Crowe Perspective:

Automation Capital Allowance Incentive

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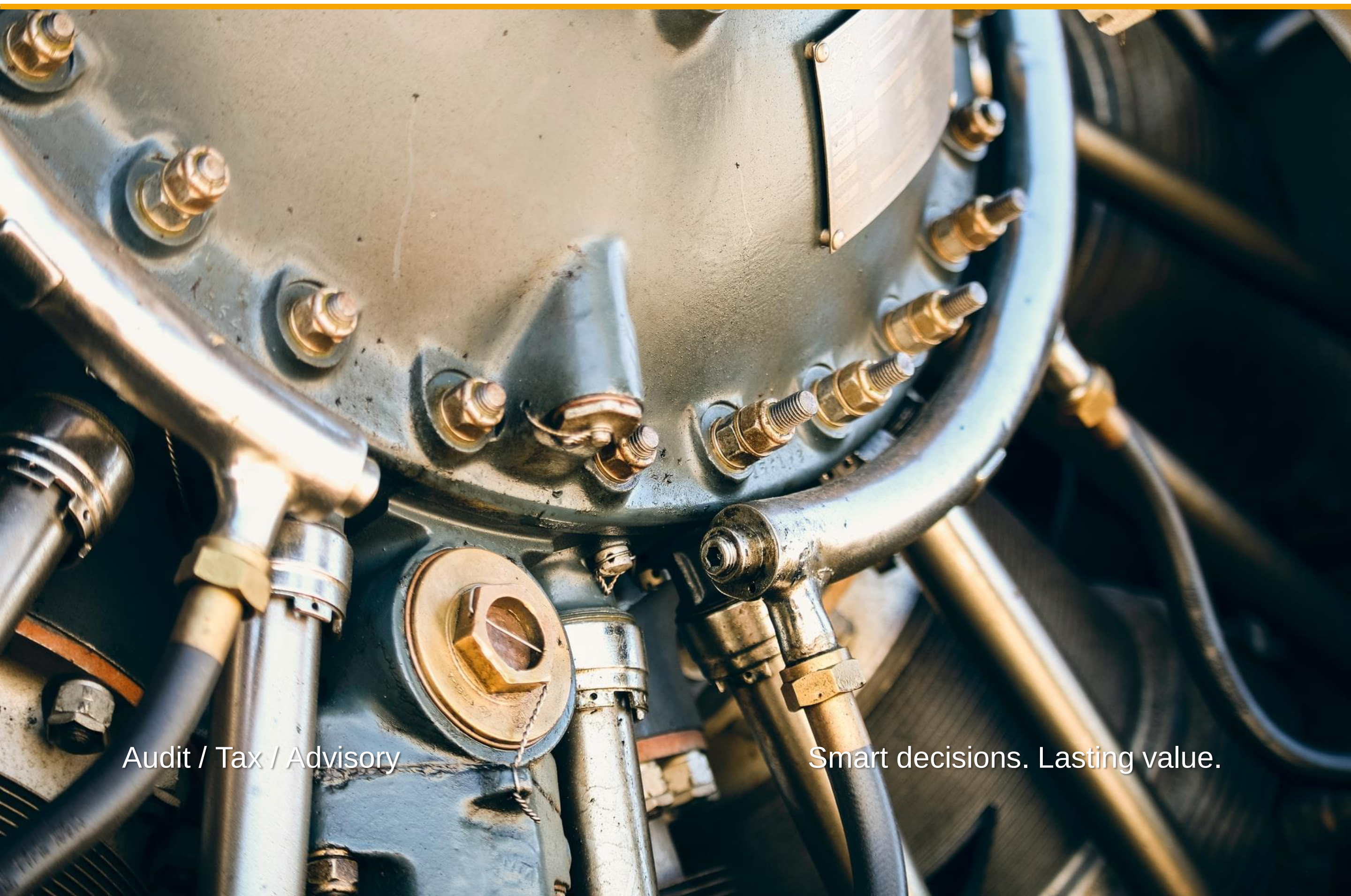

Introduction

The Automation Capital Allowance (Automation CA) incentive was first introduced in Budget 2015. The main objective of this incentive is to encourage automation in the manufacturing sector.

The Automation CA incentive is segregated into 2 industry categories i.e. labour intensive industries such as rubber, plastic wood, furniture and textile (Category 1) and other industries (Category 2).

In Budget 2020, the scope of Automation CA incentive under Category 2 was expanded to include the services sector. This was to enable service providers to invest in automation equipment in order to achieve greater efficiency and productivity in their service delivery.

The Automation CA incentive is not granted automatically. The qualifying company is required to apply and obtain prior approval from the Malaysian Investment Development Authority (MIDA) and undergo technical verification by the Standard and Industrial Research Institute of Malaysia (SIRIM) before applicants can enjoy the Automation CA incentive.

Furthermore, the Automation CA and other incentives such as Reinvestment Allowance (RA), Pioneer Status, Investment Tax Allowance are mutually exclusive.

In this article, we will discuss the key differences between RA incentive and Automation CA, and the key considerations for manufacturing companies in selecting the best incentive for their investment in automation equipment.

Key eligibility criteria for Automation CA incentive – Manufacturing Sector & Service Sector

Category	Rates of incentives	Amount of capital expenditure
Category 1: Manufacturing companies in the labour intensive industries	100% accelerated capital allowance (ACA) and 100% income tax exemption (ITE) equivalent to the ACA	Up to RM 4 million
Category 2: Manufacturing companies in other industries and service sector	100% ACA and 100% ITE equivalent to the ACA	Up to RM 2 million Note: The gazette order for the Automation CA for services sector is still pending as at to-date.

- Incorporated under Companies Act 2016 and resident in Malaysia.
- Engages in manufacturing activities / service activities and holds a business licence issued by the relevant authority.
- Automation equipment is certified by SIRIM which is more advanced than the current technology used in its manufacturing activity or service delivery
- Automation equipment must be used at least one (1) month after the installation / commissioning of the equipment for the purposes of technical verification by SIRIM.
- Has been in operations for a period of at least thirty-six (36) months.
- Incurred qualifying expenditure in the relevant basis period for the Years of Assessment (YAs) 2015 to 2023 (manufacturing sector) and YAs 2020 to 2023 (services sector)
- Submit application for Automation CA to MIDA by 31 December 2023.
- All supporting documents such as invoices, purchase orders, delivery orders and proof of payments are verified by an external auditor. The entire cost of the automation equipment must be paid.
- Possess a permit / licence / registration / accreditation / certificate / approval letter/ supporting letter from relevant Ministry / Agency / Regulator (for service sector).

Key differences between Automation CA and Reinvestment Allowance

	Reinvestment Allowance	Automation CA
Incentive period	15 consecutive YAs commencing from the first qualifying capital expenditure (QCE) incurred: YA 2020 to YA 2022 (PENJANA) YA 2023 to YA 2024 (Budget 2022)	Category 1: YAs 2015 to 2023 Category 2: YAs 2015 to 2023 Services sector: YAs 2020 to 2023
Promoted sectors	Manufacturing and selected agriculture activities	Manufacturing and services sector
Features of the incentive	RA equivalent to 60% of the QCE incurred on a factory, plant or machinery used in Malaysia	Category 1:100% ACA & 100% ITE on the first RM4 million on QCE incurred Category 2 and Service Sector: 100% ACA &100% ITE on the first RM2 million on QCE incurred
Qualifying projects	Expansion, diversification, modernisation or automation	Modernisation or automation
Additional requirements	No prior approval is required from MIDA, SIRIM or other authorities	Prior approval from MIDA is required. Jointly evaluated by MIDA and SIRIM on the non-technical and technical requirements.
Withdrawal provision	RA will be withdrawn if the assets are disposed of within 5 years	ACA – Normal CA rules apply ITE – ITE will be withdrawn if the assets are disposed of within 5 years
Timeline to utilise the unabsorbed RA / ACA	Unabsorbed RA can be carried forward for a period of seven (7) consecutive YAs upon the expiry of qualifying period of RA	Unabsorbed ACA and ITE can be carried forward to future years until fully absorbed
Non-application	Mutually exclusive with Pioneer Status (PS), Investment Tax Allowance (ITA), Allowance for Increased Exports (AIE), selected rules under Sections 127(3)(b), 127(3A) and 154 of the Malaysian Income Tax Act, 1967 (MITA).	Mutually exclusive with PS, ITA, AIE, Sections 127(3)(b), 127(3A) and 154 of the MITA (except for rules relating to allowance under Schedule 3 to the MITA, special deduction for audit expenditure, secretarial fee & tax fee and ACA for ICT equipment).

How to choose a suitable incentive – Reinvestment Allowance versus Automation CA

One of the common incentives claimed by manufacturers is the RA incentive. However, RA incentive and Automation CA incentive are mutually exclusive.

In order to demonstrate which incentive brings the most benefit, we have prepared four (4) simulations to illustrate the assessment required before deciding between the RA incentive and Automation CA incentive.

The simulations are prepared based on the following assumptions:

- Comparison of RA incentive and Automation CA incentive shown in the illustration is only for a YA.
- IA and AA rates for the plant and machinery are 20% and 14% respectively. It is assumed that none of the plant and equipment qualify for ACA under P.U.(A) 268/2021 – Income Tax (Accelerated Capital Allowance) (Machinery and Equipment including ICT Equipment) Rules 2021.
- RA incentive for a YA is restricted to 70% of statutory income (SI) for the YA and the level of productivity of the company is disregarded.

How to choose a suitable incentive –
Reinvestment Allowance versus Automation CA (cont.)

Illustration 1:

Company W is principally involved in the manufacturing of plastic products (labour intensive industries) and incurred qualifying capital expenditure totalling RM9 million in YA 2022.

	Option 1: Reinvestment Allowance (RM)		Option 2: Automation CA (RM)	
Adjusted income	12,000,000		12,000,000	
Less: Capital allowance	3,060,000	N1	5,700,000	N2
Statutory business income	8,940,000		6,300,000	
Reinvestment allowance (restricted to 70% of SI)	5,400,000		-	
ITE for Automation Equipment (restricted to 70% of SI)			4,000,000	
Net statutory income / Aggregate income / Chargeable income	3,540,000		2,300,000	
Tax payable @24%	849,600		552,000	
Tax savings			297,600	

N1 - Assuming IA rate of 20% and AA rate of 14% (plant & machinery)

N2 - IA rate of 20% and AA rate of 80% on QCE of RM4 million pursuant to P.U.(A) 252/2017 and P.U.(A) 173/2020.
IA rate of 20% and AA rate of 14% for the remaining QCE.

Illustration 2:

Company X is principally involved in the manufacturing of plastic products (labour intensive industries) and incurred qualifying capital expenditure totalling RM4 million in YA 2022.

	Option 1: Reinvestment Allowance (RM)		Option 2: Automation CA (RM)	
Adjusted income	10,000,000		10,000,000	
Less: Capital allowance	1,360,000	N1	4,000,000	N2
Statutory business income	8,640,000		6,000,000	
Reinvestment allowance (restricted to 70% of SI)	2,400,000		-	
ITE for Automation Equipment (restricted to 70% of SI)			4,000,000	
Net statutory income / Aggregate income / Chargeable income	6,240,000		2,000,000	
Tax payable @24%	1,497,600		480,000	
Tax savings			1,017,600	

N1 - Assuming IA rate of 20% and AA rate of 14% (plant & machinery)

N2 - IA rate of 20% and AA rate of 80% pursuant to P.U.(A) 252/2017 and P.U.(A) 173/2020.

How to choose a suitable incentive –
Reinvestment Allowance versus Automation CA (cont.)

Illustration 3:

Company Y is principally involved in the manufacturing of frozen food products (other industries) and incurred qualifying capital expenditure totalling RM9 million in YA 2022.

	Option 1: Reinvestment Allowance		Option 2: Automation CA	
	(RM)		(RM)	
Adjusted income	12,000,000		12,000,000	
Less: Capital allowance	3,060,000	N1	4,380,000	N2
Statutory business income	8,940,000		7,620,000	
Reinvestment allowance (restricted to 70% of SI)	5,400,000		-	
ITE for Automation Equipment (restricted to 70% of SI)	-		2,000,000	
Net statutory income / Aggregate income / Chargeable income	3,540,000		5,620,000	
Tax payable @24%	849,600		1,348,800	
Tax savings	499,200			

N1 - Assuming IA rate of 20% and AA rate of 14% (plant & machinery)

N2 - IA rate of 20% and AA rate of 80% on QCE of RM2 million pursuant to P.U.(A) 252/2017 and P.U.(A) 173/2020.
IA rate of 20% and AA rate of 14% for the remaining QCE.

Illustration 4:

Company Z is principally involved in the manufacturing of frozen food products (other industries) and incurred qualifying capital expenditure totalling RM2 million in YA 2022.

	Option 1: Reinvestment Allowance		Option 2: Automation CA	
	(RM)		(RM)	
Adjusted income	10,000,000		10,000,000	
Less: Capital allowance	680,000	N1	2,000,000	N2
Statutory business income	9,320,000		8,000,000	
Reinvestment allowance (restricted to 70% of SI)	1,200,000		-	
ITE for Automation Equipment (restricted to 70% of SI)			2,000,000	
Net statutory income / Aggregate income / Chargeable income	8,120,000		6,000,000	
Tax payable @24%	1,948,800		1,440,000	
Tax savings			508,800	

N1 - Assuming IA rate of 20% and AA rate of 14% (plant & machinery)

N2 - IA rate of 20% and AA rate of 80% pursuant to P.U.(A) 252/2017 and P.U.(A) 173/2020.

Summary

It is still timely for companies in the manufacturing and services sector to plan their investment in automation equipment and capitalise on the Automation CA incentive.

In order to qualify for the Automation CA incentive, companies should ensure that automation equipment purchased are used directly in the manufacturing activities / in its services delivery.

Companies should also ensure that the use of the automation equipment will result in an increased production volume and capacity, reduction of headcount, reduction of number of man-hours, reduction of defects, increase efficiency, etc.

The Automation CA incentive is not granted automatically. The application should be submitted to MIDA by 31 December 2023. The application will be jointly evaluated by MIDA and SIRIM. As part of the SIRIM technical verification, companies should ensure that supporting documents such as invoices, purchase orders, delivery orders and proof of payment for the automation equipment are in place and must be certified by external auditors. Furthermore, companies should ensure that payment for the entire cost of machinery, equipment and software is made. Companies that finance the cost of automation equipment via hire purchase arrangement or via grant (e.g. Smart Automation Grant) may not be able to capitalise on the Automation CA incentive.

It is worthy for companies to understand that the Automation CA incentive in terms of tax allowance is double the cost of the investment in automation equipment. Nevertheless, when comparing the size of investment by companies and the maximum amount of capital expenditure allowed for Automation CA, the benefits from other mutually exclusive incentives may outweigh Automation CA. Hence, it is advisable for companies to prepare simple simulations to assess the amount of incentives claimable and select the optimal incentives which work best for them. Selection of the best incentive will help companies to save tax costs.

This article was written by **Chong Mun Yew**, a Executive Director at Crowe Malaysia.

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