

PRACTICE NOTE NO. 1/2022

EXPLANATION IN RELATION TO THE DEFINITION OF FACTORY FOR THE PURPOSE OF REINVESTMENT ALLOWANCE CLAIM UNDER SCHEDULE 7A, INCOME TAX ACT 1967

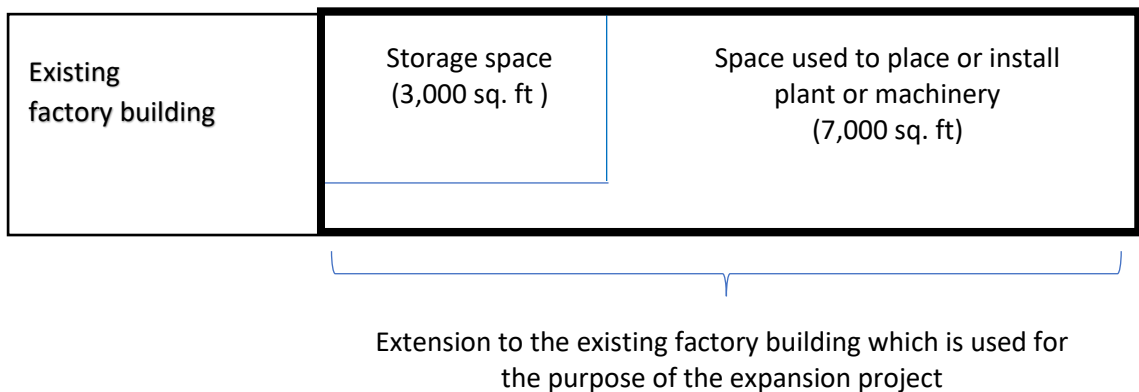
1. This Practice Note is issued to explain the meaning of 'factory' stated in paragraph 9 Schedule 7A of the Income Tax Act 1967 (ITA).
2. Factory means "portion of the floor areas of a building or an extension of a building used for the purposes of a qualifying project to place or install plant or machinery or to store any raw materials, or goods or materials manufactured prior to sale:

Provided that in respect of 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 areas of the building or the extension to that building;"

3. 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 taken into account in calculating reinvestment allowance (RA) claim under Schedule 7A of the ITA. In other words, only the portion used for the purpose of a qualifying project fulfils the definition of 'factory' and may be allowed RA claim subject to stipulated conditions.
4. This tax treatment also applies in the case of an extension or addition made to an existing factory building.

Example 1:

Company A constructs an extension to the existing factory building for an expansion project to the manufacturing operation carried out. The total area of the extension to the building is 10,000 square feet (sq. ft). A portion of the extension with an area of 3,000 sq. ft is used to store raw materials while the remaining is used as a space to place plant or machinery as follows:

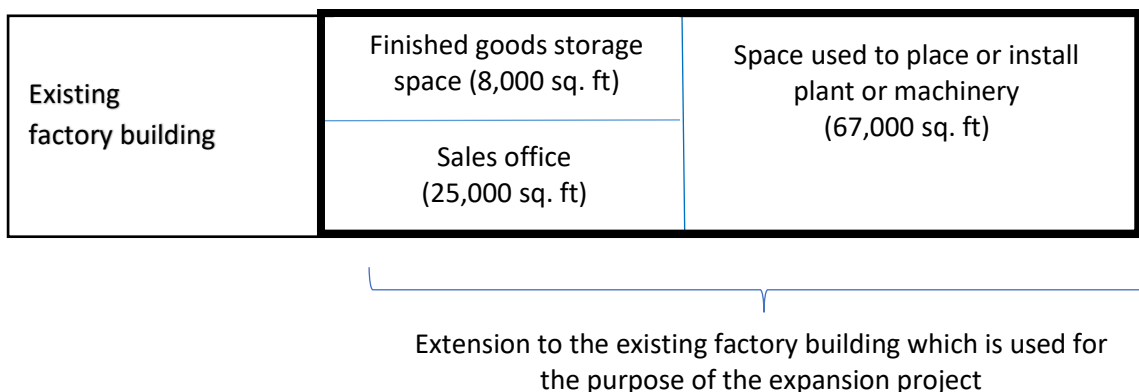


The capital expenditure incurred for the construction of the portion of space to place or install the plant or machinery in this expansion project (7,000 sq. ft) qualifies for RA. The raw materials storage space (3,000 sq. ft) does not qualify for RA claim because it does not meet the definition of 'factory' 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.

- In the event that a portion of the extension to the building is used for various purposes other than for a qualifying project, only the portion of the extension to the building used for the purpose of a qualifying project may be allowed an RA claim.

Example 2:

Company B expands the production area of manufactured product by making an extension to an existing factory building. The additional area of the extension is 100,000 sq. ft. Apart from placing plant or machinery, a portion of the extension to the building is also used as a sales office and another part is used as storage space for finished goods. The use of the total space in the extension is shown as follows:



Sales office space is not included in the 'factory' definition in paragraph 9 Schedule 7A of the ITA. Therefore, the total area of sales office space should be taken out for the purpose of determining 'factory' or space used for the purpose of a qualifying project. As the sales office does not fulfil the meaning of 'factory', hence, the expenditure for sales office space is not a qualifying expenditure for the purpose of Schedule 7A of the ITA.

Determination of RA eligibility for finished goods storage space shall be based on the ratio of the said storage space area (8,000 sq. ft) with the total area of the expansion project, namely the finished goods storage space and the space to place or install plant or machinery (8,000 sq. ft + 67,000 sq. ft).

As the finished goods storage space area has exceeded one-tenth (1/10) which is 10.67% (8,000 sq. ft / 75,000 sq. ft x 100%) of the total area of the expansion project, the said storage space does not fulfil the meaning of 'factory' and is not eligible for RA. Only the construction cost for the area used to place or install plant or machinery (67,000 sq. ft) is eligible to be given RA claim subject to stipulated conditions.

- 6. This tax treatment applies as long as the area of storage space for raw materials, goods or materials or both does not exceed one-tenth (1/10) of the total area of the extension to the building used for the purpose of a qualifying project.

Example 3:

Company C undertakes an expansion project for the company's manufacturing business by extending the existing factory building for the installation of plant or machinery, storage of materials and also a sales office. The use of space in the extension to the building is shown as follows:

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



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

For the calculation of RA, only the portion of the space used to place or install plant or machinery fulfils the meaning of 'factory' and is eligible to be given RA claim. The space for storage of materials does not fulfil the meaning of 'factory' as the space 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 building used for the purpose of the expansion project. The portion of the sales office is not taken into account in the calculation of the total area of the expansion project as it does not meet the 'factory' definition.

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