

RELEVANT TO ACCA QUALIFICATION PAPER F6 (MYS)

Tax implications of financial arrangements for motor vehicles

When a company needs a motor vehicle, it can choose to either purchase it outright by cash, through hire purchase, or to simply lease it. The tax implications of these financial arrangements should be observed closely. The qualifying expenditure (QE) or the total deduction for the lease payments may be restricted to a maximum of RM50,000, however, the maximum is raised to RM100,000 when both of the following conditions are satisfied:

1. The motor vehicle has not been used by any person prior to purchase or rental (as the case may be)
2. The total cost of the motor vehicle is not more than RM150,000

None of these restrictions apply to commercial vehicles. Commercial vehicles are vehicles licensed for commercial transportation of goods or passengers. The nature of the use of the vehicle rather than type serves to distinguish it as commercial or non-commercial. Figure 1 summarises these restrictions. This article is designed to demonstrate the effect of these principles based on the following example.

The board of Mosis Sdn Bhd, which closes its accounts on 31 December every year, has decided that a new Protem Perdonna car should be provided for its newly appointed marketing manager during his seven-year employment period that commences on 1 May 2012.

The accountant has established the following mutually exclusive options and collected the following information:

Option 1: purchase outright

The cash price of the car is RM140,000 and the seller has agreed that while the car will be registered in Mosis Sdn Bhd's name, it can settle the amount in four equal quarterly instalments commencing 1 May 2012.

At the end of the employment contract (ie 30 April 2019), Mosis Sdn Bhd expects to dispose of the car for RM20,000.

Option 2: hire purchase

Down-payment: RM14,000 on 1 May 2012.

Monthly instalment: RM2,700 for 60 months commencing 1 May 2012.

At the end of the employment contract (ie 30 April 2019), Mosis Sdn Bhd expects to dispose the car for RM 20,000.

Option 3: lease

Monthly lease payment of RM3,000 commencing 1 May 2012.

Let us now look at the tax implications of each of the options for the years of assessment 2012 until 2019.

1. Outright purchase for cash

RM140,000 is incurred on 1 May 2012 as ownership passes on that date. Since Mosis Sdn Bhd owns the asset and uses it in its business, the company is entitled to claim initial allowance and annual allowance. The annual allowance for motor vehicles are available at the accelerated rate of 20%, as compared to the rate of 14% for other plant or machinery. However, the QE is restricted to RM100,000 since it is a new non-commercial vehicle costing less than RM150,000.

Although the asset is owned for less than 12 months in 2012, there is no need to time apportion the capital allowances as the person is entitled to claim the entire capital allowance provided he owns the assets and uses it in the business at the end of the basis period. In this case the end of the basis period is 31 December of each respective year.

Since the QE has been restricted, the disposal value – for the purposes of computation of a balancing allowance or balancing charge – should be apportioned in the manner shown in Figure 2. In the case of Mosis Sdn Bhd, the disposal value of the car is RM14,286 (ie $RM20,000 \times (RM100,000 \div RM140,000)$).

As such the balancing charge is as follows:

Qualifying expenditure	RM100,000
Initial allowance (Y/A 2012) ($RM100,000 \times 20\%$)	RM20,000
Annual allowances (Y/A 2012–2015) ($RM100,000 \times 20\% \times 4$ years)	<u>RM80,000</u>
Residual expenditure on 30 April 2019	–
Less: disposal value	<u>RM14,286</u>
Balancing allowance/(charge)	<u>RM(14,286)</u>

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If the car was not provided to the marketing manager and was licensed for commercial transportation of goods or passengers, then the QE will be RM140,000 as restrictions would not apply to it. In this case, the disposal value will also not be subject to any apportionment (ie the disposal value will be RM20,000).

In addition, if the sum of RM140,000 was financed with a loan, any interest payable on the loan can be deducted against the gross income. This deduction is available on the interest incurred on the entire loan of RM140,000, regardless of whether it is a commercial vehicle or otherwise.

2 Hire purchase

As the purchaser and user of the asset is not the owner of the asset, special provisions have been made in the income tax legislation to deem the user as the owner of the asset, thereby qualifying for capital allowance on the expenditure incurred by him in the basis period for a year of assessment. The down-payment and the principal element of the instalments are regarded as QE in the year of payment. The principal element of each instalment is RM2,100, which is computed as follows:

Cash price	RM140,000
Less: down-payment	<u>RM14,000</u>
Total capital portation of the instalments	RM126,000
Divided by: number of instalments	<u>60</u>
QE portion in each instalment	<u>RM2,100</u>

Based on the QE incurred every year, Mosis Sdn Bhd is entitled for initial and annual allowances as shown in Table 1.

It is important to monitor the residual expenditure of each year of assessment's QE separately as allowances cannot be claimed once the residual expenditure has reached zero. For instance, for the QE of RM30,800 incurred in year of assessment in 2012, the claim is exhausted in year of assessment 2015. No allowance can be claimed on this QE in the year of assessment 2016 onwards, even though the capital allowances can continue to be claimed on the QE incurred in subsequent years.

Upon the disposal of the car on 30 April 2019, there will be a balancing charge of RM14,286, calculated as shown below:

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Residual expenditure on 30 April 2019 (from Table 1)	–
Less: disposal value (RM20,000 x (RM100,000 ÷ RM140,000))	<u>RM14,286</u>
Balancing allowance/(charge)	<u>RM(14,286)</u>

If the car was not provided to the marketing manager and was licensed for commercial transportation of goods or passengers, then the QE will be RM140,000 as restrictions would not apply to it. In this case, the disposal value will also not be subject to any apportionment (ie the disposal value will be RM20,000).

Irrespective of whether it is a commercial or non-commercial motor vehicle, Mosis Sdn Bhd is entitled to a deduction on interest expense of RM600 every month, which is the difference between the instalment payment (ie RM2,700) and QE (ie RM2,100). The deduction for interest expense is not subject to any restriction.

3 Lease

Unlike the options discussed previously, this option does not grant ownership of the car to Mosis Sdn Bhd and, therefore, the company is not entitled to any capital allowances. However, the lease rentals are deductible against the gross income of the business. The following table illustrates the lease payments and the tax deduction.

Y/A	Number of payments	Lease payments	Tax deduction
2012	8	RM24,000	RM24,000
2013	12	RM36,000	RM36,000
2014	12	RM36,000	RM36,000
2015	12	RM36,000	RM4,000
2016	12	RM36,000	NIL
2017	12	RM36,000	NIL
2018	12	RM36,000	NIL
2019	4	RM12,000	NIL
		RM252,000	RM100,000

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The deduction for the year of assessment 2015 is restricted to RM4,000 as the cumulative deduction is restricted to RM100,000 since it is a new non-commercial motor vehicle, the cost of which does not exceed RM150,000. For the same reasons, no further deductions are allowed for the years of assessment 2016 onwards.

However, if the car was not provided to the marketing manager and was licensed for commercial transportation of goods or passengers, then the entire lease payment of RM252,000 would be entitled for deduction against gross income of the respective years.

An overall comparison

The tax implications of these three arrangements can be summarised as follows:

Y/A	Purchase outright Capital allowances	Hire purchase Capital allowances	Hire purchase Deduction of interest	Lease payments Deduction
2012	RM40,000	RM12,320	RM4,800 (RM600 x 8 months)	RM24,000
2013	RM20,000	RM16,240	RM7,200 (RM600 X 12 months)	RM36,000
2014	RM20,000	RM21,280	RM7,200	RM36,000
2015	RM20,000	RM23,760	RM7,200	RM4,000
2016	–	RM13,840	RM7,200	–
2017	–	RM8,800	RM2,400 (RM600 x 4 months)	–
2018	–	RM3,760	–	–
	RM100,000	RM100,000	RM36,000	RM100,000
2019	(RM14,286)	(RM14,286)	–	–
TOTAL	RM85,714	RM85,714	RM36,000	RM100,000

It must be noted that, although the same fundamentals apply for the claiming of capital allowances and deduction, the mechanism of claim for motor vehicles differs. This is due to the accelerated annual allowance rate, QE or deduction restrictions, deeming provisions for hire purchase arrangements and apportionment of disposal value.

Written by a member of the Paper F6 examining team

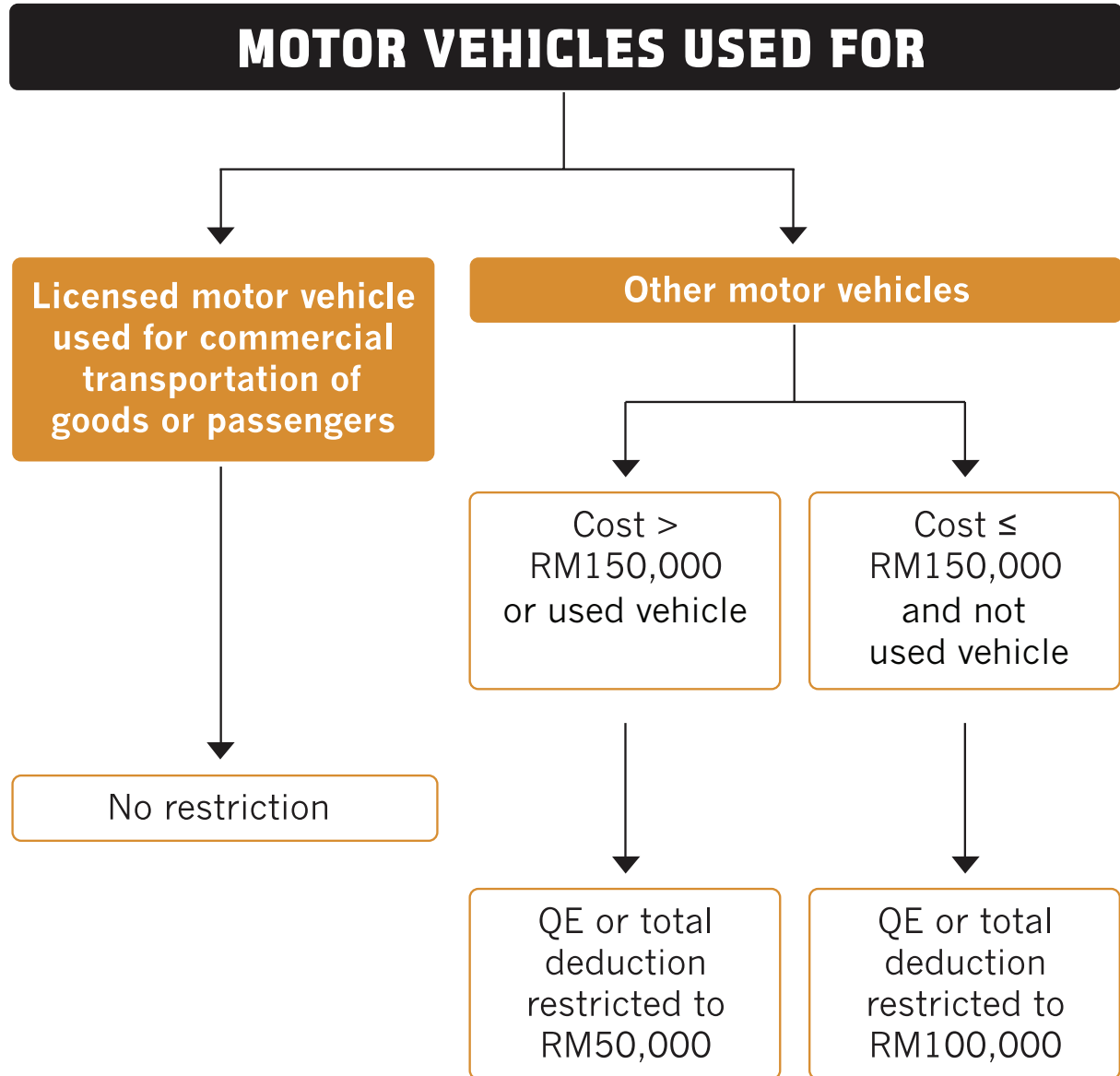
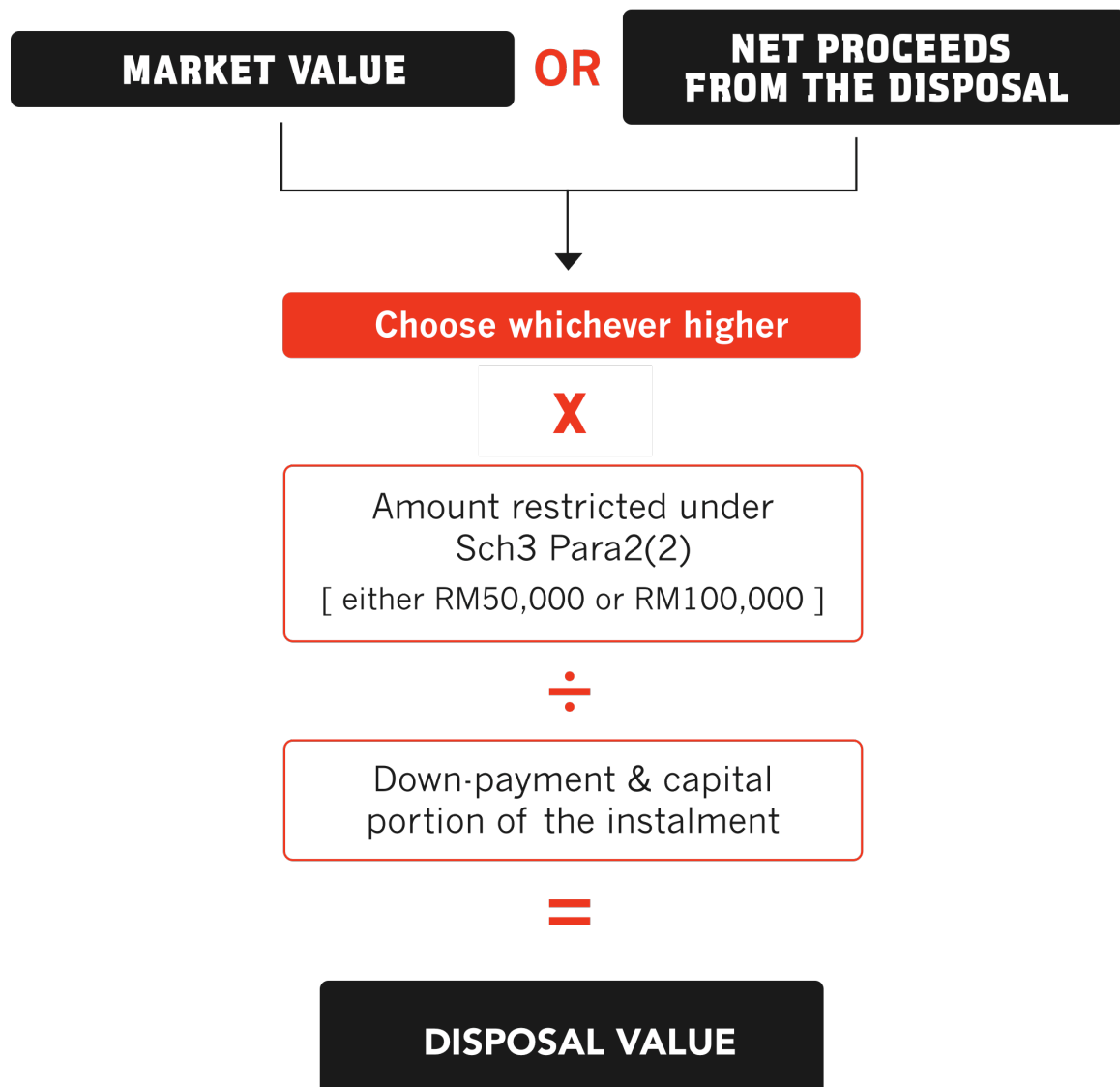
Figure 1: Restrictions under S39(k) (lease rental) and Schedule 3 Paragraph 2(2) (capital allowance)

Figure 2: Disposal value for non-commercial motor vehicle

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Table 1: Capital allowances for hire purchase

Year of assessment:	2012	2013	2014	2015	2016	Total
Number of instalments	8	12	12	12	12	
(X) QE per instalment	RM 2,100	RM 2,100	RM 2,100	RM 2,100	RM 2,100	
	RM 16,800	RM 25,200	RM 25,200	RM 25,200	RM 25,200	
(+) Down-Payment	RM 14,000	RM -	RM -	RM -	RM -	
Cost Incurred	RM 30,800	RM 25,200	RM 25,200	RM 25,200	RM 25,200	
Qualifying Expenditure	RM 30,800	RM 25,200	RM 25,200	RM 18,800	RM -	RM100,000 (maximum)
Y/A 2012 Capital Allowances:						
Initial Allowance (20%)	RM 6,160					RM 12,320
Annual Allowance (20%)	RM 6,160					
Residual Expenditure	RM 18,480					
Y/A 2013 Capital Allowances:						
Initial Allowance (20%)		RM 5,040				RM 16,240
Annual Allowance (20%)	RM 6,160	RM 5,040				
Residual Expenditure	RM 12,320	RM 15,120				
Y/A 2014 Capital Allowances:						
Initial Allowance (20%)			RM 5,040			RM 21,280
Annual Allowance (20%)	RM 6,160	RM 5,040	RM 5,040			
Residual Expenditure	RM 6,160	RM 10,080	RM 15,120			
Y/A 2015 Capital Allowances:						
Initial Allowance (20%)				RM 3,760		RM 23,760
Annual Allowance (20%)	RM 6,160	RM 5,040	RM 5,040	RM 3,760		
Residual Expenditure	RM -	RM 5,040	RM 10,080	RM 11,280		
Y/A 2016 Capital Allowances:						
Initial Allowance (20%)					RM -	RM 13,840
Annual Allowance (20%)		RM 5,040	RM 5,040	RM 3,760	RM -	
Residual Expenditure		RM -	RM 5,040	RM 7,520	RM -	
Y/A 2017 Capital Allowances:						
Annual Allowance (20%)			RM 5,040	RM 3,760	RM -	RM 8,800
Residual Expenditure			RM -	RM 3,760	RM -	
Y/A 2018 Capital Allowances:						
Annual Allowance (20%)				RM 3,760	RM -	RM 3,760
Residual Expenditure				RM -	RM -	