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DISCUSSION PAPER

TAX IMPLICATIONS RELATED TO THE IMPLEMENTATION OF FRS 5: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

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1. Introduction

1.1 Background of FRS 5

1.1.1 Rationale

a) FRS 5 supersedes IAS 35

FRS 5 is to specify the accounting for assets held for sale and the presentation and disclosure of discontinued operations. FRS 5 supersedes IAS 35 *Discontinuing Operations* which was adopted as MASB 28 *Discontinuing Operations* in Malaysia.

b) FRS 5 requirements

In the past, IAS 35 *Discontinuing Operations* provided for the disclosure of income and expenses relating to discontinuing operations in the income statement. There was no requirement for segregation of the assets and liabilities relating to discontinuing operations in the balance sheet.

FRS 5 provides for the following:

i) Classification and measurement of the assets held for sale (HFS) in the balance sheet
ii) Disclosure of assets and liabilities in the balance sheet and notes to the financial statement
iii) Disclosure of income, expenses and cashflow in the income statement for discontinued operations

1.1.2 Scope of FRS 5

The objective of FRS 5 (Para 1 FRS 5) is to specify the accounting for assets "held for sale", (HFS) and the "presentation and disclosure for discontinued operations".

In particular, the FRS requires the following:

1.1.2.1 Classification as HFS and measurement - assets that meet the criteria to be classified as HFS to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease;
The measurement requirements for FRS 5 do not apply to the following assets:

(a) Deferred tax assets (FRS 112 *Income Taxes*);
(b) Assets arising from employee benefits (FRS 119 *Employee Benefits*);

(c) Financial assets (FRS 139 *Financial Instruments: Recognition and Measurement);*
(d) Investment property measured at fair value (FRS 140 *Investment Property*);
(e) Biological assets (IAS 41 *Agriculture*); and
(f) Contractual rights under insurance contracts (IFRS 4 *Insurance Contracts*).

1.1.2.2 Presentation in balance sheet - HFS to be presented separately on the face of the balance sheet; and

1.1.2.3 Presentation of discontinued operations - the results of "discontinued operations" to be presented separately in the income statement.

1.1.3 Definition of essential terms

(a) Discontinued operation – please refer to 3.4(b) below.
(b) Disposal group – please refer to 3.1(a) below.
(c) Highly probable – significantly more likely than probable. Please refer to 3.1(c) below.

1.1.4 Effective Date

FRS 5 became operative for annual periods beginning on or after 1 January 2006. However, an entity can apply FRS 5 for a period beginning before 1 January 2006 and should disclose that fact.

2. Scope of the comments

The scope of the comments on FRS 5 in this discussion paper is as follows:

a) To highlight those areas where the tax law may be ambiguous or where no law has been provided when applied to situations envisaged by FRS 5
b) To highlight those areas where the law is clear but where implementation may not be cost effective
c) To propose the different possible methods of tax treatment for each of the situations and to suggest the most appropriate tax treatment
d) To recommend changes to the law or to the IRB departmental practices, if necessary, to facilitate the implementation of FRS 5 provisions

3. Changes introduced by the FRS regime

As mentioned in 1 above, the previous IAS 35 / MASB 28 provided only for disclosures of discontinued operations in the Income Statement. There was no requirement for classification of assets held for sale and for the measurement of these assets. The disclosure requirements were also less extensive.

FRS 5 introduced the following major changes:

3.1 Classification of assets HFS

a) **Recovered through sale** (Para 6 FRS 5)

An entity shall classify a non-current asset (or disposal group) as HFS if its carrying amount will be recovered **principally through a sale transaction** rather than through continuing use – per Para 6 of the FRS 5.

A “disposal group” is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The assets may include property, plant and equipment, inventories, intangible assets, etc.

This discussion paper is focused on the tax treatment of assets which are unclear. The tax treatments of assets which are clear such as those for assets which qualify for capital allowances, inventories, etc are not discussed here. The tax treatment for these assets will follow the general law and will depend on whether any gains on disposal or on deemed disposal are capital or revenue and realized or unrealized.

b) **Criteria to be classified as HFS** - (Para 7 FRS 5)
Before an asset can be classified as being HFS, the assets must meet the following criteria:

The assets (or disposal groups) must be **available for immediate sale in its present condition** subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its ***sale must be highly probable*** – per Para 7 of the FRS note.

c) **Meaning of “highly probable”** - (Para 8 FRS 5)

For the sale to be **highly probable**,

i) the appropriate **level of management must be committed to a plan to sell the assets** (or disposal groups),

ii) The assets or (disposal groups) must be **actively marketed for sale** at a price that is reasonable in relation to its current fair value

iii) The sale should be expected to qualify for recognition as a completed sale **within one year** from the date of classification

iv) Actions required to complete the plan should indicate that it is **unlikely that significant changes** to the plan will be made or that the plan will be withdrawn.

d) **Sale completed after one year** (Para 9 FRS 5)

In most cases, the sale should be completed within a year because an asset HFS can only be classified as such when the sale is "highly probable" [3.1(b) above]. In practical terms, it usually means that asset is being actively sold or a sale & purchase agreement has been entered into. However, it is possible for the sale to be completed after one year. Para 9 FRS 5 states that "Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period to complete a sale **does not preclude** an asset (or disposal group) from being classified as HFS". These disposals may give rise to complications in the tax treatments as discussed in 3.1(g) below.

e) **Criteria must be met at balance sheet date** (Para 12 FRS 5)

To be eligible for being classified as HFS, the criteria in 2.1(b) above have to be met at the balance sheet date. Para 12 FRS 5 states that "If the above criteria are met after the balance sheet date, an entity **shall not classify** a non-current asset (or disposal group) as held for sale in those financial statements when issued".

f) **Exceptions:**

i) Abandoned assets should not be classified as HFS (Para 13 FRS 5)

An entity **shall not classify as HFS** a non-current asset (or disposal group) that is to be abandoned unless the disposal group to be abandoned meets the criteria of "discontinued operations". Then, the entity shall present the results and cash flows of the disposal group as discontinued operations at the date on which it ceases to be used.

ii) **Assets temporarily taken out of use** should not be treated as abandoned (Para 14 FRS 5)

An entity **shall not account** for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

g) **Tax implications**

i) Still in use in the business

When an asset is classified as HFS, it signifies an intention of the company to sell the asset. If the asset is continued to be used in the business, capital allowances can continued to be claimed and there are no tax issues. When the asset is disposed off, a balancing allowance (BA) or balancing charge (BC) will be calculated in accordance with Para 61 and 62 of Schedule 3 of the Income Tax Act 1967.

ii) Ceased to be used

However, if the asset has "ceased to be used" in accordance with Para 61 of Schedule 3 of the Income Tax Act 1967, there is a deemed sale and BA / BC has to be calculated. The tax issues will relate mainly to the market value to be used for the deemed sale and how the value should be arrived at.

iii) Tax treatment on subsequent sale

An asset that is ceased to be used and for which BA / BC had been calculated will encounter uncertainty when the asset is finally sold in the following year or in a later year. What would be the tax treatment when there is a difference between the market value and the actual sales proceeds? This issue is not new and had been an issue even under the previous accounting standard. The possible scenarios and the tax treatments are discussed in 6.1.2 below.

iv) Tax treatment if the asset is not subsequently sold but reclassified to its original description

Para 26 of FRS 5 states that if an entity has classified an asset or disposal group as held for sale but the criteria for this classification are no longer met, the entity shall cease to classify the asset or disposal group as held for sale. Hence, an asset that is subsequently not sold but reclassified back to its original description (i.e. held for use) has to be brought back for CA tax purposes. This could either be by way of revoking the earlier "deemed sale" or to account for the asset under

Para 2A of Schedule 3 of the Income Tax Act 1967 as an option. The possible scenarios are discussed in 6.2 below.

3.2 Measurement of assets HFS and treatment of impairment losses or gains

a) Initial measurement (Para 15 FRS 5)

When an entity first classifies an asset as HFS, it should measure the non-current asset (or disposal group) classified as HFS at the lower of its carrying amount and fair value less costs to sell.

Example:

Carrying amount = 100
Fair value (say) = 80
Costs to sell (say) = 10
Fair value less selling costs = 70
Difference = 30

b) **Impairment loss** (Para 20 FRS 5)

Any impairment loss on initial measurement will be taken to income statement. These impairment losses will be accorded the usual tax treatment depending on whether these losses are revenue / capital and whether they are realized / unrealized, eg., if properties not qualifying for capital allowances are written down to market value, the writedown or impairment loss is not deductible for tax purposes. For discontinued operations which are defined as operations that had been disposed or are classified as HFS [3.4(b)(i) below], revenue losses which are realized could also be deductible for tax purposes.

c) Subsequent re-measurement (Para 19 FRS 5)

On subsequent re-measurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of the FRS, but are included in a disposal group classified as held for sale, shall be remeasured in accordance with **applicable FRSs** before the fair value less costs to sell of the disposal group is remeasured. Any gain or loss on the re-measurement of a non-current asset or disposal group HFS shall be included in the Income Statement as profit or loss from continuing operations (Para 37 FRS 5).

d) Gain on reversal (Para 21 FRS 5)

An entity shall recognise a gain for any subsequent increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognised. These gains on reversal will be accorded the usual tax treatment depending on whether these losses are revenue / capital and whether they are realized / unrealized.

Example:

New fair value (say) = RM1,200
New costs to sell (say) = RM150
Previous fair value (say) = RM800
Previous costs to sell (say) = RM100
Increase in net value = RM350 [(1200 – 150) – (800 – 100)]
Reversal (limited to previous impairment) = RM300

e) Not to depreciate (Para 25 FRS 5)

An entity shall not depreciate (or amortise) a non-current asset while it is classified as HFS or while it is part of a disposal group classified as HFS. This accounting treatment has no tax implications.

Interest and other expenses attributable to the liabilities of a disposal group classified as HFS shall continue to be recognized. These expenses should be accorded the usual tax treatments i.e the expenses should be deductible for tax purposes if the expenses relate to a source of business that had not ceased.

3.3 Changes to a plan of sale

a) Reasons for changes and FRS 5 treatment

It may be possible that a plan of sale for an asset HFS be changed. The change in plans may be due to the following reasons:

i) The asset is not being marketed actively in which case the asset cannot be classified as being HFS
ii) The asset is not being held for sale anymore and the company has decided to either abandon it, temporarily not use it or to bring the asset for use in the company

If there is a change in the plan of sale such that an asset cannot be classified as an asset HFS, Para 26 FRS 5 requires that “If an entity has classified an asset (or disposal group) as HFS, but the criteria in paragraphs 7 to 9 of the FRS are no longer met, the entity shall **cease to classify** the assets (or disposal groups) as HFS”. In such case, the asset has to be reclassified back to its original description eg as property, plant and equipment, instead of “assets held for sale”.

b) Tax implications

This reclassification will bring along with it the relevant tax implications such as:

i) Asset subsequently used in the business

If an asset had been "deemed sold" under Para 61 of Schedule 3 previously when it was ceased to be used, the question will arise as to how the asset should be treated for tax purposes when the asset is used in the business and reinstated as a qualifying asset. The discussion on this is found in 6.2 below.

ii) Qualifying expenditure for capital allowance purposes when asset is brought back to use

When the asset is reclassified to its original description, the question will arise as what the tax treatment should be for capital allowance purposes (see 6.2 below).

3.4 Presentation and disclosure

a) Overview

FRS 5 requires a non-current asset or disposal group classified as HFS to be disclosed in the balance sheet. Details of the disclosure requirements are shown in 3.4(c) below.

In addition, discontinued operations require additional disclosures. Details of the disclosure requirements are shown in 3.4(b)(ii) below.

Discontinued operations do not have separate accounting treatment in FRS 5 compared to non-current assets or disposal groups. The only extra requirement for Discontinued Operations in FRS 5 is the disclosure requirement. In fact, the assets and liabilities of discontinued operations will be similarly treated as "assets and liabilities HFS" if they meet the criteria of being classified as assets or liabilities HFS.

b) **Presenting Discontinued Operations** (Para 32 FRS 5)

i) Meaning of "discontinued operations"

A "discontinued operation" is a component of an entity that either has been disposed of, or is classified as HFS and:

aa) represents a separate major line of business or geographical area of operations, bb) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or

cc) is a subsidiary acquired exclusively with a view to resale.

A “component of an entity” comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity is therefore, will have been a cash-generating unit or a group of cash generating units while being held for sale.

ii) Disclosure requirements of discontinued operations

An entity shall disclose the following (Para 33 FRS 5);

aa) A single amount on the face of the income statement comprising the total of:

- aaa) the post-tax profit or loss of discontinued operations and
- bbb) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation

bb) An analysis of the single amount in item (aa) above into the following:

- aaa) the revenue, expenses and pre-tax profit or loss of discontinued operations;
- bbb) the related income tax expense; and
- ccc) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

cc) The net cash flows attributable to the operating, investing and financing activities of discontinued operations

Example on disclosure of discontinued operations:

Income Statement for the Year Ended 31 Dec 20X8

	20X8 RM'000	20X7 RM'000
Continuing operations		
Revenue	200	300
Cost of sales	(150)	(200)
Gross profit	50	100
Other income	20	30
Distribution costs	(15)	(20)
Administrative expenses	(10)	(15)
Other expenses	(5)	(5)
Finance costs	(10)	(10)
Profit before tax	30	80
Income tax expenses	(9)	(24)
Profits for the year from continuing operations	21	56
Discontinued operations		
Profits for the year from discontinued operations	3	3
Profit for the period	24	59

Notes to the financial statements

	20X8 RM'000	20X7 RM'000
Discontinued operations		
Revenue	18	12
Cost of sales	(5)	(3)
Gross profit	13	9
Other income	1	2
Distribution costs	(3)	(2)
Administrative expenses	(2)	(1)
Loss on re-measurement of assets held for disposal	(1)	(2)
Finance costs	(2)	(1)
Profit before tax	6	5
Income tax expenses	(3)	(2)
Profits for the year from discontinued operations	3	3

c) **Presentation of a non-current asset or disposal group classified as held for sale** (Para 38 FRS 5)

The presentation and disclosure requirements of a non-current asset or disposal group classified as HFS are as follows:

i) Asset or disposal group HFS should be presented in balance sheet separately
ii) Liabilities of a disposal group HFS should be presented separately from other liabilities in the balance sheet
iii) Assets and liabilities should not be offset
iv) The major classes of assets and liabilities HFS shall be separately disclosed either on the face of the balance sheet or in the notes
v) An entity shall present separately any cumulative income or expense recognised directly in equity relating to a non-current asset or disposal group classified as HFS

Example on disclosure of non-current asset or disposal group HFS:

Presentation and disclosure in balance sheet		
	20X8	**20X7**
	RM'000	RM'000
Current assets		
Cash and cash equivalents	200	150
Inventories	50	70
	250	220
Assets of disposal group/non-current asset classified as held for sale	100	80
Total Current Assets	350	300
Current liabilities		
Trade and other payables	140	100
Liabilities directly associated with disposal group/ assets classified as held for sale	80	70
Total current liabilities	220	170
Notes to financial statements		
Note 11: Disposal group classified as held for sale		
	20X8	**20X7**
	RM'000	RM'000
Disposal group:		
Assets		
Property, plant and equipment	15	10
Intangible assets	40	40
Inventories	20	15
Cash and bank balances	25	15
Assets of disposal group classified as held for sale	100	80
Liabilities		
Trade and other payables	40	30
Borrowings	15	15
Current tax payable	10	10
Deferred tax	15	15
	80	70

4. Tax treatment before FRS implementation

Before the implementation of FRS 5, IAS 35 only required disclosure of discontinued operations in the income statement but not in the balance sheet. If there are assets which have ceased to be used for the business and the assets are part of the discontinued operations, the relevant tax adjustments would have been made in the tax computations.

These tax adjustments would include the following:

(i) To calculate the BA / BC on deemed disposal of assets under Para 61 and 62 of Sch 3 if the assets are permanently disused by the Company;
(ii) To continue to claim CA under Para 56 of Sch 3 if the assets are temporarily disused and maintained in readiness to be brought back into use;
(iii) To calculate notional allowance on the asset during the years when the asset was not in use, and to calculate BA / BC in the year of actual disposal. However, this treatment is not based on any supporting law or provisions in the Act but on general practice which is normally accepted by the IRB.

5. Tax issues arising from FRS implementation

With the new FRS 5, the disclosures in the balance sheet will highlight to the tax authorities that certain assets are not in use or the assets are planned to be disposed within one year at the end of the basis period and may therefore trigger capital allowances implications. There will also be complications when the asset is subsequently sold in a subsequent basis period or when the asset is reinstated as being held for use in the business if the plan for sale did not materialize. Although these changes can be of significance for tax purposes, the tax treatments for these changes are not new per se. The complications with the various tax treatments existed even during IAS 35. This paper therefore merely highlights the complications of the various tax treatments which are available and pros and cons of each treatment. Details of these tax issues are discussed in 6 below.

6. Situations where tax issues may arise after FRS implementation

6.1 Tax treatment on classification of a non-current asset as held for sale

When an asset is HFS which means that it is about to be disposed, it will be classified as “current assets” in the balance sheet and described as “non-current asset classified as held for sale”. On adoption of this accounting treatment, a few tax issues will arise.

6.1.1 In the year that the asset is classified as HFS

In the year that the asset is classified as an asset HFS, the various scenarios and the relevant tax treatments are explained below. It should be noted that these scenarios and tax treatments may create complications when the asset is finally sold in the next year or a future year. If the asset is sold in the same year, there should be no tax complications since the actual sales proceeds can be substituted for the market value on a "deemed sale", if applicable. It should also be noted that it is possible that the asset is finally not sold in which case, further tax consequences may apply (see 6.2 below).

a) Temporary disuse

If the non-current asset classified as HFS is temporarily disused and maintained in readiness to be brought back into use, CA can continue to be given (Para 56 of Sch 3 ITA – details below).

Temporary disuse is not so likely since an asset held for sale under FRS 5 indicates that the asset is intended to be sold and not temporarily disused.

Para 56 of Sch 3 states as follows:

"For the purposes of this Schedule, an asset which is temporarily disused in relation to a business of a person shall be deemed to be in use for the purposes of the business if it was in use for the purposes of the business immediately before becoming disused and if during the period of disuse it is constantly maintained in readiness to be brought back into use for those purposes".

b) **Continued to be used**

If the asset is still used in the business pending sale, the taxpayer can continue to claim CA.

c) **Ceased to be used**

If the non-current asset classified as HFS ceases to be in use, the asset is deemed to be disposed of at the time when the asset is ceased to be used and the relevant BA / BC has to be calculated (Para 61, Sch 3 of ITA).

Para 61 of Sch 3 states as follows:

"Any plant or machinery which is used for the purposes of a business and in respect of which qualifying expenditure has been incurred is disposed of within the meaning of this Schedule if it is sold, discarded or destroyed or if it ceases to be used for the purposes of that business".

The tax issues are as follows:

i) **BA/BC** - BA / BC arising from the disposal should be calculated based on the market value at the time when the assets are ceased to be in use (Para 62, Sch 3).

ii) **Market value** - In practice, it will be difficult to determine the market value at the time when the assets are ceased to be in use.

iii) **Notional allowance** - Notional allowance is computed for the year of disuse or where no claim is made for an annual allowance to determine the residual expenditure. On subsequent disposal, BA/BC is calculated. The law relating to notional allowance which is contained in Para 68 and 69 of Sch 3 is only applicable in computing the residual value of a qualifying asset that is disposed and is not meant to apply to cases where an asset has ceased to be used. In these cases where the asset has ceased to be used for the business, the taxpayer should compute BA / BC on the deemed disposal.

Para 68 and 69 of Sch 3 on "notional allowance" state as follows:

68. A reference in this Schedule to residual expenditure at any date in relation to an asset in respect of which qualifying expenditure has been incurred by a person is to be construed as a reference to the total qualifying expenditure incurred by him on the provision, construction or purchase of the asset before that date, reduced by-

(a) the amount of any initial allowance made to that person in relation to that asset for any year of assessment;

(b) any annual allowance made to that person in relation to that asset for any year of assessment before that date;

(c) any annual allowance which, if it had been claimed (or could have been claimed, if the expenditure in respect of the asset had been qualifying expenditure and if the asset had been in use for the purposes of a business of his) by that person in relation to that asset, would have been made to him for a year of assessment before that date.

69. Any reference in that Schedule to an allowance made to a person for a year of assessment or to an allowance to which a person is entitled under this Schedule for a year of assessment is a reference to-

(a) an allowance which is claimed for a year of assessment and is made or is due to be made for that year (any such allowance being treated as having been made at the end of the basic period for the appropriate source consisting of a business for that year); and

(b) *an allowance which would have been made or to which that person would have been entitled in relation to a source consisting of a business of his for a year of assessment but for an insufficiency or absence of adjusted income or the existence of an adjusted loss for the basis period for that year.*

iv) **Valuation** – In practice the IRB accepts an independent valuer's valuation in place of market value.

d) Proposals

i) Proposal for market value

It is proposed that the market value for "deemed disposal" purposes be based on the fair value used for accounting purposes to minimize the cost of valuation. This fair value is usually arrived at by reference to the price in the draft sale and purchase agreement, negotiated prices for the assets and other relevant factors since an asset HFS is one where the sale is highly probable.

ii) Proposal for notional allowance

The calculation of notional allowance (Para 68 and 69) on "ceasing to be used" is not in the law. The proposal is to change the law so that notional allowance can be allowed to be calculated in the year that the asset is HFS but where the sale did not take place in the same year but only in a subsequent year. Alternatively, the IRB can officially allow this tax treatment by way of a departmental practice to avoid having to treat the asset HFS as a "deemed sale" for tax purposes. This would enable the "deemed sale" to be deferred until an actual sale takes place and overcome the problem of differing market values on the "deemed disposal" date and actual disposal date. In addition, this will avoid the need to revise a prior year assessment.

6.1.2 In the year that the asset is actually disposed following a "deemed disposal"

If the asset is actually disposed in a subsequent year, the scenarios and the relevant tax treatments in the year that the asset is actually disposed, are as follows:

a) Temporary disuse

If the non-current asset classified as HFS was temporarily disused previously, the tax treatments will be as follows:

a) Withdraw CA and revise previous years' tax computations

The CA given previously during the years of disuse, and now no longer maintained for use and is permanently disused, have to be withdrawn in accordance with Para 57 of Sch 3 ITA and the previous years' tax computations revised accordingly.

Para 57 of Sch 3 ITA reads as follows:

If an asset which is temporarily disused in relation to a business of a person ceases to be ready for use for the purposes of the business or if its disuse can no longer reasonably be regarded as temporary, it shall be deemed to have ceased at the beginning of the period of disuse to be used for the purposes of the business, and all such assessments shall be made as may be necessary to counteract the benefit of any allowances made to him for any year of assessment by reason of the application of paragraph 56 in relation to the asset.

b) Calculate BA / BC in the year of disuse

BA / BC will be calculated in the year that the asset was first ceased to be used in accordance with Para 61 of Sch 3 ITA [see 6.1.1(c) for details of Para 61]. Hence, the previous years' tax computations have to be revised accordingly.

There is no tax issue with respect to this scenario. However, temporary disuse is not so likely since an asset HFS under FRS 5 indicates that the asset is intended to be sold and not temporarily disused.

b) Continued to be used

If the asset HFS was in use previously (notwithstanding the classification as HFS), BA / BC will be calculated in the year of disposal. The disposal price should be based on the market value at the time of disposal or the actual sales price, whichever is higher, in accordance with Para 62 of Sch 3 ITA. There is no tax issue with respect to this scenario.

Para 62(1) of Sch 3 states as follows:

Subject to sub-paragraph (2), for the purposes of this Schedule, where an asset is disposed of by a person, its disposal value shall be taken to be an amount equal to its market value at the date of its disposal or, in the case of its disposal by way of sale, transfer or assignment-

(a) an amount equal to its market value at the date of the sale, transfer or assignment, as the case may be; or
(b) the net proceeds of the sale, transfer or assignment as the case may be, whichever is the greater:

Provided that, where the asset is disposed of in such circumstances that insurance or compensation moneys are received by that person in respect of the asset, its disposal value shall be taken to be an amount equal to its market value at the date of its disposal or those moneys, whichever is the greater.

c) **Ceased to be used**

If the non-current asset classified as HFS had ceased to be in use previously, and the asset is subsequently sold, the possible tax treatments are:

i) Revise previous year tax computation

One approach will be to revise the previous year's tax computation and substitute the previous year's market value with the current year's actual sales proceeds. The problems with this approach are as follows:

aa) **No basis** - There is no basis to revise the previous year's tax computation because the law does not provide for previous year's deemed sale market value to be replaced with the current year's actual sale proceeds;

bb) **No revision** - The taxpayer has to follow the "deemed sale" provisions under Para 61 of Schedule 3 ITA in accordance with the law and not revise the previous year market value with the actual sale proceeds;

cc) **Tax rates** - The tax rate may have changed from one year to another and this may give rise to different tax liabilities if this approach is adopted;

dd) **No error** - The taxpayer should not revise the tax computation since there is no error in the previous year's tax computation;

ee) **Penalty on revision** - Will the IRB impose penalties on revision of the tax computation or will the IRB consider this to be a technical adjustment which does not attract a tax penalty?

ff) **CP 204** - Will the IRB similarly impose a penalty in the case of an underestimation of tax (CP 204) on revision of the tax computation?

gg) **Conclusion** - Due to the issues above, this tax treatment may not be appropriate.

ii) Tax / deduct the extra gain / (loss) in the year of actual sale

The second approach is to tax the extra gain or allow deduction of the extra loss. The extra gain or extra loss in this context is the difference between the actual sales proceeds and the market value on "deemed sale". For example, if the market value on deemed sale used to calculate BA / BC in an earlier year is RM100,000 and the subsequent sales price is RM110,000, the extra gain is RM10,000. Similarly, if the sales price is RM89,000, the extra loss is RM11,000. The problems with this approach are as follows:

aa) **No basis in law** - There is no law to allow this tax treatment especially to tax the gain since the asset had been sold and the law does not allow the extra gain to be taxed again.

bb) **Taxed once** - Income should be taxed in the correct period and taxed once i.e BA / BC should not be calculated twice.

cc) **Amend the law** - The possible solution is to amend the law to allow the gain / loss to be taxed or deducted as appropriate.

dd) **Conclusion** - Due to the issues above, this tax treatment may not be appropriate.

iii) Extra gain or loss not taxable as extra gain or loss is capital in nature

The third approach is to treat the extra gain or loss as a capital gain or capital loss and not tax or allow deduction of the gain or loss as appropriate. The issues with this approach are as follows:

aa) **Approach follows the law** - This approach follow the principles of law i.e., only one sale under Para 61 is recognized for tax purposes;

bb) **Sold once** - The asset should be sold only once and should not be sold again;

cc) **Capital in nature** - Hence, any extra gain or loss is capital in nature

dd) **No need to amend law** - There is no need to amend the law under this approach

ee) **Correct method** - This is probably the correct method to adopt

ff) **Problem** - The only problem with this approach is the market value adopted for the "deemed sale" because a higher market value in a subsequent year may be disputed by the IRB, who may consider an increase in value of a depreciable asset as not normal unless this can be supported with facts and good reasons. Such possible disputes with the IRB will create uncertainties in a taxpayer's tax liabilities.

6.2 Tax treatment of asset HFS if the asset is not subsequently sold

If an asset HFS is not subsequently sold and does not meet the criteria to be classified as HFS, it will be reclassified back to its original classification. For example, a piece of equipment was previously stated in the books of accounts as "property, plant and equipment" at RM100,000. On being classified as an asset HFS, the asset was written down to a value of RM90,000. The impairment loss of RM10,000 (RM100,000 less RM90,000) was charged to the Income Statement and is not tax deductible. If the asset is not subsequently sold and cannot be classified as being HFS, it will be reclassified to "property, plant and equipment" at RM90,000.
On such reclassification (known as "held for use" in this paper), the following scenarios and tax consequences will arise:

a) Asset previously temporarily disused

If the asset transferred to "held for use" was previously temporarily disused and now being used in the business at the end of the basis period, CA will continue to be allowed in the subsequent years. However, temporary disuse is not so likely since an asset held for sale under FRS 5 indicates that the asset is intended to be sold and not temporarily disused.

b) Asset previously continued to be used

If the asset HFS was in use previously, CA will be allowed to be claimed when the asset is transferred to "held for use". There is no tax issue with respect to this scenario.

c) Asset previously ceased to be used

If the asset was previously treated as ceased to be used, BA/BC would have been calculated in the year of "deemed sale". If this asset is now reclassified as "held for use", the possible tax scenarios and the tax treatments are as follows:

i) **Revise previous year's tax computation**

One method is to revise the previous years' tax computations on the grounds that the asset was temporarily disused in the previous years since the asset has now been transferred to use. It would mean that the taxpayer had made an error of judgment in the previous years. However, the issues with this approach are as follows:

aa) **Withdraw previous BA/BC** – The BA/BC calculated in the previous years will be withdrawn.

bb) **Claim CA for temporary disuse** – The taxpayer has to treat the asset in the previous years' tax computations as being temporarily disused and claim CA under Para 56, Schedule 3 of the ITA.

cc) **Notional allowance** - Alternatively, the taxpayer can calculate notional allowance for the previous years when the asset was not in use. However, this is technically not the correct tax treatment because "notional allowance" under Para 68 Schedule 3 of ITA is only to be calculated in arriving at the residual expenditure in the case of a disposal of an asset. To allow the taxpayer to use this approach, either the law is amended or the IRB allows this approach administratively as a departmental practice.

dd) **CA in following years** - The taxpayer can continue to claim CA in the subsequent years.

ee) **Penalty on revision** - Will the IRB impose penalties on revision of the tax computation or will the IRB consider this to be a technical adjustment which does not attract a tax penalty?

ff) **CP 204** - Will the IRB similarly impose a penalty in case of an underestimation of tax (CP 204) on revision of the tax computation?

gg) **Conclusion** – this is probably the best method, i.e., revision of previous year's tax computation.

hh) **Proposal** – However, the law has to be amended to allow notional allowance to be computed in the years of disuse or the IRB has to administratively allow such notional allowance in the years of disuse.

ii) Reinstate assets under Para 2A and claim AA under Para 13A

Another method is to reinstate the assets for tax purposes under Para 2A Schedule 3 ITA at the market value prevailing at the date that the asset is reclassified as "held for use". The problems with this approach are as follows:

aa) **Not right purpose** - Para 2A was promulgated for a different purpose and not to cater to assets which had been "deemed disposed" but transferred back to use.

bb) **Non-business use** - Para 2A refers to assets used for non-business purposes whereas in this case, the asset was not in use at all as opposed to being used for non-business purposes.

cc) **Incurred** – There is strictly no qualifying expenditure that had been incurred which is eligible for capital allowances.

dd) **Market value** – there will be problems in determining the market value of the asset accurately yet economically.

ee) **Conclusion** – This approach may not be practical.

6.3 Tax treatment of impairment gains or losses

When an asset is initially classified as an asset HFS, any impairment loss on initial measurement will be taken to income statement [3.2 (b) above]. Any gain or loss on subsequent re-measurement will also be taken to the Income Statement [3.2 (c) above]. These gains or losses are usually unrealized gains or losses and would therefore not be taxable or not eligible for tax deduction. If these are realized gains or losses, the tax treatment would depend on whether the gains or losses are capital or revenue. There is usually no ambiguity about the tax treatment of these impairment gains or losses.

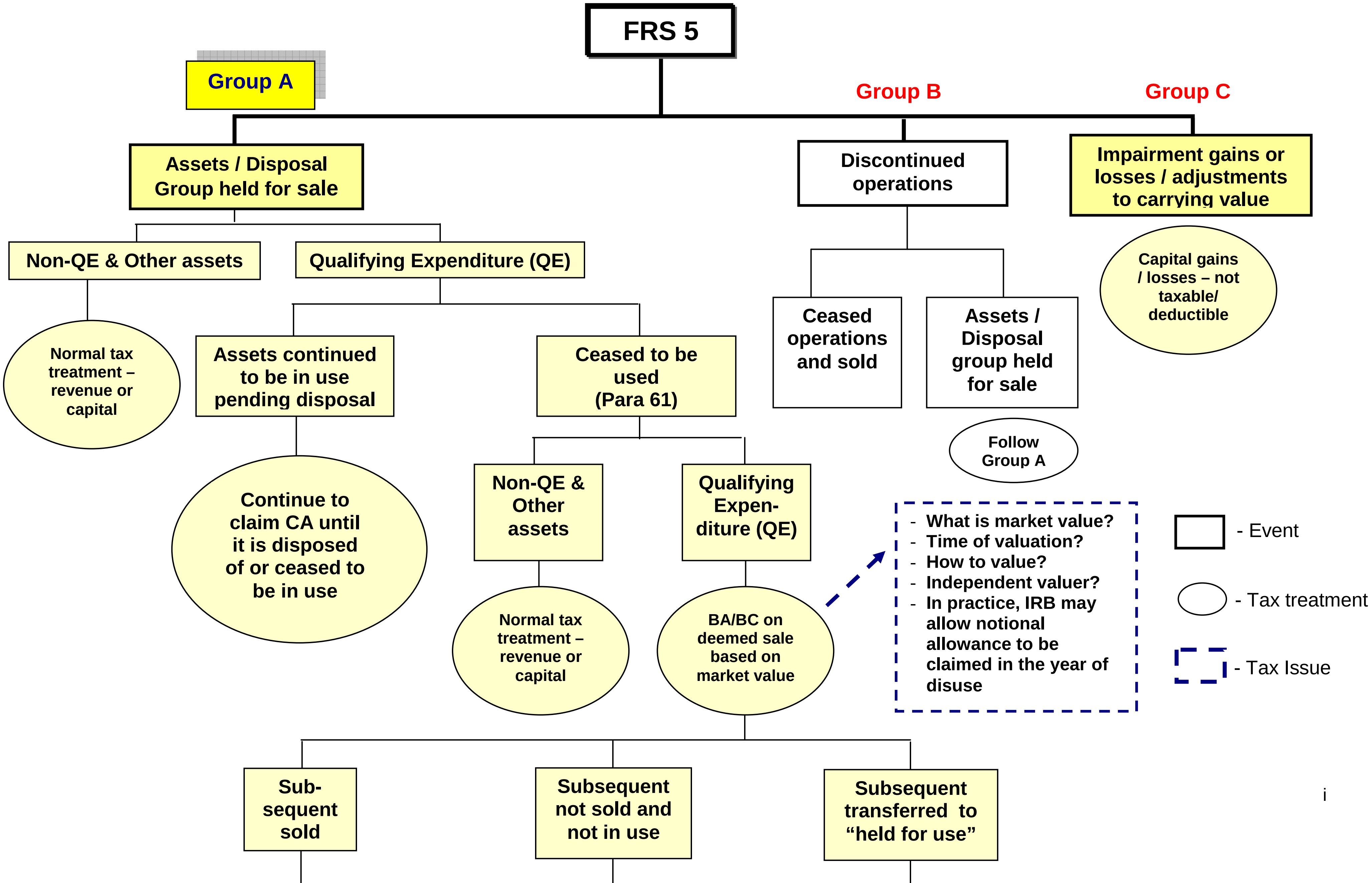
6.4 Summary of scenarios and tax treatments

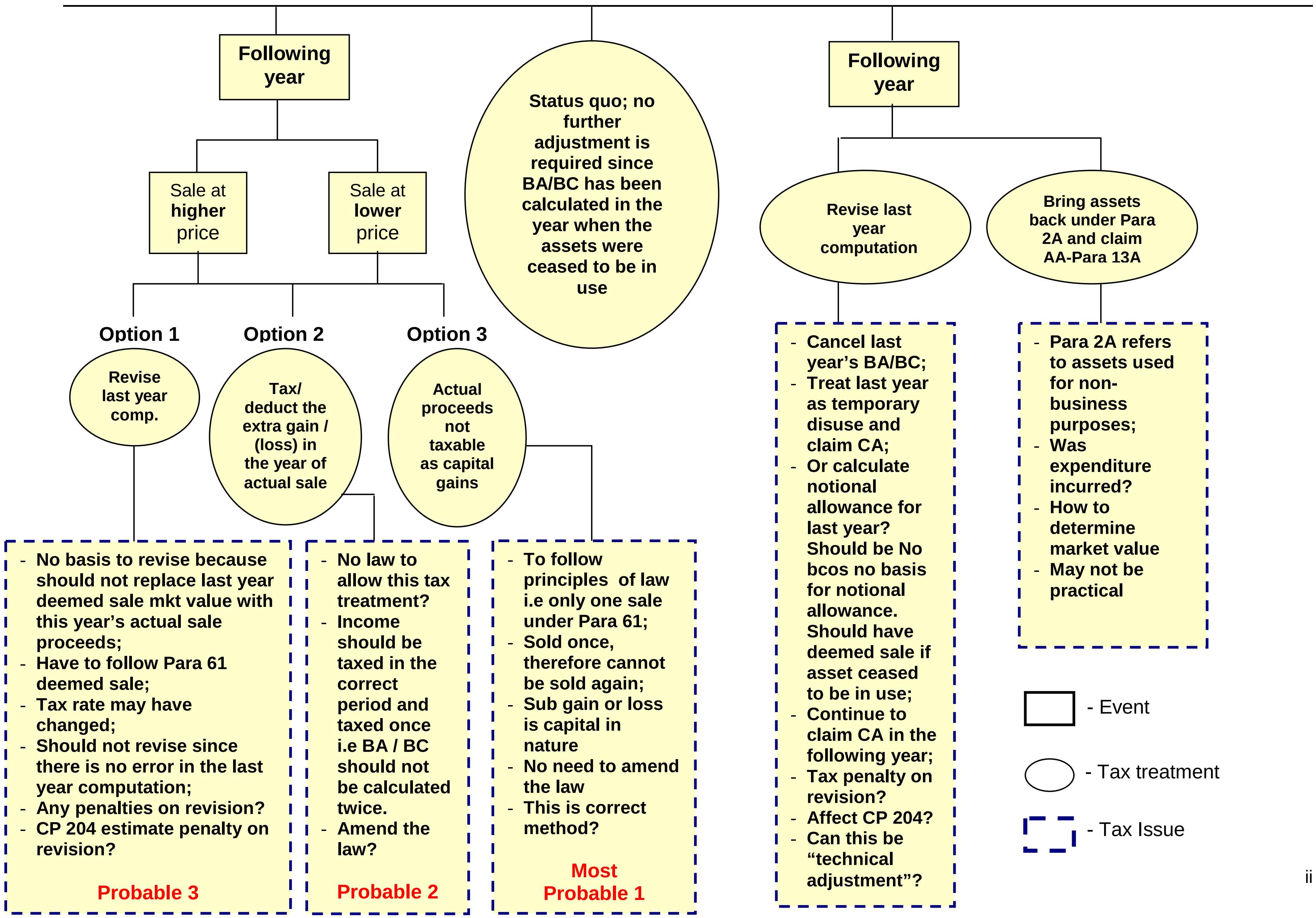
Ref	Ref	Ref	Ref	Possible tax treatments	Probable tax treatment	Proposals for change
6.1	On classification of a non-current asset as held for sale					
	6.1.1	In the year that the asset is classified as HFS				
		a)	Temporary disuse – claim CA. This scenario is not likely.		Claim CA	
		b)	Continued to be used - claim CA		Claim CA	
		c)	Ceased to be used			
			i)	BA/BC on deemed disposal		
			ii)	Difficulty in determining market value		
			iii)	In practice, IRB allows notional allowance	This may be best treatment	Change the law or IRB practice to allow notional allowance
			iv)	Per IRB, market value should be based on valuer's valuation		Allow market value to be at based on fair value for accounting purposes
	6.1.2	In the year that the asset is actually disposed				
		a)	Temporary disuse		CA will be withdrawn under Para 57 Sch 3 and BA / BC calculated in the year that the asset was first ceased to be in use	
		b)	Continued to be used – calculate BA/BC		Calculate BA / BC	
		c)	Ceased to be used			
			i)	Revise previous year tax computation		
			ii)	Tax / deduct the extra gain / (loss) in the year of actual sale		
			iii)	Extra gain or loss not taxable as extra gain or loss is capital in nature	This is probably the correct method. However, IRB may dispute market value	Perhaps, the IRB can consider allowing market value to be based on fair value for accounting purposes

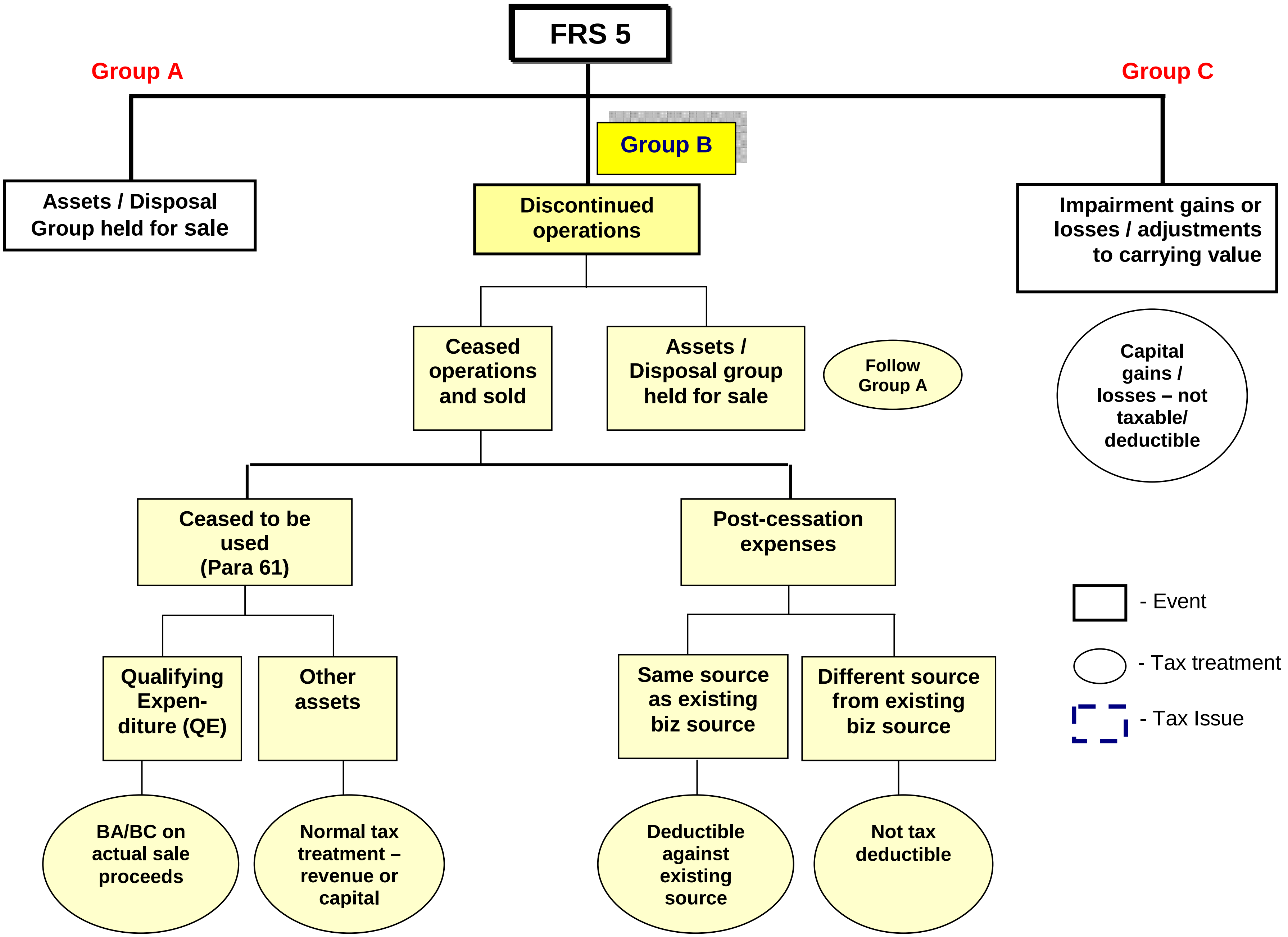
6.4 Summary of scenarios and tax treatments (cont'd)

Ref	Ref	Ref	Ref	Possible tax treatments	Probable tax treatment	Proposals for change
6.2	Tax treatment of asset HFS if the asset is not subsequently sold					
	a)	Asset previously temporarily disused – continue to claim CA			Continue to claim CA	
	b)	Asset previously continued to be used – continue to claim CA			Continue to claim CA	
	c)	Asset previously ceased to be used				
		i)	Revise last year's tax computation		This is probably the best method	Change the law or IRB practice to allow notional allowance
		ii)	Bring assets back under Para 2A and claim AA under Para 13A			
6.3	Tax treatment of impairment gains or losses					
	Usually not taxable / not deductible. Depends on whether gains or losses are realized / unrealized and whether capital / revenue				No uncertainty of tax treatment	

Tax Implications on Financial Reporting Standard 5 – Non-current Assets Held for Sale and Discontinued Operations




Following year
Sale at higher price
Sale at lower price
Option 1
Revise last year comp.
Option 2
Tax/ deduct the extra gain / (loss) in the year of actual sale
Option 3
Actual proceeds not taxable as capital gains
- No basis to revise because should not replace last year deemed sale mkt value with this year's actual sale proceeds;
- Have to follow Para 61 deemed sale;
- Tax rate may have changed;
- Should not revise since there is no error in the last year computation;
- Any penalties on revision?
- CP 204 estimate penalty on revision?
Probable 3
- No law to allow this tax treatment?
- Income should be taxed in the correct period and taxed once i.e BA / BC should not be calculated twice.
- Amend the law?
Probable 2
- To follow principles of law i.e only one sale under Para 61;
- Sold once, therefore cannot be sold again;
- Sub gain or loss is capital in nature
- No need to amend the law
- This is correct method?
Most Probable 1
Status quo; no further adjustment is required since BA/BC has been calculated in the year when the assets were ceased to be in use
Following year
Revise last year computation
Bring assets back under Para 2A and claim AA-Para 13A
- Cancel last year's BA/BC;
- Treat last year as temporary disuse and claim CA;
- Or calculate notional allowance for last year? Should be No bcos no basis for notional allowance. Should have deemed sale if asset ceased to be in use;
- Continue to claim CA in the following year;
- Tax penalty on revision?
- Affect CP 204?
- Can this be "technical adjustment"?
- Para 2A refers to assets used for non-business purposes;
- Was expenditure incurred?
- How to determine market value
- May not be practical
- Event
- Tax treatment
- Tax Issue


FRS 5
Group A
Group B
Group C
Assets / Disposal Group held for sale
Discontinued operations
Impairment gains or losses / adjustments to carrying value
Ceased operations and sold
Assets / Disposal group held for sale
Follow Group A
Capital gains / losses – not taxable/ deductible
Ceased to be used (Para 61)
Post-cessation expenses
Qualifying Expen-diture (QE)
Other assets
Same source as existing biz source
Different source from existing biz source
BA/BC on actual sale proceeds
Normal tax treatment – revenue or capital
Deductible against existing source
Not tax deductible
- Event
- Tax treatment
- Tax Issue