of that building or extension.**

***( Pg 12, PR 10/2020)***

# Manufacturing (Note 2)

**Paragraph 9 of Schedule 7A of the ITA 1967 defines manufacturing as :-**

a) **Conversion - manual/mechanical means - organic/inorganic materials → a new product - changing the ~~size~~, ~~shape~~ ( deleted wef YA2016) , composition, nature /quality of such materials;**
b) **Assembly of parts → a piece of machinery or products; or**
c) **Mixing of materials - chemical reaction process including biochemical process - changes the structure of a molecule – the breaking of the intra molecular bonds or by altering the spatial arrangement of atom in the molecule, but *<u>does not include</u>* :-**
   i. **Installation of machinery/equipment – purpose of construction;**
   ii. **Simple* *packaging* operations e.g. bottling, placing in boxes, bags & cases;**
   iii. **Simple* fixing;**
   iv. **Simple* mixing of any products;**
   v. **Simple* assembly of parts;**

# Manufacturing (Cont'd)

**Paragraph 9 of Schedule 7A of the ITA 1967 defines manufacturing as :-**

**c) vi. Any activity – ensure the preservation of products in good condition during transportation & storage**

**vii. Any activity to facilitate shipment & transportation;**

**viii. Any activity of packaging/presenting goods for sale; or**

**ix. Any activity that may be prescribed by the Minister, notwithstanding the above interpretation.**

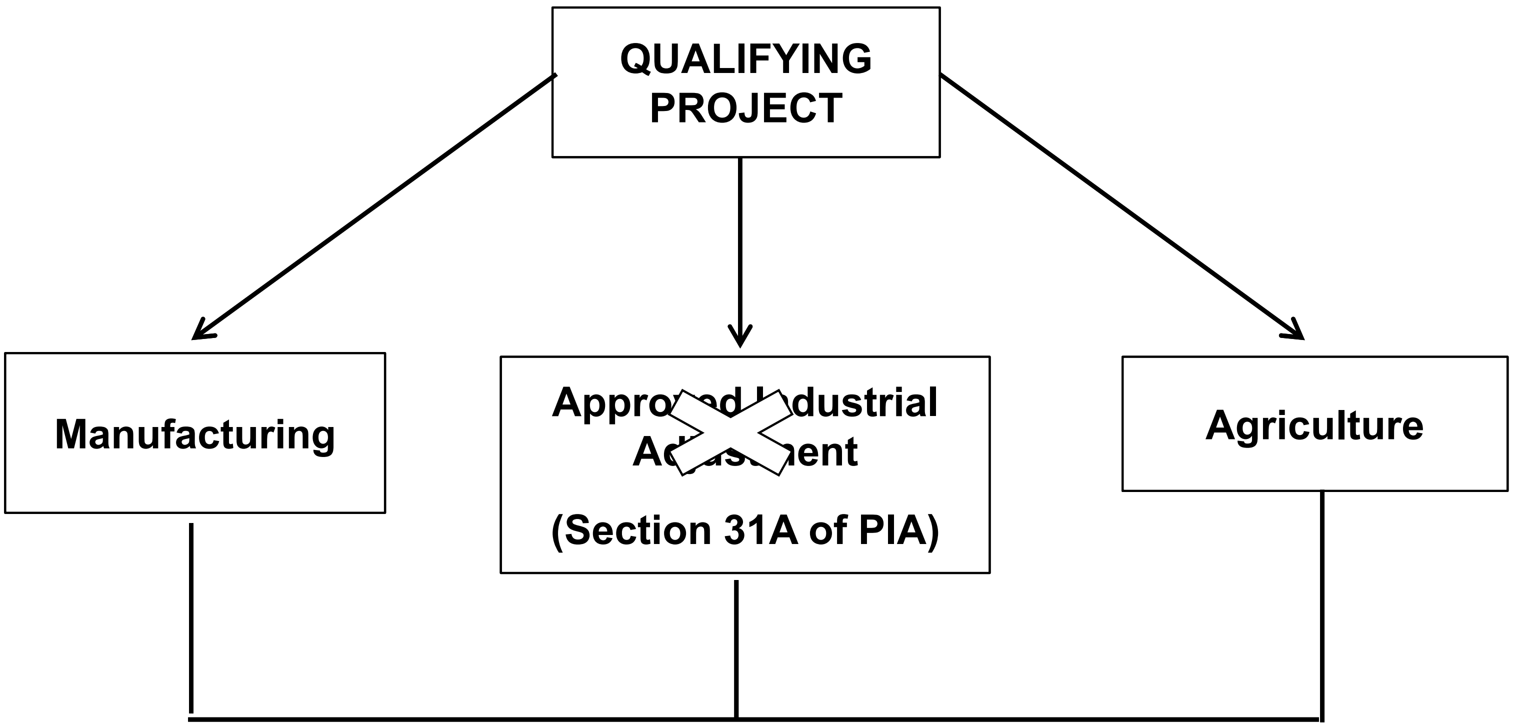
*simple = activity which does not need *special* skills, special machines, special apparatus, or special equipment especially produced or installed for carrying out the activity *( as defined in the Act wef YA2016)*

*Eg 4 & 5 PR 10/2020*

# Treatment of waste for reuse

| Purpose | RA | Example in PR 10/2020 |
|---|---|---|
| use in the same manufacturing activity | / | 8 |
| To treat the waste material before discharging from the factory | x | 7 & 9 |
| Conversion of waste material and by-product | / | Qualify as a diversification |
| | | |
| | | |
| | | |
| | | |

# REINVESTMENT ALLOWANCE (RA) (Cont'd) - Qualifying Project




a) Expansion production capacity *(including backward integration)*
b) Modernisation of production facilities
c) Diversification into related products
d) Automating existing biz of manufacturing / processing

**Existing biz**

# Diversification

**The following are also regarded as diversification, per PR 10/2020 :-**

- **Manufacturing of by-products** ***( EG 16,PR 10/2020)***

- **Manufacturing of wastes into a related product** ***( EG 15 PR 10/2020)***

- **Forward integration refers to moving from existing production of raw materials/intermediate products to the production of downstream products such as another intermediate product or an end product**

***( EG 14, PR 10/2020)***

# REINVESTMENT ALLOWANCE (RA)

- Conditions:

✓ Tax resident company

✓ Have been in operation for $>_=$ 36 months

✓ Incurred capital expenditure on factory, P & M in the basis period for YA

✓ Such assets must be in used in Malaysia

✓ For the purpose of a qualifying project for expansion, modernization, diversification or automating its existing business

# RA

March/June 2021 Q1

e) Further investment in YA 2026

(i) Explain why EMM will be eligible for the reinvestment allowance (RA) in respect of the additional investment of RM18 million; and

(ii) Explain the mechanism by which RA is deducted and quantify the tax saving potentially available to EMM.

# RA

(e) Further investment in YA 2026

(i) **Eligibility for reinvestment allowance (RA)**

We understand that in YA 2026, EMM expects to invest a further RM18 million to increase its output for export to the rest of Asia. This will render EMM eligible for reinvestment allowance (RA) because it fulfils the following conditions:

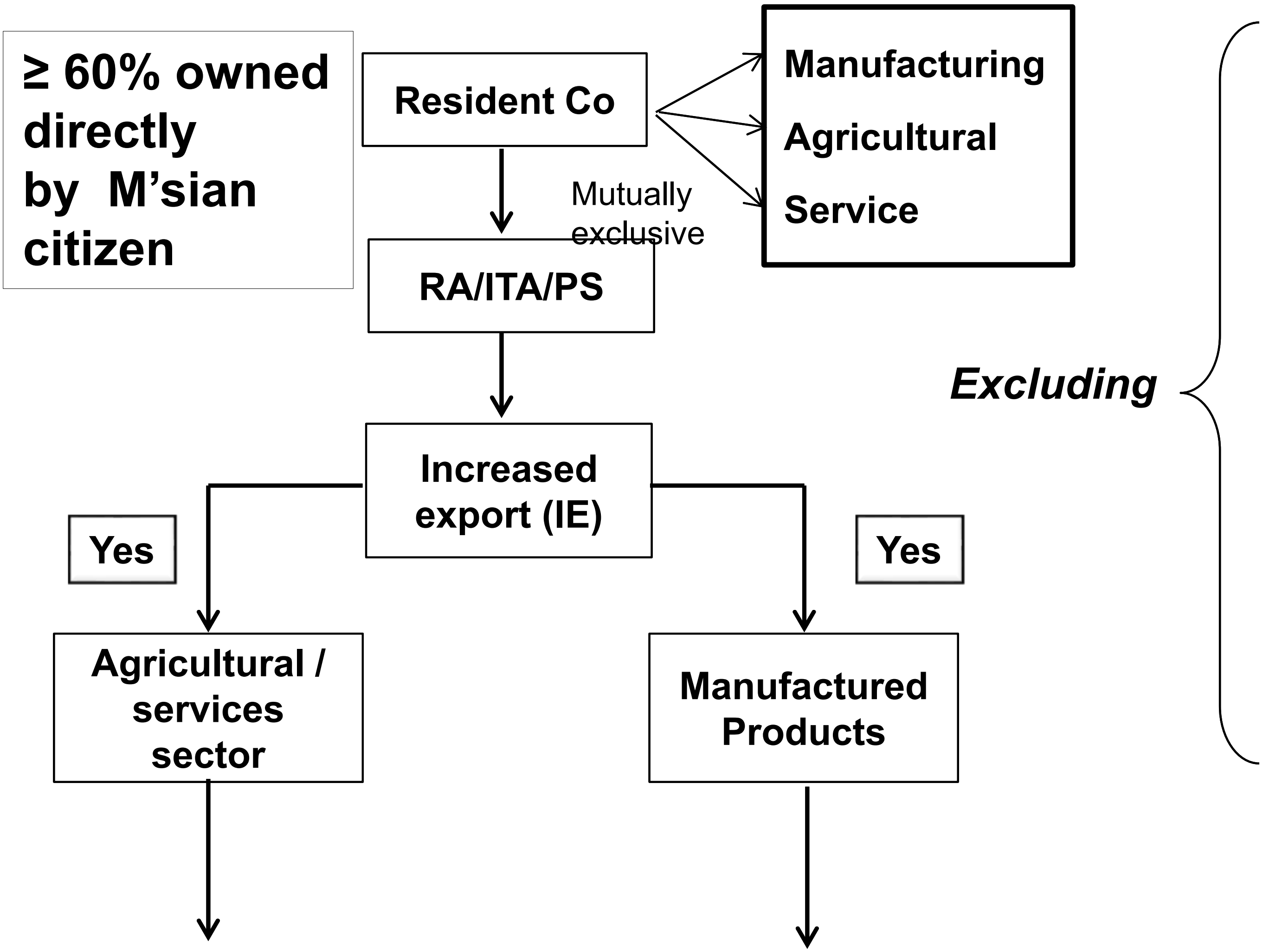
- EMM is a manufacturing company resident in Malaysia;
- In YA 2026, EMM would have been in operation for more than 36 months as it commenced operations in October 2021;
- In YA 2026, EMM intends to increase its manufacturing capacity. This is an expansion project which constitutes a qualifying project eligible for RA;
- In connection with the expansion project, EMM expects to incur capital investment of RM18 million on factory premises and machinery and equipment. This constitutes qualifying capital expenditure (QCE) for the purposes of RA;
- EMM does not expect to benefit from any tax incentive or tax exemption in YA 2026.

(ii) **RA – mechanism and tax savings**

The reinvestment will allow EMM an additional deduction of 60% of the amount of the QCE incurred, i.e. RM10·8 million (60% of RM18 million). This is deducted from a maximum of 70% of the statutory income (SI) in YA 2026. Any unabsorbed amount may be carried forward to be similarly deducted from 70% of SI in the ensuing YAs until its full absorption.

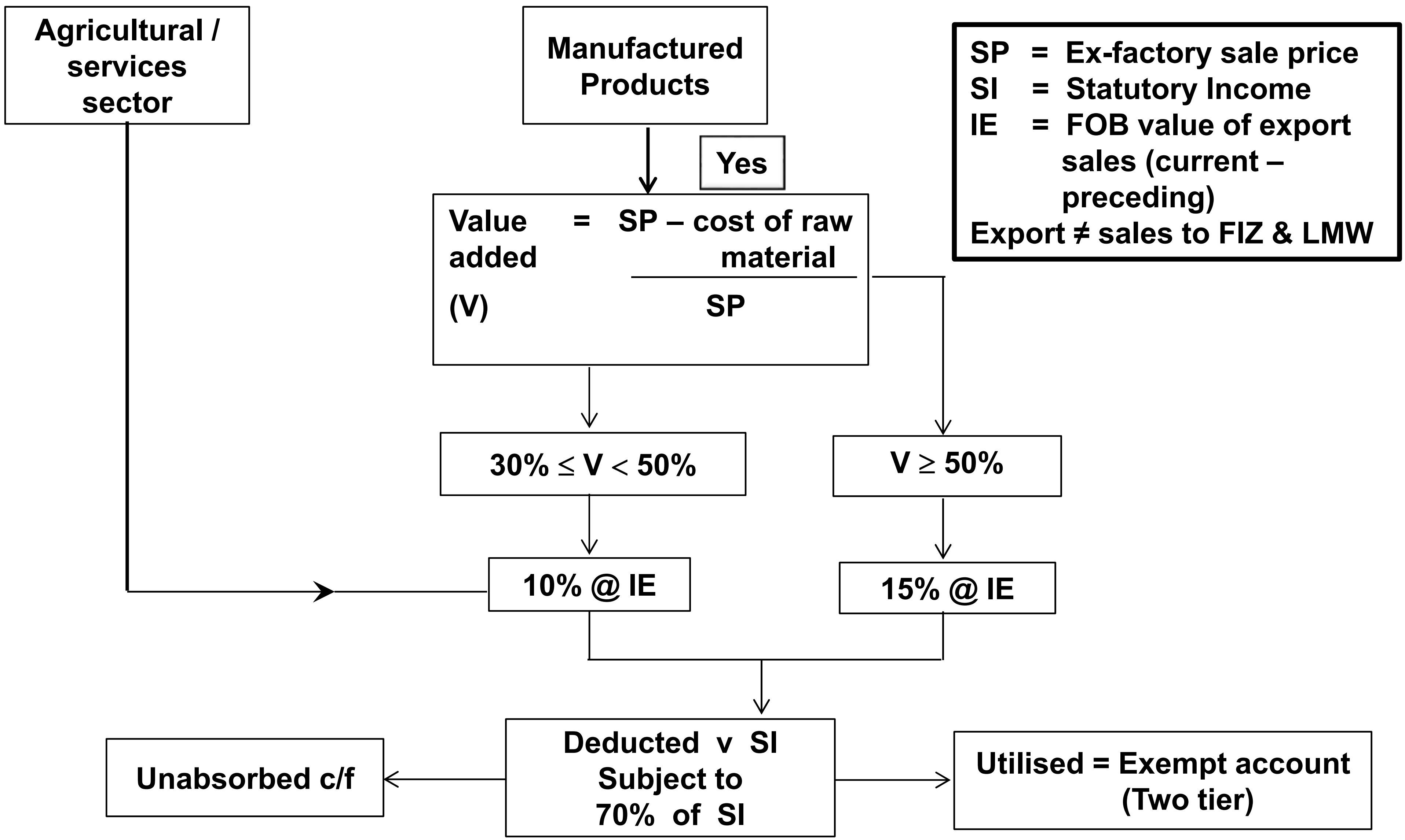
The tax saving thus potentially available to EMM is RM10·8 million at 24%, i.e. RM2,592,000.

# ALLOWANCE FOR INCREASED EXPORTS

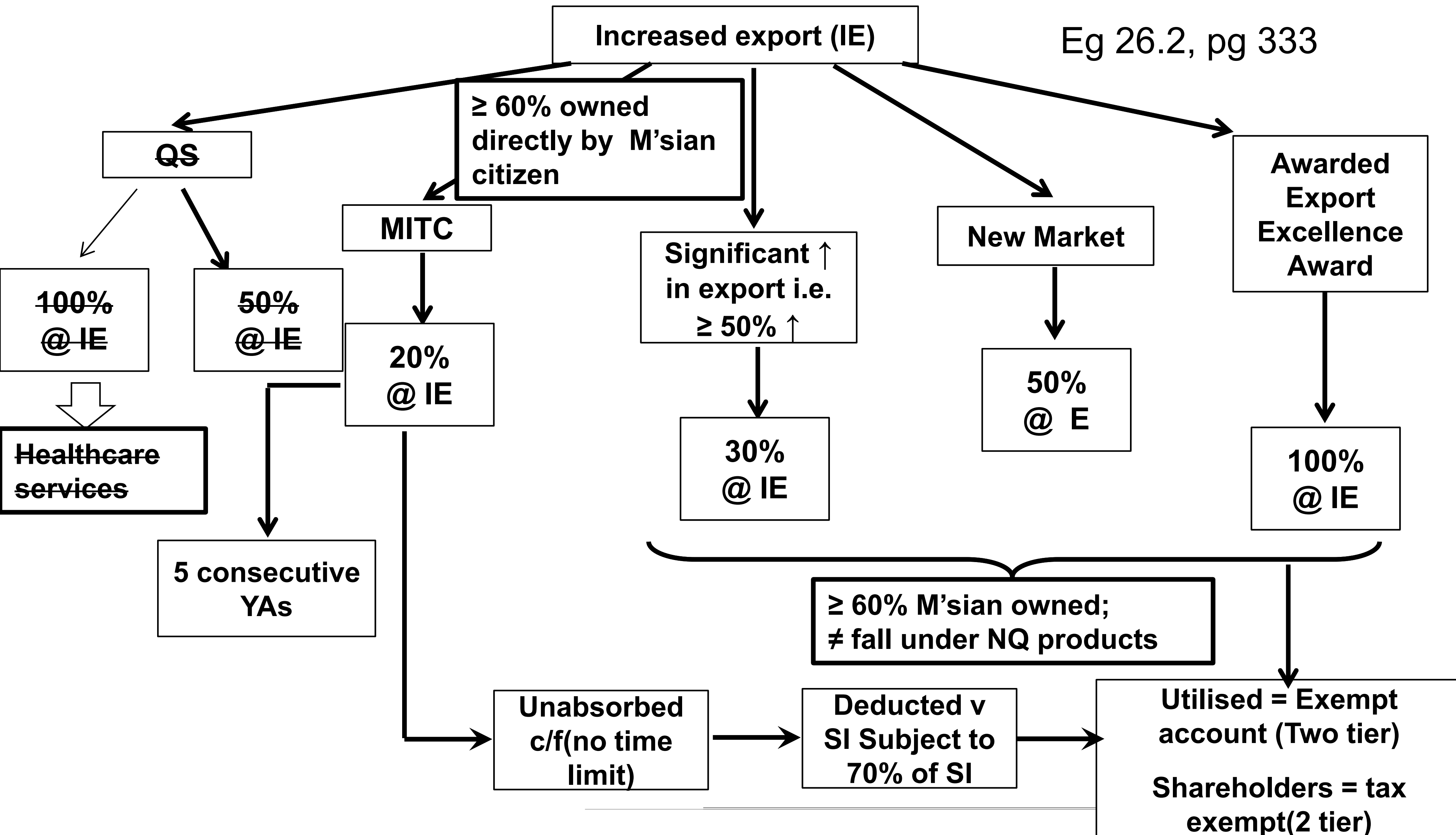



- Tin ingots or slabs, tin ore and concentrates
- Natural rubber sheet and slabs, Standard Malaysian Rubber, crepe natural rubber latex and natural gums
- Crude palm kernel oil, palm kernel cakes and crude palm oil
- Copra, copra cakes and crude coconut oil
- Logs, Sawn timber (ungraded and non-kiln dry) and wood chips (except briquettes)
- Petroleum oils (crude and other gaseous hydrocarbons (liquified or in gaseous state) hydrogen, nitrogen and oxygen.

# ALLOWANCE FOR INCREASED EXPORTS (Cont'd)



# ALLOWANCE FOR INCREASED EXPORTS



# Allowance for Increased Exports (AAIE)

| | MITC<br><br>PU(A) 60/2002 | General incentives for increased exports<br><br>PU(A) 162/2019 | Special incentive for increased exports<br><br>PU(A) 162/2019 |
|---|---|---|---|
| Applicable to | A company approved by MATRADE | • a company resident in Malaysia ; and<br>• carrying on activities of manufacturing or agriculture | • a company resident in Malaysia ; and<br>• carrying on activities of manufacturing or agriculture |

# Allowance for Increased Exports (AAIE)

| | MITC<br><br>PU(A) 60/2002 | General incentives to increased exports<br><br>PU(A) 162/2019 | Special incentive to increased exports<br><br>PU(A) 161/2019 |
|---|---|---|---|
| Conditions | • Incorporated in Malaysia and ≥ 60% Malaysian owned<br><br>• Achieved annual sales of > RM10m | • **≥ 60% owned directly by M'sian citizen**<br><br>• Agricultural produce consisting of fresh and dried fruits, fresh and dried flowers, ornamental plants and ornamental fish, frozen raw prawn or shrimp, frozen cooked and peeled prawn + frozen raw cuttlefish and squid | • **≥ 60% owned directly by M'sian citizen**<br><br>• Agricultural produce consisting of fresh and dried fruits, fresh and dried flowers, ornamental plants and ornamental fish, frozen raw prawn or shrimp, frozen cooked and peeled prawn + frozen raw cuttlefish and squid |

# Allowance for Increased Exports (AAIE)

| | MITC<br><br>PU(A) 60/2002 | General incentives to increased exports<br><br>PU(A) 162/2019 | Special incentive to increased exports<br><br>PU(A) 161/2019 |
|---|---|---|---|
| Conditions (Cont'd) | • ≤20% of the Company's annual sales is derived from the trading of commodities<br><br>• Uses local services for the purposes of banking, finance, insurance, uses local ports, airports | • Certain types of product are specifically excluded | • Certain types of product are specifically excluded |

*Eg 26.3,26.4 pg 336*

| | MITC<br><br><br><br><br>PU(A) 69/2002 | General incentives to increased exports<br><br>PU(A) 161/2019 | Special incentive to increased exports<br><br>PU(A) 161/2019 |
|---|---|---|---|
| Non application | | • Any PIA tax incentives ~~(except for Double deduction for promotion of exports)~~<br>• Reinvestment allowance under Schedule 7A<br>• Granted exemption under 127(3)(b)/127(3A)<br>• Make a claim under Section 154 except for<br>->audit fee<br>->secretary/tax fee<br>->CA<br>• Export sales of products<br>→ St prohibition of export<br>→ Listed in the Schedule | • Any PIA tax incentives ~~(except for Double deduction for promotion of exports)~~<br>• Reinvestment allowance<br>• Exemption under Section 127(3)(b) or 127(3A)<br>• Make a claim under Section 154 except for<br>->audit fee<br>->secretary/tax fee<br>->CA<br>• Export sales of products<br>→ St prohibition of export<br>→ Listed in the Schedule |

# RA vs AAIE

**- mutually exclusive**

| | **RA** | **AAIE** |
|---|---|---|
| Export s | × | √ |
| Capital intensive | √ | × |
| Tax exempt account (*) | depend on QCE incurred & utilised | depend on increase in exports & utilised |
| Unabsorbed CA (same business activity) | c/f until fully utilised | c/f until fully utilised |
| Unutilised RA / AAIE (same business activity) | c/f until fully utilized(limited to 7 consecutive Yas) | c/f until fully utilised |

# RA vs AAIE

Dec 2020 Q1

**Corporate exercise information**

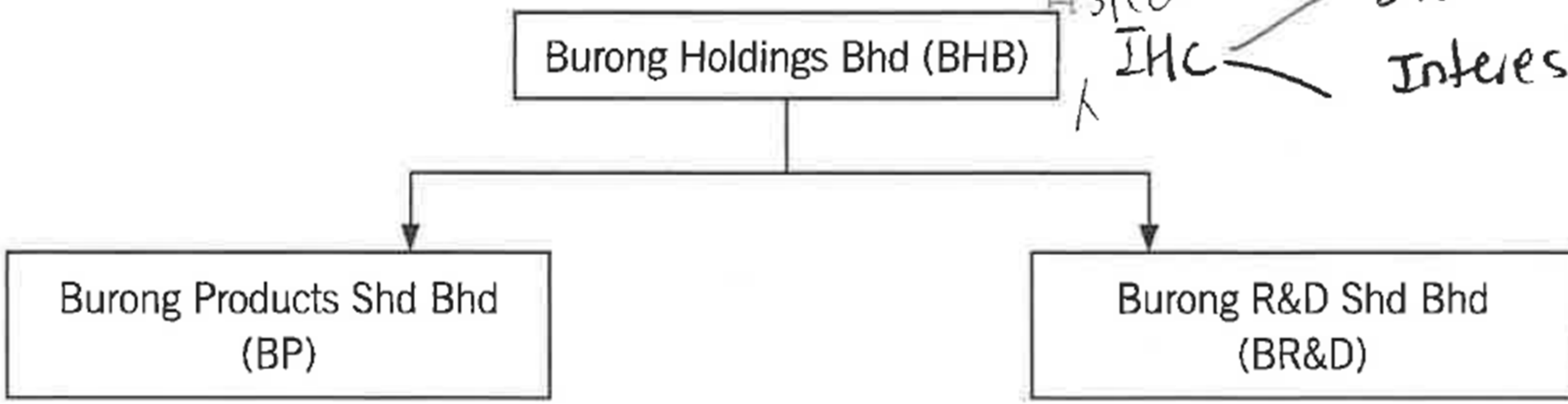
1. BP, incorporated and tax resident in Malaysia, is wholly owned by the Lee family who are citizens of Malaysia.
2. BP processes raw birds' nests into highly prized ready-to-consume bottled birds' nest essence and related birds' nest products. The tax authorities have confirmed that the activity constitutes 'manufacturing' for tax purposes.
3. BP has been exporting its products to China since 2019. Recent market surveys have indicated significant potential increase in demand in China. BP expects to register annual increases of 60% to 80% in exports for the financial years ending September 2021 to 2023. The value of the increased exports is estimated to be about RM50 million each year.
4. An initial public offer (IPO) will be launched by listing at the Bursa Malaysia in October 2023. The listed vehicle will be an investment holding company, Burong Holdings Bhd (BHB). BHB will acquire 100% of BP and incorporate a new company to carry out research and development (R&D) on birds' nest products. All three companies will be resident in Malaysia and close their accounts annually to 30 September.

# RA vs AAIE

Dec 2020 Q1

5. The corporate structure will be as follows:

listed IHC — Div, Interest income




6. The IPO is expected to raise RM80 million for BHB and the proposed utilisation is as follows:

| | RM'000 |
|---|---|
| Acquisition of 100% shareholding in BP | 20,000 |
| Loan to BP | 23,000 |
| Acquisition of 100% shareholding in BR&D | 7,000 |
| Other investments and reserves | 26,000 |
| Operating expenditure | 4,000 |
| | 80,000 |

18m to build birds' ho

5m R&D sen

YA2024

7. Of the RM23 million loan, BP will use RM18 million in October 2023 to build birds' hotels to produce its own

# RA vs AAIE

Dec 2020 Q1

Of the RM23 million loan, BP will use RM18 million in October 2023 to build birds' hotels to produce its own birds' nests so that it will not have to heavily depend on raw birds' nests from external suppliers. Birds' hotels are concrete buildings with small windows with a conducive interior environment to attract migratory swift birds to build and maintain their nests therein. These birds' nests are periodically harvested and processed into essence and other products. The tax authorities have confirmed that the production and harvesting of birds' nests constitute a 'manufacturing' activity for income tax purposes.

# RA vs AAIE

Dec 2020 Q1

**(a) Tax incentives available to BP**

**(i)** Explain why BP is eligible for the following incentives and how each incentive measure operates:

- Allowance for significant increase in exports (ASIE) of 30%; and
- Reinvestment allowance.

Remember to highlight the ownership requirement for ASIE.

**(ii)** As the two incentives are mutually exclusive, explain the importance to BP of timing claims for each incentive measure.

# RA vs AAIE

1 Report

To: Ms Long, Burong Products Sdn Bhd (BP)
From: Tax associate, Tax Firm
Date: 1 December 2020
Subject: **Tax issues arising from the planned initial public offer (IPO) by Burong Holding Bhd (BHB)**

We refer to the initial public offer exercise to be undertaken by Burong Holding Bhd (BHB) and your request for our assistance relating to tax issues.

(a) **Tax incentives available to BP**

(i) We have considered the following potential tax incentives which may be relevant given that BP will register substantial increase in exports, has expansion plans and intends to spend on research and development (R&D).

**Allowance for significant increase in exports (ASIE)**
This incentive measure is available if the following conditions are satisfied:

- The company is incorporated in Malaysia and tax resident in Malaysia;
- At least 60% of the paid-up ordinary share capital is directly owned by Malaysian citizens;
- The company manufactures and exports a product;
- The value of increased exports is at least 50% in a year of assessment (YA).

B/4 taking over

As BP is incorporated in Malaysia and a tax resident, is 100% owned by the Lee family, who are Malaysian citizens, the production of birds' nest essence and related products is considered as 'manufacturing', and it expects to register value of increased exports of 60% to 80% each YA, BP potentially qualifies for the ASIE in YAs 2021–2023.

Upon BHB's takeover of the ownership of BP after the listing exercise, BP will no longer be directly owned by Malaysian citizens: BHB, being a company rather than an individual, is incapable of being a citizen. Hence BP will not be eligible for ASIE for YA 2024 and thereafter.

citizens: BHB, being a company rather than an individual, is incapable of being a citizen. Hence BP will not be eligible for ASIE for YA 2024 and thereafter.

# RA vs AAIE

ASIE is an amount equal to 30% of the value of increased exports, estimated to be about RM50 million each year, i.e. RM15 million (RM50 million x 30%). This RM15 million is an allowance deducted from the statutory income (SI) of BP, subject to a maximum of 70% of the SI each year. Any unabsorbed amount may be carried forward.

**Reinvestment allowance (RA)**
As BP has plans to undertake upward integration by producing its own raw birds' nest, there is expansion which constitutes a qualifying project eligible for RA. The RM18 million for the building of birds' hotels will be the qualifying capital expenditure (QCE).

60% of the QCE of RM18 million will yield an RA of RM10·8 million (RM18 million x 60%) which is effectively exempt from tax. Each year, the RA allowed is up to 70% of SI. Any unabsorbed amount may be carried forward.

**(ii)** As the ASIE and RA are mutually exclusive, the respective claim must not occur in the same YA. BP expects to register 60% to 80% increase in value of exports during the YAs 2021, 2022 and 2023, so BP will be able to claim ASIE in YAs 2021 to 2023.

The qualifying capital expenditure on birds' hotels of RM18 million will be incurred in October 2023. If claimed, RA will be available in YA 2024 because RM18 million is incurred during the basis period 1 October 2023 to 30 September 2024.

BP must be mindful that the timing of the claims for ASIE and RA happens in different YAs as explained above to avoid the mutual exclusion.

# RA, AAIE, MITC ( March/June 2019)

1 Assume today's date is 4 June 2019.

You are a tax associate of Tax Firm, and one of your clients is PandaiBuat Sdn Bhd (PBSB), a Malaysian resident company which manufactures air purifiers. Last week, your tax manager held a meeting with PBSB's chief financial officer, Mr Bok Chek Wai (Mr Bok), and took the following notes:

Notes from meeting with Mr Bok

– PBSB has paid up ordinary share capital of RM4·3 million, of which 75% is held by Malaysians and the remaining 25% is held by a foreign company.

– It started producing air purifiers in January 2017 at its Shah Alam, Malaysia manufacturing complex for the domestic market. Its domestic sales are wholly transacted through its wholly-owned subsidiary, Niaga Sdn Bhd (NSB), a company incorporated in Malaysia.

– NSB also exports rubber wood, and uses Malaysian banks, insurance companies and the Klang, Malaysia port facilities in its trading business.

– In the year of assessment (YA) 2019, PBSB started to export its air purifiers directly, i.e. not through NSB.

– The value-added rate is 40%.

– Both PBSB and NSB close their accounts annually to 30 April.

Sales revenue for the financial year ended 30 April 2019, and the revenue forecasts for the following year are as follows:

# RA, AAIE, MITC ( March/June 2019)

| | y.e. 30 April 2019 (actual) RM'000 | y.e. 30 April 2020 (forecast) RM'000 |
|---|---|---|
| PBSB | | |
| Export sales of air purifiers | 2,500 | 3,500 |
| NSB | | |
| Export of rubber wood | 1,000 | 2,000 |
| Domestic sales of air purifiers | 9,500 | 9,500 |

– Mr Bok has approached your firm as he wants advice on whether it will be more advantageous for PBSB to continue exporting air purifiers directly, or to export the air purifiers through NSB. He would like to know the tax treatment and related tax issues for each option and your recommendation as to the best way to export the air purifiers in YA 2020.

– During the period January to March 2019, PBSB conducted a feasibility study regarding a plan to diversify into manufacturing air coolers. The study cost RM170,000.

– Following the positive outcome of the study, PBSB now intends to incur capital expenditure of RM2·75 million in March 2020 to set up an air cooler manufacturing facility (factory, plant and machinery) in its Shah Alam manufacturing complex. Mr Bok understands that this project will be eligible for the reinvestment allowance (RA).

# RA, AAIE, MITC ( March/June 2019)

Following the meeting, your tax manager has asked you to draft a report to PBSB addressing the following issues:

**(a) PBSB's eligibility for the allowance for increased export (AIE)**

**(i)** On the basis that PBSB exports the air purifiers directly, explain how PBSB fulfils the eligibility requisites for the AIE in YA 2020.

By the way, your tax manager has checked the law and found out that for exports with value added of at least 30% but not exceeding 50%, the allowance is 10% of the increase in exports.

**(ii)** Compute the tax savings from the AIE claimable by PBSB in respect of YA 2020.

**(b) NSB's eligibility for the Malaysian international trading company (MITC) incentive**

**(i)** Assuming NSB were to export the air purifiers, explain how NSB qualifies for certification as a MITC and is therefore eligible for the MITC incentive in the YA 2020.

**(ii)** Compute the tax savings from the MITC incentive claimable by NSB in respect of YA 2020.

**(c) The diversification project**

**(i)** Explain how PBSB is eligible for the reinvestment allowance (RA) in respect of the diversification into air coolers.

**(ii)** Compute the tax savings from the RA claimable by PBSB.

# RA, AAIE, MITC ( March/June 2019)

**(d)** Tax planning

Advise whether PBSB or NSB should export the air purifiers in YA 2020.

With regard to the diversification project, advise the best course of action in view of the mutual exclusion of the AIE and RA.

**(e)** Deductibility of the feasibility study costs

Consider whether the cost of the feasibility study carried out by PBSB would be treated as revenue or capital expenditure, and conclude as to its tax deductibility.

**(f)** Distribution of dividends by NSB

Assuming NSB claims the MITC incentive in YA 2020, and distributes both exempt dividends from an exempt account and single-tier dividends to its holding company PBSB, state:

- how much of each type of dividend may be distributed, and
- how each type of dividend is treated in the hands of PBSB.

# RA, AAIE, MITC ( March/June 2019)

Required:

Draft the report to PandaiBuat Sdn Bhd (PBSB) as instructed by your tax manager.

The following marks are available:

(a) (i) PBSB's eligibility for the allowance for increased export (AIE). (4 marks)

(ii) Computation of tax savings. (3 marks)

(b) (i) Niaga Sdn Bhd's (NSB) eligibility for the Malaysian international trading company (MITC) incentive. (5 marks)

(ii) Computation of tax savings. (3 marks)

(c) (i) The reinvestment allowance (RA) available in respect of the diversification project. (5 marks)

(ii) Computation of tax savings. (2 marks)

(d) Tax planning regarding the choice of incentives by PBSB and NSB. (3 marks)

(e) Deductibility of the feasibility study costs. (3 marks)

(f) Tax treatment of distributions by NSB to PBSB by way of:

- exempt dividends from exempt account; and
- single-tier dividends. (3 marks)

# RA, AAIE, MITC ( March/June 2019)

1 Report to PandaiBuat Sdn Bhd

From Tax Firm
To Mr Bok Chek Wai, Chief financial officer, PandaiBuat Sdn Bhd
Date 4 June 2019

This report considers the key tax issues of PandaiBuat Sdn Bhd (PBSB) and Niaga Sdn Bhd (NSB) arising from increased exports and PBSB's diversification project.

**(a) (i) PBSB's eligibility for the allowance for increased export (AIE)**

PBSB satisfies the following requirements for AIE:

- PBSB is a resident company engaged in the manufacture of air purifiers for both the domestic and export markets.
- PBSB expects to register export sales of RM3·5 million in YA 2020. This represents a 40% increase in value added [(3,500,000 – 2,500,000)/2,500,000] over the YA 2019 export sales. The rate of the AIE for PBSB will therefore be 10% of the value of increase in export sales in YA 2020 over that of the preceding year (YA 2019).

However, there is a non-application clause for AIE, if the company is granted incentives under the Promotion of Investments Act or reinvestment allowance under the Income Tax Act.

**(ii) Tax savings**

Please refer to the appendix for the tax savings arising from the claim of AIE.

# RA, AAIE, MITC ( March/June 2019)

**(b) (i) Eligibility for the Malaysian international trading company (MITC) incentive**

NSB fulfils the following conditions for certification as an MITC for the year of assessment (YA) 2020:

- NSB is incorporated in Malaysia.
- NSB is wholly owned by PBSB, which is 75% held by Malaysians. NSB is therefore effectively 75% held by Malaysians. This exceeds the minimum requirement of 60%.
- For YA 2020, if NSB were to export the air purifiers, it expects to have sales revenue of RM15 million (RM2 million + RM9·5 million + RM3·5 million) which exceeds the minimum requirement of RM10 million annual sales for an MITC.
- Of its total sales, rubber wood sales of RM2 million will constitute 13·3% (2 million/15 million) of total sales of NSB. This fulfils the requirement that no more than 20% of its sales revenue comes from the trading of primary commodities.
- As NSB uses Malaysian banks, insurance companies and Klang port facilities, it also fulfils the requirement that an MITC uses local services for the purposes of banking, finance and insurance and uses local ports and airports.

Therefore, NSB is likely to succeed when it applies to the Malaysian External Trade Development Corporation (MATRADE) for certification as an MITC. With such a letter from MATRADE, NSB will be eligible for the MITC incentive.

**(ii) Tax savings**

Please refer to the appendix for the tax savings arising from the claim of the MITC incentive.

# RA, AAIE, MITC ( March/June 2019)

**(c) (i)** The diversification project

PBSB is eligible for the reinvestment allowance (RA) in respect of the diversification into air coolers because it fulfils the following conditions:

– PBSB is a resident company in Malaysia;

– It has been manufacturing since January 2017;

– By March 2020, when the capital expenditure will be incurred, it would satisfy the minimum 36 months' operation condition;

– It will incur capital expenditure of RM2·75 million on a factory, plant and machinery used in Malaysia;

– PBSB is embarking on a qualifying project of diversification for the purposes of RA.

However, PBSB will not qualify for RA if it claims the AIE, as the two incentive measures are mutually exclusive.

**(ii)** Tax savings

Please refer to the appendix for the tax savings arising from the claim of RA.

# RA, AAIE, MITC ( March/June 2019)

**(d)** Tax planning

The tax saving accruing to NSB in claiming the MITC incentive amounts to RM216,000. This compares very favourably to PBSB claiming AIE, which yields a tax saving of only RM24,000.

Moreover, if PBSB were to claim AIE, it would not be eligible for RA in YA 2020. Considering the RA yields a hefty tax saving of RM396,000 compared to RM24,000 (for AIE), it is clear that PBSB should not claim AIE.

We recommend therefore that NSB should take on the exporting of the air purifiers, and claim the MITC incentive. PBSB will then be in a position to claim RA in YA 2020.

**(e)** Deductibility of the feasibility study costs

The feasibility study costing RM170,000 may be argued to be revenue in nature because the products (i.e. air purifiers and air coolers) are related; the latter is merely an extension of the existing business. It is incurred during the process of producing income from manufacturing and therefore constitutes a tax deductible revenue expense.

On the other hand, the expenditure pertains to a new product and was incurred during the pre-production period. Therefore, the feasibility study helps put the company in a position to decide on the launching of a new product. Viewed thus, it is not incurred in the process of producing income, but incurred in order to produce the income, it is clearly capital in nature.

On balance, we are of the view that the feasibility study expenditure is capital in nature, and is not tax deductible.

*Alternative acceptable conclusion*
*On balance, we are of the view that the feasibility study expenditure is revenue in nature, because the two products are closely related, pertaining to the same source of business, and is directly related to the income-earning process, therefore tax deductible.*

# RA, AAIE, MITC ( March/June 2019)

**(f) Distribution of dividends by NSB**

Assuming that NSB claims the MITC incentive in the YA 2020 and distributes both exempt dividends and single-tier dividends to its holding company PBSB:

– The amount of single-tier dividends which can be distributed by NSB will be restricted to the availability of its retained earnings.

  In the hands of PBSB, a single-tier dividend will be specifically exempt under the law [under paragraph 12B, Schedule 6].

– The amount of exempt dividends which can be distributed will similarly be restricted to the availability of retained earnings. It is additionally restricted to the amount of the MITC incentive of RM216,000, when it is fully absorbed against the statutory income of NSB.

  PBSB will be exempt from tax in respect of this dividend. PBSB in turn can distribute exempt dividends of up to RM216,000 to its shareholders, who will also be tax exempt under the two-tier exempt dividend provisions.

**End of report**

# RA, AAIE, MITC ( March/June 2019)

Appendix

Tax savings of the three incentive measures in YA 2020

| | | RM'000 | RM'000 |
|---|---|---|---|
| (a) (ii) | PBSB's claim for AIE | | |
| | Value of exports in YA 2019 | | |
| | Export of air purifiers | 2,500 | |
| | Value of exports in YA 2020 | | |
| | Export of air purifiers | 3,500 | |
| | Value of increased exports | | 1,000 |
| | Value added = 40% | | |
| | Therefore, tax exemption is 10% of increased exports of RM1 million, to be set off against 70% of statutory income until fully absorbed | | 100 |
| | Tax saving at 24% | | 24 |
| (b) (ii) | NSB's claim for the MITC incentive | | |
| | Value of exports in YA 2019 | | |
| | Export of rubber wood | | 1,000 |
| | Value of exports in YA 2020 | | |
| | Export of air purifiers | 3,500 | |
| | Export of rubber wood | 2,000 | 5,500 |
| | Value of increased exports | | 4,500 |
| | Tax exemption: 20% of increase in exports | | |
| | To be set off against 70% of statutory income until fully absorbed | | 900 |
| | Tax savings at 24% | | 216 |

# RA, AAIE, MITC ( March/June 2019)

**(c) (ii) PBSB's claim for RA**

| | |
|---|---|
| Qualifying capital expenditure (QCE) | 2,750 |
| RA at 60% of QCE of RM2·75 million<br>To be set off against 70% statutory income until fully absorbed | 1,650 |
| Tax saving at 24% | 396 |