INLAND REVENUE BOARD MALAYSIA

ALLOWABLE PRE-OPERATIONAL AND PRE-COMMENCEMENT OF BUSINESS EXPENSES

PUBLIC RULING NO. 2/2010

Translation from the original Bahasa Malaysia text

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling as provided for under section 138A of the Income Tax Act 1967 is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

Director General of Inland Revenue,
Inland Revenue Board Malaysia.

1. This Ruling provides clarification on the treatment of pre-operational or pre-commencement of business expenses allowable when a person commences his operations or his business under the provisions of the Income Tax Act 1967 (ITA) and the Rules that have been issued by the Minister of Finance:

   1.1 Schedule 4B of the ITA – Qualifying Pre-Operational Business Expenditure;

   1.2 Income Tax (Deduction for Incorporation Expenses) Rules 2003 [P.U.(A) 475/2003] and Income Tax (Deduction for Incorporation Expenses) (Amendment) Rules 2005 [P.U.(A) 472/2005];

   1.3 Income Tax (Deduction for Approved Training) Rules 1992 [P.U.(A) 61/1992] and Income Tax (Deductions for Approved Training) (Amendment) Rules 1995 [P.U.(A) 111/1995];

   1.4 Income Tax (Deduction of Pre-Commencement of Business Training Expenses) Rules 1996 [P.U.(A) 160/1996];

   1.5 Income Tax (Deduction for Establishment Expenditure of Real Estate Investment Trust or Property Trust Fund) Rules 2006 [P.U.(A) 135/2006];

   1.6 Income Tax (Deduction on Expenditure for Establishment of an Islamic Stock Broking Business) Rules 2007 [P.U.(A) 65/2007]; and

   1.7 Income Tax (Deduction of Pre-Commencement of Business Expenses relating to Employee Recruitment) Rules 2008 [P.U.(A) 361/2008].

2. **Interpretation**

   The words used in this Ruling have the following meaning:

   2.1 "Pre-operational" has the meaning as defined in Schedule 4B of the ITA and any reference to "pre-operational" or "prior to the commencement of operations" should be interpreted subject to the conditions imposed under the specific provisions.

   2.2 "Pre-commencement of business" has the meaning as defined in the specific Rules. The determination of the date of commencement of a business requires a consideration of all the circumstances and facts of each case. Generally, commencement of business means the commencement of activities undertaken in the course of business or activities that are part of the income producing process as distinguished from activities that are preparatory to the carrying on of a business. Subject to the specific circumstances and facts of the case, the following examples may be indicative of the commencement of a business if the act or activity constitutes part of a series of acts or activities that are actively carried out or undertaken in the course of the business:

(i) the purchase of raw materials in the case of manufacturing;

(ii) the purchase of goods for resale in the case of retailing; or

(iii) the first planting of seedlings or buying of animal stocks in the case of agriculture.

However, any reference to "pre-commencement" or "prior to the commencement" of business may only be so interpreted if it is consistent with the relevant conditions imposed under the specific Rules.

2.3 "Adjusted income', "statutory income", "aggregate income", "total income" and "defined aggregate income" refer to income as determined under Chapters 4, 5, 6 and Schedule 4B of the ITA.

3. How the tax law applies

3.1 Generally, expenses incurred by a person prior to the commencement of his operations or his business would not be allowable as a deduction against the gross income of his business as they are considered not wholly and exclusively incurred in the production of the income.

3.2 However, Schedule 4B of the ITA and the specific Rules allow for the deduction of certain expenses that are incurred prior to the commencement of operations or business.

3.3 This Ruling gives general guidelines on the pre-operational and pre-commencement of business expenses that are allowable to a person as a deduction against:

(i) the gross income in arriving at the adjusted income of the business; or

(ii) the aggregate income in arriving at the total income.

4. Qualifying pre-operational business expenditure incurred for approved business venture outside Malaysia – Schedule 4B of the ITA

4.1 Certain pre-operational business expenditure in relation to a proposal to undertake investment in a business venture in a country outside Malaysia can be claimed by a company if:

(i) the company is resident in Malaysia; and

(ii) the business venture has been approved by the Minister of Finance.

4.2 The pre-operational business expenses in connection with an approved business venture which qualify for deduction are:

(i) expenses which are directly attributable to the conduct of feasibility studies, including the cost of employing consultants;

(ii) expenses which are directly attributable to the carrying out of market research or survey or the obtaining of market information, including the cost of employing consultants;

(iii) expenses incurred on fares for travel to a country outside Malaysia by a representative of the company for purposes of conducting feasibility study or market survey; and

(iv) actual expenses not exceeding RM400 per day for accommodation and sustenance for the whole period commencing with the representative's departure from Malaysia and ending with his return to Malaysia.

Example 1:

Ansel Sdn Bhd, a company resident in Malaysia, produces household electrical equipment. It proposes to build a factory in China. Before embarking on this venture, the company sends its marketing director to China to conduct a survey. The following expenses are incurred:

Details of expenses	**Amount (RM)**	
Market research (by a Chinese consultant)		5,000
Travel and other expenses:		
Air fare	3,000	
Hotel (RM200 X 10 days)	2,000	
Food allowance (RM100 x 10 days)	1,000	6,000
Total		**11,000**

*While the expenses incurred appeared to be within the prescribed limits, deduction **cannot** be allowed under these provisions unless the venture has been approved by the Minister of Finance.*

4.3 Qualifying pre-operational business expenses shall be allowed as a deduction against the defined aggregate income in the manner provided for in Schedule 4B of the ITA. Any unabsorbed expenses can be carried forward to the following years of assessment until the whole amount of the deduction has been made.

Example 2:

Same facts as in Example 1 and the venture has been approved by the Minister of Finance. The company has the following position for the year of assessment 2009:

Details	**Amount (RM)**
Statutory income of business #2 (electrical equipment)	20,000
Adjusted loss of business #1 (retail)	5,000
Adjusted loss of business #1 (brought forward)	2,000
Qualifying pre-operational business expenses	11,000

The tax computation should be as follows:

Statutory income of business #2	*20,000*
Statutory income of business #1	*Nil*
Aggregate of statutory income from business	***20,000***
Less: business adjusted loss brought forward	*2,000*
Aggregate income	***18,000***
Less: business adjusted loss for current year	*5,000*
Defined aggregate income	***13,000***
Less: qualifying pre-operational business expenses	*11,000*
Total income	***2,000***

5. **Incorporation expenses – Income Tax (Deduction for Incorporation Expenses) Rules 2003 [P.U.(A) 475/2003] and Income Tax (Deduction for Incorporation Expenses) (Amendment) Rules 2005 [P.U.(A) 472/2005]**

5.1 With effect from the year of assessment 2004, for the purpose of ascertaining the adjusted income from a business for the basis period for a year of assessment of a company which is incorporated in Malaysia-

(i) on or after 13.9.2003 and having an authorized capital of not more than RM2,500,000; or

(ii) on or after 1.1.1973 but prior to 13.9.2003 and having an authorized capital of not more than RM250,000,

the following expenses of incorporation are allowed as a deduction against the gross income from its business:

(a) the cost of preparing and printing the memorandum of association, the articles of association and the prospectus, and of circulating and advertising the prospectus;

(b) the cost of registering the company and the statutory documents, together with fees and stamp duties payable thereon;

(c) the cost of drawing up the preliminary contracts and stamp duties payable thereon;

(d) the cost of printing debentures and stamp duty (if any) payable thereon and of share certificates and letters of allotment;

(e) the cost of the seal of the company; and

(f) underwriting commission.

5.2 The said incorporation expenses incurred by the company shall be deemed to be incurred in the basis period for a year of assessment in which the company commences its business.

5.3 A company which has an authorized capital of not more than RM2,500,000 and has incurred incorporation expenses from 13.9.2003 until 31.12.2003 and that period forms part of the basis period for the year of assessment 2003, that incorporation expenses shall be deemed to have been incurred and be given a deduction in the basis period for the year of assessment 2004.

5.4 The deduction is to be made in the tax computation for the year of assessment indicated in paragraph 5.2 or 5.3 above if the expenses have been capitalised in the company's balance sheet. For incorporation expenses which have been charged out in the company's profit & loss account, adjustments would be made to the tax computation if there are expenses other than those specified in paragraph 5.1.

Example 3:

Biz Sdn Bhd was incorporated in Malaysia on 11.2.2008 with an authorized capital of RM2,000,000. It commences a retail business dealing in hardware on 1.5.2008 and closes its accounts on 30.4.2009. The following incorporation expenses have been capitalized in its first balance sheet as at 30.04.2009:

Details of expenses	**Amount (RM)**
Preparation & printing Memorandum & Articles of Association	1,000
Registration of company (including stamp duty)	3,500
Company seal	200
Total	**4,700**

The incorporation expenses amounting to RM4,700 can be deducted against the gross income of the company for the basis period 1.5.2008 – 30.4.2009.

Example 4:

Camin Sdn Bhd was incorporated in Malaysia on 1.3.2008 with an authorized capital of RM3,000,000 and a paid up capital of RM2,000,000. Incorporation expenses (similar to those in Example 3 above) amount to RM4,700.

The incorporation expenses ***cannot*** *be allowed as a deduction against the gross income of the company as its authorized capital exceeds RM2,500,000.*

Example 5:

Manikam commenced his catering business as a sole-proprietorship on 10.3.2006. He decided to incorporate a private limited company to take over the catering business as the business was doing well and he planned to further expand the business. Thus Moneycome Sdn Bhd was incorporated on 1.8.2008 with an authorized capital of RM1,000,000 and a paid up capital of RM500,000.

Manikam transacted all his business and kept the records under Moneycome Sdn Bhd from 1.8.2008. As such, the date of commencement for the company would be 1.8.2008. The incorporation expenses claimed by the company for the basis period 1.8.2008 to 31.7.2009 are as follows:

Details of expenses	**Amount (RM)**
Preparation and printing of memorandum & articles of association	1,000
Cost of registering the company	2,500
Company secretary fees	400
Service tax (RM400 @ 5%)	20
Travelling (reimbursement)	100
Miscellaneous (photostating etc)	50
Total	**4,070**

Only the expenses on preparation and printing of memorandum & articles of association and cost of registering the company amounting to RM3,500 are eligible for deduction under the Rules.

Note: The same tax treatment would apply if a partnership were to be converted to a private limited company.

6. **Pre-commencement of business expenditure on approved training – Income Tax (Deduction for Approved Training) Rules 1992 [P.U.(A) 61/1992] and Income Tax (Deductions for Approved Training) (Amendment) Rules 1995 [P.U.(A) 111/1995]**

6.1 With effect from the year of assessment 1992, a **manufacturing company** is allowed a deduction double the amount of expenditure incurred on approved training in computing its adjusted income for the year of assessment in which the gross income first arises.

6.2 This double deduction incentive is given if the manufacturing company satisfies the following conditions:

(i) it has incurred the said expenditure during the period of pre-commencement of its business;

(ii) the expenditure is in respect of training its employees for the acquisition of crafts, supervisory or technical skills which will contribute directly to the future production of its products;

(iii) the training is provided under a training programme approved by the Malaysian Industrial Development Authority (MIDA) or a training programme conducted by a training institution approved by the Minister of Finance; and

(iv) the said employees are Malaysian citizens.

6.3 The expenditure qualifying for the deduction is double the amount paid by the company to the training institution in respect of the said training programme. The claim must be supported by a letter of approval from MIDA or a letter from the approved training institution certifying details of the training programme (including the amount paid) and that the employees of the company have attended the training programme.

Example 6:

Densers Sdn Bhd was incorporated on 1.8.2008 with the intention of producing condensers for automobile air conditioners. Before commencement of production, the company recruited 30 employees, all of whom were Malaysians. 20 of them were sent for training on machining at Institut Kemahiran MARA (IKM), a training institution approved by the Minister of Finance. The other 10 were sent to study machining and assembly of condensers at the factory of its associate company in Japan. The following expenses were incurred:

Details of expenses	In Malaysia (RM)	In Japan (RM)
Travelling allowance (paid to the recruits)	4,000	-
Course fees (including food and lodging)	40,000	-
Food and accommodation		50,000
Air fare		25,000
Total	**44,000**	**75,000**

A letter from IKM was submitted to confirm that the amount paid by the company for the training programme was RM40,000 and that the employees of the company had attended it. The company commenced production on 1.1.2009 and the first accounts are prepared for the period 1.8.2008 to 31.12.2009.

The company can be allowed a deduction of RM80,000, that is double the amount on the expenditure of RM40,000 incurred on the training programme in Malaysia in ascertaining its adjusted income for the basis period 1.1.2009 – 31.12.2009. The travelling allowance of RM4,000 ***cannot*** *be allowed as only the amount paid to the training institution qualifies for the deduction.*

The expenditure on training in Japan ***cannot*** *be allowed under these Rules as the associate company is not a training institution approved by the Minister of Finance.*

6.4 With effect from 1.7.1993, companies that contribute to the Human Resource Development Fund (HRDF) do not qualify for the deduction under these Rules. HRDF is a fund established with the aim of encouraging direct participation of the private sector in skills development. Companies in certain sectors are required to contribute levy to HRDF at the rate that has been determined. Companies that have made levy contributions qualify for a training grant from HRDF to fund the training expenses to enhance the skills of their employees.

7. Pre-commencement of business training expenses – Income Tax (Deduction of Pre-Commencement of Business Training Expenses) Rules 1996 [P.U.(A) 160/1996]

7.1 With effect from the year of assessment 1996, a company which provides training to its employees prior to the commencement of its business can be allowed a single deduction on such training expenses in ascertaining its adjusted income from the business if:

(i) the training is to impart basic skills to enable the company to commence its business;

(ii) the training expenses are incurred within one year prior to the commencement of the business; and

(iii) the training expenses are of the kind that is allowable under section 33 of the ITA.

Example 7:

Same facts as in Example 6.

The expenses incurred in training the employees in Japan prior to commencement of business amounting to RM75,000 can be allowed as a deduction under these Rules in ascertaining the company's adjusted income for the basis period 1.1.2009 – 31.12.2009.

7.2 A company does not qualify for a deduction under the Rules if:

(i) it is receiving training grants from the Government; or

(ii) it is claiming double deduction of training expenses under the Income Tax (Deductions for Approved Training) Rules 1992 and the Income Tax (Deductions for Approved Training) (Amendment) Rules 1995.

8. Establishment expenditure of a Real Estate Investment Trust (REIT) or Property Trust Fund (PTF) – Income Tax (Deduction For Establishment Expenditure of Real Estate Investment Trust or Property Trust Fund) Rules 2006 [P.U.(A) 135/2006]

8.1 A REIT or PTF is a unit trust that is approved by the Securities Commission (SC).

8.2 With effect from the year of assessment 2006, a REIT or PTF which has incurred establishment expenditure can claim a deduction of such expenditure against its gross income in ascertaining the adjusted income of its business for the basis period for a year of assessment.

8.3 Establishment expenditure that can be allowed as a deduction are legal, valuation and consultancy fees for purpose of establishing the unit trust prior to approval by the SC. The expenditure incurred by the unit trust shall be deemed to have been incurred in the basis period for a year of assessment in which the business of that unit trust commenced.

Example 8:

Excel Bhd has a few commercial properties in its group of companies which are rented out and has a good mix of tenants whose businesses are flourishing. Excel Bhd decided to pool the properties and form a unit trust in order to enjoy tax incentives offered by the Government. The Excel Real Estate Trust was established on 1.8.2007 and the establishment expenditure incurred was RM800,000. Excel Bhd made submission to the Securities Commission for the unit trust to be approved as a REIT. Approval was granted and Excel Real Estate Trust invited subscriptions from the public on 1.1.2008.

The establishment expenditure of RM800,000 can be allowed as a deduction from its gross income for the basis year 2008.

9. Establishment expenditure of an Islamic stock broking company – Income Tax (Deduction on Expenditure For Establishment of an Islamic Stock Broking Business) Rules 2007 [P.U.(A) 65/2007]

9.1 An Islamic stock broking company is a company incorporated under the Companies Act 1965 and is a company licensed under the Securities Industry Act 1983. The company operates an Islamic stock broking business approved by the Bursa Malaysia.

9.2 An Islamic stock broking company resident in Malaysia which has incurred establishment expenditure can claim a deduction of such expenditure against its gross income in ascertaining the adjusted income of its business for the basis period for a year of assessment.

9.3 Establishment expenditure which can be claimed are consultancy and legal fees, cost of feasibility study, cost of market research and cost of obtaining license and business approval for the purpose of establishing an Islamic stock broking business. The expenditure incurred by the company shall be deemed to have been incurred in the basis period for a year of assessment in which the business of that company commenced.

9.4 An Islamic stock broking company qualifies for the deduction of establishment expenditure if:

(i) an application for approval of the Islamic stock broking business is made to the Bursa Malaysia from 2.9.2006 until 31.12.2009; and

(ii) the company commences its Islamic stock broking business within 2 years from the date of approval by the Bursa Malaysia.

To further encourage the establishment of Islamic stock broking companies, the Government has extended the period for the application for approval of Islamic stock broking business until 31.12.2015 – the Income Tax (Deduction on Expenditure For Establishment of an Islamic Stock Broking Business) (Amendment) Rules 2009 [P.U.(A) 401/2009].

Example 9:

Al-Aiman Stock Broking Sdn Bhd was incorporated on 2.1.2007 and is a company licensed under the Securities Industry Act 1983. The company made an application to the Bursa Malaysia on 1.3.2007 for approval to carry out an Islamic stock broking business. The approval was granted on 1.6.2007.

Al-Aiman incurred RM500,000 on legal and consultancy fees, market research, cost of obtaining license and business approval for the establishment of its Islamic stock broking business. The company commenced its business on 1.5.2009 and closes its accounts on 31.12.2009.

Since its business commenced within 2 years from the date of approval by the Bursa Malaysia, the company is entitled to deduct the establishment expenses of RM500,000 against its gross income for the basis period 1.5.2009 to 31.12.2009.

Note: If Al-Aiman Sdn Bhd were to commence its Islamic stock business after 31.5.2009 (that is after 2 years from the date of approval by the Bursa Malaysia), the company would not be eligible to claim the establishment expenses of RM500,000.

10. **Pre-commencement of business expenses relating to recruitment of employees – Income Tax (Deduction of Pre-Commencement of Business Expenses relating to Employee Recruitment) Rules 2008 [P.U.(A) 361/2008]**

10.1 With effect from the year of assessment 2009, a person who incurred expenses in respect of recruitment of employees prior to the commencement of his business can be allowed a deduction of such expenses against his gross income in ascertaining his adjusted income from the business.

10.2 The allowable expenses are –

(i) expenses on the recruitment of employees to enable the person to commence his business;

(ii) expenses of the kind allowable under section 33 of the ITA relating to the recruitment of employees; and

(iii) expenses incurred within the period of 1 year prior to the commencement of his business.

10.3 The recruitment expenses which qualify for deduction include expenses incurred in participation of job fairs, payment to employment agencies and head-hunters.

10.4 The expenses incurred shall be deemed to have been incurred on the day the business commences.

Example 10:

Farid is an expert in information technology (IT) and marketing of consumer products. After working many years in a multinational company, he intended to set up his own business by selling healthcare products through the internet. Farid registered a sole-proprietorship on 3.6.2008. He paid agency fees of RM5,000 to an employment agency to recruit two IT graduates and an accounts clerk before he commenced his business on 1.1.2009.

The agency fees of RM5,000 which he paid to the employment agency can be allowed as a deduction against his gross income for the year of assessment 2009.

Example 11:

A Swiss company intended to set up a factory manufacturing pharmaceutical products in Malaysia. A subsidiary company, Genpharma Sdn Bhd was incorporated on 1.6.2008. Genpharma advertised in several local newspapers for various positions available in the company. It engaged an employment agency to recruit a hundred foreign workers for its production department. Genpharma also seek the services of a head-hunting company to recruit a suitable person as its Chief Operating Officer. Genpharma commenced operations on 1.3.2009 and closes its accounts on 31.12.2009.

All the expenses which Genpharma incurred in the recruitment of its employees prior to 1.3.2009 are deemed to be incurred on the day when it commenced its business and can be allowed as a deduction against its gross income for the year of assessment 2009.

Example 12:

Same facts as in Example 11 and the Chief Operating Officer started his employment on 1.2.2009. Genpharma Sdn Bhd has to pay a salary of RM20,000, employer's contribution to the Employees Provident Fund (EPF) of RM2,400 and miscellaneous administrative expenses of RM6,000 for the month of February 2009.

The expenses amounting to RM28,400 are of the kind allowable under section 33 of the ITA but the said expenses are not part of the recruitment expenses. Therefore no deduction is allowable against its gross income for the year of assessment 2009 under these Rules.

11. This Ruling is effective from the year of assessment 2010 and subsequent years. It supersedes the Public Ruling No. 2/2002 issued on 8 July 2002.

Director General of Inland Revenue,
Inland Revenue Board Malaysia.