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In this issue

- Public Ruling 3/2018 – Qualifying Expenditure and Computation of Industrial Building Allowances
- New public rulings on taxation of resident individuals
- Amended guideline on deduction for expenses relating to secretarial fees and tax filing fees
- Revised guideline on research & development incentives

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Public Ruling 3/2018 – Qualifying Expenditure and Computation of Industrial Building Allowances

The IRB has issued a new Public Ruling 3/2018 – Qualifying Expenditure and Computation of Industrial Building Allowances ("PR 3/2018"), which explains the IRB's tax treatment in relation to qualifying building expenditure (QBE) and computation of industrial building allowance (IBA). This follows the earlier issuance of Public Rulings 8/2016 and 10/2016 on the determination of industrial buildings.

PR 3/2018 explains the types of expenditure that would qualify as QBE and be eligible for IBA. The salient points to note from PR 3/2018 are as follows:

1. Cost of constructing additions, renovations and alterations

QBE includes capital expenditure on additions, renovations and alterations to existing buildings which is explained as follows:

- *Addition* – Costs involved in constructing additions to a building due to insufficient space in the building or other reasons in order to fulfil any requirement or usage related to a business.

- *Renovation* – Includes reconstruction of internal structures (not included in the category of plant and machinery or repairs) of a building without constructing an additional new building or reconstruction which involves structural changes to a building and improvements.

- *Alteration* – Construction work which results in overall change (significant improvement) of the original structure. In example 3 of PR 3/2018, the expenditure incurred on repairing part of a factory roof is not a QBE but is a normal maintenance expense which is a deduction under section 33(1) of the Income Tax Act 1967 (ITA).

2. Records to prove the reasons for incurring the costs

In addition to the usual record keeping of costs incurred, claimants are required to maintain documentary proof of the reasons for the addition, renovation or alteration costs. Only reasons which are reasonable and acceptable will be considered as QBE.

Based on the examples set out under paragraph 4 of PR 3/2018, the maintenance of records to prove the reasons for incurring the costs are required to determine whether the costs incurred represent:

- Addition, renovation or alteration which is QBE
- Provision of plant and machinery which is not QBE but qualifying plant expenditure
- Revenue expenditure

3. Demolition costs

Demolition costs will qualify as QBE subject to the following conditions:

1. The old building was not an industrial building, and
2. The newly constructed building is situated precisely on the same site occupied by the old building.

Our comments

The new PR 3/2018 together with Public Ruling 8/2016 – Industrial Building Part I, and Public Ruling 10/2016 – Industrial Building Part II complete the guidance for tax treatment of industrial buildings. With these public rulings, taxpayers now have clear guidance to determine which buildings would qualify as an industrial building and the types of expenditure that will qualify as QBE for purposes of claiming IBA.

Companies should take this opportunity to review the claims of IBA made to date to determine if they have been made in line with the guidance provided in the public ruling, as well as to determine if there are expenditure eligible for IBA which have inadvertently not been included in the IBA claim.

4. Purchased building - cost of land, building and legal fees

- The cost of land is to be identified separately when determining the QBE. Where cost of land and building cannot be separately identified, the claimants will need to obtain a valuation of these items from the Valuation and Property Services Department or a professional valuer.
- Based on paragraph 70 of Schedule 3 of the ITA, only the legal fees which relate to building costs represent QBE. Hence, legal fees are to be prorated into portions which relate to building costs and land costs based on the value of building and land.

5. Industrial buildings under specific paragraphs of Schedule 3 of the ITA

PR 3/2018 provides explanation on the tax treatment of capital expenditure incurred by both owners and tenants of industrial buildings falling under the following paragraphs of Schedule 3; specifically whether the expenditure incurred is to be treated as QBE in the hands of the owner and tenant of such buildings.

Paragraph of Schedule 3	Type of building
37A	Licensed private hospital, maternity home and nursing home
37B	Building used for research or training
37C	Building used for warehouse
37E	Building used for approved service project
37F	Building used for hotel
37G	Airport
37H	Motor racing circuit
42A	Building for the provision of living accommodation for employees in the business of manufacturing, hotel or tourism business or an approved service project
42B	Building for a school or an educational institution
42C	Building for the purposes of industrial, technical or vocational training

(a) Business operator is owner of building

The public ruling clarifies that in accordance with paragraph 16B, the owner of buildings falling under the paragraphs stated in the table above would only be eligible to claim IBA on capital expenditure incurred on the building if the owner also operates the business, e.g. business of a licensed private hospital under paragraph 37A.

Where part of the building is rented out, the claim of IBA to the owner is restricted to the part of the industrial building which is not rented out. However, where the floor area which is rented out is less than 10% of the whole building's floor area, then the owner is entitled to IBA claim on the whole building. Where the portion of the building which is rented out changes throughout the period of ownership of the building, the IBA claim is to be adjusted accordingly (refer to example 11).

PR 3/2018 also clarifies that paragraph 16B only applies to new buildings which are constructed or purchased from year of assessment (YA) 2016.

(b) Business operator is tenant of building

Tenants of a building are generally eligible to claim IBA in respect of the capital expenditure incurred by him on alteration or renovation on the building if the building is used as an industrial building. However, for industrial buildings under specified paragraphs of Schedule 3, the entitlement of a tenant to IBA claim on alteration or renovation costs would be dependent on whether the original building was used as the same type of industrial building.

i. Alterations or renovations on industrial buildings specified under paragraphs 37A and 37B of Schedule 3

Tenants are entitled to claim IBA on the alteration and renovation costs incurred on the following types of industrial buildings, regardless of whether the original building was an industrial building, or an industrial building of the same type:

- Licensed private hospital, maternity home and nursing home (paragraph 37A)
- Building used for research or training (paragraph 37B)

ii. Alterations or renovations on other specified industrial buildings

Tenants are only entitled to claim IBA on expenditure incurred on alteration or renovation provided the original building was of the same industrial building type as specified under paragraphs 37C, 37E, 37F, 37G, 37H, 42A, 42B or 42C.

The following are some examples provided in PR 3/2018 to illustrate the eligibility of alteration or renovation costs incurred by tenants of specified industrial buildings to IBA claim:

Type of building		Alteration/renovation costs incurred by tenant (QBE or Non-QBE)
Original building	**Building used by tenant as**	
Shop house (not IB)	Maternity home (IB under Paragraph 37A)	QBE - (does not matter whether original building is an IB under Paragraph 37A)
Maternity home (IB under Paragraph 37A)	Research building (IB under Paragraph 37B)	QBE - (does not matter whether original building is an IB under Paragraph 37B)
Shop house (not IB)	Hotel (IB under Paragraph 37F)	Non-QBE - (original building is not a hotel)
Airport (IB under Paragraph 37G)	Motor racing circuit (IB under Paragraph 37H)	Non-QBE - (original building is not a motor racing circuit)

New public rulings on taxation of resident individuals

The IRB has issued 3 new public rulings on the taxation of resident individuals. The last update to a public ruling on this topic was in 2008. The new public rulings have effectively consolidated the earlier public rulings (Public Ruling 1/2005 and 2/2005) and re-issued them in 3 separate parts, the contents of which have been updated to reflect the latest position in the legislation. The 3 new public rulings are:

i. Public Ruling 4/2018 –Taxation of a resident individual Part I - Gifts or contributions and allowable deductions ("PR 4/2018")

ii. Public Ruling 5/2018 – Taxation of a resident individual Part II - Computation of total income and chargeable Income ("PR 5/2018")

iii. Public Ruling 6/2018 – Taxation of a resident individual Part III - Computation of income tax and tax payable ("PR 6/2018")

The above 3 public rulings replace the following public rulings:

- Public Ruling 1/2005 – Computation of total income for individual
- Public Ruling 2/2005 – Computation of income tax payable by a resident individual, and its addendums

PR 5/2018 explains the determination and computation of total income and chargeable income for an individual from various sources (business, employment, and other sources such as dividends, royalties, rents, etc.) as well as the computation of chargeable income under a combined assessment for a husband and wife.

PR 6/2018 explains the determination of income tax payable after tax rebates for an individual, and under a combined assessment for a husband and wife.

PR 4/2018 explains the allowable deductions for an individual, including gifts and contribution made. The following are points to note from PR 4/2018:

Deduction for further education fees

The deduction is given to an individual for fees expended up to RM7,000 on courses in selected fields at tertiary level, and any course for a degree at Master or Doctorate levels, undertaken in any institution or professional body in Malaysia recognized by the government or approved by the Finance Minister. The list of the recognized local institutions are to be obtained from the official portal of Ministry of Higher Education at www.mohe.gov.my. However, the deduction will be disallowed if the individual fails to complete the course.

Deduction for medical examination expenses

A deduction of up to RM500 is given to an individual for expenses incurred on a complete medical examination of himself/herself, spouse or child. PR 4/2018 explains "complete medical examination" to mean a full medical check-up as defined by the Malaysian Medical Council which includes:

(a) physical examination such as eye, ear, nose, throat, neck, chest, heart, breast, abdomen, hand, foot, weight examination, blood pressure,
(b) blood and urine test, and
(c) discussion with the physician conducting the test on the results of the examination.

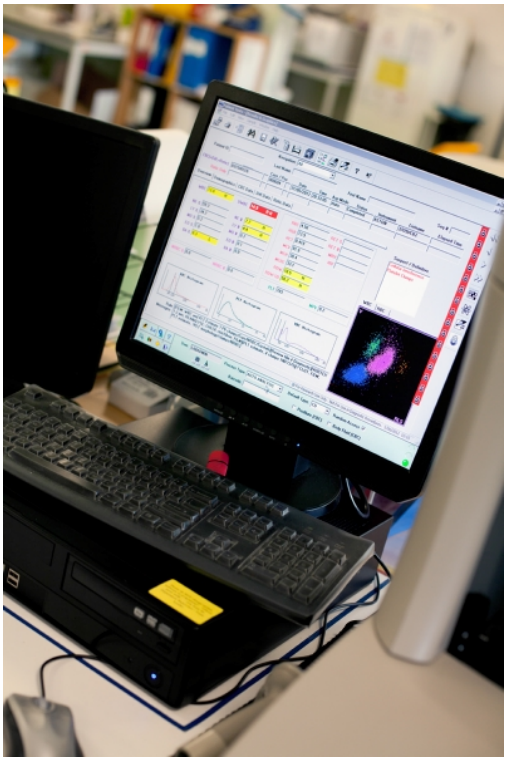
Laboratory tests such as blood tests, urine analysis and x-ray examination are not eligible for deduction as such tests cannot be categorized as a complete medical examination.

Deduction for medical treatment, special needs and carer for parents

A deduction up to RM5,000 is allowed to an individual on the expenses incurred by him for the medical treatment, special needs and carer for his parents. PR 4/2018 also provides the list of equipment that would qualify for deduction for the medical and special needs of parents. This list is however, not exhaustive and may include other equipment as determined by medical practitioners registered with the Malaysian Medical Council.

Lifestyle relief

Lifestyle relief provides an individual with a deduction for expenditure incurred on the purchase of reading materials, personal computer, tablet, smart phone, sports equipment (including gym membership) and internet subscription, for a combined total limited to RM2,500. Where fees for fitness classes (e.g. yoga, zumba, aerobics, etc.) are included in the gymnasium membership, they can be claimed as a deduction. However, if the fees for these classes are separate from the gymnasium membership fees, the fees for such classes are not allowable as a deduction.



Amended guideline on deduction for expenses relating to secretarial fees and tax filing fees

Following the issuance of a guideline for deduction of secretarial and tax filing fees dated 17 August 2018, numerous clarification had been sought by taxpayers and professional bodies on the uncertainty in relation to the deductibility of such fees. The IRB has now issued an amended guideline which reflects the IRB's position on the application of the gazette order (P.U.(A) 336/2014 - Income Tax (Deduction for expenses in relation to Secretarial Fee and Tax Filing Fee) Rules 2014) allowing deductions for such fees.

The amendments to the guideline has made clear the following IRB position on the deduction of secretarial and tax filing fees.

- Tax deduction for the secretarial and tax filing fees will only be given in a YA after the services are rendered, the liability has crystallised and is chargeable to the profit & loss account, and the amount is paid. The fee does not have to be incurred and paid in the same basis period for a YA in order for a tax deduction to be made.

- In line with the above, the IRB has amended example 4 in the guideline. Where the tax filing fee is for the filing of the YA 2015 tax return, but invoiced in 2016 and paid in 2017, the fee is allowed a deduction in YA 2017 when it is paid.

Revised guideline on research & development incentives

MIDA has issued a revised guideline on tax incentives for i) research and development (R&D) company, and ii) contract R&D company, which takes effect from 1 July 2018. Similar to the revised Green Technology guideline, this revision follows the review undertaken by the Forum on Harmful Tax Practices (FHTP) in 2017 under the Base Erosion Profit Shifting (BEPS) Action Plan 5: "Countering harmful tax practices more effectively, taking into account transparency and substance." The guideline on R&D incentives is the second guideline to be revised to comply with the FHTP review.

Under BEPS Action Plan 5 companies intending to enjoy the benefits of the R&D incentive have to ensure that substantial activities are undertaken in Malaysia. "Substantial activities" for a non-IP regime is defined as having adequate number of full-time employees working in Malaysia with the necessary qualifications and incurring adequate amount of operating expenditure to undertake the services/projects for business purposes in Malaysia.

This incentive is classified as a Non-IP regime by the FHTP. The following are the salient changes made to the guideline:

1. Exclusion from tax exemption

Income generated from Intellectual Property (IP)* will no longer be exempted.

**IP income refers to any income derived from the ownership or licensing of rights to use IP assets (such as royalties, capital gains and other income from the sale of an IP asset) and from embedded IP income (from the sale of products and the use of processes directly related to the IP asset).*

2. Eligibility criteria – New requirements

a) *Operating expenditure* – Applicants must invest an adequate amount of annual operating expenditure**.

b) *Employees* – Applicants must have adequate number of full-time employees performing research and technical functions in Malaysia with degree or diploma in technical fields with relevant experience:
   - Manufacturing-based R&D - 50% of company's total workforce
   - Agricultural-based R&D - 5% of the company's total workforce

***The operating expenditure should include local services for insurance, legal, banking, ICT and transportation; if those services could be sourced from local/domestic service providers.*

3. Treatment of tax incentive approvals

- Companies granted **approval before 16 October 2017** can continue to enjoy the existing incentive until 30 June 2021, without the imposition of the substantial activities requirements. In order to retain the incentive after 30 June 2021, companies are required to meet the new and additional requirements stated above and is required to submit an application to MIDA.

- Companies granted **approval from 16 October 2017 onwards** without the substantial activities requirements can only enjoy the existing incentive until the earlier of the publishing of the new guideline/legislation or 31 December 2018.

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