Public Ruling No. 2/2002

ALLOWABLE PRE-OPERATIONAL & PRE-COMMENCEMENT OF BUSINESS EXPENSES FOR COMPANIES

1.0 TAX LAW

This Ruling applies in respect of pre-operational and pre-commencement of business expenses allowable to a company under the following:

1.1 **Income Tax (Deduction of Incorporation Expenses) Rules, 1974 [P.U. (A) 134 / 1974]**;

1.2 **Schedule 4B, Income Tax Act 1967 - Qualifying Pre-Operational Business Expenditure**;

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

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

2.0 THE APPLICATION OF THIS RULING

This Ruling considers the pre-operational and pre-commencement of business expenses that are allowable, under the specific provisions [hereinafter referred to as *the specific provisions*] in the Income Tax Act 1967 or the specific Rules [hereinafter referred to as *the specific Rules*] mentioned in paragraph 1.0 above, to a company when it commences its operations or its business.

3.0 HOW THE TAX LAW APPLIES

3.1 Generally, expenses incurred by a company prior to the commencement of its operations or its business [*see paragraphs 4.1 and 4.2*] would not be allowable as a deduction against the gross income of its business as they are not con-sidered wholly and exclusively incurred in the production of the income.

3.2 Schedule 4B of the Income Tax Act 1967 [hereinafter referred to as *the Act*] 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 company as a deduction against:

3.3.1 the gross income in arriving at the adjusted income of the business; or

3.3.2 the aggregate income in arriving at the total income; of the company [*see paragraph 4.3*].

3.4 **Incorporation expenses**
[Income Tax (Deduction of Incorporation Expenses) Rules, 1974]

3.4.1 For a company incorporated in Malaysia on or after 1 January 1973 with an authorized capital not exceeding 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, 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;

C. the cost of drawing up the preliminary contracts and stamp duty thereon;

D. the cost of printing and stamping debentures (if any) and of share certificates and letters of allotment;

E. the cost of the seal of the company; and

F. underwriting commission.

3.4.2 The said incorporation expenses should be allowed as a deduction against gross income in ascertaining the adjusted income in respect of the business source of the company for the basis period for the year of assessment [*Y/A*] in which it commenced that business.

3.4.3 The deduction is to be made in the tax computation for the Y/A indicated in paragraph 3.4.2 above, whether or not the said incorporation expenses have been capitalised in the company's balance sheet or have been written off in the profit & loss account of the company for the relevant accounting period.

Example 1
Company A is incorporated in Malaysia on 11.02.2002 with an authorized capital of RM250,000. It commences a retail business dealing in hardware on 01.08.2002 and closes its accounts on 31.07.2003. The following incorporation expenses have been capitalised in its first balance sheet as at 31.07.2003:

Details of expenses	***Amount [RM]***
Preparation & printing Memorandum & Articles of Association	500
Registration of company (including stamp duty)	3,500
Company seal	200

The incorporation expenses amounting to RM4,200 can be deducted against the gross income of the company for the basis period 01.08.2002 - 31.07.2003. [For details of the determination of the basis period, see Public Ruling No. 7/2001.]

Example 2
Company B is incorporated in Malaysia on 01.03.2002 with an authorized capital of RM300,000 and an issued capital of RM150,000. Incorporation expenses (similar to those in *Example 1* above) amount to RM4,200.

The incorporation expenses ***cannot*** *be allowed as a deduction against the gross income of the company as its authorized capital exceeds RM250,000.*

3.5 Pre-operational business expenditure incurred outside Malaysia [Schedule 4B, Income Tax Act 1967]

3.5.1 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 if:

A. the company is resident in Malaysia; and
B. the business venture has been approved by the Minister of Finance

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

A. expenses which are directly attributable to the conduct of feasibility studies, including the cost of employing consultants;

B. expenses which are directly attributable to the carrying out of market research or survey or the obtaining of marketing information, including the cost of employing consultants;

C. 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

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

Details of expenses	***Amount [RM]***	
Market research (by a Mongolian consultant)		5,000
Travel & other expenses:		
Air fare	*2,000*	
Hotel (RM200 x 10 days)	*2,000*	
Food allowance (RM100 x 10 days)	*1,000*	5,000
Total		10,000

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

3.5.3 Qualifying pre-operational business expenses should be allowed as a deduction against aggregate income in the manner provided for in Schedule 4B of the Act. Any unabsorbed qualifying pre-operational business expenditure can be carried forward to the following Y/A.

Example
ABC Sdn. Bhd. has incurred qualifying pre-operational business expenses [*see the Example in paragraph 3.5.2 above*] for a business venture which has been approved by the Minister of Finance. It has the following position for Y/A 2002:

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	10,000

The 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
Deduct: Business adjusted loss brought forward	2,000
Aggregate income	18,000
Deduct: Current year business adjusted loss	5,000
	13,000
Deduct: Qualifying pre-operational business expenses	10,000
Total income	3,000

3.6 Pre-commencement of business expenditure on approved training [Income Tax (Deduction for Approved Training) Rules 1992]

3.6.1 A **manufacturing** company can be allowed a **double deduction** for pre-commencement of business expenditure on approved training in computing its adjusted income if it satisfies the following conditions:

A. it has incurred the said expenditure during the period of pre- commencement of its business;

B. the expenditure is in respect of training its employees for the acquisition of craft, supervisory or technical skills which will contribute directly to the future production of its products;

C. 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

D. the said employees are Malaysian citizens.

3.6.2 The expenditure qualifying for the deduction is the amount paid by the company to the training institution in respect of the said training programme. The claim must be supported by the 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
A company which intends to produce condensers for automobile air conditioners commences operations on 01.08.2002. Before commencement of production, the company recruits 30 employees, all of whom are Malaysians. 20 of them are sent for training on machining at Institut Kemahiran MARA [*IKM*], a training institution approved by the Minister of Finance, and the other 10 are sent to study machining and assembly of condensers at the factory of its associate company in Japan. The following expenditure is incurred:

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

A letter from IKM is submitted to confirm that the amount paid by the company for the training programme is RM40,000 and that the employees of the company have attended it.

The company commences production on 01.01.2003 and the first accounts are prepared for the period 01.08.2002 to 31.07.2003.

The company can be allowed a double deduction under these Rules for the expenditure of RM40,000 incurred on the training programme in Malaysia in ascertaining its adjusted income for the basis period 01.08.2002 - 31.07.2003 [for details of the determination of the basis period, see Public Ruling No. 7/2001]. *The travelling allowance (RM4,000)* ***cannot*** *be allowed as only the amount paid to the training institution*

(IKM) in respect of the programme qualifies for 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* [see, however, paragraph 3.7.1 below] .

3.6.3 These Rules have effect from Y/A 1992 and subsequent years of assessment.

3.6.4 With effect from 01.07.1993, companies that contribute to the Human Resource Development Fund [*HRDF*] do not qualify for the deduction under these Rules.

3.7 Pre-commencement of business training expenses [Income Tax (Deduction of Pre-commencement of Business Training Expenses) Rules 1996]

3.7.1 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:

A. the training is to impart basic skills to enable the company to commence its business;

B. the training expenses are incurred within one year prior to the commencement of the business; and

C. the training expenses are of the kind that is allowable under section 33 of the Act.

E xample

[See the *Example* in paragraph 3.6.2 above .]

The expenses incurred in training the employees in Japan prior to commencement of business amounting to RM75,000 can be allowed as a single deduction under these Rules in ascertaining the company's adjusted income for the basis period 01.08.2002 - 31.07.2003 .

3.7.2 The following do not qualify for a deduction under these Rules: :

A. a company receiving training grants from the Government; and

B. a company claiming double deduction of training expenses under **the Income Tax (Deduction for Approved Training) Rules 1992** [*see paragraph 3.6 above*].

4.0 INTERPRETATION

For the purpose of this Ruling:

4.1 "Pre-operational" has the meaning as defined in the specific provisions [*see paragraphs 3.5.2 above*] 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.

4.2 "Pre-commencement of business" has the meaning as defined in the specific Rules [*see paragraphs 3.4, 3.6 and 3.7 above*]. 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 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:

4.2.1 the purchase of raw materials in the case of manufacturing;

4.2.2 the purchase of goods for resale in the case of retailing;

4.2.3 the first planting in the case of agriculture;

4.2.4 the levelling of land in the case of construction; or

4.2.5 the purchase of land in the case of property development.

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.

4.3 "Adjusted income", "statutory income", "aggregate income" and "total income" refer to income as determined under Chapters 4, 5 and 6 of the Act.

(Issue Date: 8 July 2002)