

REINVESTMENT UPDATES FROM

RELEVANT TO ACCA QUALIFICATION PAPER P6 (MYS)

Reinvestment allowance (RA), as the name suggests, is an incentive to encourage companies to reinvest and expand their businesses. It is only granted after the company has been in business for a certain period of time, and only to companies resident in Malaysia.

The *Study Guide* for Paper P6 (MYS), under item A2(c)(v), requires candidates to identify the eligibility conditions for RA and to determine the tax treatment of adjusted income, adjusted losses, capital allowances and reinvestment allowance. However, some fundamental changes have been made as a result of the 2009 Budget proposals, which were subsequently gazetted as the Finance Act 2009. The purpose of this article is to highlight and explain these changes.

THE MEANING OF A QUALIFYING PROJECT HAS BEEN CHANGED

Candidates need to understand what a 'qualifying project' is as RA is only available for such a project. Until the recent changes, there were four types of qualifying project. One of these, participating in industrial adjustment, has been deleted. The only qualifying project remaining unchanged is an agricultural project to expand, modernise, or diversify a business of cultivation and farming.

The remaining two project types have been changed:

- (i) 'Manufacturing' is the most common project type, but the description of this activity previously included the word 'processing', which has now been deleted. However, a new comprehensive description of manufacturing has been introduced (see below).

- (ii) The rearing of chickens and ducks has now been extended to include the expansion of a closed house system as well as transformation from an opened house to a closed house system. Candidates need not expect questions on this change, as the incentive is only available for the years of assessment 2009 and 2010.

THE DEFINITION OF MANUFACTURING HAS BEEN CLARIFIED

Manufacturing is now defined to mean:

- ▣ conversion, by manual or mechanical means, of organic or inorganic materials into a new product by changing the size, shape, composition, nature or quality of such materials
- ▣ assembly of parts into a piece of machinery or products
- ▣ mixing of materials by a chemical reaction process including biochemical process that changes the structure of a molecule by the breaking of the intramolecular bonds or by altering the spatial arrangement of atom in the molecule.

The new definition clearly excludes:

- ▣ the installation of machinery or equipment for the purpose of construction
- ▣ simple packaging operations such as bottling, placing in boxes, bags and cases
- ▣ a simple fixing
- ▣ a simple mixing of any products
- ▣ a simple assembly of parts
- ▣ any activity to ensure the preservation of products in good condition during transportation and storage
- ▣ any activity to facilitate shipment and transportation
- ▣ any activity of packaging or presenting goods for sale
- ▣ any activity that may be prescribed by the Minister.

ALLOWANCES - THE 2009 BUDGET

The word 'simple', for this purpose, is stated to describe an activity that does not need special skills, machines, apparatus or equipment especially produced or installed in order to carry out the activity.

Candidates are not expected to be familiar with the application of all of these technical descriptions. An awareness of the general concept will suffice.

EXTENSION OF THE 'PERIOD OF BEING IN OPERATION' FROM 12 MONTHS TO 36 MONTHS

With the recent amendments, only companies which have been in operation for not less than 36 months can qualify for RA. This applies to companies seeking to qualify for the incentive under any one of the three remaining kinds of qualifying project.

EXAMPLE 1

Based on an updated version of Question 1(b) in Paper P6 (MYS) of June 2008.

Peacock Sdn Bhd, a newly incorporated company, acquired an existing manufacturing business on 1 December 2008 and commenced to carry on the business from that date, making up accounts to 30 November each year.

Subsequently, Peacock Sdn Bhd incurred the following capital expenditure:

| | | |
|------------------|--|-------------|
| 30 November 2009 | Drilling machines | RM200,000 |
| 1 January 2010 | New production line to automate manufacturing operations | RM1,000,000 |

WITH THE RECENT AMENDMENTS, ONLY COMPANIES WHICH HAVE BEEN IN OPERATION FOR OVER 36 MONTHS CAN QUALIFY FOR RA. THIS APPLIES TO COMPANIES WHO QUALIFY FOR THE INCENTIVE UNDER ANY ONE OF THE THREE REMAINING KINDS OF QUALIFYING PROJECT.

Candidates are required to state, with reasons, whether Peacock Sdn Bhd qualifies for RA in either or both of the years of assessment 2009 and 2010.

Peacock Sdn Bhd will not qualify for RA for either of the years of assessment 2009 and 2010 because the qualifying capital expenditure was incurred within 36 months after commencing operations. However, if the company incurred qualifying capital expenditure on or after 1 December 2011, it would qualify for RA, because the company would have completed 36 months of operation.

A qualifying project in manufacturing must involve the expansion, modernisation, or automation of an existing business, or diversifying it into any related product within the same industry.

REMOVAL OF 'CONTROL SALE' PROVISIONS IN RESPECT OF RA

With the new changes, a company purchasing an asset from a related company within the same group, where that asset was acquired for a project qualifying for RA, may not itself claim RA on that asset. Basically, this applies where any of the following control sale provisions are present:

- ▣ the disposer of the asset is a person over whom the acquirer of the asset has control
- ▣ the acquirer of the asset is a person over whom the disposer of the asset has control
- ▣ some other person has control directly or indirectly over the disposer and acquirer of the asset
- ▣ the acquisition is effected in consequence of a scheme of reconstruction or amalgamation of companies.

Although most of the recent changes apply from the year of assessment 2009, this change has effect in relation to any acquisition on or after 8 January 2009.

EXAMPLE 2

Based on an updated version of Question 1(c) in Paper P6 (MYS) from June 2008.

Jupiter Bhd is a long-established company with two subsidiary companies:

- ▣ Venus Sdn Bhd, in which Jupiter holds 75% of the ordinary shares
- ▣ Mercury Sdn Bhd, in which Jupiter holds 65% of the ordinary shares.

The principal activity of each company is manufacturing and neither enjoys any tax incentives other than RA. Each company has a 31 March year end.

During the year to 31 March 2009, Jupiter Berhad launched an expansion programme which was treated as a qualifying project for the purposes of RA. On 1 October 2009, two machines were purchased for the purposes of the expansion programme from the subsidiary companies as detailed below in **Table 1**.

Jupiter Berhad would be barred from claiming RA on either of the machines if the subsidiaries were entitled to RA on them. If that were not the case, Jupiter may be eligible to claim RA on the cost of acquiring the relevant asset from the relevant subsidiary.

CLAWBACK OF RA – EXTENSION OF PERIOD

The period during which the disposal of an asset on which RA has been given will trigger a clawback has been extended from two years from the date of acquisition to five years.

EXAMPLE 3

Using the facts in **Example 2**, any RA claimed by the subsidiaries would be clawed back because the assets were disposed of within five years from the date of acquisition. The clawback would not apply if Venus Sdn Bhd sold the borer on or after 1 July 2013 and Mercury Sdn Bhd sold the grinder after 1 July 2012.

Any RA given is deemed not to have been given at all. Consequently, on any disposal within five years of acquisition, Venus Sdn Bhd and/or Mercury Sdn Bhd would suffer a clawback of the allowance claimed, presumably for the year of assessment 2009 and the year of assessment 2008 respectively, with appropriate consequences. Candidates should note that the clawback provision applies to a disposal in any circumstances, whether a control sale or not.

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TABLE 1: EXPANSION PROGRAMME FOR JUPITER BHD'S SUBSIDIARY COMPANIES

| Machine acquisition by Jupiter Berhad | Acquired from | Original acquisition | | |
|---------------------------------------|-----------------|------------------------------|-------------|------------|
| | | Cost to Jupiter Berhad RM | Date | Cost RM |
| Borer | Venus Sdn Bhd | 70,000 | 1 July 2008 | 147,000 |
| Grinder | Mercury Sdn Bhd | 56,000 | 1 July 2007 | 112,000 |

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THE PERIOD DURING WHICH THE DISPOSAL OF AN ASSET ON WHICH RA HAS BEEN GIVEN WILL TRIGGER A CLAWBACK HAS BEEN EXTENDED FROM TWO YEARS FROM THE DATE OF ACQUISITION TO FIVE YEARS. CANDIDATES SHOULD NOTE THAT THE CLAWBACK PROVISION APPLIES TO A DISPOSAL IN ANY CIRCUMSTANCES, WHETHER A CONTROL SALE OR NOT.