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Malaysian Inland Revenue Board 's Practice Note No. 2/2020

Claiming of Capital Allowance on the Development Cost for Customised Computer Software under the Income Tax (Capital Allowance) (Development Cost for Customised Software) Rules 2019

The Malaysian Inland Revenue Board ("MIRB") has issued Practice Note No. 2/2020 ("Practice Note") dated 16 March 2020 on 9 April 2020. The Practice Note seeks to provide some guidance on the implementation of the Income Tax (Capital Allowance) (Development Cost for Customised Software) Rules 2019 ("Rules") by the MIRB. The Rules allow for capital allowance to be claimed on the development cost for customised software incurred by a Malaysian resident person from YA 2018. The capital allowance will be claimed over four years based on **an initial allowance of 20% and annual allowance of 20%.**

Pursuant to the Rules, "**development cost for customised computer software**" means **consultation fee, payment for rights of software ownership** and **incidental fee** relating to the development of customised computer software. For the purposes of claiming capital allowance under the Rules, the MIRB has provided limited clarification on the above terms in the Practice Note as follows:

1 **Development Cost for Customised Computer Software**

Expenditure incurred in the production of **new software or in the improvement of the existing software** to be used for the purpose of a business.

2 **Consultation Fee**

Consultation fee incurred on the development of the software specifically for the purpose of developing a new software system, modification or modernisation of the existing software **excluding** consultation fees related to initial procedure or planning stage such as feasibility study or preliminary study.

3 **Payment for the Rights of Software Ownership**

Payment for the right to use the software exclusively.

4 **Incidental Fee**

Payment incurred which enables the use of the software in a business and being capitalised such as change of requirement of the software.

The Practice Note does not specifically address whether the Rules also apply to self-developed software. It also does not provide an expansive list of examples of **incidental fees** regarded as relating to the development of customised computer software. It is therefore likely that further confirmation from the MIRB will have to be sought on the application of the Rules.

The application of the Rules is subject to Schedule 3 of the Income Tax Act 1967 ("the ITA"). Payments of development cost for customised computer software to non-residents are subject to withholding tax ("WHT") under **Section 109 or 109B** of the ITA depending on the facts of each case. Failure to withhold and remit the relevant WHT to the MIRB within one month after paying or crediting the non-resident would result in a penalty amounting to 10% of the unpaid WHT. In addition, no capital allowance would be allowed in respect of qualifying capital expenditure incurred for which WHT under Section 109B of the ITA, if applicable, has not been paid or remitted to the MIRB.

Capital allowance can be claimed from the YA that the customised computer software is capable of being used in a business.

As the Rules were only gazetted on 3 October 2019, where a Company has incurred development costs for customised computer software for YA 2018 and/or YA 2019 but did not claim capital allowance in the submitted Tax Return, the Company may revise its tax computation and submit an amended Tax Return. The MIRB is likely to conduct a desk audit on the amended Tax Return before approving the claim. If a Company has claimed capital allowances on the development cost for customised computer software prior to YA 2018, it may be argued that the cost should be regarded as having been incurred on the provision of "plant" used for the purposes of a business.

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