INLAND REVENUE BOARD MALAYSIA

PROPERTY DEVELOPMENT

PUBLIC RULING NO. 1/2009

Translation from the original Bahasa Malaysia text

DATE OF ISSUE : 22 MAY 2009

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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A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.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 explains the basis of determining gross income for the purpose of computing adjusted income derived from the business of property development.

2. The provisions of the Income Tax Act 1967 (ITA) related to this Public Ruling are paragraphs 4*(A)* and 23*(A)*, section 24, subsections 33(1) and 33(2), section 35, subsection 36(1), sections 39 and 91 of the ITA.

3. The words used in this Ruling have the following meanings:

   3.1 "Development units" means units of residential, commercial or industrial building and vacant lots developed for sale;

   3.2 "Progress payments" means amounts billed for work performed on properties sold in respect of property development activities, whether or not they have been paid;

   3.3 "Project" means a cluster of development units erected within a designated geographical area forming a cost-accumulating centre and includes vacant lots developed for sale, and where a cluster of development unit is erected in more than one phase, the development units erected in each phase shall be treated as a separate cluster of development units erected within a designated geographical area;

   3.4 "Property developer" means a company, an individual, a partnership, a co-operative society, a body of persons, who or which engages in or carries on or undertakes or causes to be undertaken property development;

   3.5 "Property development" means the activity of acquiring land for the purpose of developing, constructing or causing to be constructed thereon and selling completed residential, commercial or industrial buildings, whether as a whole or by parcels therein, and development and sale of vacant lots for the construction of such buildings thereon including homesteads, hobby farms, orchards or for other similar purposes;

   3.6 "The DGIR" refers to the Director General of Inland Revenue Board Malaysia.

4. **Date of commencement of business**

   4.1 The date of commencement of a property development business is a question of fact. Generally, the DGIR deems a property development

business commences on a date when some significant activities or essential preliminaries to the normal operations of property development are undertaken.

4.2 Examples of significant activities or essential preliminaries are the physical possession of the development site, the active development of the land such as leveling of land or piling or booking of houses by house buyers.

4.3 The above paragraph explains further the statement made in paragraph 4.2.5 of Public Ruling No. 2/2002 (Allowable Pre-operational & Pre-commencement of Business Expenses for Companies) which states that the purchase of land might be an indication that the property development business has commenced.

Example 1:

Company A, a property development company, bought a piece of agriculture land and applied for conversion to housing land. It launched the housing project by inviting the public to make bookings. Active development such as earthwork and piling was carried out.

The relevant information is as follows:

Activities	Date
Incorporation of company	02.01.2004
Purchase of land	12.02.2006
Application for conversion of land	23.06.2006
Booking of houses opened to public	11.02.2007
Active development of land	05.04.2007

Since the company is a property developer and the activities closely follow one another after the purchase of the land, the date of commencement of the property development business is 12.02.2006 which is the date of purchase of land.

Example 2:

Company B, incorporated on 18.08.2000 purchased a piece of land on 13.11.2002 with the intention of carrying out the business of property development.

The relevant information and activities carried out by Company B are as follows:

Information and Activities	Date
Purchase of land	13.11.2002
Application for conversion and subdivision of land	03.01.2006
Application for development order	03.01.2006
Application for court order to evict squatters from the land	27.11.2006
Court order to evict the squatters	09.03.2007
Approval for development of land	30.05.2007
Signed agreement with Y Sdn Bhd to develop land	27.07.2007

In this case, the date of commencement of the business is not 13.11.2002, the date of purchase of land, but 03.01.2006 which is the date of application for conversion and subdivision of land. Here, an essential element of indication of commencement of business activity is the commitment to the project and activities undertaken.

4.4 Notwithstanding the above paragraphs, the date of commencement of a property developer may be on any other date as the DGIR considers appropriate and reasonable.

5. Recognition of income prior to completion of projects

5.1 The taxation and recognition of gross income from a property development business are determined in accordance with section 24 of the ITA which provides for the gross income from a business to be assessed on a receivable basis.

5.2 Income from property development business shall be recognised, as development activity progresses, by reference to the stage of completion of the development activity at the balance sheet date.

5.3 Under the “Percentage of Completion method” as stated in the preceding paragraph, revenue is matched with expenses incurred in reaching the stage of completion.

5.4 Under this method, the stage of completion of a development project may be determined in a few ways. The common ways are:

(a) based on progress billings;

(b) based on cost incurred to date;

(c) based on surveys of work performed; or

(d) any other formula.

5.5 Income recognition shall commence when all the following criteria are met:

(a) when the sale of the development units is effected (when sales and purchase agreements are signed); and

(b) upon commencement of development activities.

5.6 Gross income

The gross income of a property developer of a property developer for the basis period for a year of assessment in respect of each property development project shall be the estimated gross profit of the property developer for that period.

Example 3:

Company C with accounts ending on 31 December each year has a project with three phases in Kuala Lumpur and the estimated gross profit from the project in year 2007 is as follows:

Phase	**Estimated gross profit (RM)**
1	2,500,000
2	3,000,000
3	2,200,000
Total	**7,700,000**

Therefore, the gross income of Company C in respect of the property development business for basis year 2007 is RM7,700,000.

5.7 Estimated gross profit

The estimated gross profit from a property development project for the basis period for a year of assessment (Y/A) is an amount determined by applying the following formula:

$$\frac{A}{B} \times C$$

Where

A = sum of progress payments in respect of the project, received and receivable in that basis period (the figures must reflect the actual position prevailing at the balance sheet date);

B = total estimated sale value of the project; and

C = total estimated gross profit from the project, i.e., the gross profit which the developer expects to make in relation to the project or phase.

Example 4: single phase project

Company D whose accounts end on 31 December each year commenced a housing project (single phase) in year 2005 and estimates that the project will be completed in year 2008. Total estimated sale value of the project is RM24 million and total estimated costs is RM16 million, giving an estimated gross profit of RM8 million.

Payments received and receivable are as follows:

Year	**Payment received and receivable (RM'000)**
2005	5,000
2006	8,000
2007	6,000
2008	5,000
Total	24,000

Applying the formula above, the estimated gross profit for each year of assessment is as follows:

Year of assessment	2005	2006	2007	2008
Estimated gross profit for the project (RM'000)	8,000			
Total payments received & receivable (RM'000)	5,000	8,000	6,000	5,000
Total sales value of project (RM'000)	24,000			
Estimated gross profit for the year RM'000	$\frac{5,000}{24,000}$ X 8,000 = **1,667**	$\frac{8,000}{24,000}$ X 8,000 = **2,666**	$\frac{6,000}{24,000}$ X 8,000 = **2,000**	= **1,667** **1

[**1 should be replaced by the actual amount (actual gross profit of the project less the estimated gross profit recognised for year 2005, 2006 and 2007) determined at the end of the project. See Example 17]

Example 5: a multiphase project

E & E Development, a partnership in property development business, has a project with two phases progressing concurrently. Phase 1 is expected to be completed by 2008, and Phase 2 by 2009. The following information is provided by the partnership:

Phase 1	**RM'000**
Total sales value of project	40,000
Total costs of project	32,000
Estimated gross profit	8,000

Payments received and receivable are as follows:

Year ended 31 Dec	Payment received and receivable (RM'000)
2005	6,000
2006	14,000
2007	14,000
2008	6,000
Total	40,000

Phase 2

	RM '000
Total sales value of project	60,000
Total cost of project	50,000
Estimated gross profit	10,000

Payments received and receivable are as follows:

Year ended 31 Dec	Payment received and receivable (RM'000)
2005	5,000
2006	12,000
2007	16,000
2008	20,000
2009	7,000
Total	60,000

The estimated gross profit for each year will be as follows:

Phase 1	2005 RM'000	2006 RM'000	2007 RM'000	2008 RM'000
Estimated gross profit from phase	8,000			
Total payments received & receivable	6,000	14,000	14,000	6,000
Total sales value of phase	40,000			
Estimated gross profit for the year	6,000 / 40,000 X 8,000 = **1,200**	14,000 / 40,000 X 8,000 = **2,800**	14,000 / 40,000 X 8,000 = **2,800**	= **1,200** **2

[**2 should be replaced by the actual amount (actual gross profit of the project less the estimated gross profit recognised for year 2005, 2006 and 2007) determined at the end of the project. See Example 17]

Phase 2	2005 RM'000	2006 RM'000	2007 RM'000	2008 RM'000	2009 RM'000
Estimated gross profit from phase	10,000				
Total payments received & receivable	5,000	12,000	16,000	20,000	7,000
Total sales value of phase	60,000				
Estimated gross profit for the year	5,000 / 60,000 X 10,000 = **833**	12,000 / 60,000 X 10,000 = **2,000**	16,000 / 60,000 X 10,000 = **2,667**	20,000 / 60,000 X 10,000 = **3,333**	= **1,167** **3

[**3 should be replaced by the actual amount (actual gross profit of the project less the estimated gross profit recognised for year 2005,

2006 and 2007) determined at the end of the project. See Example 17]

5.8 Fair and reasonable estimates

In computing the estimated gross profit using the formula in paragraph 5.7 above, the developer shall use fair and reasonable estimates.

5.9 Other formula

The DGIR may allow a property developer to use a formula other than the formula provided for in paragraph 5.7 to determine the estimated gross profit from a property development project. The formula adopted shall be in accordance with the accounting standards or practice applicable during the basis period that relates to the project.

Example 6:

F Sdn. Bhd. has a development project for which the cost to date formula was adopted in arriving at the percentage of completion. The financial data of the project is as follows:

i.	No. of units built	100
ii.	No. of units sold	40
iii.	Sale price per unit (RM)	300,000
iv.	Cost excluding land cost (RM)	
	- cost incurred to date	11,000,000
	- further cost to completion	10,000,000
v.	Total cost	21,000,000
	Cost of land	4,000,000
vi.	Budgeted cost per unit (RM) $\frac{25,000,000}{100}$	=250,000
vii.	Total sale value of units sold (RM)	40 X 300,000 =12,000,000

viii.	Total budgeted cost of units sold (RM)	40 X 250,000 =10,000,000
ix.	Percentage of completion $\frac{11{,}000{,}000}{21{,}000{,}000^*} \times 100\%$	= 52%
x.	Attributable profit or loss (RM) Income : 12,000,000 X 52% Expenses : 10,000,000 X 52%	 = 6,240,000 = 5,200,000 1,040,000

* Total cost for this purpose should not include cost of land and site materials not yet used.

5.10 The developer shall ensure that in applying whatever formula as stated in paragraph 5.9 above, fair and reasonable estimates for the project are used.

5.11 Consistency and fair spread

Where the estimated gross profit of a property developer has been ascertained in accordance with the formula as described in paragraph 5.7 or 5.9, the developer shall apply the formula consistently throughout the period of its property development project. The result shall reflect a fair spread of the estimated gross profit for the relevant period.

Example 7:

Company G commenced two projects in year 2005. The company had recognized income by using the percentage of completion method based on progress payment for both the projects.

From year of assessment 2006, Company G decided to switch to using cost to date formula for the second project. Company G can use different formula for the two projects from year of assessment 2006 onwards. However, whatever formula adopted for each project must be used consistently until the project is completed.

5.12 Where the method of accounting used results in a distortion of the true and fair spread of the estimated profits for taxation purposes, the DGIR shall review assessments for all the relevant years to ensure a

fair and reasonable spread of the estimated gross profit over the duration of the project.

5.13 This Ruling explains the income tax treatment to be applied for property development projects where –

(a) the project/phase takes more than one accounting period to complete; or

(b) the date at which the property development activity is entered into and the date at which the property development activity is completed fall into different accounting periods.

5.14 Where a property developer prepares his accounts on a completion of contract method, the property developer is required to compute his income tax liability for a year of assessment by using the percentage of completion method to determine and declare estimated profits annually. Property developers are not permitted to defer the recognition of profits in the accounts until the property development is completed.

6. Separate source of income

In ascertaining the gross income from his property development business, a property developer has to treat each property development project as a separate and distinct source of income from the property development business, although the development business as a whole still constitutes one source of income for the company.

Example 8:

Company H has the same facts as in Example 3 above. For year 2007 Company H has a project with 3 phases where each phase is treated as a separate source:

Phase	1	2	3
Type of Development	condominium	double storey terrace houses	double storey semi-detached houses
Estimated gross profit (RM)	2,500,000	3,000,000	2,200,000
Allowable expenses (RM)	2,100,000		

Capital allowance in respect of the business of property development is RM380,000.

Tax computation for the business of property development for Y/A 2007 is as follows:

	RM	
Gross income of Phase 1	2,500,000	
Gross income of Phase 2	3,000,000	
Gross income of Phase 3	2,200,000	7,700,000
Less : allowable operating expenses		2,100,000
Total Adjusted Income		5,600,000
Less : capital allowance		380,000
Statutory income of the property development business		5,220,000

7. Estimated loss from uncompleted projects

7.1 Computation of estimated loss

The estimated loss for the basis period for a year of assessment shall be ascertained in accordance with the formula provided for in paragraph 5.7 or 5.9. In applying the formula, the total estimated gross profit in the formula is replaced with total estimated loss from the project.

Example 9:

J Sdn Bhd has a development project in Ampang with several phases which are expected to be completed in 3 years. Phase 2 which will take three years to complete is expected to cause an estimated gross loss of RM50,000.

Phase 2 is 20% completed in the first year. The estimated loss of Phase 2 for the first year is computed as follows:

[20% x RM(50,000)] = RM (10,000)

7.2 Where for a basis period for a year of assessment a property developer anticipates that there would be an estimated loss from one or more of its property development projects for that basis period, the estimated loss or aggregate of estimated loss from those projects is allowed to be set off against the aggregate of the estimated gross profits from the other property development projects of the property developer for the same basis period.

7.3 Estimated loss less than estimated gross profit

Where the estimated loss or aggregate of estimated loss from one or more projects is less than the aggregate estimated gross profit from other projects, the difference is the gross income from the development business.

Example 10:

K Development Sdn. Bhd. which closes its accounts on 31.12.2006 has a housing project in Shah Alam with three (3) phases. The estimated income of the three phases for the year 2006 are as follows:

		RM
Phase 1	Estimated gross profit	30,000
Phase 2	Estimated gross loss	(10,000)
Phase 3	Estimated gross loss	(15,000)

The total estimated loss from phase 2 and phase 3 (RM25,000) is allowed to be set off against the estimated gross profit of RM30,000 from phase 1. The difference of RM5,000 is the gross income from the development business for Y/A 2006.

7.4 Estimated loss more than aggregate estimated profit

Where the estimated loss or aggregate estimated loss of the property developer from certain projects for that basis period exceeds the aggregate estimated gross profit from other projects, the excess shall be disregarded for the purposes of ascertaining the chargeable income of the developer for that basis period and subsequent basis periods until the projects are completed and actual losses are ascertained.

Example 11: Net estimated loss disregarded

L Development Sdn. Bhd. which closed its accounts on 31.12.2006 has a housing project in Kajang with three (3) phases. The estimated income of the three phases for the year 2006 are as follows:

		RM
Phase 1	Estimated gross profit	30,000
Phase 2	Estimated gross loss	(10,000)
Phase 3	Estimated gross loss	(22,000)

The aggregate estimated loss of L Development Sdn. Bhd. is RM(32,000). This exceeds the estimated profit of phase 1 by RM2,000. Hence the gross income for the year 2006 from the development business is "Nil". The net estimated loss of RM(2,000) is disregarded for the year 2006 and subsequent years until the projects for phase 2 and phase 3 are completed and actual loss is ascertained. The net loss of RM(2,000) cannot be used to offset against other sources of income of the company.

Example 12: Estimated loss cannot be offset against actual gross profit

Company M with year ending 31.12.2006 has a housing project in Penang with three (3) phases. The actual profit from the completed Phase 1 and estimated profit/loss from the remaining two phases are as follows:

		RM
Phase 1	Actual current year gross profit	20,000
Phase 2	Estimated gross profit	10,000
Phase 3	Estimated gross loss	(15,000)

The gross income of Company M for the year 2006 from the development business is RM20,000. The estimated loss of RM(15,000) from phase 3 can only be allowed to be set off against the estimated gross profit of RM10,000 from phase 2 and the excess loss of RM(5,000) is disregarded for the year of assessment 2006 and subsequent years of assessment until the project is completed and actual loss is ascertained.

8. Revision of estimates and tax computation

8.1 In the course of a project, circumstances may arise where the original estimates of a property developer need to be revised. Revision of estimates is allowed only under the following circumstances:

(a) there is a variation in the development cost of the project;

(b) there is a variation in the selling price of the development units of the project; or

(c) any commercial reasons as may be accepted by the DGIR.

8.2 Such circumstances may result in a change in the estimated gross profit, thus giving rise to one of the following situations:

(a) estimated gross profit is reduced; or

(b) estimated gross profit becomes estimated loss.

8.3 Where the situations in paragraph 8.2 arise due to any of the circumstances described in paragraph 8.1, the property developer may revise the estimated gross profit for that basis period and the immediately following basis periods by using the revised figures for sales and cost. Prior years' assessments based on the original estimates should not be reopened since any compensating adjustments will be made in the final year of the project using actual figures.

Example 13: revision of estimates

Company N, a property developer, commenced a housing project in 2006. The original estimates for the year ended 31.12.2006 at the commencement of the project are subsequently revised in year 2007. The reasons for the revision are that development costs have increased and at the same time the selling price of houses were reduced to attract more buyers. These reasons are acceptable to the DGIR. Company N provides the following particulars:

		Original Estimates (RM) 2006	**Revised Estimates (RM) 2007**
i.	Total sales value of project	10,000,000	9,500,000 (B)
ii.	Total cost of development	7,000,000	7,500,000
iii.	Total gross profit	3,000,000	2,000,000 (C)
iv.	Amount receivable in		
	Year 2006	3,000,000	3,000,000)
	Year 2007	3,000,000	2,700,000) (A)
	Year 2008	2,000,000	1,900,000)
	Year 2009	2,000,000	1,900,000)

Applying the formula, the estimated gross profit for each year is as follows:

Year	Original estimate RM	Revised estimate RM
2006	900,000	631,580
2007	900,000	568,420
2008	600,000	400,000
2009	600,000	400,000
Total	3,000,000	2,000,000

Since the revision is made in 2007, the revised estimates will be taken into the computation with effect from Y/A 2007. The original estimate in respect of year ended 31.12.2006 amounting to RM900,000 is not to be adjusted. Thus the property developer would have been subject to tax on a total gross profit as follows:

Year of assessment	RM
2006	900,000 (original estimate)
2007	568,420)
2008	400,000) (revised estimate)
2009	400,000)
Total	2,268,420

Adjustments have to be made in the final year of the project when the actual figures and profit are known.

Example 14:

Same facts as in Example 13 except that Company N decides to use the cumulative progress billings as follows :

Year of assessment	Cumulative progress billing	Cumulative profit
2006	3,000,000	3,000,000/10,000,000 X 3,000,000 = 900,000
2007	5,700,000	5,700,000/9,500,000 X 2,000,000 = 1,200,000
2008	7,600,000	7,600,000/9,500,000 X 2,000,000 = 1,600,000
2009	9,500,000	9,500,000/9,500,000 X 2,000,000 = 2,000,000

Hence, for each year of assessment the property developer would be subject to tax on current year profit as follows:

Year of a ssessment	Cumulative profit to date	Less	Cumulative profit up to previous year of assessment	Current year profit RM
2006	900,000	-	0	900,000
2007	1,200,000	-	900,000	300,000
2008	1,600,000	-	1,200,000	400,000
2009	2,000,000	-	1,600,000	400,000
			Total	2,000,000

9. Withdrawal of purchases

In the case where a property purchaser surrenders or withdraws from his purchase, he may lose all payments already made to the property developer. In such a situation, the property developer will usually make an adjustment in his accounts to reflect the withdrawals. The adjustment is to be given effect in the year of assessment in which the adjustment to the current year account is made. For example, where a purchaser after having purchased a

house in 2006 withdraws or cancels the purchase in 2007, the developer will make an adjustment in respect of the withdrawal in his accounts for the year 2007 itself. His assessment for Y/A 2006 would have been finalised previously. Though the withdrawal would affect his tax liability for Y/A 2006, the assessment is not to be reopened. Instead, the adjustment will be taken into account in computing his income tax liability for Y/A 2007.

Example 15:

P Development Sdn. Bhd. commenced a new project in year 2006 to build 200 houses scheduled to be completed in 2009. In 2006, all 200 houses were sold. When the company prepared its annual accounts for the year ended 31.12.2007, ten (10) purchasers withdrew their purchases.

These buyers will lose the payments made in 2006. No payments were made in 2007. The company is unable to resell the said 10 houses in 2007. Other information given by the company is as follows:

Information	**RM'000**
Total sale price of 200 houses	40,000
Total estimated cost of development	30,000
Original estimated gross profit	10,000
Payments receivable in 2006	20,000
Payments receivable in 2007	10,000
Payments receivable in 2008	6,000
Payments receivable in 2009	4,000
Payments receivable in 2006 for the 10 houses	1,000
Payments received in 2006 for the10 houses	600*
Payments receivable for 2007 for the10 houses	500

* forfeited in year 2006

Year of assessment 2006

The original estimated gross profit for the year as determined by the company is:

$$\frac{RM20,000,000}{RM40,000,000} \times RM10,000,000 = RM5,000,000$$

This amount would be taken as the gross profit in the company's assessment for the Y/A 2006. In view of the withdrawal of the 10 purchasers the company recalculates its estimated gross profit to be:

$$\frac{(*)\ RM19,000,000}{RM40,000,000} \times RM10,000,000 = RM4,750,000$$

(*) Total payments receivable for year 2006 less amount receivable relating to houses withdrawn = (RM20,000,000 - RM1,000,000).

The company, therefore, makes a prior year adjustment of RM250,000 (RM5,000,000 less RM4,750,000) in its accounts for the year ended 31.12.2007.

For income tax purposes, however, the assessment for Y/A 2006 based on the original estimated gross profit of RM5,000,000 is not to be reopened. The adjustment of RM250,000 will be made for Y/A 2007.

Year of assessment 2007

In the books of the company the estimated gross profit in respect of 190 houses will be:

$$\frac{(**)\ RM9,500,000}{RM40,000,000} \times RM10,000,000 = RM2,375,000$$

(**) Total payments receivable for year 2007 less amount receivables relating to houses withdrawn is RM9,500,000 (RM10,000,000 - RM500,000).

For income tax purposes, the estimated gross profit of RM2,375,000 is adjusted by deducting the amount of RM250,000 arising out of the withdrawal.

Notes:

(i) The above example should be distinguished from the case where a buyer defaults his payments. In such a case, there is no withdrawal and the profit is to be assessed in full.

(ii) For purposes of record, a full list of withdrawals has to be kept and filed properly.

(iii) Payment received in year 2006 for the 10 houses (RM600,000) which was forfeited would have been recognised as part of the development business income in the profit and loss account and would be taxed as such in Y/A 2007.

10. Completion of project

10.1 Date of completion of a project

A property development project is deemed completed on -

(a) the date on which the Temporary Certificate of Fitness for Occupation is issued;

(b) the date on which the Certificate of Fitness for Occupation (CFO) is issued; or

(c) the date of any other certification which has a similar

effect; whichever is earlier.

[**Note:** With effect from 12 April 2007, the Certificate of Completion and Compliance (CCC) replaces the CFO. However, the local authorities will continue issuing CFOs for projects where building plans were approved before this date].

10.2 The developer is required to obtain the CFO or CCC, whichever is applicable, for the house purchasers at its own cost and expense.

10.3 Where a phase consist of a few blocks of condominiums or apartments and the blocks are separately given CFO/CCC or vacant possession on different dates, the date of completion for each block is deemed to be the date of CFO/CCC or vacant possession, whichever is earlier.

Example 16:

Company Q undertakes a condominium project consisting of 3 blocks. Block 1 was completed on 01.08.2007. Due to some unforeseen circumstances, development work on Block 2 and 3 were stopped in March 2007 when the works done had reached 50% and 30% respectively.

Block 1 is deemed completed when CFO/CCC is issued or when house buyers are given vacant possession of their condominium

units, whichever is earlier. Company Q is required to prepare final accounts for Block 1.

10.4 Preparation of final accounts

Where in a basis period for a year of assessment a property development project is deemed to have been completed, the property developer shall ascertain the actual gross profit or loss from the project by preparing a final account for the project.

10.5 Adjustments may need to be made to profit and/or losses to conform to the ITA and other variations in treatment as contained in this Ruling.

10.6 Tax treatment upon completion of project

10.6.1 Actual gross profit or loss

Upon completion of a project or delivery of vacant possession of completed units where the final figures become available and the actual gross profit or loss for the whole project can be ascertained, the following situations may arise:

(a) the actual gross profit from the whole project is more than the total estimated gross profit of the developer for that period as ascertained using the formula in paragraph 5.7 above and which has been taxed;

(b) the actual gross profit from the whole project is less than the total estimated gross profit of the developer for that period as ascertained using the formula in paragraph 5.7 above and has been taxed; or

(c) there is an actual loss from the project.

10.6.2 Actual gross profit more than estimated gross profit

Where the actual gross profit from the whole project is more than the total estimated gross profit that has been taxed in the earlier years of assessment, the amount equal to the excess shall be taken as gross income for the final basis period.

Example 17:

	RM'000	RM'000
Actual gross profit from project Less:		3,800
Estimated gross profit for year 1	700	
Estimated gross profit for year 2	900	
Estimated gross profit for year 3	1,200	2,800
Excess gross profit from project		1,000

The excess gross profit of RM1,000,000 is taken to be the gross profit for the final year. Prior year assessments would not be reopened or reviewed.

10.6.3 Actual gross profit less than estimated gross profit

Where the actual gross profit from the whole project is less than the total estimated gross profit that has been taxed, the actual profit for the final basis period and preceding basis periods may be apportioned by applying the formula as in paragraph 5.7 or 5.9. Any assessments that have been made or will be made for those relevant periods may be revised or determined accordingly.

In applying the formula in paragraph 5.7 or 5.9, the property developer shall use the actual sales, cost, profit or loss from that project.

Example 18:

A project commenced in year 2005 and is completed in year 2008. The actual gross profit for the project as ascertained in 2008 is RM2,000,000. The estimated gross profit taken into computation for the project is as follows:

Year of assessment	Estimated gross profit (RM'000)
2005	500
2006	1,300
2007	800
Total estimated gross profit	**2,600**

Since the total of the estimated gross profit for years of assessment 2005 to 2007 exceeds the final actual gross profit by RM600,000, all the prior year assessments may be reviewed. The final gross profit for years of assessment 2005 to 2008 will be ascertained as follows:

	RM'000	RM'000
Actual gross profit for the project	**2,000**	
Less: (by applying formula)		
Gross profit for Y/A 2005 (20%)		400
Gross profit for Y/A 2006 (50%)		1,000
Gross profit for Y/A 2007 (25%)		500
Gross profit for Y/A 2008 (5%)		100
Total		**2,000**

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However, if the company chooses not to reopen the preceding years' assessments, the DGIR may allow the company to do so on condition there are no tax implications for all the relevant years of assessment.

10.6.4 Project with actual loss

Where a project finally ends in a loss, the actual gross loss from the project has to be apportioned to each relevant years of assessment by applying the formula in paragraph 5.7 or 5.9.

10.7 Concurrent multiple projects

A developer may carry on a few projects at the same time**,** with perhaps a project being completed in the basis period and a new one launched in the same basis period**.** The following example illustrates a multiple project company case where:

(a) a particular project is followed through from commencement to completion;

(b) there is a midstream revision of estimated gross profits to estimated gross loss for that project; and

(c) there is a gross loss situation at the end of the project.

Example 19:

Company R commenced a project X in 2004 which is completed in 2007. Gross profit for the project was originally estimated at RM800,000 but revised in 2006 to a loss of RM(200,000). The final accounts showed an actual loss of RM(205,000). The revision was for reasons acceptable to the DGIR. The original and revised allocations of gross profit or loss for each year based on the formula are computed by the company as follows:

Table 1

Project X 31 Dec	Original Estimated Gross Profit (RM)	Revised (in 2006) Gross Profit (RM)
2004	250,000	(62,500)
2005	250,000	(62,500)*
2006	150,000	(37,500)
2007	150,000	(37,500)
Total	**800,000**	**(200,000)**

*based on the formula

Table 2

Project X 31 Dec	Original Estimate (RM)	Revised (at the end of project) Estimate (RM)
2004	250,000	(62,500)
2005	250,000	(62,500) *
2006	150,000	(37,500)
2007	150,000	(42,500)
Total	**800,000**	**(205,000)**

*based on the formula

The company appealed for reopening of the relevant prior years' assessments. Particulars given in respect of other projects including profit and loss expenses are:

Year ended 31 Dec (RM)	2004	2005	2006	2007
Project W (gross profit)	30,000	30,000	-	-
Project Y (gross Profit)	-	20,000	20,000	60,000
Project Z (gross Profit)	150,000	-	-	-
P/L expenses	30,000	15,000	20,000	10,000

Income tax computations

Assuming the figures for all other projects require no change, and the items in the profit and loss accounts are fully allowable, the tax computations for Company R will be as follows:

Year of Assessment 2004

Estimated gross profit/ (loss)	**Original (RM)**	**Revised** (in year 2007)(1) **(RM)**
Project X	250,000	(62,500) (2)
Project W	30,000	30,000
Project Z	150,000	150,000
	430,000	117,500 (3)
P/L expenses	(30,000)	(30,000)
Adjusted income	400,000	87,500

Notes:

(1) The revision is made in 2007 when the final accounts for the project give the actual loss.

(2) The amount is the proportion based on the formula on the actual loss of RM(205,000).

(3) The actual loss for Project X is set off against the actual and estimated gross profit of other projects.

Year of Assessment 2005

Estimated gross profit / (loss)	Original (RM)	Revised (in 2007)(1) (RM)
Project X	250,00	(62,500) (2)
Project W	30,000	30,000 (5)
Project Y	20,000	20,000
	300,00	(12,500) (3)
P/L expenses	(15,000)	(15,000)
Adjusted income (loss)	285,000	(27,500) (4)

For (1), (2) and (3) see notes under Y/A 2004.

(4) The loss of RM(12,500) can be taken to add to the allowable expenses thus giving an adjusted loss of RM(27,500).

(5) Project W ceased in 2005 and in this example it is assumed that the figure for the year requires no adjustment.

Year of Assessment 2006

Estimated gross profit / (loss)	Original (1) (RM)	Revised (in 2007) (4) (RM)
Project X	(37,500)	(37,500)
Project Y	20,000	20,000
	Nil (2)	(17,500)
P/L expenses	(20,000)	(20,000)
Adjusted income/(loss)	(20,000) (3)	(37,500) (5)

(1) Since notification of the revised estimated loss for Project X was given by the company in 2006, no revision will be made to prior year assessments i.e. years of assessment 2004 and 2005.

(2) The estimated loss (Y/A 2006) for Project X is allowed to be setoff against estimated gross profit for project Y and the excess of RM(17,500) shall be disregarded.

(3) As the estimated loss for Project X is allowed against the estimated gross profit for Project Y, the allowable expenses of RM20,000 is deducted from the Nil aggregate gross income, resulting in adjusted loss of RM(20,000).

(4) & (5) The final position, revised in 2007, will be an adjusted loss of RM(37,500) since the loss for Project X is now an actual loss.

Year of Assessment 2007

Estimated/Actual gross profit/(loss)	Original (1) (RM)
Project X	(42,500)
Project Y	60,000
	17,500
P/L expenses	(10,000)
Adjusted income	7,500

(1) Finalised in 2007

10.8 Individual developers

In the case of an individual developer or partner in a joint venture project, where his personal rates of income tax may fluctuate, he is allowed to review the prior years' assessments made upon completion of the project.

Example 20:

Individual developer Mr. S commenced a housing project in 2005 which he completed in 2007. On completion of the project the gross profit is ascertained as RM1,500,000. The estimated gross profit taken into computation for the project is as follows:

Year of assessment	RM'000
2005	750
2006	750
2007	400
Total	1,900

Since the actual gross profit is less than the estimated gross profit taken into account in respect of Y/A 2005 to 2007, Mr. S can review all his prior years' assessments.

The actual gross profit for each year of assessment will be recalculated as follows:

Year of assessment	RM'000
2005	$\frac{A}{B}$ X 1,500 = 600 as revised
2006	$\frac{A}{B}$ X 1,500 = 600 as revised
2007	$\frac{A}{B}$ X 1,500 = 300 as revised
Total	1,500

Where

$$\frac{A}{B}, \frac{A1}{B1}, \frac{A2}{B2} = \frac{\text{Payments received and receivable}}{\text{Total value of development project}}$$

For each of the respective years of assessment as used in prior years' assessments.

11. Outgoings and expenses of property developers

11.1 Adjusted income

In arriving at the adjusted income of the business of a property developer for the basis period for each year of assessment, all outgoings and expenses wholly and exclusively incurred in the production of that income during that period as permitted by the ITA would be allowed. However, adjustments have to be made in the income tax computations for each year of assessment for outgoings and expenses prohibited under section 39 of the ITA.

11.2 Expenses mentioned in paragraph 11.1 above refer to all expenses which are deductible under the ITA. Such expenses include tender fees and related expenses after the first phase/project and for subsequent phase/project in respect of a property development project of the developer which are incurred after the commencement of the property development business of the developer.

11.3 In preparing the accounts, a property developer has to distinguish between direct expenses which are part of development expenditure and expenses which forms the day-to-day expenditure of the property development business and debited to the Profit and Loss Account.

11.4 Property Development Costs

11.4.1 Property development costs comprise all costs that are directly attributable to development activities or that can be reasonably allocated to such activities.

11.4.2 All direct expenses which are related to the property development project including infrastructure cost such as drainage, inner roads, reservoir, oxidation ponds etc. that adds value to the project should be capitalised in the Development Expenditure account.

11.4.3 Development expenditure includes –

(a) interest paid or payable on loans taken by the property developer to finance the purchase of land or development works of its property development project; and

(b) the proportion of the common infrastructure cost that relates to the project.

11.4.4 The Development Expenditure Account for each project or phase should be kept separately and has to be made available for each year of assessment.

11.4.5 With regards to the cost of land capitalised in the Development Expenditure Account, any surplus on revaluation of land (if the cost taken is revalued cost) is not an allowable expense. It should be added back proportionately when the project or phase is completed.

11.4.6 Expenses incurred prior to the date of commencement of the project such as cost of land, survey fees, soil investigation expenses, architect fees etc. are cost attributable to the development project. Where a project consists of more than one phase, such development costs has to be shown separately.

11.4.7 A property developer is required to make the necessary adjustments for outgoings or expenses which are reflected in the Development Expenditure Account. Where items such as materials for another project and provision for TNB substation have been included in the Development Expenditure Account, these have to be taken out so as to arrive at the allowable Development Expenditure to be carried forward to the following year of assessment. This is to ensure that upon completion of a project, only the final year's accounts need to be adjusted.

11.5 Allocation of land cost

Where a property development project consist of more than one phase with different types of properties, the allocation of land cost for each phase should be done by reference to land area (acreage). This is particularly important where there are vacant lots reserved for future development.

Example 21:

Company T has a piece of land with total land area of 200 hectare. The company plans to build a block of luxurious condominium on 10% of the land area while reserving the balance of 180 hectare for bungalow houses in future.

The cost of the whole piece of land is RM10 million. Hence the cost of land to be allocated to the condominium project is RM1 million.

Example 22:

U Development Sdn. Bhd. bought a piece of land with an area of 300 hectare for RM1 million. The land is divided into 4 parcels. Parcels 1, 2 and 3 are for immediate development whereas parcel 4 is reserved for future use. Development work on parcel 1 commenced on 01.07.2006. Cost of each parcel, calculated by reference to the proportionate land area (acreage) is as follows:

Parcel	Land area		Land cost	
	Hectare	%	RM'000	%
1	30	10	100	10
2	45	15	150	15
3	75	25	250	25
4	150	50	500	50
Total	300	100	1,000	100

Example 23:

Company V undertakes a mixed development project consisting of semi-detached houses, terrace houses and condominiums on a 500 hectare site. The condominium block itself consist of units with various sizes : one-room, two room, three room and penthouse unit.

The basis of allocating cost of land should be in accordance with the respective land area (acreage) of each type of development.

However, for the condominium block, the allocation of cost of land allotted for the whole block of condominium may then be divided amongst the various units by using the relative sales value of each unit.

11.6 Allocation of common infrastructure cost

The accounting standards prescribe that common costs may be allocated using relative sales value or any other generally accepted method. For income tax purposes common infrastructure costs have to be apportioned in accordance with:

(i) the area (acreage) method;

(ii) the relative sales value method; or

(iii) any method that is acceptable by the DGIR.

A property developer who chooses to apply any of the method above need not apply to the DGIR. He only needs to indicate it in the tax computation and ensure that the method used reflects a fair and reasonable allocation of the costs.

Example 24:

W Bhd's development project has the following particulars:

(a) Number of phases: 5

(b) Total developmental area: 30 hectares

(c) Years to complete the whole project : 8 years

(d) Total budgeted cost incurred on common infrastructure on 30 hectares: RM9,000,000;

(e) Actual cost incurred for common infrastructure: RM3,000,000 up to 31.12.2006

(f) Date of commencement of Phase 1: 05.06.2005

(g) Area of Phase 1: 3 hectares

(h) Gross development value of Phase 1: 10% of the whole project

(i) Date of completion of Phase 1: 31.12.2006

(j) Allocation of common infrastructure cost to Phase 1 is as follows:

$$\frac{\text{Total development area of Phase 1}}{\text{Total development area of all phases}} \times \text{Common infrastructure cost}$$

$$\frac{3}{30} \times \text{RM3,000,000}$$

$$= \text{RM300,000}$$

11.7 Fees paid for soliciting projects

11.7.1 A property developer may make payment of fees to certain parties for soliciting or securing projects. Such payments may be termed as kick-back, commission, management fee etc. The terms of agreement may provide, among others :

(a) payments to be in the form of a fixed sum or a percentage or a combination of both;

(b) payment of such fees to be made prior to commencement of a project, during the project period and/or after completion of project; and

(c) payments to be made in a lump sum or in instalments or a combination of both.

11.7.2 For income tax purposes, the deductibility of such expenses would depend on the purpose, nature and circumstances such fees arise. Where the services provided by the payee involves no more than securing the project, the fees paid would be deemed as a kick-back and would not qualify for deduction. However, where after securing the project, the payee is actively involved in the management and running of the project, then the fees paid would qualify as commission or management fee deductible as part of administrative expenses.

11.8 Warranty or Defects liability expenses

11.8.1 From the date a property development project is deemed to have been completed as described in subparagraphs 10.1 and 10.3, any defects or faults in a building which become apparent within a period of 18 calendar months (24 months w.e.f.1.12.2007) have to be repaired or made good by the property developer at its own cost and expense within 30 days of receiving a written notice from the purchaser.

11.8.2 The manner of claiming defects liability expenses in respect of the defects liability of a property development project which are incurred in a basis period or any following basis periods would depend on the circumstances and choice made by the property developer.

11.8.3 Sufficient income from the project

Where there is sufficient income from the development project, expenses on defects liability can be allowed as a deduction against the gross income from the project for the basis period or the following basis periods as the case may be.

Example 25:

X Sdn Bhd which closes its accounts on 31 December every year has a multiphase project in Johor Baru that runs concurrently. Phase 1 of the project was completed on 30.06.2006. The company incurred expenses on defects liability amounting to RM5,000 on 30.9.2006. Its income tax computation is as follows:

Year of assessment 2006

Gross Income from Phase 1	RM 10,000
Less: defects liability expenses incurred	RM 5,000
	RM 5,000

Example 26:

Same facts as in Example 25 except that the company incurred expenses on defects liability amounting to RM3,000 on 31.05.2007. Its income tax computation is as follows:

Year of assessment 2007

Gross income from Phase 1	RM 12,000
Less: defects liability expenses incurred	RM 3,000
	RM 9,000

11.8.4 Insufficient or no income from the project

Where there is insufficient or no gross income from a development project for a basis period or following basis periods, expenses on defects liability which cannot be deducted in full or in part will be allowed in one of two methods described in paragraphs 11.8.5 and 11.8.7.

11.8.5 No election by developer

If the property developer does not make an election as described in paragraph 11.8.7 below, the defects liability

expenses will be allowed as a deduction against the aggregate gross income from the other development projects for that basis period or any following basis periods as the case may be.

11.8.6 In the event that the aggregate of gross income from other projects is not sufficient to absorb the losses as described in paragraph 11.8.5 above, the defects liability expenses can be deducted against other sources of income of the property developer. In other words, the character of the loss has now changed to current year loss under subsection 44(2) of the ITA.

Example 27:

Y Sdn Bhd which closes its account on 31 December has a multiphase project in Penang. Phase 2 of the project which commenced in November 2004 was completed on 30.04.2006. Defects liability expenses of RM3,000 was incurred on 30.09.2006. The income tax computation is as follows:

Year of assessment 2006

Gross income from Phase 2	RM 2,000
Less: defect liability expenses incurred	RM 3,000
Gross loss from Phase 2	RM(1,000)
Less: aggregate gross income from other phases	RM 4,000
Gross income from development business	RM 3,000

Example 28:

Same facts as in Example 27 except that the aggregate gross income from the other phases is RM500 for year 2006. Its income tax computation is as follows:

Year of assessment 2006

Gross income from Phase 2	RM 2,000
Less: defects liability expenses incurred	RM 3,000
Gross loss from Phase 2	RM (1,000)
Less: aggregate gross income from other phases	RM 500
Gross loss from development business	RM (500)

This gross loss of RM500 can be deducted against other sources of income of Y Sdn. Bhd. e.g. dividend, interest etc.

11.8.7 Election by developer

A property developer can make an election to have the expenses on defects liability allowed as a deduction against the gross income from the same project for the basis period preceding the basis period in which the expenses are incurred. Any expenses which cannot be fully deducted shall be allowed as a deduction for the next preceding period and so on until fully deducted for the duration of the project.

11.8.8 Irrevocable election

If a property developer decides to choose the method as described in paragraph 11.8.7, the election is irrevocable. This election can be made either in the tax computation for the current year of assessment or in the revised tax computations for prior years of assessment to the respective branch offices of Inland Revenue Board Malaysia.

Example 29:

Company Z with accounts ending on 31 December has a project with 2 phases. Phase 1 commenced on 01.02.2006 and was completed on 10.01.2008. After serious consideration, the company decided to make an election as described in paragraph 11.8.7 above. Details of income and defects liability expenses are as follows:

Year of assessment	Gross income (RM)
2006	80,000
2007	30,000
2008	10,000

Defects liability expenses of RM42,000 was incurred in the year 2008.

Tax computation is as follows:

Year of assessment 2008

Gross income from Phase 1	RM10,000
Less : defects liability expenses incurred	RM 42,000
	NIL

Unabsorbed defects liability expenses of RM32,000 is carried back to year of assessment 2007 where the tax computation would be reviewed.

Year of assessment 2007

Gross income from Phase 1	RM30,000
Less : unabsorbed defects liability expenses carried back from year 2008	RM32,000
	NIL

Unabsorbed defects liability expenses of RM2,000 is carried back to year of assessment 2006 where the tax computation would be reviewed.

Year of assessment 2006

Gross income from Phase 1	RM80,000
Less : unabsorbed defects liability expenses carried back from year 2007	RM 2,000
	RM78,000

11.9 Liquidated Damages

11.9.1 A property developer has to complete and deliver the property to the house purchaser within 24 calendar months (36 months for condominiums). If the developer fails to deliver vacant possession within this period, he shall be liable to pay to the purchaser a sum calculated at a rate as in the sales and purchase agreement as liquidated damages (LAD) until the purchaser takes vacant possession of the building.

11.9.2 For income tax purposes, the provision for LAD is not an allowable expense. A developer's liability only arises when payment of the LAD becomes a fact. The liability is incurred as and when the actual amount of LAD is ascertained and agreed to between the developer and purchasers.

11.9.3 For a developer with a single development project who has insufficient income after any of the certificates as described in paragraph 10.1 above is issued, he may claim the LAD expenses accrued after the issuance of the said certificate to be carried back and allowed as a deduction against the gross income from the same project for the basis period preceding the basis period in which the expenses are incurred. Any expenses which cannot be fully deducted shall be allowed as deduction for the next preceding period and so on until fully deducted for the duration of the project.

11.9.4 This concession is given to a developer who:

(i) developes only one project/phase;

(ii) has sold all the units in that project/phase;

(iii) goes into liquidation upon completion of the project/phase; and

(iv) has insufficient or no income from the project to offset the LAD expenses.

11.10 Strata title expenses

11.10.1 For income tax purposes, the provision for strata title expenses is not an allowable expense. It is allowable as a deduction only when the amount as ascertained by the land office issuing the strata titles is paid by the developer.

11.10.2 For a developer with a single development project who has insufficient income after any of the certificates as described in paragraph 10.1 above is issued, he may claim the strata title expenses paid by him to be carried back and allowed as a deduction against the gross income from the same project for the basis period preceding the basis period in which the expenses are incurred. Any expenses which cannot be fully deducted shall be allowed as a deduction for the next preceding period and so on until fully deducted for the duration of the project.

11.10.3 This concession is given to a developer who:

(i) has developed only one project/phase;

(ii) has sold all the units in that project/phase;

(iii) goes into liquidation upon completion of the project/ phase; and

(iv) has insufficient or no income from the project to offset the strata title expenses.

11.11 Legal and professional fees

11.11.1 Legal and professional fees such as stamping, filing, and legal fees incurred in connection with the arrangement of loans, including bridging loans, are not allowable under section 39 of the ITA.

11.11.2 Cost incurred in arranging end-financing facilities for the purchaser is allowed as this expense is incurred as a facility not for the benefit of the property developer but for the benefit of his customers.

11.11.3 Fees paid for the valuation of land at the time of purchase by the property developer, legal fees paid for transfer of land titles, subdivision and conversion of land, compensation for eviction of squatters are allowable expenses.

11.12 Marketing and promotional expenses

11.12.1 Marketing expenses in the form of advertisements in media, billboards, brochures etc. are allowable as expenses under subsection 33(1) of the ITA.

11.12.2 Expenses such as free legal fees, free cabinets or free air-conditioners are allowable deductions as expenses incurred in the provision of entertainment which is related wholly to sales arising from the business of a property developer under subparagraph 39(1)(*L*)(vii) of the ITA.

11.13 Guarantee fee

Guarantee fee paid to a guarantor in respect of a loan or facility granted to a property developer is a capital cost of raising funds and is not deductible.

11.14 General administrative expenses

11.14.1 Where non-allowable expenses are charged to the profit and loss account, adjustments have be made to the income tax computation to disallow the expenses according to provisions of the ITA.

11.14.2 General administrative expenses such as audit fees and bank charges are allowable against the gross income of the property development business under subsection 33(1) of ITA if they are incurred in the production of income of the property development business.

11.15 Interest expense

11.15.1 A property developer may charge interest expense in the :

(a) Development Expenditure Account; and/or

(b) Profit and Loss Account.

11.15.2 Interest paid on loans taken for financing the purchase of land and development works are to be capitalised or debited in the Development Expenditure Account. It should not be charged to the Profit and Loss Account as part of administrative expenses.

11.15.3 Where funds borrowed to acquire land cannot be related to a particular parcel or parcels, the interest incurred should be allocated to all land held during the year in proportion to the cost of each parcel. Interest would be allowed as part of the cost of sales based on the percentage of completion method.

11.15.4 Where a property developer charges interest which is not allowable to development expenditure, adjustment has to be made by taking out the amount of interest charged from the Development Expenditure Account.

11.15.5 To qualify for deduction, the interest expense not only has to be incurred but also has to satisfy the test that it is incurred in the production of gross income. In other words, only interest attributable to the phases or projects, which produced income would qualify as a deduction.

Example 30:

Same facts as Example 22. Total interest expense incurred by the developer in the year 2006 on the whole piece of land is RM80,000. Hence, the interest expense to be allocated to each parcel is calculated as follows:

$$\frac{\text{Cost of parcel}}{\text{Total cost of land}} \times \text{Total interest}$$

Therefore, the interest expense to be allocated to each parcel would be:

Parcel	Interest for the parcel (RM)
1	$\frac{100,000}{1,000,000}$ X 80,000 = 8,000
2	$\frac{150,000}{1,000,000}$ X 80,000 = 12,000
3	$\frac{250,000}{1,000,000}$ X 80,000 = 20,000
4	$\frac{500,000}{1,000,000}$ X 80,000 = 40,000
	Total interest = 80,000

Since only Parcel 1 had commenced in the year 2006, therefore only interest expense of RM8,000 incurred in respect of Parcel 1 would be allowed as part of the cost of sales based on the percentage of completion method for Y/A 2006.

The amount of interest allocated to each parcel shall be capitalised in the respective Development Expenditure Account.

11.15.6 The deductibility of the interest expense and the amount of interest to be deducted should strictly follow the principle of percentage of completion, that is deduction is based on the percentage of completion of the phase or project.

11.15.7 Interest that has been charged to the Profit and Loss Account or capitalised in the Development Account should be restricted where appropriate, in accordance with subsection 33(2) of the ITA. If interest restriction under

subsection 33(2) of the ITA is applicable, it should be computed for the basis period for each year of assessment.

12. Valuation of stock and stock transfers

12.1 Where a property is acquired as trading stock, the cost of the property should be its cost at the date of its acquisition. In the event of subsequent sale or disposal of the property, any profit made is subject to income tax.

12.2 Where the property developer transfers his trading stock to fixed assets, this would amount to a withdrawal of the stock in trade for his own use or for no consideration within the meaning of subsection 24(2) of the ITA. The market value of the property at the time of its withdrawal would be subject to tax in accordance with paragraph 24(2)*(B)* of the ITA. Any subsequent disposal of the property prior to 01.04.2007 would be subject to tax under the Real Property Gains Tax Act 1976 (RPGT Act).

Example 31: withdrawal of stock in trade

Company AA, a property development company, withdrew several unsold houses from the “stock in trade” and transferred them to “fixed assets” at cost at the end of the financial year. These houses were subsequently rented out to derive rental income.

Paragraph 24(2)*(A)* of the ITA is applicable. The market value of the stock brought into account as fixed assets shall be treated as gross income of the company under paragraph 24(2)*(B)* of the ITA.

The rental income is assessed under paragraph 4*(D)* of the ITA.

12.3 Unsold units of property

Where a property developer has stock of unsold houses and these houses are rented out in the meantime, the rental income is assessable under paragraph 4*(A)* of the ITA.

Example 32: unsold units

BB Development Sdn Bhd, a property developer, completed a project of 295 units of townhouses in 2006. The company sold 285 units, leaving another 10 units unsold. These units were rented out in the meantime.

Subsection 24(2) of the ITA is not applicable in this case. There is no transfer of stock in trade to fixed assets. Rental income derived from the unsold units is assessed under paragraph 4*(a)* of the ITA. In the event of sale of these houses subsequently, the profits are subject to income tax under paragraph 4*(a)* of the ITA.

12.4 Transfer of land as fixed asset to trading account

Where there is a transfer of land from the fixed asset account to the trading account of a property developer, the value of the land shall be its market value at the date of the transfer to the trading account provided that the facts of the case are the same as the facts in the case of *DGIR vs LCW [1975] 1 MLJ 250.*

In the case of a transfer of assets under subparagraph 17(1) of Schedule 2 of the RPGT Act, where such an asset is taken by the transferee company into its trading stock (deemed to be a disposal of the asset) at a value in excess of the acquisition price paid by the transferor company plus the permitted expenses incurred by the transferor company, the excess will constitute a chargeable gain to the transferee company at the date when the asset is taken into its trading stock pursuant to subparagraph 17(2) of Schedule 2 of the RPGT Act.

[**Note:** With effect from 1 April 2007, the Minister exempts any person from all provisions of RPGT Act in respect of any disposal of chargeable assets after 31.3.2007 - Real Property Gains Tax (Exemption) (No.2) Order 2007].

12.5 Stock of land not yet developed

Where the development business of a property developer has not commenced and the developer receives rental income from the land in its possession such as rental of land, parking fees etc, the rental income is assessable under paragraph 4*(d)* of the ITA, unless the facts of the case prove that the letting of the land is a business source chargeable to tax under paragraph 4*(a)* of the ITA.

12.6 Cessation of business - whether unsold houses are stock or fixed assets

Whether unsold houses of a property developer are to be treated as stock or fixed assets upon the cessation of his business of property development will depend on the facts of the case.

13. Other issues related to property development

Interest income from Housing Development Account

Interest income derived from the Housing Development Account should be assessed under paragraph 4*(c)* the ITA.

14. Information required for audit

Information and documents to be made available for examination during a tax audit include:

(a) Name, address and location of project;

(b) Number of phases planned;

(c) Approved layout and site plan;

(d) Date of completion for each phase of the project;

(e) A reconciliation of the number of approved lots with the number of lots sold and the number unsold as at the end of the accounting period;

(f) Confirmation whether any lots were disposed of at lower than the normal selling price. If so, details of the acquirers should be kept for reference;

(g) Cost of Sales - how the figures are arrived at;

  (i) Separate lists of details of development expenditure and direct expenses for each phase of a project as debited in the Development Expenditure Account in the balance sheet;

  (ii) List of administrative expenses which are charged to the Profit and Loss Account;

  (iii) Joint venture agreement for joint venture projects; and

  (iv) Other relevant correspondence and documents.

15. **Joint Venture project**

15.1 A joint venture project is a project undertaken jointly usually between a landowner (including a company) and a property developer under an agreement to develop a property development project, whereby:

(a) the landowner surrenders his land to the property developer for development and in return receives:

(i) a certain number of houses upon the completion of the project;

(ii) a certain percentage of the progress payments from the sale of the houses built under the project; or

(iii) the sales proceeds from the houses allotted to him and sold on his behalf by the property developer.

or

(b) the landowner and the property developer agree to some other arrangement under the joint venture project.

15.2 The recognition of income for income tax purposes in respect of a joint venture project depends on the terms and conditions of the agreement made between the landowner and the property developer. Hence, joint venture projects have to be dealt with according to the facts of each case.

15.3 Generally, the income tax treatment in respect of joint venture projects is as follows:

(a) where the land owner does not take an active part in the development activities of the project (notwithstanding the fact that he may involve himself in the marketing of units allotted to him by the developer), the land owner is not undertaking a business; and

(b) where the land owner actively participates in the development activities of the project together with the property developer, the land owner is deemed to be undertaking the business of a property development.

16. **Effective Date**

This Ruling is effective for the year of assessment 2006 and subsequent years of assessment. It supersedes the Public Ruling No. 3/2006 dated 13 March 2006.

Director General of Inland Revenue,
Inland Revenue Board Malaysia.