



Maximising Capital Allowances for Business Growth

June 2023

●

Capital Allowance (CA) is a tax-deductible expense that businesses can claim against their adjusted income, with the aim to reduce their tax liability. The primary purpose of CA is to encourage businesses to invest in new plant and machinery, thereby expanding their businesses and stimulating economic growth.

CA maximisation refers to the process of maximising the tax benefits that a business can claim through CA. This can be achieved by making strategic investments in building, plant and machinery by carefully managing the timing and value of these investments, and ensuring that the business is making full use of the available CA.

In addition, analysing the detailed cost breakdown of an asset (i.e. newly acquired hotel building, factory, etc.) may accelerate the CA claim of a business.

To maximise CA, it is important for businesses to have a good understanding of the tax rules and regulations that govern CA, as well as a sound knowledge of the company's own financial situation and the types of investments that are likely to generate the largest tax benefits.

In this article, we will discuss the basics of CA, industrial building allowance (“IBA”), objectives and effects in maximising the CA of a business.

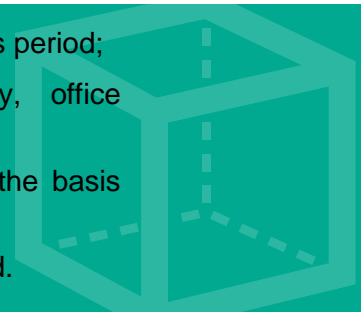
Start with the basics

What is CA?

In computing the adjusted income from a business source for a basis period:

- Tax deduction is not allowed on capital expenditure and accounting depreciation of assets used in generating the gross income of a business. This is due to capital expenditure and accounting depreciation of assets not being revenue expenditure.
- Accounting depreciation is not considered as a tax-deductible expense as it is merely a write off of the cost of fixed assets over a period of time.
- However, Schedule 3 of the Income Tax Act 1967 (“ITA”) provides for a mechanism to claim tax deduction in the form of CA on capital expenditure incurred for asset acquisition.
- The CA claim is restricted to its individual business source and cannot be used to set off against adjusted income of another business source.
- The conditions for a taxpayer to claim CA are as follows:

- Asset was used for the purpose of business during the basis period;
- Incurred qualifying expenditure (i.e. plant, machinery, office equipment, etc.) during the basis period;
- The taxpayer was the owner of the asset at the end of the basis period;
- Asset was in use by the owner at the end of the basis period.



Start with the basics (cont.)

The CA Rates

Capital Allowance consists of:



Initial allowance (“IA”)

A fixed rate of 20% based on the original cost of the asset at the time when the capital expenditure was incurred.



Annual allowance (“AA”)

A flat rate is given every year based on the original cost of the asset.

AA rates vary according to the types of assets and the rates are tabulated as follows:

Types Of Assets	IA (%)	AA (%)
Heavy machinery	20	20
General plant and machinery	20	14
ICT equipment and software packages	20	20
Others (i.e. furniture and fixtures, office equipment)	20	10
Motor vehicles	20	20



Start with the basics

What is IBA?

IBA is the qualifying capital expenditure incurred on the construction or acquisition of a building.

A company is allowed to claim IBA on the qualifying capital expenditure incurred for the construction or acquisition of a building if the capital expenditure is incurred for business purposes. The general IBA rates are 10% IA and 3% AA.

However, not all capital expenditure incurred for the construction or acquisition of the building qualifies for IBA. Schedule 3 of the ITA provides that such IBA should be given for qualifying capital expenditure incurred on building which is an industrial building or a special building such as the following:



Factory



Warehouse



Airport



Dock, wharf, jetty



Hotel registered with the Ministry of Tourism, Arts and Culture



Private hospital, maternity home and nursing home licensed under the relevant laws



Motor racing circuit approved by the Minister of Finance



Etc.

Objectives of a CA Maximisation Study

WHY should a business undertake a CA maximisation study?

- Generally, a tax agent of the business may not analyse the capital expenditure in detail (i.e. especially for renovation, land and building categories) as it requires a significant amount of time to go through the supporting documents and to keep the tax compliance fee as low as possible. When a CA maximisation study is undertaken, a thorough analysis of these costs / capital expenditure will be carried out to maximise the CA claims. Hence, businesses can accelerate their CA / IBA claims and ease their cashflows.
- A CA maximisation study will serve as a proper paper to document and support the CA and IBA claims in the event of a tax audit to be carried out by the Inland Revenue Board (“IRB”).

WHEN should a business undertake a CA maximisation study?

- When the business acquires a new industrial building such as a hotel building to expand its business and the business needs a detailed cost breakdown of the industrial building.
- When the business plans to invest in major renovations at its respective retail outlets (which may or may not be an industrial building).
- When the business needs to gauge its tax exposure before / after significant capital investment is made into its business expansion plan.

WHAT documents should a business have when it undertakes a CA maximisation study?

- Specifically, for acquisition of industrial building, a proper valuation report (i.e. to be certified by a qualified quantity surveyor) for determining the value of the land and building should be obtained.
- The relevant bill of quantities (“BOQ”) and invoices for the major renovation / construction work on the building.

The Effects of Undertaking a CA Maximisation Study

The following is the simulation of the effect of undertaking a CA maximisation study.

Illustration 1

For illustration 1 purposes, we will use a hotel building (i.e. a hotel registered with Ministry of Tourism, Arts and Culture – an industrial building) as an example.

Before a CA maximisation study		After a CA maximisation study		
Year of assessment ("YA")	2023	YA		2023
Description	RM ('000)	Description	% of purchase price	RM ('000)
Purchase price of hotel building	10,000	Purchase price of hotel building		10,000
<u>IBA claim (without a valuation report) – Note 1</u>		<u>Types of assets</u>		
IBA – (10% IA, 3% AA)	1,300	Plant and machinery	30%	3,000
		Furniture, fittings and equipment	20%	2,000
<u>IBA claim (with a valuation report)</u>		Hotel operation equipment	10%	1,000
Building cost (i.e. say RM8 million)	1,040	Building structural cost	20%	2,000
IBA – (10% IA, 3% AA)		Land cost	20%	2,000
Land cost (i.e. say RM2 million) Not qualified for CA / IBA	N/A			
		<u>CA and IBA claim</u>		
AA for subsequent YA (RM8 million x 3%)	240	Plant and machinery (IA 20%, AA 14%)		1,020
		Furniture, fittings and equipment (IA 20%, AA 10%)		600
		Hotel operation equipment (IA 20%, AA 10%)		300
		Building structural cost (IA 10%, AA 3%)		260
		Land cost (non-qualifying)		
		Total CA and IBA claim – Note 2		2,180
		AA for subsequent YA (RM420k+RM200k+RM100k+RM60k) – Note 2		780

Note 1

- Based on our experience, some businesses may use the purchase price amounting to RM10 million to claim for the IBA.
- However, the hotel building cost may include land cost which does not qualify for CA / IBA claim. Therefore, the business may have overclaimed its IBA based on the illustration above.

Note 2

- Percentage increase in CA claims for the current YA after a CA maximisation study is a staggering 109% [i.e. (RM2.180 mil – RM1.04 mil)/RM1.04 mil x 100%].
- Percentage increase in CA claims for the subsequent YA is a whopping 225% [i.e. (RM780k – RM240k)/RM240k x 100%].

The Effects of Undertaking a CA Maximisation Study (cont.)

Illustration 2

For illustration 2 purposes, we will use a food and beverage (“F&B”) retail outlet (i.e. a non-industrial building) as an example.

Before a CA maximisation study		After a CA maximisation study			
Year of assessment (“YA”)	2023	YA			2023
Description	RM	Description	CA rate	Qualifying capital expenditure after a CA maximisation study	RM
Renovation cost for a single F&B retail outlet <i><u>Breakdown of renovation cost (i.e. without analysing BOQ)</u></i>	430,000	Renovation cost for a single F&B retail outlet <i><u>Breakdown of renovation cost (i.e. after analysing BOQ)</u></i>	N/A	N/A	430,000
Preliminaries	11,000	Preliminaries (Note 2)	Revenue expenditure	Revenue expenditure	11,000
Finishing work	110,000	Floor finishes - disallowed for CA claim, part of business setting	Non-qualifying	Non-qualifying	60,000
Ceiling, building, doors and carpentry works	198,000	Wall finishes - disallowed for CA claim, part of business setting	Non-qualifying	Non-qualifying	50,000
Plumbing and sanitary systems	26,000	Ceiling works - disallowed for CA claim, part of business setting	Non-qualifying	Non-qualifying	45,000
Power, network points and fittings	85,000	Carpentry works (Note 3)	20% AA, 10% IA	21,600	36,000
	430,000	Building works (Note 4)	20% AA, 14% IA	10,700	107,000
Total CA claim (Note 1)	Nil	Doors - disallowed for CA claim, part of business setting	Non-qualifying	Non-qualifying	18,000
		Plumbing and sanitary systems (Note 5)	20% IA 14% AA	18,200	26,000
		Lighting points and fittings (Note 4 and Note 6)	20% IA 14% AA	10,800	36,000
AA for subsequent YA (Note 1)	Nil	Kitchen power points (Note 4)	20% IA 14% AA	20,000	25,000
		Network points (Note 4)	20% IA 14% AA	14,000	16,000
		Total CA claim for current YA (RM6.48k+RM3.64k+RM6.19k+RM3.67k+RM6.80k+RM4.76k)			95,300
AA for subsequent YA (RM2.16k+RM1.50k+RM2.55k+RM1.52k+RM2.8k+RM1.96k)			31,540		
			12,490		

The Effects of Undertaking a CA Maximisation Study (cont.)

Illustration 2

Note 1

Based on our experience, other tax agents may completely disallow CA claim for renovation cost in order to maintain a lower tax compliance fee. Some tax agents may only conduct a minimal inspection on the renovation cost documents for CA claim purposes in order to maintain a lower tax compliance fee as well. Nonetheless, some of the capital expenditure in the renovation cost may qualify for CA claim if further analysis is to be conducted (i.e. to go through the BOQ in detail).

Note 2

To partially claim as revenue expenditure based on the overall percentage of the qualifying capital expenditure incurred on renovation.

Note 3

To partially claim CA on the carpentry work (i.e. cabinets, seat bench, etc.) which fulfils the functional test. Hence, such carpentry work may be considered as a plant.

Note 4

To partially claim CA as some expenditure incurred is part and parcel of a plant and machinery. The CA rate for such expenditure is based on the plant and machinery.

Note 5

To partially claim CA as some expenditure incurred (i.e. hot and cold water systems) may be considered as a plant based on the relevant tax case laws.

Note 6

To partially claim CA as some special lighting acquired and used for the purposes of creating special ambience to attract customers.



Summary

Based on the illustrations on the effects of undertaking a CA maximisation study, businesses should conduct a CA maximisation study as part of their corporate strategy whenever a significant capital investment is to be made. A CA maximisation study can result in lower taxable profits and therefore a lower tax bill.

In summary, maximising capital allowances involves:

- **Identifying eligible capital expenditure** - this includes items such as plant and machinery, equipment and industrial buildings.
- **Keeping supporting documents** - detailed records of all capital expenditure should be kept, including invoices, bills of quantity, valuation reports and receipts for the IRB's verification purposes.
- **Claiming the maximum allowances** - the maximum allowances should be claimed in each year of assessment in order to reduce the taxable profits and lower the tax bill.
- **Seeking professional advice** - a tax advisor can assist in ensuring that the correct allowances are claimed and that the process is handled correctly.

Need help with your CA maximisation study? Please feel free to reach out to us and we will be glad to assist you.



This article was written by **Eric Lai**, a Senior Tax Advisory Manager at Crowe Malaysia. If you wish to seek clarification on any of these issues, please contact eric.lai@crowe.my



Contact us

Crowe Malaysia PLT
Level 15, Tower C
Megan Avenue II
12, Jalan Yap Kwan Seng
50450 Kuala Lumpur
Malaysia

Tel. +603 2788 9898

About us

About Crowe Malaysia

Crowe Malaysia is the 5th largest accounting firm in Malaysia and an independent member of Crowe Global. The firm in Malaysia has 12 offices, employs over 1,200 staff, serves mid-to-large companies that are privately-owned, publicly-listed and multinational entities, and is registered with the Audit Oversight Board in Malaysia and the Public Company Accounting Oversight Board in the US.

About Crowe Global

Crowe Global is one of the top 10 accounting firms with over 200 independent accounting and advisory firms in more than 145 countries. For almost 100 years, Crowe has made smart decisions for multinational clients working across borders. Our leaders work with governments, regulatory bodies and industry groups to shape the future of the profession worldwide. Their exceptional knowledge of business, local laws and customs provide lasting value to clients undertaking international projects.

www.crowe.my