INLAND REVENUE BOARD OF MALAYSIA

QUALIFYING EXPENDITURE AND COMPUTATION OF INDUSTRIAL BUILDING ALLOWANCES

PUBLIC RULING NO. 3/2018

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CONTENTS **Page**

1.	Objective	1
2.	Relevant Provisions of the Law	1
3.	Interpretation	1
4.	Qualifying Building Expenditure	2
5.	Other Qualifying Building Expenditure	8
6.	The date Qualifying Building Expenditure Incurred	10
7.	Eligibility to Claim Industrial Building Allowances	10
8.	Subparagraph 16B(1), Schedule 3 of the ITA	11
9.	Part of a Building or an Extension to a Building not Used as an Industrial Building (Paragraph 66, Schedule 3 of the ITA)	20
10.	Relevant Interest	21
11.	Temporary Disuse of Building	25
12.	Disclaimer	26
	Appendix I – Summary of Qualifying Building Expenditure for claiming of Industrial Building Allowances	27

DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

Director General of Inland Revenue,
Inland Revenue Board of Malaysia.

1. **Objective**

The objective of this Public Ruling (PR) is to explain the tax treatment in relation to qualifying building expenditure (QBE) and the computation of industrial building allowances (IBA).

2. **Relevant Provisions of the Law**

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are section 2 and Schedule 3.

3. **Interpretation**

The words used in this PR have the following meaning:

3.1 “Building” includes any structure erected on land (not being plant or machinery).

3.2 “Director General” means the Director General of Inland Revenue referred to in section 134 of the ITA.

3.3 “Qualifying building expenditure” means capital expenditure incurred on the construction or purchase of a building which is used at any time after its construction or purchase, as the case may be, as an industrial building.

3.4 "Residual expenditure" of an industrial building means qualifying building expenditure less -

(a) initial allowances;

(b) annual allowances;

(c) notional allowance which is equal to the annual allowances if claimed or could have been claimed.

3.5 “Company” means a body corporate and includes any body of persons established with a separate legal entity by or under the laws of territory outside Malaysia and a business trust.

4. **Qualifying Building Expenditure**

QBE is capital expenditure incurred by a person on the cost of –

(a) constructing the original building which would include cost of constructing additions or rebuilding of that building, renovations and alteration; or

(b) purchase of a building

provided that the building is used as an industrial building for the purpose of a business of that person at the end of the basis period.

4.1 Cost of construction of a building

4.1.1 **QBE for a building that is constructed would include construction cost**

Capital expenditure on the construction of a building that qualifies includes -

(a) architect's fees for designing a plan of the industrial building;

(b) the cost of preparing plans and others in connection with obtaining approval from local authorities for construction of the building;

(c) the cost in connection with the title to the building such as legal charges and stamp duty;

(d) the cost of clearing the old site including the demolition of any old structure, provided that the old structure was not an industrial building and that the new building is situated precisely on the same site occupied by the old building;

(e) cost associated with works on the site such as piling, digging of foundations for drains, water pipes and electricity cables;

(f) the cost of construction of the building which will include materials, labour, haulage, management, supervision and other overhead charges directly related to the construction;

(g) cost of installing fittings that form part of the building such as wiring for electric supply;

(h) incidental expenditure on works which may be separately contracted such as drainage system, installation of water and electricity; and

(i) cost of constructing additions, renovations and alterations to an existing building which are capital in nature.

Note: The following are capital expenditure on the construction of buildings which are not included as QBE –

(i) cost associated with the acquisition of site such as land cost, legal charges, payment of stamp duty and surveyor;

(ii) the cost of clearing the site of any previous works or demolishing the previous structure which was an industrial building; and

(iii) the payment for compensation to obtain the right to occupy or own a property.

4.1.2 Cost of constructing additions

Cost of constructing additions is a cost involved in constructing additions to a building due to insuffficent space in the building or other reasons in order to fulfill any requirement or usage related to a business.

Example 1

Sunshine Sdn Bhd (SSB) owns a building which is used as a factory for the production of plastic bottles for pharmaceutical products. The Company incurred expenditure on the construction of additions to the building for a grading section which is needed to escape the noise pollution from the section where the factory's machinery are located. SSB intends to claim IBA on that expenditure.

The expenditure on the construction of additions to the building is QBE for IBA claims.

4.1.3 Cost of renovations

Renovation is not defined in the ITA. However, the determination can be made based on the facts of the case. If renovations incurred are not included in the category of plant and machinery or repairs, then the capital expenditure incurred on renovations to the internal structure of a building can be considered as QBE for IBA claims. Renovations include the reconstruction of structures inside a building without constructing an additional new building or reconstruction which involves structural changes to a building and improvements.

Example 2

The owner of Hotel Sri Melati Sdn Bhd with financial year ending on 31 March incurred expenditure on renovations in the building and no additional building was erected. The following is the renovation expenditure for the year ended on 31 March 2017 which is claimed by the company and the tax treatment of QBE claims.

(a) The renovations done are not replacement of worn out items but involved additional structures in the hotel building. The following expenditure qualifies for IBA claims:

   (i) construction of a registration counter;

   (ii) construction at 5 additional standard rooms and additional installation of electrical wiring in the five rooms;

   (iii) gas duct system; and

   (iv) construction of a permanent glass partition for staff restroom and canteen.

(b) Expenditure incurred on plant and machinery which qualifies for capital allowances:

   (i) additional air-conditioning equipment; and

   (ii) construction of a billboard on the rooftop of a hotel building.

4.1.4 **Cost of alterations**

Alteration is construction work which results in an overall change of the original structure as the improvement to the old structure is significant. Alteration is done to a building which is used as an industrial building for the purposes of improving the quality of service and increasing the productivity of a business. Reasons for the alterations should be clearly stated and accompanied by supporting documents and would be considered based on facts of each case.

Example 3

Nestin Sdn Bhd owns a building which is used as a factory for the production of aluminum beverage cans. The Company incurred expenditure on the alteration of the factory and claimed IBA on the following expenses:

(i) repaired part of the roof at the production section with a new roof of the same quality because of roof leaking problem;

(ii) removed the entire layer of the slippery cement floor in the packing section and replacing it with quality tiles to avoid the risk of accidents and to smoothen the work processes at that section; and

(iii) replaced the wall between the section for grading and the section for the placement of machinery with a sound-proof wall. The alteration was needed to reduce noise pollution in the grading section so as not to disrupt the quality control work processes.

The expenditure on repairing part of the roof at the production section with a new one because of the leaking problem is not a QBE as it is a normal maintenance expense. However, the expenditure is eligible for a deduction under subsection 33(1) of the ITA.

The expenditure on removing the entire layer of a slippery cement floor and replacing it with tiles for safety reason and to smoothen the work processes is an improvement to the building. Similarly the expenditure on the installation of a sound-proof wall is an improvement to the building. Thus, both of these expenditures are QBE for the purpose of claiming IBA.

4.1.5 **Record keeping**

Taxpayers are required to keep proper records of the cost of constructing the original building, the additions, renovations and alterations. Records include documents stating the reason for the additional expenses for the cost of constructing additions, renovations and alterations. Only reasons which are reasonable and acceptable will be considered by the Director General for the purpose of claiming IBA.

4.2 Cost of purchase of a building

4.2.1 Purchase of a building means there is the occurrence of a sale transaction, transfer or assignment of the relevant interest in a building [paragraph 58, Schedule 3 of the ITA].

4.2.2 Purchase price for an industrial building includes legal fee, stamp duty and other incidental expenses incurred by the purchaser in connection with the purchase but does not include the price of any land or an interest of any land purchased together with the building [paragraph 70, Schedule 3 of the ITA].

Example 4

Sari Jati Sdn Bhd (accounts ending on 30 June) constructed a furniture factory on 15.05.1962 at a construction cost amounting to RM90,000. The company had claimed IBA since it was eligible to do so.

On 30.06.2017, the company moved to Terengganu and sold the factory to Meranti Sdn Bhd (accounts ending on 30 June) at a price of RM250,000 which does not include the land price.

QBE for Meranti Sdn Bhd is equivalent to the purchase price of the building i.e. RM250,000.

4.2.3 The cost of site (land) where the building is erected which is included in the purchase price, shall be identified separately when determining the QBE. If the cost of the building and the land cannot be identified separately, a person needs to obtain a valuation from the Valuation and Property Services Department (VPSD) or a professional valuer to determine the cost of the building and cost of the land.

Example 5

Best Noodles Manufacturing Sdn Bhd (accounts ending on 31 December) purchased a factory building on 15.1.2017 for RM950,000. The company could not submit the cost of land and building separately since both the costs are not specified in the sale and purchase agreement. The company wanted to claim IBA on the factory building of RM978,500 which includes legal fees relating to the cost of building and land totaling RM28,500 commencing from the Year of assessment 2017.

The purchase price that can be taken into account as QBE is the cost of building and legal fees relating to the cost of building only, the cost of land and legal fees relating to the cost of land is excluded. The VPSD had determined the costs of land and building as follows:

	RM
Cost of land	500,000
Cost of building	450,000
Purchase price	950,000

QBE:

Cost of building	450,000
[1]Legal fees relating to the cost of building	13,509
	463,509

Note:

$$\frac{RM450{,}000}{RM950{,}000} \times RM28{,}500 = RM13{,}509^{1}$$

4.2.4 Commencing Year of assessment 2005, paragraph 3, Schedule 3 of the ITA was amended to give effect that the QBE for a purchased building is the purchase price of the building. Following the amendment, paragraphs 3A, 4, 5 and the proviso to paragraph 35, Schedule 3 of the ITA were no longer relevant and had been repealed.

4.2.5 However, for an industrial building that was purchased **prior to the Year of assessment 2005**, the following two special provisions are still maintained for purposes of computing IBA.

(a) **Special provision to paragraph 3, Schedule 3 of the ITA**

QBE is based on whether the building -

(i) has not been used as an industrial building before it was purchased;

(ii) was used as an industrial building within one month prior to the purchase; or

(iii) was not in use as an industrial building within one month prior to the purchase.

(b) **Special provision to paragraph 35, Schedule 3 of the ITA**

Balancing charge is not imposed for an industrial building that is sold after 50 years from the date it was constructed or purchased if the QBE for that building was determined in accordance with the provisions of paragraphs 3A, 4 and 5, Schedule 3 of the ITA (please refer to paragraph 4.2.4 of this PR).

Example 6

Lagenda Sdn Bhd (accounts ending on 30 June) constructed a shoe factory on 01.07.1966 at a cost of RM65,000. The company claimed IBA in accordance with paragraph 4, Schedule 3 of the ITA since it was eligible to do so. On 30.06.2018, the company sold the factory to Callysia Sdn Bhd (accounts ending on 30 June) for RM190,000 excluding the cost of land.

Since the QBE for the factory has been determined in accordance with the provision of paragraph 4, Schedule 3 of the ITA and the factory was sold after 50 years i.e. 53 years from the date it was constructed, Lagenda Sdn Bhd would not be imposed a balancing charge on the disposal of the factory to Callysia Sdn Bhd.

4.2.6 An industrial building which is disposed of after 50 years from the date of construction or purchase would be imposed a balancing charge except where the QBE has been determined in the manner mentioned in paragraph 4.2.5 above.

5. Other Qualifying Building expenditure

5.1 Where capital expenditure incurred on preparing, cutting, tunnelling or levelling land in order to prepare a site for the installation of machinery or plant (installation cost) exceeds 75% of the aggregate cost (cost of plant and machinery + cost of installation), that total cost is treated as expenditure on a building.

5.2 If such a building qualifies as an industrial building, the aggregate cost would be QBE for the purpose of IBA. A building as such shall be treated as disposed of if the plant or machinery is disposed of.

The scenario can be summarized as follows:

	RM
Cost of plant or machinery	**X**
Cost of installation	**Y**
Agregate cost	**Z**

If Y > 75% of Z, then Z shall be treated as QBE.

If Y = or < 75% of Z, then Z is not treated as QBE.

Example 7

Wow Biotech Sdn Bhd, a manufacturer of high quality cosmetics has incurred capital expenditure for the installation of a new vacuum emulsifier machine in the factory. The function of this machine is to produce a product in liquid form either as cream, jell or oil. The expenditure incurred is as follows:

	RM
Cost of the machine	40,000
Cost of preparing the site for installation	121,000
Agregate cost	161,000

75% of RM161,000 is RM120,750. The cost of preparing the site for the installation of machine amounting to RM121,000 exceeds 75% of the agregate cost of the machine and preparing the site. Thus, the agregate cost of RM161,000 shall be treated to be QBE and eligible for IBA. No capital allowances can be claimed on that machine.

5.3 Please refer to Appendix I for a summary of the QBE.

6. The date Qualifying Building Expenditure Incurred

6.1 Constructed building

(a) QBE is deemed to have been incurred on the day on which the construction of the building is completed [paragraph 55(a), Schedule 3 of the ITA].

(b) If the construction of a building is completed before a business is about to carry on, the QBE shall be deemed to be incurred on the date the business commences [proviso to paragraph 55, Schedule 3 of the ITA].

6.2 Purchased building

(a) QBE is deemed to have been incurred on the day the expenditure becomes payable [paragraph 55(b), Schedule 3 of the ITA].

(b) Purchase of a building occurs when there is sale, transfer or assignment of a relevant interest in the building [paragraph 58 of Schedule 3 of the ITA].

(c) If the building is purchased before commencement of a business, the QBE shall be deemed to be incurred on the date the business commences [proviso to paragraph 55, Schedule 3 of the ITA].

6.3 Date of sale, purchase, transfer or transmission shall be construed as a reference to the date of completion of the sale, purchase, transfer or transmission, as the case may be; or the date of possession of the asset sold, purchased, transferred or transmitted, whichever is the earlier [paragraph 59, Schedule 3 of the ITA].

7. Eligibility to Claim Industrial Building Allowances

IBA comprises of initial allowance (IA) and annual allowance (AA) or AA only at the rate prescribed for each type of industrial building. In general, the rate for IA is given at 10% of the QBE and the rate for AA is 3% of the QBE unless it is stated specifically at a different rate.

7.1 **IA** shall be allowed to a person who has incurred QBE in the basis period for a year of assessment on the construction or purchase of a building for the purposes of his business **and at the end of the basis period** for a Year of assessment –

(a) the person is the owner of the building;

(b) the building was in use or was about to be used as an industrial building; and

(c) if the building was disposed of in that basis period, the building must have been used as an industrial building in the period prior to the disposal.

7.2 **AA** shall be allowed for a year of assessment to a person who has incurred QBE on the construction or purchase of a building **and at the end of the basis period** for a year of assessment -

(a) the person is the owner of the building; and

(b) the building was in use for purposes of the business.

8. Subparagraph 16B(1), Schedule 3 of ITA

8.1 Business Operator is the Owner of the Building

8.1.1 Commencing from the year of assessment 2016, the provision under subparagraph 16B(1), Schedule 3 of the ITA clarifies that a person who is eligible to claim IBA must be the owner and business operator of the following types of industrial buildings –

(a) Licensed private hospital, maternity home and nursing home (paragraph 37A, Schedule 3 of the ITA).

(b) Building used for research (paragraph 37B, Schedule 3 of the ITA).

(c) Warehouse (paragraph 37C, Schedule 3 of the ITA).

(d) Building used for approved service project (paragraph 37E, Schedule 3 of the ITA).

(e) Hotel (paragraph 37F, Schedule 3 of the ITA).

(f) Airport

(paragraph 37G, Schedule 3 of the ITA).

(g) Motor racing circuit
(paragraph 37H, Schedule 3 of the ITA)

(h) Building used as living accommodation for employees which is provided by a person carrying on a business of manufacturing, hotel or tourism or an approved service project under Schedule 7B of the ITA
(subparagraph 42A(1), Schedule 3 of the ITA).

(i) Child care centre provided by an employer
(subparagraph 42A(2), Schedule 3 of the ITA).

(j) A school building or an educational institution
(paragraph 42B, Schedule 3 of the ITA).

(k) Building for industrial, technical of vocational training
(paragraph 42C, Schedule 3 of the ITA).

8.1.2 A building owner who rents out his building to another person to carry on the business mentioned in paragraph 8.1.1 above is not eligible to claim IBA on that building although the tenant uses it as an industrial building i.e. paragraph 60, Schedule 3 of the ITA does not apply.

Example 8

On November 2017, Lestari Resources Sdn Bhd (LR) purchased a building to set up a college and later rented it to Smart Sdn Bhd (SSB). The college was used by SSB for its business activity in connection with education. The college is an educational institution approved by the Minister of Education.

LR is the owner of the college building but does not operate the educational business. Thus, LR is not eligible to claim IBA for the building.

8.1.3 Subparagraph 16B(1), Schedule 3 of the ITA applies to expenditure incurred on new buildings which are constructed or purchased commencing from the year of assessment 2016.

8.2 **Business Operator is a Tenant of the Building**

8.2.1 The tenant is eligible to claim IBA in respect of the capital expenditure incurred by him on alteration or renovations on the building as mentioned in paragraph 8.1.1 in this PR that he uses as an industrial building.

8.2.2 Alteration or renovations shall be incurred on the type of building which falls under the same provisions except the provision of paragraphs 37A and 37B, Schedule 3 of the ITA.

8.2.3 Under the provisions of paragraph 37A and 37B, Schedule 3 of the ITA, tenants are eligible to claim industrial building allowances on the cost of alteration and renovation of the rented buildings irrespective whether the original building -

(i) is an industrial building or not; or

(ii) is an industrial building under different categories of buildings or different of paragraphs as mentioned in paragraph 8.1.1 in this PR.

8.2.4 The following are examples of whether the alteration or renovations incurred by a tenant on a building under subparagraph 16B(1), Schedule 3 of the ITA is a QE for the purpose of claiming the IBA –

	Type of building		QBE
	Original	Alteration / Renovation	Eligible / Not eligible
(a)	Factory Paragraph 63	Warehouse Paragraph 37C	Not eligible refer to paragraph 8.2.2
(b)	Research Paragraph 37B	Private hospital Paragraph 37A	Eligible refer to paragraph 8.2.3
(c)	Maternity home	Research	Eligible

	Paragraph 37A	Paragraph 37B	refer to paragraph 8.2.3
(d)	Shop house	Maternity home Paragraph 37A	Eligible refer to paragraph 8.2.3
(e)	Office	Research Paragraph 37B	Eligible refer to paragraph 8.2.3
(f)	Shop house	Hotel Paragraph 37F	Not eligible refer to paragraph 8.2.2
(g)	Airport Paragraph 37G	Litar lumba kenderaan bermotor Paragraph 37H	Not eligible refer to paragraph 8.2.2
(h)	School Paragraph 42B	University/College Paragraph 42B	Eligible refer to paragraph 8.2.2
(i)	Industrial training Paragraph 42C	School Paragraph 42B	Not eligible refer to paragraph 8.2.2

8.3 Part of a Building not Used as an Industrial Building (Subparagraph 16B(1) and Subparagraph 16B(2), Schedule 3 of the ITA)

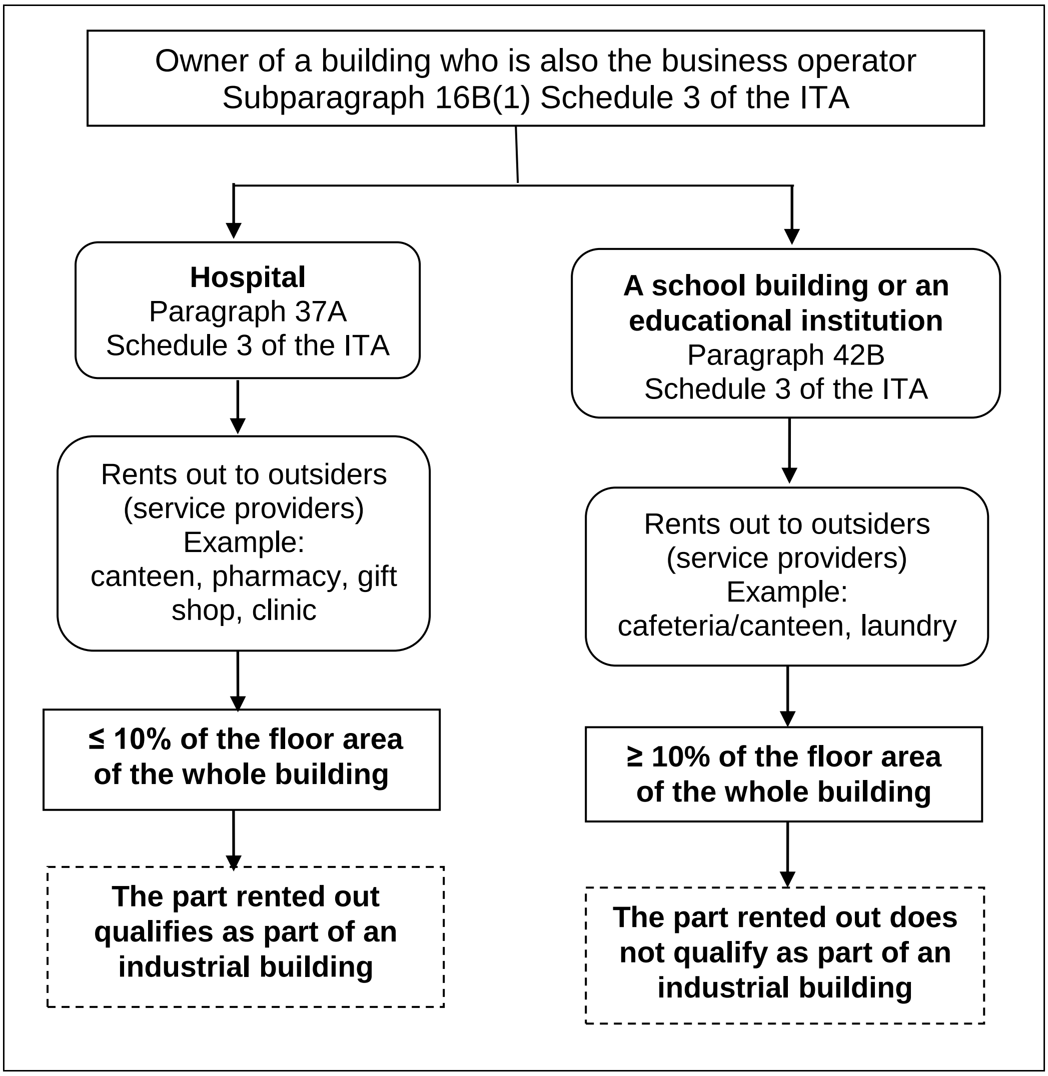
8.3.1 The 10% rule applies to the owner of an industrial building who carries on a business as mentioned in paragraph 8.1.1 in this PR who rents out part of the industrial building.

8.3.2 If part of a building is rented out by the owner and the space rented out does not exceed 10% of the floor area of the whole building, the whole building qualifies as an industrial building.

8.3.3 If the space rented out exceeds 10% of the floor area of the whole building, that part of the building rented out does not qualify as an industrial building.

8.3.4 The determination of capital expenditure for the part of the building rented out is calculated based on the floor area.

Example 9



Example 10

Cybersil Sdn Bhd (CSB) established the Cybersil University which is an educational institution approved by the Ministry of Higher Education Malaysia. The course that is offered to students is a degree course on Taxation Law. A building that was constructed comprised of three blocks of four-storey buildings, i.e. :

Block 1 - classrooms and lecture halls.

Block 2 - computer lab, library, and lecturers' rooms.

Block 3 - Cafeteria, restaurant, self service laundry shop and hostel.

Santai Cafeteria, Dagang Restaurant and Harum Laundromat which are situated in block 3 are rented out to outsiders.

The total cost of floor area and construction cost for the three blocks are 180,000 square feet and RM1.5 million respectively. CSB intended to claim IBA under the provision of paragraph 42B, Schedule 3 of the ITA for the year of assessment 2018.

The apportionment of floor area based on the rented space are as follows:

	Floor area per square foot	The rented part based on floor area (%)	% of the total floor area that is used for rental
Santai Cafeteria	10,000	5.6	19.5%
Dagang Restaurant	20,000	11.1	
Harum Laundromat	5,000	2.8	

Referring to the above computation, part of the building that is rented out to outsiders for the business of cafeteria, restaurant and self service laundry is not part of the industrial building in view of the fact that the floor area for the three spaces rented out exceeds 10% of the floor area of the whole building. Therefore, the part of construction cost that is used for rentals of 19.5% is RM292,500* (RM1,500,000 x 19.5%).

The portion of the building which is used directly in the educational service, that is, classrooms, lecture halls, computer lab, library, lecturers' rooms and [2]hostel qualify as industrial buildings.

Thus, the QBE is RM1,207,500 (RM1,500,000 – RM292,500*).

CSB is eligible to claim IBA for the buildings as follows –

	RM
QBE	1,207,500
Year of assessment 2018	
Annual Allowances (10% x RM1,207,500)	120,750
Residual expenditure	1,086,750

Note:

[2]A hostel which is situated either within or outside the university compound qualifies as an industrial building if the management of the hostel is undertaken by the university itself.

Example 11

On January 2016, Klasik Lavender Sdn Bhd (KLSB) (accounts ending on 31 December) purchased a 12-storey hotel building costing RM10 million. The hotel business commenced operations in June 2016 and its management is controlled by the KLSB.

The hotel building qualifies as an industrial building under the provision of paragraph 37F, Schedule 3 of the ITA.

From June 2016 to 2020, KLSB rented the ground floor, the third floor and the fourth floor to outsiders according to the rental period as follows:

Year	Outsider	Floor of building	Business
2016 to 2020	Rayyan Co.	Ground – 1/2 of the ground floor	Seafood Restaurant
2018	Jintan Co.	Ground – 1/4 of the ground floor	Traditional Food Restaurants
	Muthu Co.	Ground – 1/4 of the ground floor	Grocery store

to	Aura Wellness Spa Co.	Third - 1/2 of the third floor	Spa and gymnasium
2020	Softcare Pharmacy Co.	Third - 1/2 of the third floor	Pharmacy
2020	Naufal Co.	Fourth	Boutiques

Percentage of the rental floor area of the whole 12-storey building is as follows –

Year of assessment	% of the entire floor area 12 storey that is used for rental
2016 - 2017	0.5/12 x 100 = 4%
2018 - 2019	2/12 x 100 = 17%
2020	3/12 x 100 = 25%

For the years of assessment 2016 and 2017, the ground floor is part of the industrial building as the percentage of the rented floor area does not exceed 10% of the whole building. Thus, the entire cost of the building (100%) qualifies for purposes of IBA.

For the years of assessment 2018 and 2019, the ground floor and the third floor of the building are not part of an industrial building as the rented floor area exceeds 10% of the floor area of the whole building. Therefore, the cost of building that qualifies for IBA claim will be adjusted to 83% (100% - 17%).

For the year of assessment 2020, the percentage of rented floor area on the ground floor, 3rd floor and 4th floor exceeds 10% of the whole building. Therefore, the cost of a building that qualifies for IBA claim will be adjusted to 75% (100% - 25%).

For the year of assessment 2021, no part of the floor area of the building is rented out. Therefore, the cost of a building that qualifies for IBA claim will be adjusted to 100%.

Below are the computation of IBA on QBE amounting to RM10 million from the years of assessment 2016 until year of assessment 2021.

	RM ('000) Claimable portion	RM ('000) Unclaimable portion	RM ('000)
QBE			10,000
Year of assessment 2016			
Initial Allowance (10% x RM10,000,000)	**1,000**		
Annual Allowance (3% x RM10,000,000)	**300**		1,300
Residual expenditure			8,700
Year of assessment 2017			
Annual Allowance (3% x RM10,000.000)			300
Residual expenditure			8,400
Year of assessment 2018			
QBE=RM8,300,000 (83% x RM10,000,000)			
Annual Allowance (3% x RM8,300,000)	**249**	51	300
Residual expenditure			8,100
Year of assessment 2019			
Annual Allowance (3% x RM8,300,000)	**249**	51	300

Residual expenditure			7,800
Year of assessment 2020			
QBE=RM7,500,000 **(75% x RM10,000,000)**			
Annual Allowance (3% x RM7,500,000)	**225**	75	300
Residual expenditure			7,500
Year of assessment 2021			
QBE= RM10,000,000 (100%)			
Annual Allowance (3% x RM10,000,000)			300
Residual expenditure			7,200

9. Part of a Building or an Extension to a Building not Used as an Industrial Building (Paragraph 66, Schedule 3 of the ITA)

9.1 Part of a building or of an extension to a building is considered as an industrial building if the part that is not used as an industrial building does not exceed 1/10 (10%) of the overall construction cost of the building or extension.

9.2 The determination of capital expenditure for the part or extension to a building is calculated based on -

(a) total cost of construction;

(b) floor area; or

(c) other apportionment method that is considered fair and reasonable by the Director General.

Example 12

Best Sdn Bhd constructed three separate blocks of buildings. Block A is used for the manufacturing process of plastic bags, Block B is used as a warehouse for the storage of finished plastic bags for export and Block C as general office. The three blocks were constructed within the same compound and inter-connected with lanes built by the company. The construction cost for these three blocks are determined as follows –

	RM
Block A - Factory	1,450,000
Block B - Warehouse	150,000
Block C - General office	98,000
	1,698,000

Block C for general office shall be treated as part of an industrial building if the 10% rule of the capital expenditure is complied with.

	Capital expenditure based on construction cost (RM)	% of construction cost
Blok C – General office	98,000	5.8% (RM98,000/RM1,698,000 x 100%)

Referring to the above computation, Block C which is used as general office is part of the industrial building as the percentage of construction cost of Block C does not exceed 10% of the total construction cost for Block A, Block B and Block C.

10. Relevant Interest

10.1 Generally, IBA is allowed to a person who incurred QBE for the purpose of his business. If a person owns a building apart from the buildings listed in paragraph 8.1.1 of this PR and leases or rents out the building to another person (tenant) who uses the building as an industrial building, IBA shall be allowed to the owner of the building [paragraph 60, Schedule 3 of the ITA].

Example 13

Rafflesia Sdn Bhd (Rafflesia) owns a warehouse near Port Klang that is rented out to Orchid Sdn Bhd (Orchid). Orchid uses the warehouse for the storage of imported rice before being distributed within the country. The rental source received by Rafflesia is assessed under paragraph 4*(d)* of the ITA.

The warehouse which is rented out is an industrial building as provided under subparagraph 63(c), Schedule 3 of the ITA. IBA can be claimed by Rafflesia although the rental income is a non-business source.

10.2 The relevant interest is the interest in the building to which the person who incurred the expenditure was entitled when he incurred it. Where a person is entitled to two or more interests in a building, when he incurs qualifying expenditure on the building and one of the interests is reversionary on all the others, the reversionary interest is to be the relevant interest.

10.3 An interest does not cease to be a relevant interest by reason of the creation of any lease or other interest which is a sublease or subinterest of the first lease or interest.

10.4 Where the relevant interest is a leasehold interest which expires because it is surrendered or because the person entitled to the leasehold interest acquires the reversionary interest, the interest to which the leasehold interest merges becomes the relevant interest.

Example 14

Madu Epal Sdn Bhd (accounts ending on 31 December) acquired a leasehold interest on a piece of land for a period of 10 years in the Banting industrial area for RM580,800 in 2004. In the year ended 31 December 2006, the company constructed a building for the manufacturing and processing of apple honey and incurred QBE amounting to RM450,000. On 02.02.2008, the company acquired a freehold interest on the land at a price of RM1,200,000.

Madu Epal Sdn Bhd (ME)

ME has a relevant interest in the building that it constructed and is eligble to claim IBA for the year of assessment 2006 and subsequent years of assessment.

Although the leasehold interest in the building has been changed to a freehold interest, the building is not disposed of. Therefore the company still retains the relevant interest and there is no change in the computation of IBA.

	RM	**RM**
Qualifying expenditure		450,000
Year of assessment 2006		
Initial allowance (10% x RM450,000)	45,000	
Annual allowance (3% x RM450,000)	13,500	58,500
Residual expenditure		391,500

Year of assessment 2007 – 2016		
Annual allowance (10% X RM13,500)		135,000
Residual expenditure		256,500

Example 15

Same facts as in Example 15 except that on 10.01.2009, the company leased the building to Lebah Asli Sdn Bhd (accounts ending on 31 December) which used the building as an industrial building. Lebah Asli Sdn Bhd incurred RM260,000 on an additional structure on 15.02.2009 for its business. The lease expired on 31.12.2016. The additional structure is deemed to be disposed of at a market value of RM170,000 on 1.1.2017.

Lebah Asli Sdn Bhd (LA)

LA also has a relevant interest on the expenditure incurred in constructing the additional structure from year of assessment 2009 to year of assessment 2016.

	RM	RM
Qualifying expenditure		260,000
Year of assessment 2009		
Initial allowance (10% x RM260,000)	26,000	
Annual allowance (3% x RM260,000)	7,800	33,800
Residual expenditure		226,200
Year of assessment 2010 - 2016		
Annual allowance (7 x RM7,800)		54,600
Residual expenditure		171,600
Year of assessment 2017		
Disposal price		170,000
Balancing allowance for year of assessment 2017		1,600

If the lease which expired on 31.12.2016 was not renewed by LA, the building including the additional structure would revert to the owner of the building (ME) who would not make any payment to LA for that additional structure.
The additional structure is deemed to have been disposed of as provided under paragraph 48(c), Schedule 3 of the ITA at a market value on 31.12.2016 [paragraph 62, Schedule 3 of the ITA]. If the market value is higher than the residual expenditure, there is a balancing charge that would be imposed on LA. On the reverse, a balancing allowance would be allowed to LA.

10.5 Generally, there are two types of relevent interest to an industrial building [paragraphs 49-51, Schedule 3 of the ITA], i.e. -

(a) Relevant interest of the owner in respect of the main building; and

(b) Relevant interest of a person who rents the building to which expenditure has been incurred by him on additional structures or renovations for the purpose of his business.

10.6 The owner of the building has an absolute interest which will entitle him to continue his claim for IBA in respect of the building as long as the building is used as an industrial building, i.e., paragraph 60, Schedule 3 of the ITA applies.

10.7 The tenant who leases the building is said to have a leasehold interest in the building and is eligble to claim IBA in respect of the QBE which is incurred by him on additional structures or renovations to the building as long as he uses the building as an industrial building.

10.8 Renovations incurred by the lessee or tenant shall be pysically and clearly identified from the original building of the owner.

10.9 As long as the lease is continued and no matter what happens to the absolute interest, the tenant is still entitled to claim IBA in respect of the expenditure incurred by him.

Example 16

QA Leasing Corporation Sdn Bhd is the owner of several factory buildings which are completed in the year ended 30 May 2017. In July 2017 a factory was leased to Tan Tin Sdn Bhd which then incurred QBE with the construction of an additional structure to place its plant and machinery for the manufacture of tin cans.

There are two relevent interests to the industrial building, i.e. –

(a) The absolute interest of QA Leasing Corporation Sdn Bhd in the construction of the original building and is eligble to claim IBA in respect to the factory building that was rented out as the tenant uses the building as an industrial building.

(b) The leasehold interest of Tan Tin Sdn Bhd on the expenditure incurred, ie to build an additional structure for the purposes of its business and is eligble to claim IBA in respect of that expenditure as long as the company uses it as an industrial building.

10.10 When the structure of an industrial building has changed after renovations have been done by the tenant, the owner of the building cannot adjust his claims on IBA based on cost for the portion of industrial building for each year of assessment. For the purposes of IBA, the owner and the tenant must make the claims based on actual expenditure incurred by them respectively on the industrial building.

11. Temporary Disuse of Building

11.1 A building is deemed to be used as an industrial building even though it is not actually being used if [paragraph 56 and 57, Schedule 3 of ITA] :

(a) the building was used for the purpose of a business immediately before disuse;

(b) during the period of disuse, the building is constantly maintained in readiness to be brought back into use; and

(c) the period of disuse is temporary.

Example 17

Semerah Padi Sdn Bhd owned a building that was used as a factory and storage of rice for distribution in the state of Kedah and Perlis. Due to the economic recession factor, the factory was not used for a period of 2 years. During that period, the factory was constantly being maintained in a proper manner such as cleaners were hired to clean the factory building and its compound and was carried out pest control.

Semerah Padi Sdn Bhd is eligible to claim IBA for that period because the factory is still properly maintained and ready to be used any time.

11.2 A building is deemed to have ceased to be used as an industrial building for the purposes of a business at the beginning of the period of disuse as an industrial building when -

(a) the building is not ready to be used; or

(b) the period of disuse as an industrial building is no longer regarded as temporary.

11.3 If it is clear that the period of disuse is permanent and annual allowances have been given as though the period of disuse was temporary then the following actions should be taken -

(a) previous assessments would not be reviewed; and

(b) allowances should cease from the year in the basis period for which the period of disuse is permanent.

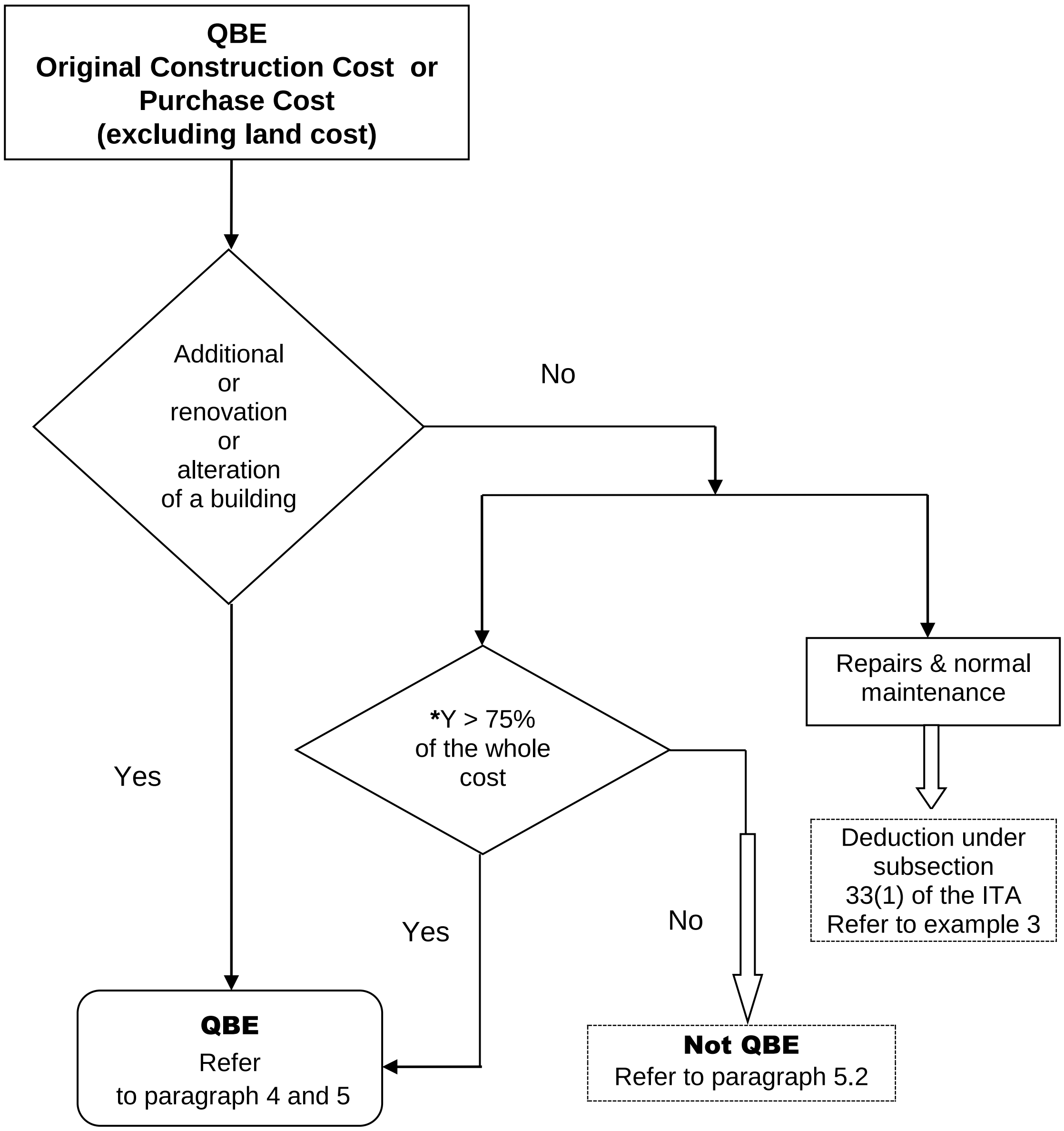
12. Disclaimer

The examples in this PR are for illustration purposes only and are not exhaustive.

Director General of Inland Revenue,
Inland Revenue Board of Malaysia.

APPENDIX I

Summary of Qualifying Building Expenditure for claiming of Industrial Building Allowances



Note :
***Costs incurred on preparing, cutting, tunnelling or levelling land in order to prepare a site for the installation of plant and machinery (P & M)