



Crowe Perspectives:

Reinvestment Allowance (RA)

The latest updates and issues in claiming RA
for manufacturing activities in recent years

25 April 2022

Reinvestment Allowance (RA) is an incentive given to Malaysian resident companies involved in the manufacturing sector and selected agricultural sector to incentivise these companies to reinvest and grow their businesses.

In order to qualify for the RA incentive, such companies must have been in business operations (i.e. manufacturing or agricultural) for at least 36 months. In addition, these companies must have incurred capital expenditure in carrying out relevant qualifying RA projects such as expansion, modernisation, automation and / or diversification in order to qualify for RA incentives in the relevant year of assessment (YA).

RA incentive is available for a period of 15 consecutive YAs beginning from the YA in which the capital expenditure was first incurred.

An additional 3 consecutive years of RA period from YA 2016 to YA 2018 (i.e. Special RA) has been provided under the Finance Act 2016 for companies which have exhausted the initial 15 years of RA period.

Furthermore, the Special RA was reintroduced in the National Economic Recovery Plan (i.e. PENJANA) and was enacted through the Finance Act 2020. The Special RA period provided in the Finance Act 2020 is from YA 2020 to YA 2022.

Effective from YA 2019, any unabsorbed RA can only be carried forward to be absorbed for a maximum period of seven (7) consecutive YAs after the expiry of the qualifying period for RA.

In this article, we will discuss the latest updates on the RA incentive and issues in claiming RA for manufacturing activities in the recent years.

Latest updates on RA

Extension of Special RA

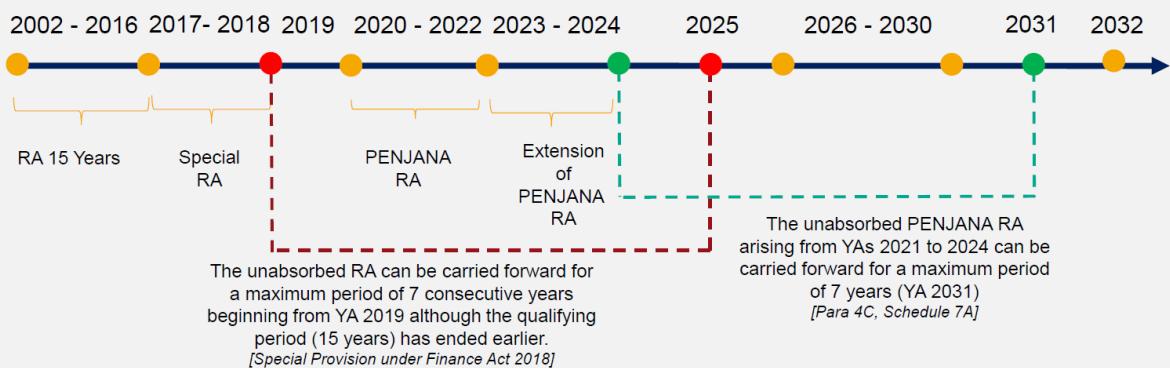
Based on the Finance Act 2021 which was gazetted on 31 December 2021, the Special RA is extended for an additional two (2) years to YA 2024. The following table illustrates the eligibility period for RA claim for companies which have exhausted the initial 15 years of RA period:

RA incentive period expired in (YA)	Previously						Now	
	Special RA incentive (Finance Act 2016)			Additional Special RA incentive (PENJANA RA)			Extension of Special RA (extension of PENJANA RA)	
	Extended eligibility period (YA)			Extended eligibility period (YA)			Extended eligibility period (YA)	
	2016	2017	2018	2020	2021	2022	2023	2024
2015 or prior	✓	✓	✓	✓	✓	✓	✓	✓
2016		✓	✓	✓	✓	✓	✓	✓
2017			✓	✓	✓	✓	✓	✓
2019 or prior				✓	✓	✓	✓	✓
2020					✓	✓	✓	✓
2021						✓	✓	✓
2022							✓	✓

Time limit for carrying forward unabsorbed RA

New Paragraph 4C, Schedule 7A of the Malaysian Income Tax Act 1967 (MITA)

The unabsorbed RA under the PENJANA RA can only be carried forward for a period of seven (7) consecutive years, beginning from YA 2025. Any unabsorbed RA after the seven (7) years will be disregarded. The following timeline illustrates the eligibility period to carry forward the unabsorbed RA claimed under the Special RA and PENJANA RA:



Latest updates on RA (cont.)

Practice Note 1/2022: Explanation in relation to the definition of 'factory' for RA claims (the Practice Note)

The Practice Note was issued by the Inland Revenue Board of Malaysia (IRBM) on 17 January 2022.

The meaning of 'factory' has been reiterated in the Practice Note as follows:

- "Factory" means portion of the floor areas of a building or an extension of a building used for the purposes of a qualifying project to place or install plant or machinery or to store any raw materials, or goods or materials manufactured prior to sale:
 - Provided that in respect of the portion of the building or extension of the building used for the storage of raw materials, or goods or materials, or both, it shall not be more than one-tenth of the total floor area of the building or the extension to that building (i.e. One-tenth Rule).
- The use of space for the purpose of storage of raw materials or other goods or both which exceeds one-tenth of the total floor areas of the factory shall not be considered in calculating RA claim under Schedule 7A of the MITA;
- Only the portion used for the purpose of a qualifying project fulfils the definition of 'factory' and may be allowed for RA claim subject to stipulated conditions.

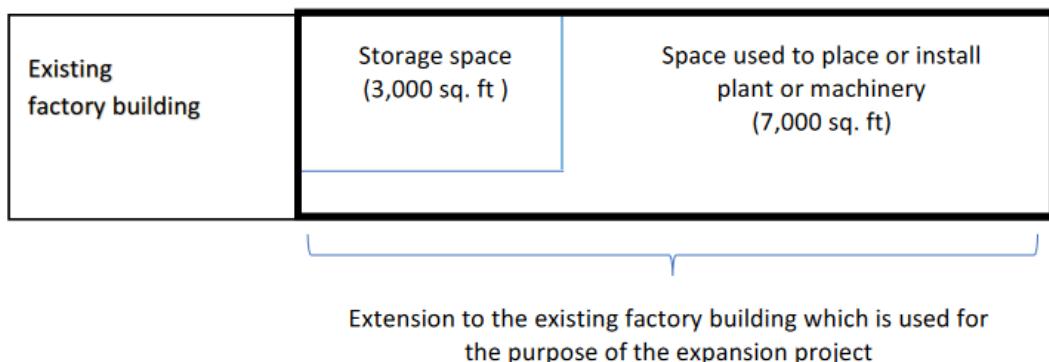


Latest updates on RA (cont.)

Practice Note 1/2022: Explanation in relation to the definition of 'factory' for RA claims (the Practice Note) (cont.)

In the Practice Note, the IRBM provided three (3) examples on how the One-tenth Rule should be calculated. A summary of the examples is as follows:

Example #1



- A manufacturing company has incurred capital expenditure to construct an extension to the existing factory building (i.e. expansion project).
- The total area of the extension to the factory building is 10,000 square feet (sq. ft).
- The capital expenditure incurred for the construction of the portion of space to place or install the plant or machinery in this expansion project (i.e. 7,000 sq. ft.) qualifies for RA claim.
- The storage space (i.e. 3,000 sq. ft.) does not qualify for RA claim as the area exceeds one-tenth (1/10) which is 30% (3,000 sq. ft. / 10,000 sq. ft. x 100%) of the total area of the extension to the existing building.

Latest updates on RA (cont.)

Practice Note 1/2022: Explanation in relation to the definition of 'factory' for RA claims (the Practice Note) (cont.)

Example #2

Existing factory building	Finished goods storage space (8,000 sq. ft)	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

Note: The Practice Note states that the sales office is not included in the 'factory' definition in Paragraph 9 of the Schedule 7A of the ITA. Therefore, the total area of sales office should be taken out for the purpose of determining 'factory' or space used for the purpose of a qualifying project.

- A manufacturing company has incurred capital expenditure to construct an extension to the existing factory building (i.e. expansion project).
- The total area of the extension to the factory building is 100,000 sq. ft.
- The extension to the factory building also includes a sales office (i.e. 25,000 sq. ft.).
- The capital expenditure incurred for the construction of the portion of space to place or install the plant or machinery in this expansion project (i.e. 67,000 sq. ft.) qualifies for RA claim.
- The finished goods storage space (i.e. 8,000 sq. ft.) does not qualify for RA claim as the area exceeds one-tenth (1/10) which is 10.67% (8,000 sq. ft. / 75,000 sq. ft. x 100%) of the total area of the extension to the existing building.

Latest updates on RA (cont.)

Practice Note 1/2022: Explanation in relation to the definition of 'factory' for RA claims (the Practice Note) (cont.)

Example #3

Existing factory building	Materials storage space (15,000 sq. ft)	Space used to place or install plant or machinery (65,000 sq. ft)
	Sales office (20,000 sq. ft)	

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

Note: The Practice Note states that the sales office is not included in the 'factory' definition in Paragraph 9 of the Schedule 7A of the ITA. Therefore, the total area of sales office should be taken out for the purpose of determining 'factory' or space used for the purpose of a qualifying project.

- A manufacturing company has incurred capital expenditure to construct an extension to the existing factory building (i.e. expansion project).
- The total area of the extension to the factory building is 100,000 sq. ft.
- The extension to the factory building also includes a sales office (i.e. 20,000 sq. ft.).
- The capital expenditure incurred for the construction of the portion of space to place or install the plant or machinery in this expansion project (i.e. 65,000 sq. ft.) qualifies for RA claim.
- The materials storage space (i.e. 15,000 sq. ft.) does not qualify for RA claim as the area exceeds one-tenth (1/10) which is 18.75% (15,000 sq. ft. / 80,000 sq. ft. x 100%) of the total area of the extension to the existing building.

Latest updates on RA (cont.)

Discussion on the Practice Note

Pursuant to Paragraph 9 of Schedule 7A of the MITA, the definition of 'factory' does not specifically state that the areas in the factory which are not:

- used to place or install plant or machinery; or
- used to store any raw materials, or goods or materials for manufacturing

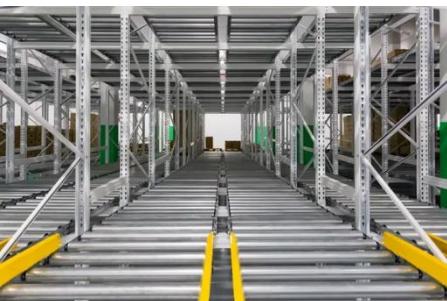
should not be taken into account for calculating the One-tenth Rule.

Therefore, there is a contradicting view on the calculation of the One-tenth Rule between the MITA and the Practice Note.

Since the Practice Note is an interpretation by the IRBM, taxpayers should be allowed to follow the interpretation of the law (i.e. MITA). This principle is established in the tax case of *RGTSB v Ketua Pengarah Hasil Dalam Negeri*.

In view of the above, technically, the sales office area stated in examples 2 and 3 above could be taken into account when calculating the One-tenth Rule.

As a result, the finished goods storage space area in example 2 above will be less than 10% of the total floor area of the factory (i.e. 8%). The manufacturing company in example 2 will then be eligible to claim RA for the capital expenditure incurred for the finished goods storage space area and the space used to install plant or machinery.





Issues in claiming RA for manufacturing activities in the recent years

RA incentive is considered one of the favourite tax incentives amongst companies in the manufacturing sector because no prior approval is required from the relevant authorities for claiming this incentive. Nonetheless, there are also certain challenges in making a claim. The following are some of the issues in claiming RA incentive in recent years:

No.	Issues in claiming RA	Explanation and potential implications	Reference
1	Factory building Claimant did not obtain / possess the relevant documentation (i.e. letter from main contractor stating that the factory building construction is completed) for the purpose of factory building completion date. The completion date will determine the relevant YA for RA claim of the factory building (i.e. expenditure is incurred).	The RA claim for the factory building could be delayed to the subsequent YAs until the factory building certificate of completion and compliance (i.e. Borang F) is issued.	Para 1(b) and 9 of Schedule 7A, Para 55 of Schedule 3 of the MITA
2	Useful life of an asset The determination of useful life of the qualifying assets is not available.	The useful life of an asset which is less than two (2) years will be claimed as revenue expenditure instead of capital expenditure. Hence, RA incentive may not be available for these assets.	Item 3.5 of the Public Ruling (PR) No. 6/2015, Para 1(b) of Schedule 7A of the MITA
3	Date of asset put in use The date of qualifying asset put in use for manufacturing activity is not available (i.e. especially for assets acquired close to the end of a YA).	The RA claim for these qualifying assets could be delayed to the subsequent YA when the date of the asset put in use is able to be ascertained.	Para 1(b) and 9 of Schedule 7A, Para 55 of Schedule 3 of the MITA



Issues in claiming RA for manufacturing activities in the recent years (cont.)

No.	Issues in claiming RA	Explanation and potential implications	Reference
4	Manufacturing process The manufacturing process flow of a product is not in place.	Without the manufacturing process flow, it will be difficult to justify that the assets acquired are directly used in the manufacturing process.	Para 9 of Schedule 7A of the MITA
5	Treatment of waste assets Assets acquired for treatment of waste before discharging the treated waste out from the factory may not qualify for RA claim.	Assets acquired for treatment of waste may not be entitled for RA claim unless the treated waste is being reused / recycled for the manufacturing process.	Item 6.3 of the PR No. 10/2020
6	Manufacturing process for RA purposes The start and end of the manufacturing process for RA purposes is not fully understood by claimant. The manufacturing activity would be considered completed for RA purposes once the finished product can be identified (i.e. product packed in retail packaging).	Assets acquired (i.e. carton box sealer machine, automated robot for packing of retail packaging into carton boxes, etc.) to be used at the end of the manufacturing process for RA purpose may not be entitled for RA claim.	Item 6.2 of the PR No. 10/2020
7	Replacement assets Acquiring replacement assets for RA claim.	Assets acquired for the manufacturing process to: <ul style="list-style-type: none"> Replace existing worn out plant and machinery parts, and Replace similar assets which do not result in any RA project will not be eligible for RA claim.	Item 8.3.2 of the PR No. 10/2020



Issues in claiming RA for manufacturing activities in the recent years (cont.)

No.	Issues in claiming RA	Explanation and potential implications	Reference
8	<p>Measurement of achievements</p> <p>No proper measurement in place to capture the specific achievement data for RA projects (i.e. data on increase of production capacity, production efficiency measurement, cost savings records, etc.).</p>	<p>The RA project may not be able to be justified without the specific achievement data. Hence, the capital expenditure incurred may not qualify for RA claim.</p>	Para 9 of Schedule 7A of the MITA and Item 7 of the PR No. 10/2020
9	<p>Indirectly used assets</p> <p>Assets which are indirectly used in the manufacturing process</p>	<p>Assets acquired which are indirectly used in the manufacturing process do not have the following characteristics / purposes in the manufacturing process:</p> <ul style="list-style-type: none"> • Effect a change in material to form a product to be sold; • Have an active or necessary role in the manufacture of the product for sale; • Be used in handling, storage, or conveyance of materials or product to be sold; or • Be used to package the product for sale. <p>Hence, the assets acquired may not be entitled for RA claim.</p>	Para 9 of Schedule 7A of the MITA and Item 8.3 of the PR No. 10/2020



Summary

The main reason for issues in claiming RA is due to the lack of planning and understanding of the RA mechanism by taxpayers.

Besides proper planning and understanding of the RA mechanism, eligible taxpayers are encouraged to carry out a detailed RA study in the relevant YA. The purpose of an RA study is to analyse, organise and justify the RA claims and projects undertaken by the taxpayers.

Furthermore, the RA study should be documented properly (i.e. RA documentation) in the relevant YA. The RA documentation will serve as the first line of defense in the event of a tax audit by the IRBM in the future.

With the extension of the Special RA incentive period to YA 2024, taxpayers who are eligible to claim the Special RA incentive should start to plan their capital expenditures and RA projects accordingly in order to maximise the RA incentive.

A good RA documentation will help taxpayers to mitigate or minimise unexpected tax liabilities in the future.

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



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



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