

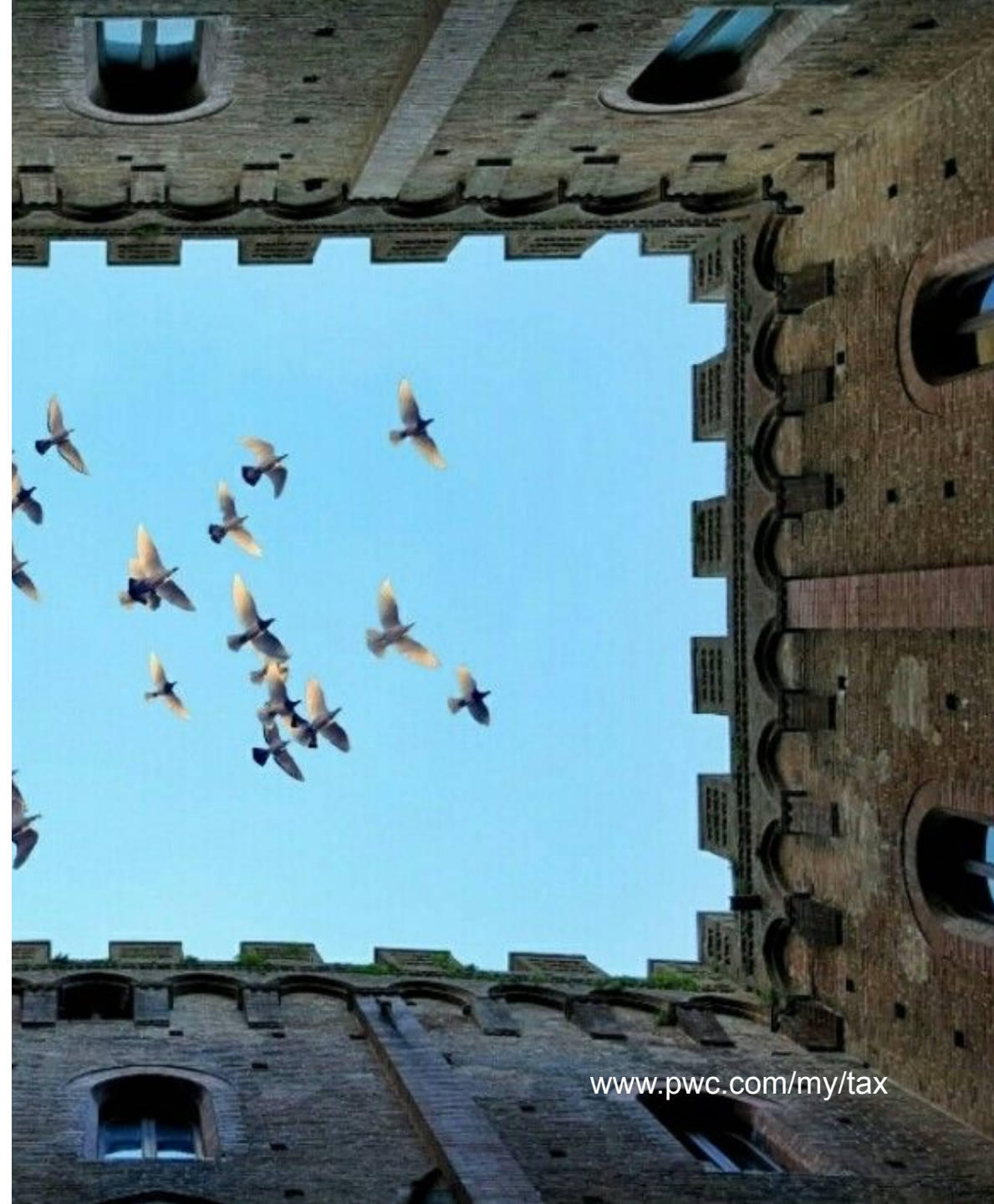


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Practice Note 1/2022 - Explanation in Relation to the Definition of Factory for Reinvestment Allowance (RA) Claims

The IRB has issued its Practice Note 1/2022 - Explanation in relation to the definition of factory for the purposes of RA claim under Schedule 7A of the Income Tax Act 1967 (ITA 1967) (the “PN 1/2022”).



The term “factory” is defined in Paragraph 9, Schedule 7A of the ITA 1967 as follows:

“Factory” means portion of the floor areas of a building or an extension of a building used for the purposes of qualifying project to place or install plant or machinery or to store any raw material, or goods or materials manufactured prior to sale**:*

*Provided that in respect of portion of the building or extension of the building used for the storage of raw material, or goods or materials, or both, it **shall not be more than one-tenth** of the total floor areas of that building or extension;*

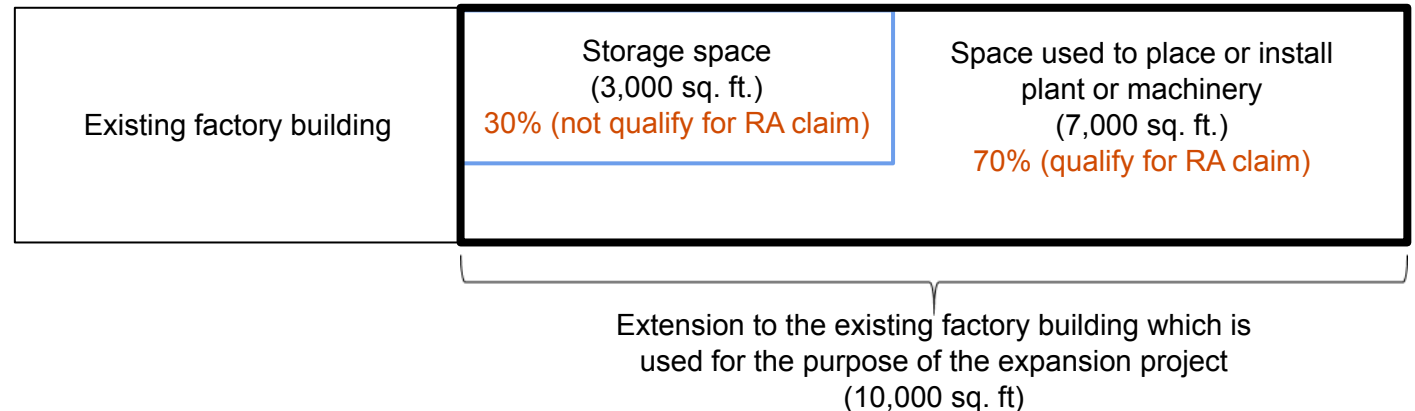
* Referred to collectively hereinafter as “production area”.

** Referred to collectively hereinafter as “storage space”.

PN 1/2022 is issued to explain the definition of ‘factory’ for the purpose of RA claim. Highlights of PN 1/2022 include:

1. IRB's current (updated) treatment where storage space is involved

Where the storage space is more than one-tenth of the total floor area of that building or extension, only the storage area is not regarded as factory. This is illustrated in Example 1 of PN 1/2022. Salient parts are reproduced below for reference.



1. IRB's current (updated) treatment where storage space is involved (cont'd)

In its previously issued Public Ruling 10/2020 - Reinvestment Allowance Part I - Manufacturing Activity (PR 10/2020) [available on IRB's website www.hasil.gov.my (Legislation > Public Rulings)], the IRB had illustrated that where the storage space exceeds 10% of the total area, the entire area would not qualify as factory for RA claims purposes. This is illustrated in Diagrams no. 1 and 2 of paragraph 8.2 of PR 10/2020 (reproduced below):

Diagram 1

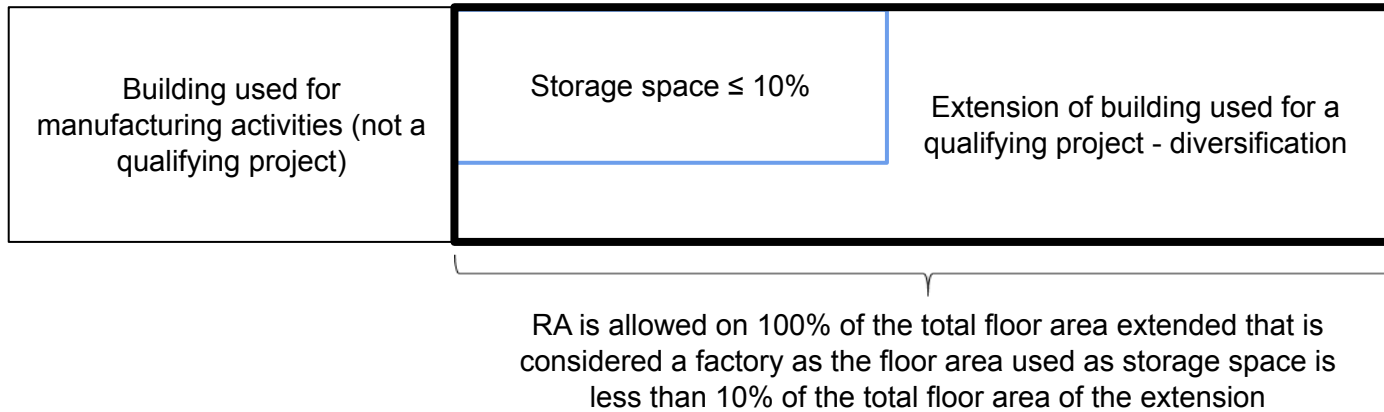
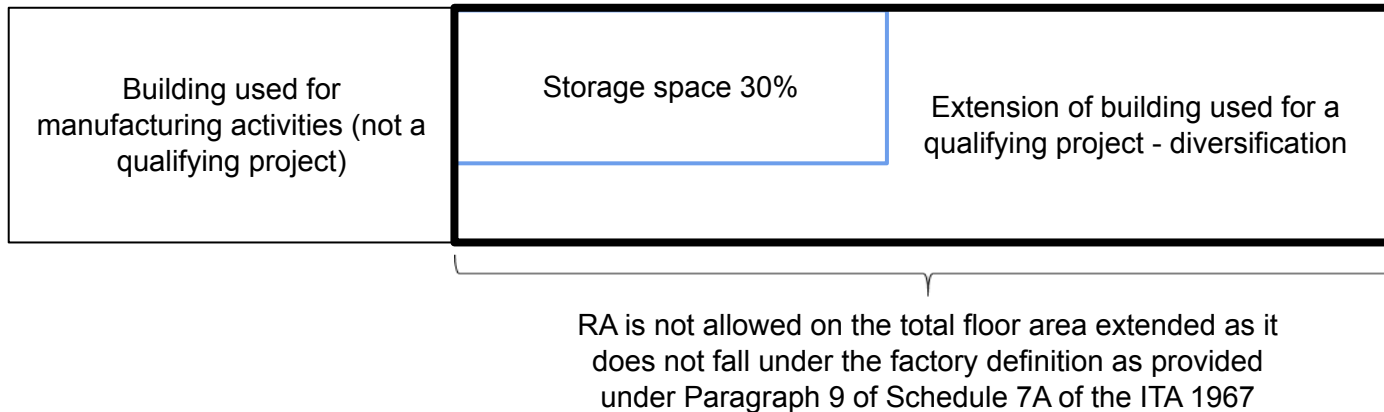


Diagram 2



2. Constituents of floor areas in determining portions which qualify as factory

In determining areas which qualify as factory, non-production and non-storage areas (e.g. sales office space) are taken out from the denominator in computing whether the storage area is more than one-tenth of the total floor area. This is illustrated in Example 2 of PN 1/2022. Salient parts are reproduced below for reference.

Existing factory building	Finished goods storage space (8,000 sq. ft) 10.67% $(8,000 \text{ sq. ft} / (8,000 \text{ sq. ft} + 67,000 \text{ sq. ft}) \times 100\%)$	Space used to place or install plant or machinery (67,000 sq. ft)
	Sales office (25,000 sq. ft)	

Extension to the existing factory building which is used for the purpose of the expansion project

**Total area for the purposes of determining “factory”
 area = 75,000 sq. ft (8,000 sq. ft + 67,000 sq. ft)**

Determination of RA eligibility for the finished goods storage space shall be based on the ratio of the said storage space area (8,000 sq. ft) to the total area of the expansion project [comprising the finished goods storage space and the space to place or install plant or machinery (8,000 sq. ft + 67,000 sq. ft)]. Based on this computation, the ratio of the finished goods storage space to the total area is 10.67%. As the finished goods storage space is more than one-tenth of the total area, it does not fulfil the meaning of factory for RA purposes. Therefore, construction costs for the finished goods storage space are not eligible for RA claims and only the construction costs for the space used to place or install plant or machinery are eligible for RA claims.



MIDA's Media Release on Amendments to the Definition of "Contract Research and Development (R&D) Company" and "R&D Company"

MIDA has issued a media release on amendments to the definition of "Contract R&D Company" and "R&D Company" in the Promotion of Investments Act 1986 (PIA 1986) including application for approval as an R&D Company.



Following the Budget 2022 measure on the amendment to the definitions of "Contract R&D Company" and "R&D Company" under Section 2 of the Promotion of Investments Act 1986 [refer to [TaXavvy Budget 2022 Edition \(Part 2\)](#)], the Finance Act 2021 has provided that existing R&D Companies and Contract R&D Companies which intend to retain their R&D status after a grace period of 6 months (from 1 January to 30 June 2022) must give notification of their intention for the Ministry of International Trade and Industry's consideration on or before the expiry of the grace period.

MIDA has recently issued a media release dated 3 February 2022 that the notification is to be submitted to MIDA for consideration. For this purpose, companies are required to provide documents to prove that they are undertaking activities relating to R&D as defined under the PIA 1986* and comply with conditions imposed previously in their approval letters.

** R&D is defined under Section 2 of PIA 1986 as any systematic, investigative and experimental study that involves novelty or technical risk carried out in the field of science or technology with the object of acquiring new knowledge or using the results of the study for the production or improvement of materials, devices, products, produce, or processes, but does not include -*

- (a) quality control or routine testing of materials, devices or products;*
- (b) research in the social sciences or the humanities;*
- (c) routine data collections;*
- (d) efficiency surveys or management studies;*
- (e) market research or sales promotion;*
- (f) routine modifications or changes to materials, devices, products, processes or production methods; or*
- (g) cosmetic modifications or stylistic changes to materials, devices, products, processes or production methods.*

The media release is available on the MIDA's website www.mida.gov.my (Legislation > Media & Events > Announcement/ Media Release).

Revision of Estimate of Tax Payable in the 11th Month of the Basis Period (11th month)

The IRB has recently updated the following with respect to the revision in the 11th month:

- FAQ on the revision of estimate of tax payable in the 11th month for the years of assessment (YAs) 2021 and 2022 and the deferment of tax instalment payments for micro, small and medium enterprises (MSMEs) (“FAQ”); and
- Application form for the revision of the estimate of tax payable in the 11th month.

Following the announcement under Budget 2022, the IRB has issued the FAQ and application form for the revision of the estimate of tax payable in the 11th month (refer to [TaXavvy 30/2021](#)).

Based on the FAQ updated on 3 December 2021, the last day for submission of the application for 11th month revision for YA 2022 is on the last day of the 11th month of the basis period. Where the 11th month falls in November 2022 (i.e. financial year ending in December 2022), the last day to submit the application is brought forward to 31 October 2022

The IRB has recently updated the FAQ and the application form to amend the timeline for submission of the revision of the estimate of tax payable in the 11 month. For YA 2022, the IRB has now stated that only companies with a financial year ending up to 30 November 2022 qualify for the 11th month revision. Companies with financial year ending in December 2022 would not be entitled to make the special revision of tax estimate in the 11th month.

The FAQ and application form is available on the IRB’s website www.hasil.gov.my (Home > FAQ MCO 3.0) and (Forms > Download Forms > Other Forms) respectively.



Earning Stripping Rules - Amendment

The Income Tax (Restriction on Deductibility of Interest) (Amendment) Rules 2022 (“Amendment Rules”) has been gazetted to amend the Income Tax (Restriction on Deductibility of Interest) Rules 2019 (“ESR Rules”).

ESR in brief

Under the ESR Rules which took effect from 1 July 2019, tax deduction on interest expense in connection with or on any financial assistance in a controlled transaction is restricted to 20% of Tax-EBITDA when certain conditions are met. Refer to [TaXavvy 9/2019](#) and [TaXavvy 11/2019](#) for further details.

For ESR purposes, the computation of Tax-EBITDA is essentially expressed using the following formula:

Adjusted income from business + *qualifying deduction* + total interest expense incurred for the business which is in connection with or on financial assistance from a controlled transaction.

Amendment Rules

Effective from 1 February 2022, the ESR Rules are amended as follows:

	Prior to amendment	After amendment
Definition of “qualifying deduction” for the computation of Tax-EBITDA	<p>Qualifying deduction means:</p> <p>“(a) an amount equal to the amount of expenditure incurred by the person computed in any deduction falling to be made under the Act where the amount of deduction is twice the amount of the expenditure incurred by a person;</p> <p>(b) any claim for deduction under any rules made under paragraph 154(1)(b) of the Act where the deduction is allowed for purposes of ascertaining the adjusted income of the person.”</p>	<p>Qualifying deduction means:</p> <p>“(a) where there is business expenditure incurred in the profit and loss account is allowed as deduction under the Act and the amount of the deduction allowed exceeds the amount of the business expenditure incurred, an amount equal to the difference between the amount of the deduction allowed and the amount of the business expenditure incurred in the profit and loss account; or</p> <p>(b) where there is no business expenditure incurred in the profit and loss account, the amount of deduction allowable under the Act.”</p>

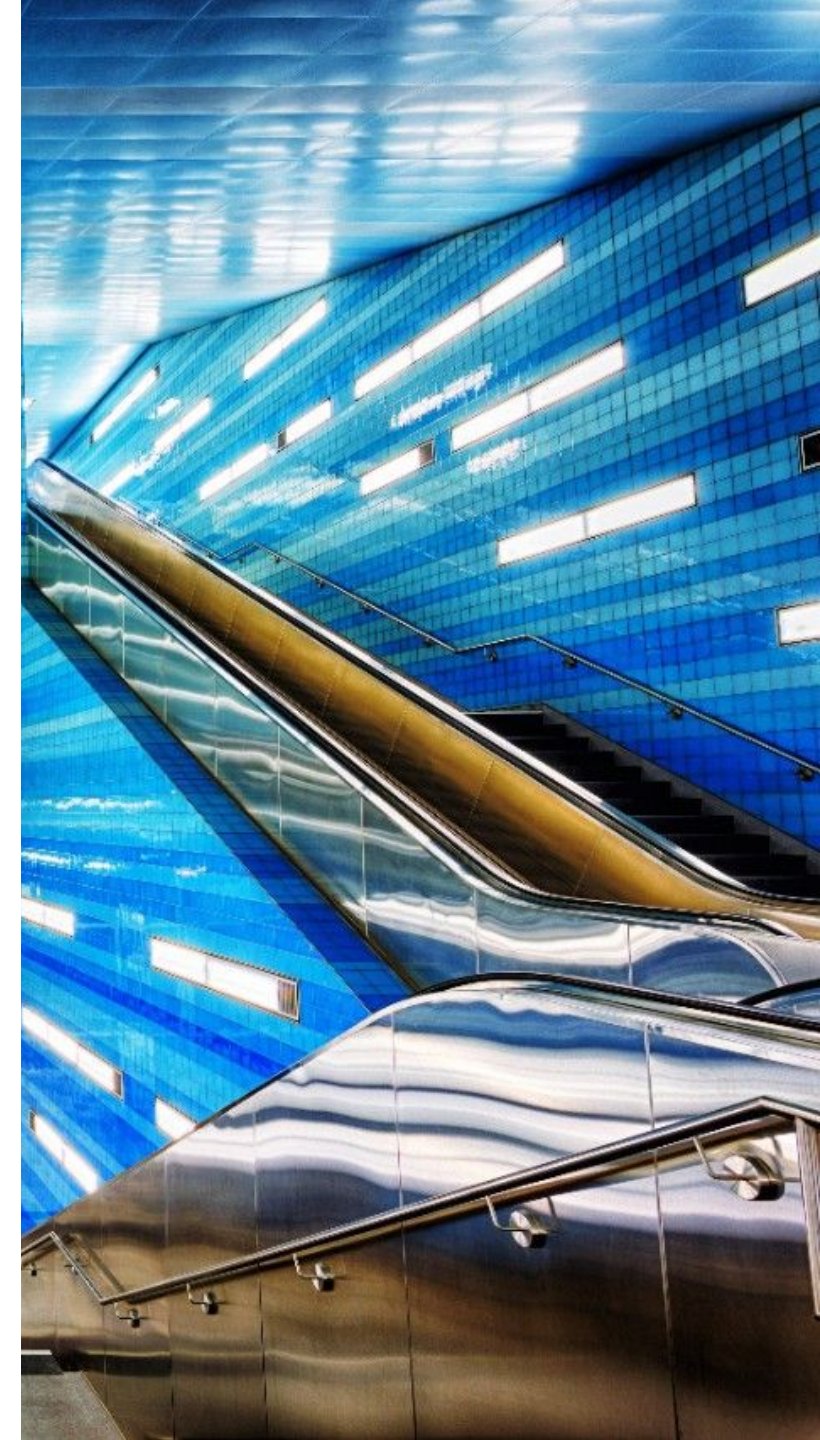


Amendment Rules (cont'd)

Prior to amendment	After amendment
<p>Definition of “qualifying deduction” for the computation of Tax-EBITDA</p>	<p><i>Comment:</i> The new definition of qualifying deduction provides a formula to reverse incentive claims* deducted in arriving at adjusted income.</p> <p><i>*e.g. special deduction, further deduction, double deduction, etc.</i></p>
<p>Carry forward rules</p>	<p>The carry forward rules now apply to any <i>person</i>, and is not limited to a company.</p> <p>In respect of companies, the eligibility to carry forward interest expense which has been restricted remains to be subject to the existing shareholders’ continuity test.</p>

Carry forward rules were specified only for a *company*.

Note: The carry forward rules allow interest expense restricted under ESR Rules in a year of assessment (YA) to be carried forward and deducted against adjusted income from business for the subsequent YAs. It is, however, subject to satisfying the substantial shareholders continuity test. Refer to [TaXavvy 9/2019](#) for further details.



Guidelines on Prescribed Labuan Business Activities for Non-Licensed Trading Entities

The Labuan FSA has issued the Guidelines on Prescribed Labuan Business Activities for Non-Licensed Trading Entities in Labuan International Business and Financial Centre.

As previously outlined in [TaXavvy 1/2022](#), the Labuan Financial Services Authority (Labuan FSA) has issued a FAQ on Labuan Business Activity (Requirements for Labuan Business Activity) Regulations 2021 dated 14 December 2021 (“FAQ”) to provide details on activities covered under item 20* of the First Schedule of the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2021.

Subsequent to the issuance of the FAQ, the Labuan FSA has issued the Guidelines on Prescribed Labuan Business Activities for Non-Licensed Trading Entities in Labuan International Business and Financial Centre (“Guidelines”) to provide details on the said activities. The guidance set out in the Guidelines are not materially different from those stated in the previously issued FAQ.

The Guidelines are effective from 1 January 2019.

*Activities under item 20 are:

- Administrative services
- Accounting services
- Legal services
- Backroom processing services
- Payroll services
- Talent management services
- Agency services
- Insolvency related services
- Management services other than Labuan company management



Accelerated Capital Allowance for Excursion Buses

The Income Tax (Accelerated Capital Allowance) (Excursion Bus) (Amendment) Rules 2022 (the “Amendment Rules”) has been gazetted. The Amendment Rules is effective from YA 2022.

The Amendment Rules amend the Income Tax (Accelerated Capital Allowance) (Excursion Bus) Rules 2021 to give effect to the Budget 2022 proposal to extend the accelerated capital allowance (initial allowance 20%; annual allowance 40%) for acquisition of locally assembled excursion buses by licensed tour operators for another 3 YAs from YA 2022 to YA 2024.

Refer [TaXavvy 22/2021](#) for details on qualifying conditions.

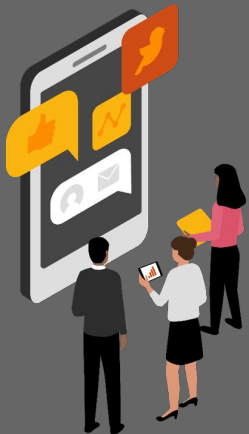


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