



**INLAND REVENUE BOARD OF MALAYSIA**

**PRE-OPERATIONAL  
BUSINESS EXPENDITURE**

**PUBLIC RULING NO. 11/2013**

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A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.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

**1. Objective**

This Public Ruling explains the deductions allowed for certain expenditure incurred prior to the commencement of a business.

**2. Summary Of Changes**

This Public Ruling replaces the Public Ruling No. 2/2010 issued on 3 June 2010 under the title “Allowable Pre-Operational And Pre-Commencement Of Business Expenses”. Significant changes made to that Public Ruling are summarized in the table below:

Paragraph In Public Ruling No. 2/2010	Changes In This Public Ruling		
	Paragraph	Item	Reference
-	-	New title	Editorial changes
1	1	Rephrased	
	2	Summary of changes	
	3	Rephrased	<ul style="list-style-type: none"> <li>○ P.U. (A) 401/2009</li> <li>○ P.U. (A) 76/2012 (New)</li> </ul>
2	4	Renumbered	Editorial changes
2.1	5.1		
2.2	5.2		
-	4.1	New	Clarification
	4.2		
2.3	4.3	Rephrased	
3	6	Renumbered	Editorial changes
4	7		

4.1	7.1	Rephrased	Clarification
4.2	7.2		
4.3	7.3	Paragraph and Example 2 are rephrased	
5	8	Renumbered	Editorial changes
5.1 (ii)	-	Deleted	
5.3	-		
6	9	Renumbered	Clarification
		Example 6 rephrased	
6.2(i)	9.3(a)	Rephrased	
7	10	Renumbered	Editorial changes
8	11	Rephrased	Clarification
		Example 8 replaced	
9	12	Renumbered and rephrased	
		Example 9 rephrased	
10	13	Renumbered	
		Example 12 rephrased	
		New Example 13	
10.1	13.2	Rephrased	
11	-	Deleted	
-	14	New	P.U. (A) 76/2012 (New)

### 3. Related Provisions

The provisions related to this Public Ruling are -

3.1 Schedule 4B of the Income Tax Act (ITA) 1967, and

3.2 the Rules issued by the Minister of Finance:

- (a) P.U.(A) 61/1992
- (b) P.U.(A) 111/1995
- (c) P.U.(A) 160/1996
- (d) P.U.(A) 475/2003
- (e) P.U.(A) 472/2005
- (f) P.U.(A) 135/2006
- (g) P.U.(A) 65/2007
- (h) P.U.(A) 361/2008
- (i) P.U.(A) 401/2009, and
- (j) P.U.(A) 76/2012.

### 4. Interpretation

The words used in this Public Ruling have the following meaning:

4.1 "Resident" means resident in Malaysia for the basis year for a year of assessment by virtue of section 7 or section 8 of the ITA 1967.

4.2 "Person" includes a company, a body of persons, a limited liability partnership and a corporation sole.

4.3 "Adjusted income", "statutory income", "aggregate income" and "total income" refer to income as determined under Chapters 4, 5 and 6 in Part III of the ITA 1967.

### 5. Pre-Operation And Pre-Commencement Of Business

5.1 "Pre-operational" has the meaning as defined in Schedule 4B of the ITA 1967 and any reference to "pre-operational" or "prior to the commencement of operations" should be interpreted subject to the conditions imposed under the provision.

- 5.2 “Pre-commencement of business” has the meaning as defined in the Rules. The determination of the date of commencement of a business requires 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:
- (a) the purchase of raw materials in the case of manufacturing,
  - (b) the purchase of goods for resale in the case of retailing, or
  - (c) 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.

## **6. Application Of Tax Law**

- 6.1 Generally, expenses incurred by a person prior to the commencement of his operations or business would not be allowable as a deduction against the gross income of his business as they are not wholly and exclusively incurred in the production of the income.
- 6.2 However, Schedule 4B of the ITA 1967 and the Rules as mentioned in paragraph 3.2 above allow for the deduction of certain expenses that are incurred prior to the commencement of operations or business.
- 6.3 This Public Ruling gives general guidelines on the pre-operational and pre-commencement business expenses that are allowable to a person as a deduction against -
- (a) the gross income in arriving at the adjusted income of the business, or
  - (b) the aggregate income in arriving at the total income of the business.

**7. Qualifying Pre-Operational Business Expenditure Incurred For Approved Business Venture Outside Malaysia**

7.1 Schedule 4B of the ITA 1967 provides that, with effect from the year of assessment 1992, certain pre-operational business expenditure in relation to a proposal to undertake investment in a business expansion 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.

7.2 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,
- (b) expenses which are directly attributable to the carrying out of market research or survey or the obtaining of market information,
- (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.

Expenses as mentioned in paragraphs 7.2 (a) and 7.2 (b) above include consultation cost for conducting feasibility studies, market research or market survey.

**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 Schedule 4B of the ITA 1967 unless the venture has been approved by the Minister of Finance.

7.3 Qualifying pre-operational business expenses shall be allowed as a deduction against the defined aggregate in arriving at the total income. The defined aggregate means the aggregate income after deducting –

- (a) the amount of any adjusted loss from business for the basis period for the relevant year of assessment under subsection 44(2) of the ITA 1967, and
- (b) the amount of prospecting operations expenditure, if any, under Schedule 4 of the ITA 1967.

Any unabsorbed qualifying pre-operational business expenses can be carried forward to the following years of assessment until the whole amount of the deduction has been made.

**Example 2**

The facts are the same 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 2012:

Details	Amount (RM)
Adjusted loss of Business 1 (Retail)	(5,000)
Statutory income of Business 2 (Electrical Equipment)	20,000
Business loss brought forward (b/f)	(6,000)
Qualifying pre-operational business expenses	11,000

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**Tax Computation**

Statutory income of Business 1	Nil
Statutory income of Business 2	<u>20,000</u>
Aggregate of statutory income from businesses	20,000
Less: Business loss b/f	<u>(6,000)</u>
Aggregate income	14,000
Less: Adjusted business loss for current year	<u>(5,000)</u>
Defined aggregate	9,000
Less: Qualifying pre-operational business expenses (restricted)	<u>9,000</u>
Total income / Chargeable income	<u>Nil</u>
Unabsorbed pre-operational business expenses carried forward = (2,000)	

**8. Incorporation Expenses**

8.1 The Rules related to the deduction of incorporation expenses are—

- (a) Income Tax (Deduction For Incorporation Expenses) Rules 2003 [P.U.(A) 475/2003], and
- (b) Income Tax (Deduction For Incorporation Expenses) (Amendment) Rules 2005 [P.U.(A) 472/2005].

8.2 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 on or after 13.9.2003 and having an authorized capital of not more than RM2,500,000, 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.

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

8.4 The deduction is to be made in the tax computation for the year of assessment indicated in paragraph 8.3 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 8.2 above.

**Example 3**

Biz Sdn Bhd was incorporated in Malaysia on 11.2.2012 with an authorized capital of RM2,000,000. It commenced a retail business dealing in hardware on 1.5.2012 and closed its accounts on 30.4. 2013. The following incorporation expenses had been capitalized in its first balance sheet as at 30.4.2013:

Details Of Expenses	Amount (RM)
Preparation and printing memorandum and article of association	1,000
Registration of company (including stamp duty)	3,500
Company seal	200
Total	4,700

The incorporation expenses amounting to RM 4,700 can be deducted against the gross income of the company for the basis period 1.5.2012 to 30.4.2013.

**Example 4**

Camin Sdn Bhd was incorporated in Malaysia on 1.3.2012 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) amounted to RM 4,700.

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 10.3.2010. 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 1.8.2012 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 1.8.2012. As such, the date of commencement for the company would be 1.8.2012. The incorporation expenses claimed by the company for the basis period 1.8.2012 to 31.7.2013 are as follows:

<b>Details Of Expenses</b>	<b>Amount (RM)</b>
Preparation and printing of memorandum and articles of association	1,000
Cost of registering the company	2,500
Company secretarial 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 and articles of association and cost of registering the company amounting to RM3,500 are eligible for deduction.

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

**9. Expenditure On Approved Training**

9.1 The Rules related to the deduction of expenditure on approved training are as follows:

- (a) Income Tax (Deductions For Approved Training) Rules 1992 [P.U.(A) 61/1992], and
- (b) Income Tax (Deductions For Approved Training) (Amendment) Rules 1995 [P.U.(A) 111/1995].

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- 9.2 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.
- 9.3 This double deduction incentive is given if the manufacturing company satisfies the following conditions:
- (a) it has incurred the said expenditure during the period prior to the commencement of its business,
  - (b) 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,
  - (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.
- 9.4 The expenditure which qualifies for 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 1.8.2011 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:

<b>Details Of Expenses</b>	<b>In Malaysia (RM)</b>	<b>In Japan (RM)</b>
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 RM 40,000 and that the employees of the company had attended it. The company commenced production on 1.1.2012 and the first accounts were prepared for the period 1.8.2011 to 31.12.2012.

The company can be allowed a deduction of RM 80,000, 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 1.1.2012 to 31.12.2012. The travelling allowance of RM 4,000 cannot be allowed as only the amount paid to the training institution approved by the Minister of Finance 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.

- 9.5 With effect from 1.7.1993, companies that contribute to the Human Resources Development Fund (HRDF) do not qualify for 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 pay the 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.

## **10. Pre-Commencement Business Training Expenses**

- 10.1 The Rules related to the deduction of the above expenses are the Income tax (Deduction Of Pre-Commencement Of Business Training Expenses) Rules 1996 [P.U. (A) 160/1996].
- 10.2 With effect from the year of assessment 1996, a company which provides training to its employees prior to the commencement of its

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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 ITA 1967.

#### **Example 7**

The facts are the same 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 1.1.2012 to 31.12.2012.

10.3 A company does not qualify for a deduction under the above Rules if -

- (a) it is receiving training grants from the Government, or
- (b) 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.

#### **11. Establishment Expenditure Of A Real Estate Investment Trust (REIT) Or Property Trust Fund (PTF)**

11.1 The Rules related to the deduction of the above expenditure are the Income Tax (Deduction For Establishment Expenditure Of Real Estate Investment Trust Or Property Trust Fund) Rules 2006 [P.U. (A) 135/2006].

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

11.3 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.

11.4 Establishment expenditure that can be allowed as a deduction are legal, valuation and consultancy fees for the 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 Real Estate Investment Trust (Excel REIT) was established on 1.12.2010 and approved by the Securities Commission on 15.12.2010. The total establishment expenditure on legal, valuation and consultancy fees incurred prior to approval by the Securities Commission was RM800,000. Excel REIT acquired from Excel Berhad's group of companies a few commercial properties together with all the tenancies, leases and licences via an agreement dated 1.1.2011. Excel REIT invited subscriptions from the public on 1.2.2011 and was listed in Bursa Malaysia on 1.3.2011. Its first set of accounts was closed on 31.12.2011.

The establishment expenditure of RM800,000 on legal, valuation and consultancy fees is deductible against the gross income of Excel REIT for the year of assessment 2011. It is deemed to be incurred in the basis period for the year of assessment 2011 in which the business commenced.

Note:

The date of commencement of the business of a REIT is the date on which a real property of the REIT is made available for letting. In this case, as Excel REIT acquired the properties together with the tenancies on 1.1.2011, the properties were made available for letting on 1.1.2011 and let out on the same date by Excel REIT. The business of Excel REIT therefore commenced on 1.1.2011.

## **12. Establishment Expenditure Of An Islamic Stock Broking Company**

12.1 The Rules related to the deduction of the above expenditure are as follows:

- (a) Income Tax (Deduction On Expenditure For Establishment Of An Islamic Stock Broking Business) Rules 2007 [P.U. (A) 65/2007], and
- (b) Income Tax (Deduction On Expenditure For Establishment Of An Islamic Stock Broking Business) (Amendment) Rules 2009 [P.U. (A) 401/2009].

12.2 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.

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- 12.3 Effective from 2.9.2006, 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.
- 12.4 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.
- 12.5 An Islamic stock broking company qualifies for the deduction of establishment expenditure if -
- (a) an application for approval of the Islamic stock broking business is made to the Bursa Malaysia from 2.9.2006 to 31.12.2015, and
  - (b) the company commences its Islamic stock broking business within 2 years from the date of approval by the Bursa Malaysia.

**Example 9**

Al-Aiman Stock Broking Sdn Bhd was incorporated on 2.1.2010 and is a company licensed under the Securities Industry Act 1983. The company made an application to the Bursa Malaysia on 1.3.2010 for approval to carry out an Islamic stock broking business. The approval was granted on 1.6.2010. 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 1.5.2012 and closed its accounts on 31.12.2012.

Since the application to Bursa Malaysia was made within the period 2.9.2006 to 31.12.2015 and the business commenced within 2 years from the date of approval by Bursa Malaysia, the company is entitled to deduct the establishment expenses of RM500,000 against its gross income for the basis period 1.5.2012 to 31.12.2012.

Note: If Al-Aiman Sdn Bhd were to commence its Islamic stock business after 31.5.2012 (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.

**13. Pre-Commencement Business Expenses Relating To Employee Recruitment**

- 13.1 The Rules related to the deduction of the above expenses are the Income Tax (Deduction Of Pre-Commencement Of Business Expenses Relating To Employee Recruitment) Rules 2008 [P.U. (A) 361/2008].
- 13.2 With effect from the year of assessment 2009, a person resident in Malaysia who has 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.
- 13.3 The allowable expenses are—
- (a) expenses on the recruitment of employees to enable the person to commence his business,
  - (b) expenses of the kind allowable under section 33 of the ITA 1967 relating to the recruitment of employees, and
  - (c) expenses incurred within the period of one (1) year prior to the commencement of his business.
- 13.4 The recruitment expenses which qualify for deduction include expenses incurred in participation of job fairs, payment to employment agencies and head-hunters.
- 13.5 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 decided to set up his own business by selling healthcare products through the internet. Farid registered a sole-proprietorship on 3.6.2012. 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 1.1.2013.

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 2013.

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**Example 11**

A Swiss company intended to set up a factory manufacturing pharmaceutical products in Malaysia. A subsidiary company, Genpharma Sdn Bhd (Genpharma) was incorporated on 1.6.2011. 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 sought the services of a head-hunting company to recruit a suitable person as its Chief Operating Officer. Genpharma commenced operations on 1.3.2012 and closed its accounts on 31.12.2012.

All the expenses which Genpharma incurred in the recruitment of its employees prior to 1.3.2012 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 2012.

**Example 12**

The facts are the same as in Example 11. The Chief Operating Officer started his employment on 1.2.2012. Genpharma Sdn Bhd had 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 2012.

The expenses amounting to RM28,400 are of the kind allowable under section 33 of the ITA 1967 and incurred before the commencement of business, but they are not part of the recruitment expenses. Therefore no deduction is allowable against its gross income for the year of assessment 2012 under these Rules.

**Example 13**

Electrotherm Sdn Bhd (Electrotherm) was incorporated on 1.2.2012. It recruited a highly experienced engineer whose contract of service with another company was still in force. The other company agreed to the early termination of the contract but demanded a compensation of RM20,000 from the engineer as stipulated in the contract. The compensation was paid by Electrotherm on 1.4.2012. Electrotherm commenced its business on 1.5.2012 and closed its accounts on 31.12.2012.

The compensation of RM20,000 is not an expense of the kind allowable under section 33 of the ITA 1967. It is therefore not allowable as a deduction against Electrotherm's gross income for the year of assessment 2012 under these Rules.

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**14. Expenditure On Franchise Fee**

- 14.1 “Franchise” refers to a contract or an agreement between two or more persons by which the franchisor grants to the franchisee the right to operate a business according to the franchise system during a term as determined by the franchisor. In return for the grant of rights, the franchisee may be required to pay a franchise fee or other form of consideration.

The franchise fee is an one-off payment required to be paid by the franchisee to the franchisor before the franchisee commences his business. It is paid for the right to use a mark, trade secret, confidential information, intellectual property or system of franchise owned by the franchisor in accordance with the terms of a franchise agreement. The payment shall not include royalty payment or other periodical payments. It can be paid in one lump sum or instalments.

- 14.2 The Rules related to the deduction of the expenditure on franchise fee are the Income Tax (Deduction For Expenditure On Franchise Fee) Rules 2012 [P.U. (A) 76/2012].

- 14.3 The Rules have been introduced with effect from the year of assessment 2012 to further support the development of the local franchise industry.

The Rules stipulate that, for the purpose of ascertaining the adjusted income of a person resident in Malaysia from his franchise business for the basis period for a year of assessment, he is allowed a deduction for an expenditure incurred on the franchise fee paid to the franchisor prior to the commencement of his franchise business. His franchise business should be using a local franchise brand and the franchise fee must not be refundable.

A local franchise brand means a trade mark or service mark that is registered under the Trade Marks Act 1976 by the franchisor whose franchise business is registered with the Registrar of Franchise in the Ministry of Domestic Trade, Co-Operatives and Consumerism (MDTCC). The brand must be developed in and originated from Malaysia (Malaysian brand).

The franchisor must wholly own the local franchise brand. Where the franchisor is a company incorporated under the Companies Act 1965, at least 70% of the issued share capital of the company is owned by Malaysian.

- 14.4 The expenditure incurred on the franchise fee is deemed to be incurred in the basis period for a year of assessment in which the franchise business commences.

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**Example 14**

Jatifah Sdn Bhd, a company resident in Malaysia, is granted the right to undertake a franchise business using a fast food brand called "ENAK". Enak Sdn Bhd, a company incorporated under the Companies Act 1965 in Malaysia, has registered "ENAK" under the Trade Marks Act 1976 with the Registrar of Trade Marks in MDTCC. It has also registered its fast food business as a franchise with the Registrar of Franchise in MDTCC. The issued share capital of Enak Sdn Bhd is 100% owned by Malaysian.

Under the franchise agreement dated 1.1.2011, Enak Sdn Bhd grants the rights to Jatifah Sdn Bhd to carry on the franchise business for a term of 10 years in return for a franchise fee of RM80,000 and royalty calculated based on 3% of monthly gross sales as well as other payments. On 1.2.2011, Jatifah Sdn Bhd paid the franchise fee of RM80,000 which is not refundable. It commenced the operation of its franchise business on 1.7.2011 and closed its first set of business accounts on 30.6.2012.

The franchise fee of RM80,000 incurred and paid by Jatifah Sdn Bhd prior to the commencement of business is allowable as a single deduction against the gross income of its franchise business for the year of assessment 2012. The franchise fee is deemed to have been incurred in the basis period for year of assessment 2012 in which the franchise business commenced.

Note: If the franchise fee was paid by four (4) equal instalments on 1.2.2011, 1.8.2011, 1.2.2012 and 1.8.2012, the whole amount of the franchise fee RM80,000 would still be allowable and deemed to be incurred in the basis period for year of assessment 2012.

**Example 15**

The facts are the same as in Example 14, except that Enak Sdn Bhd is not wholly owned by Malaysian in respect of its issued share capital. As confirmed by the Company Secretary, the share holding position of the company at the date of signing the franchise agreement on 1.1.2011 was as follows -

- (a) 60% of the issued share capital of Enak Sdn Bhd is owned by Bluebells Sdn Bhd and the balance of 40% is owned by Malaysian, and
- (b) 70% of the issued share capital of Bluebells Sdn Bhd is owned by non-Malaysian with the balance of 30% owned by Malaysian.

In this case, only 58% [ 40% + ( 60 x 30% ) ] of the issued share capital of Enak Sdn Bhd is owned by Malaysian. Since less than 70% of the issued share capital of Enak Sdn Bhd is owned by Malaysian, the franchise fee of RM80,000 is thus not deductible against the gross income of the franchise business of Jatifah Sdn Bhd.

- 14.5 Where a trade mark or service mark owned by a foreign person is used in a franchise, the Rules shall not apply as the trade mark or service mark is not a local franchise brand.

#### Example 16

“TORO” pizza is a well known brand owned by Toro Inc, a company incorporated in Italy. Toro Inc expands its business to Malaysia and registers “TORO” with the Registrar of Trade Marks. The Registrar of Franchise approves the application from Toro Inc to sell its franchise rights in Malaysia. Through a registered franchise broker, Toro Inc grants its franchise right to Malanim Sdn Bhd for franchise fee, royalty and other periodical payments.

Malanim Sdn Bhd, a company resident in Malaysia, becomes the master franchisee in respect of “TORO” in Malaysia. It registered the franchise with the Registrar of Franchise and paid the unrefundable franchise fee of RM120,000 on 1.3.2012 before commencing its franchise business on 1.4.2012. Its first set of accounts was made up from the date of incorporation 1.1.2012 to 31.12.2012.

In this case, Toro Inc is the foreign franchisor whereas Malanim Sdn Bhd is the franchisee in Malaysia. “TORO” is not a “local franchise brand” in respect of Malanim Sdn Bhd’s business. Consequently, the franchise fee of RM120,000 paid by Malanim Sdn Bhd is not allowable as a deduction against its gross income for the year of assessment 2012.

#### Example 17

The facts are the same as in Example 16. Malanim Sdn Bhd subsequently registers itself as a master franchisee with the Registrar of Franchise. It grants its franchise rights to a sub-franchisee by the name of Hamishah in Malaysia to use “TORO” in return for a franchise fee of RM60,000 and other payments in accordance with the terms of the franchise agreement made. Hamishah, an entrepreneur resident in Malaysia, paid the franchise fee prior to the commencement of her business.

In this case, although Malanim Sdn Bhd is the local master franchisee, the brand “TORO” still does not qualify as a “local franchise brand” in respect of Hamishah’s business. Thus, the franchise fee of RM60,000



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paid by Hamishah is not an allowable expense in ascertaining the adjusted income of her franchise business.

**Director General Of Inland Revenue,  
Inland Revenue Board Of Malaysia**