



**Datuk D P Naban**  
Senior Partner  
Tax, SST & Customs  
T: +603 6208 5858  
E: dpn@lh-ag.com



**S Saravana Kumar**  
Partner  
Tax, SST & Customs  
T: +603 6208 5813  
E: sks@lh-ag.com

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## **Taxpayer Wins Allowances For Factory Works**

*Ketua Pengarah Hasil Dalam Negeri v LC & B Sdn Bhd*

Yesterday, the Court of Appeal unanimously dismissed the appeal by the Director General of Inland Revenue (**DGIR**) in *LC & B's* case. The Court of Appeal affirmed the decision of the High Court in allowing the taxpayer's claim for industrial building allowance (**IBA**) and reinvestment allowance (**RA**), among other things, on the renovation cost incurred on the factory.

The taxpayer was successfully represented by Datuk D P Naban and S Saravana Kumar, partners from the firm's Tax, SST & Customs Practice, and associate, Steward Lee.

### **Brief Facts**

The taxpayer, which manufactures food products, acquired and renovated an existing factory in Johor as part of its business expansion. It claimed IBA and RA for the capital expenditure incurred on the:

- demolition of substructures in the factory; and
- reconstruction of certain parts of the factory, including the front entrance and guardhouse, as well as resurfacing the driveways and erecting metal fencing to secure the factory compound.

The taxpayer also purchased several machines, such as spiral mixers and electronic doughnut mixers, which were placed and used in one of its key outlets located in a shopping mall in the Klang Valley. The taxpayer claimed RA on the capital expenditure incurred to purchase those machines.

The DGIR disallowed the IBA and RA claims. The Special Commissioners of Income Tax (**SCIT**) agreed with the DGIR's finding. However, on appeal, the SCIT's decision was set aside by the High Court.

### **Industrial Building Allowance**

The DGIR disallowed the IBA on the basis that the IBA is only available for the construction of factory. According to the DGIR,

construction should be distinguished from reconstruction and renovation and, therefore, IBA is restricted to the construction of a new building only. As for the guardhouse, resurfaced driveways and metal fencing, the DGIR claimed that these were located outside the factory building and thus, do not qualify for IBA.

The taxpayer submitted that paragraph 45 of Schedule 3 to the Income Tax Act 1967 (ITA) stipulates that construction includes reconstruction and rebuilding. Hence, the High Court had correctly decided that the demolition works were necessary for the construction of the building for the taxpayer's manufacturing activity and, thus, should be part of the capital expenditure incurred in the construction of the building for IBA.

In relation to the other structures, the taxpayer argued that the High Court has correctly referred to the functionality and entirety tests, which have been applied previously in tax cases like *Success Electronics* and *OKA Concrete Industries*. The taxpayer added that for the purposes of IBA, a factory building includes any structure erected on land, so long as it is necessary and integral to the adequate functioning of the factory.

### **Reinvestment Allowance**

The DGIR disallowed the RA claim on the basis that the taxpayer's outlet in the Klang Valley was not licensed under the Industrial Co-ordination Act 1975 and thus, the outlet is not a factory. The DGIR also argued that the machines for which RA was claimed were not used in the taxpayer's factory in Johor.

The taxpayer responded that the High Court had correctly held that RA is available for plant and machinery used in the expansion of the taxpayer's existing manufacturing business. Paragraph 1(b) of Schedule 7A to the ITA allows RA to be claimed on the capital expenditure incurred for plant, machinery or factory for a qualifying project. It is not confined to plant and machinery used in a factory as claimed by the DGIR.

### **Conclusion**

Upon hearing the submissions of both parties, the Court of Appeal found no merits in the appeal and dismissed the DGIR's appeal.

This landmark decision allows taxpayers, especially those in the manufacturing sector, to maximise their IBA and RA claims on the capital expenditure incurred in expanding and modernising their business.

If you have any queries pertaining to IBA, RA or other tax incentives, please contact our partners **Datuk D P Naban** or **S Saravana Kumar** from the Tax, SST & Customs Practice at [tax@lh-ag.com](mailto:tax@lh-ag.com)

Solaris Dutamas  
No. 1, Jalan Dutamas 1  
50480 Kuala Lumpur  
Malaysia

T +603 6208 5888  
F +603 6201 0122/0136  
E [enquiry@lh-ag.com](mailto:enquiry@lh-ag.com)  
W [www.lh-ag.com](http://www.lh-ag.com)

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