GUIDELINES FOR INCOME TAX TREATMENT OF MALAYSIAN FINANCIAL REPORTING STANDARDS (MFRS) 140: INVESTMENT PROPERTY

1. INTRODUCTION

MFRS 140 requires all entities to determine the fair value of investment property, for the purpose of either measurement (if the entity uses the fair value model) or disclosure (if it uses the cost model).

1.1 Definition of terms

a. Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under finance lease) to earn rentals or for capital appreciation or both, rather than for:

   i. Use in the production or supply of goods or services or for administrative purposes, or
   ii. Sale in the ordinary course of business.

   Therefore, an investment property generates cash flows independently of the other assets held by an entity. This distinguishes investment property from owner-occupied property (OOP).

b. Fair value (FV) means the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

c. OOP refers to property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

2. OBJECTIVE

The objective of this Guideline is to explain the resulting income tax treatment arising from the adoption of the MFRS 140.

3. TAX TREATMENT

NO.	ISSUES	TAX TREATMENT
3.1	**ADOPTION OF COST MODEL**	
	Accounting Implication The acquisition cost of the investment property is reflected in the audited accounts with disclosure note on the fair value (FV) of the property.	**a. Investment Property Classified As Industrial Building (IB)** No changes in tax treatment. Depreciation and impairment loss are to be added back. If investment property (IP) is used as an IB [building provided under paragraph 63, Schedule 3 of the Income Tax Act (ITA) 1967], paragraph 60, Schedule 3 of ITA 1967 is applicable. The owner of the building is entitled to Industrial Building Allowance (IBA) even though the letting of the IP constitutes a non-business source of income. The amount of qualifying building expenditure for the purpose of IBA under paragraph 3, Schedule 3 of 1967 shall be equal to the amount incurred on that building and any impairment on the IP will not affect the qualifying expenditure. **b. Interest expense (the IP is financed by borrowings)** i. Rental is the only source Although IP generates only rental income, the rental income constitutes two separate sources [either paragraph 4(a) or 4(d) of ITA 1967] Interest expense is allowable against the rental income from each source. If there is more than one source of income (rental and business source), the amount of interest allowable against business income has to be restricted

		under subsection 33(2) of ITA 1967. Then, the part of the interest restricted that attributable to IP is allowable against the rental income. ii. Where construction of IP is in progress and interest expense is capitalized (MFRS 123), the interest is not allowable as a deduction as rental has not yet constituted a source of income. Therefore interest incurred is not allowed to be deducted in the tax computation. It is also not allowable as a deduction when it is charged to profit and loss account. (Public Rulings No. 3/2011 and No. 4/2011 applies)
3.2	**ADOPTION OF FAIR VALUE MODEL**	
	Accounting Implication FV of the investment property is reflected in the audited accounts. The increase or decrease in the FV of the property is taken to the income statement.	**a. Investment Property Classified As IB** No changes in tax treatment. Depreciation and impairment loss are to be added back. The amount of qualifying building expenditure for purposes of IBA under paragraph 3, Schedule 3 of ITA 1967 shall be equal to the amount incurred on that building (not at FV) and any impairment will not affect the qualifying expenditure. **b. Interest expense (the investment property is financed by borrowings)** Tax treatment on interest expense is similar to subparagraph 3.1(b) above. (Public Rulings No. 3/2011 and No. 4/2011 applies)

		Any changes in FV will be disregarded for tax purposes.
3.3	**TRANSFER FROM INVESTMENT PROPERTY TO OOP**	
	Accounting Implication The deemed cost of the investment property shall be the FV at the date of the transfer.	**a. The IB previously rented out is taken back for own use** i. IB continue to be used as an IB The company may continue to claim IBA. ii. Building ceased to be used as an IB It is a disposal under paragraph 48, Schedule 3 of ITA 1967. The disposal value will be determined under subparagraph 62(1), Schedule 3 of ITA 1967. The disposal value is the market value at the date of transfer. The market value is determined by the Valuation And Property Services Department (JPPH). iii. Non-IB becomes IB Qualifying expenditure (expenditure incurred) is reduced by notional allowance (during the period building is not used as an IB) under subparagraph 68(c), Schedule 3 of ITA 1967. **b. Interest expense** Interest expense is allowable against business income provided the building continues to be used for business purposes. However, for an investment holding company (IHC), once the building is transferred to OOP, the building is no longer part of the

		group of properties generating rental income for the IHC. As a result, interest and other expenses of that building cannot be deducted against any income of the IHC. Any change in FV will be disregarded for tax purposes.
3.4	**TRANSFER FROM OOP TO INVESTMENT PROPERTY**	
	Accounting Implication After the transfer, FV of the investment property is reflected in the audited accounts. The increase or decrease in the FV of the property is taken to the income statement.	**a. The building previously occupied for own use is now rented out** i. Non-IB becomes IB Qualifying expenditure (expenditure incurred) is reduced by notional allowance (during the period building is not used as IB) under subparagraph 68(c), Schedule 3 of ITA 1967. ii. Continues to be used as IB The company may continue to claim IBA. Paragraph 60 of Schedule 3 is applicable. iii. Building ceased to be used as IB It is a disposal under paragraph 48, Schedule 3 of ITA 1967. The disposal value is determined in accordance with subparagraph 62(1) of Schedule 3. The disposal value is the market value at the date of transfer. The market value is determined by JPPH. Balancing Charge (BC) or Balancing Allowance (BA) will be calculated if the building is

		IB (IBA has been claimed) prior to the transfer. IB is deemed to be disposed. **b. Interest expense** When the building is transferred to IP at any time in the basis period for a year of assessment, interest incurred for the whole of basis period has to be apportioned according to the relevant period the building was used as business (OOP) and as rental (IP). In the subsequent year of assessment the whole interest will be allowed against rental source. If there is no rental source the interest expense will be disregarded. Tax treatment of rental income can be referred to PR 4/2011. Any change in FV will be disregarded for tax purposes. **Note:** As explained in subparagraph 3.4(a)(ii) above, a building that is transferred from IP to OOP and no longer used as IB after the transfer, that building is deemed to be disposed off for the purpose of Schedule 3. BC/BA will be computed. The market value of the building at the date of the transfer is taken as disposal value. In the case where that building is transferred back to IP, the rental income is treated as a new source of income. Even though the building may be IB, IBA is not allowable as the IB had been deemed disposed of when it was transferred from IP to OOP in the first instance.

3.5	TRANSFER FROM INVESTMENT PROPERTY TO INVENTORY	
	Accounting Implication FV at the date of transfer becomes the cost of the inventory and is taken to the income statement.	When the IP is transferred to inventory, the value of the property is the market value at the date of transfer as determined by the JPPH. Gains from the difference between historical cost and market value of the IP will be charged to the income statement. Gains taken to the income statement is chargeable to Real Property Gain Tax (RPGT) subject to the holding period. [paragraph 17A, Schedule 2 of Real Property Gain Tax Act 1976] BC/BA will be computed if the building is IB (IBA has been claimed) prior to the transfer. IB is deemed to be disposed of. Any change in FV will be disregarded for tax purposes.
3.6	**TRANSFER FROM INVENTORY TO INVESTMENT PROPERTY**	
	Accounting Implication The increase or decrease in the FV of the property is taken to the income statement.	If the company transfers the inventory to IP, it will be treated under paragraph 24(2)(a) of ITA 1967. The market value of the inventory at the date of the transfer as determined by JPPH will be treated as gross income under paragraph 24(2)(a) of ITA 1967. The difference between the market value and the cost of the inventory is liable to tax. Any change in fair value will be disregarded for tax purposes.

3.7	**TRANSFER FROM PROPERTY IN THE COURSE OF THE CONSTRUCTION OR DEVELOPMENT TO INVESTMENT PROPERTY**	
	Accounting Implication The change in FV over carrying amount is taken to the income statement. Property constructed for future use as investment property is measured at FV if the FV is reliably determinable on a continuing basis.	If the property under construction is part of the inventory of the company, a transfer of this inventory to IP will be treated under paragraph 24(2)(a) of 1967. The market value of that inventory at the date of the transfer as determined by JPPH will be treated as gross income under paragraph 24(2)(a) of ITA 1967. The difference between market value and the cost of the inventory is liable to tax. Any change in fair value will be disregarded for tax purposes.
3.8	**Other Issue**	Most probably disposal of an IP is subject to RPGT. If IRB can establish badges of trade exist then the gain from the disposal can be taxed under ITA 1967.

LEMBAGA HASIL DALAM NEGERI MALAYSIA

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