



**REVENUE DIVISION  
MINISTRY OF FINANCE  
BRUNEI DARUSSALAM**

# **INCOME TAX PUBLIC RULING**

## **CONSTRUCTION CONTRACTS AND PROPERTY DEVELOPMENT**

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## 1.0 OBJECTIVE

- 1.1 The purpose of this ruling is to explain how income is determined to compute income under Section 8 of the Income Tax Act (ITA), Chapter 35 from the business of construction contracts and property development.

## 2.0 RELEVANT PROVISIONS OF THE LAW

- 2.1 The relevant provisions of the ITA, Chapter 35 to this Public Ruling are Section 2, Section 8, Section 11, Section 12, Section 26, Section 30, Section 31, Section 61 and Section 62.

## 3.0 DEFINITIONS

- 3.1 "Construction contracts" means contracts for the performance of construction services specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and include main and ancillary contracts including but not limited to mechanical engineering, electrical engineering, public utilities projects, project design and consultancy, architectural designing and infrastructural contracts;
- 3.2 "Construction contractor" means a company who or which engages in or carries on or undertakes or causes to be undertaken construction contracts including sub-contractor;
- 3.3 "Property developer" means any individual, person, body of persons, company, firm or society, who or which engages in or carries on or undertakes or causes to be undertaken property development.
- 3.4 "Property development" refers to the business 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 parcel 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.
- 3.5 "Collector" refers to the Collector of Income Tax appointed under Section 3 of the ITA.
- 3.6 "Substantially completed" means ninety-five per cent of the total estimated construction costs have been incurred; and

3.7 "Progress billings" means amounts billed for work performed on a contract (including retention sums) in respect of construction contracts, whether or not they have been paid.

#### 4.0 DATE OF COMMENCEMENT OF BUSINESS

4.1 A construction contract/property development contract commences either on the date:

- a) when the contract is secured, a letter of award is offered, or possession of a construction site is obtained (whether in writing or otherwise); or
- b) on the commencement of an activity which comprises part of a series of activities that are actively carried out in the course of a construction contract business; or on any date as the Collector considers appropriate and reasonable.

#### 5.0 RECOGNITION OF INCOME PRIOR TO COMPLETION OF CONTRACT

5.1 The taxation and recognition of income from the business of construction contract and property development are ascertained according to Section 8 of the ITA which requires income of any person to be assessed on accrual basis.

5.2 Under accrual basis, income is recognized when it is due and not when it is received and costs are recognized when obligations arise or liabilities are incurred and not when payments are made.

5.3 As construction contract activity progresses, income from construction contract business shall be recognised accordingly, by reference to the stage of completion of the construction contract activity at the balance sheet date.

5.4 The recognition of income referred to paragraph 5.3 above is referred as "Percentage of Completion method" where revenue is matched with expenses incurred in reaching the stage of completion.

5.5 Estimated gross profit

The estimated gross profit for the basis period for the year of assessment in respect of a construction contract shall be an amount determined according to the formula below:

$$\frac{\text{Sum of progress billings received and receivables in that basis period*}}{\text{Total contract price or amount}} \times \text{Total estimated gross profit from the contract}$$

\*Figures must reflect actual position prevailing at the balance sheet date

Example 1

AB Construction Sdn Bhd has its account closed on 31<sup>st</sup> December every year. The company was awarded with a contract to build a school valued at BND 10 million. The construction began on 1<sup>st</sup> June 2017 and is anticipated to finish by 31<sup>st</sup> December 2019. The company expects to earn a profit of BND 2 million from the contract. The company uses progress billings method to compute its estimated profit for years of assessment 2018, 2019 and 2020 for tax purpose.

Payments received and receivables are as follows:

<b>Year of Assessment</b>	<b>Payments received and receivable (BND '000)</b>
2018	5,000
2019	2,000
2020	3,000
<b>Total</b>	<b>10,000</b>

The estimated profit for each year of assessment is calculated as follows:

<b>Year of Assessment</b>	<b>Estimated profit (BND '000)</b>
2018	$\frac{5,000}{10,000} \times 2,000 = 1,000$
2019	$\frac{2,000}{10,000} \times 2,000 = 400$
2020	$\frac{3,000}{10,000} \times 2,000 = 600$
<b>Total</b>	<b>2,000</b>

5.6 Income under Section 8 of the ITA

The income under Section 8 of the ITA from a construction contractor from each construction contract for the basis period for a year of assessment shall be the estimated gross profit of the construction contractor from each contract for the same basis period.

## Example 2

Referring to Example 1 above, the income under Section 8 of the ITA of AB Construction Sdn Bhd is as follow:

<b>Year of Assessment</b>	<b>Estimated gross profit BND</b>	<b>Income under Section 8 BND</b>
2018	1,000,000	1,000,000
2019	400,000	400,000
2020	600,000	600,000

### 5.7 Other formula

Construction companies also have the option to use other formula to determine estimated gross profit from a construction contract. The formula adopted must be according to the accounting standards or practice applicable during the basis period that relates to the contract. The other formula includes cost method where stage of completion is measured by:

$$\frac{\text{Contract cost incurred to date}}{\text{Estimated total costs}} \times \text{Total estimated gross profit from the contract}$$

When the formula described in paragraph 5.5 and 5.7 are being applied, construction companies must ensure that fair and reasonable estimates for the contract are used.

### 5.8 Consistency and fair spread

When a construction contractor has a chosen a formula either in paragraph 5.5 or 5.7 to determine its estimated gross profit of a construction contract, the company must use the formula consistently throughout the period of the contract to ensure fair spread of the estimated gross profit for the relevant basis periods.

## Example 3

In Example 1 above, if AB Construction Sdn Bhd intends to opt for other method (for example – cost method) to compute the estimated gross profit, the computation may be accepted by the Collector on condition that the company uses the same method consistently until the completion of the contract.

5.9 If accounting method caused a distortion to the true and fair spread of estimated profits for tax purposes, the Collector is to review assessments for all the relevant years so as to make sure estimated gross profit is fairly and reasonably spread over the duration of the contract.

5.10 No progress billings issued

If it is stipulated in contract agreement that the construction contractor will not issue progress billings for the duration of the contract, the company has to apply the second formula or other accounting practice to compute the estimated gross profit for each year of assessment for tax purposes.

Example 4

CD Construction Sdn Bhd was awarded a contract in March 2017 to build an office for Company HI Sdn Bhd. Both of the companies came to an agreement that CD Construction Sdn Bhd would not issue any progress billings and Company HI Sdn Bhd did not have to pay until the construction of the office was finished and handed over to Company HI Sdn Bhd in July 2018.

In this case, CD Construction Sdn Bhd with accounts closed on 31<sup>st</sup> December each year, is required to compute estimated gross profits for the years of assessment 2018 and 2019 by using any formula as described in paragraph 5.5 above, despite the fact that the agreement stated no progress billings were made to Company HI Sdn Bhd.

5.11 This Ruling describes the income tax treatment to be applied for construction contracts and property development contracts where:

- a) More than one accounting period is required to complete the contract; or
- b) The date on which the contract activity is entered into and the date on which the contract activity is completed fall into different accounting periods.

Example 5 - duration of contract falling into different basis periods

EF Construction Sdn Bhd closes its accounting on 30<sup>th</sup> June every year, entered into a contract to build a factory. The value of the contract is BND2 million and the company estimates the profit of the contract is BND360,000. The company starts construction on 01<sup>st</sup> March 2017 and it is anticipated to end by 31<sup>st</sup> October 2017. The company uses the formula as in paragraph 5.5 above to recognize its estimated profits from the contract for years of assessment 2018 and 2019. The computation is as follows:

<b>Year of Assessment</b>	<b>Progress Billings BND '000</b>	<b>Estimated Profit BND '000</b>
2018	500	$\frac{500}{2,000} \times 360 = 90$
2019	1500	$\frac{1,500}{2,000} \times 360 = 270$

Example 6 – duration of contract falling into different basis period

GH Development Sdn Bhd, a property developer has a financial year which ends every 30<sup>th</sup> June and the company entered into a contract with a group of clients to develop a residential area in Muara with 15 houses. The project is to be carried out in three phases whereby Phase 1 is expected to be completed on 30<sup>th</sup> November 2017, Phase 2 on 30<sup>th</sup> September 2018 and Phase 3 on 31<sup>st</sup> July 2018. The activity of the project began on 30<sup>th</sup> May 2017. According to the contract, the clients will pay the company upon the completion of each phase. The value of the contract is BND 4,500,000 and the company estimates a profit of BND 1,350,000. The computation is as follows:

<b>Year of Assessment</b>	<b>Progress Billings BND '000</b>	<b>Estimated Profit BND '000</b>
2018	900	$\frac{900}{4,500} \times 1,350 = 270$
2019	1,575	$\frac{1,575}{4,500} \times 1,350 = 472.5$

- 5.12 Since it is not permissible to delay the bringing of profits into accounts until a construction contract is completed for tax purpose, therefore, a construction contractor who prepares his accounts based on a completion of contract method, such person is required by the Collector to calculate its income tax liability for a year of assessment using percentage of completion method to determine and declare the estimated profits annually.
- 5.13 To determine how much income should be recognised for construction contract, a construction company should refer to the stage of completion of the contract activity at the end of each accounting period. This can also be adopted in the case of contracts which are large and fragmented into phases, and require more than one accounting period or year to complete. Where the contract is fragmented into phases, the percentage of completion basis should be applied to each phase separately.



## 6.0 SEPARATE SOURCE OF INCOME

For the purpose of determining the income of a company from its construction contract business, each contract is to be treated as a separate and distinct source of income of the company from the construction contract business, even if the construction contract business as a whole still represents one source of income for the company.

### Example 7

IJ Construction Sdn Bhd closes its account every 31<sup>st</sup> December and the following are the contracts which the company are engaged in for the year 2017 where each contract is treated as a separate source:

<b>Contract</b>	<b>1</b>	<b>2</b>	<b>3</b>
Type of contract	Office	School	Library
Estimated gross profit (BND)	4,000,000	8,000,000	5,000,000
Allowable expenses (BND)	12,200,000		

Capital allowance in respect of the business of construction contract is BND500,000.

The following is the tax computation for IJ Construction Sdn Bhd from the business of construction contract for the year of assessment 2018:

	<b>BND</b>	
Gross profit of contract 1	4,000,000	
Gross profit of contract 2	8,000,000	
Gross profit of contract 3	5,000,000	17,000,000
Less: deductions under section 11		12,200,000
		4,800,000
Less: Capital allowance		500,000
<b>Statutory Income</b>		<b>4,300,000</b>

Each contract is treated as separate source.

### 6.1 Separate construction contract

Where a construction contractor has to construct a number of assets in one contract, the construction of each asset should be treated as a separate construction contract when:

- a) Separate proposals have been submitted for each asset;

- b) Each asset has been subject to separate negotiation and the company and customer have been able to accept or reject that part of the contract relating to each asset; and
- c) The costs and revenues of each asset can be identified.

#### Example 8

KL Construction Sdn Bhd has a contract with a university to build 4 blocks of buildings which include an administration block, a hall, a mosque and a canteen. Each of the 4 buildings meets all the three criteria in this paragraph. Therefore, the company should treat each building as a separate contract, despite the fact that company has signed one contract only with the university.

### 6.2 Single construction contract

If there are two or more contracts are entered into, either with a client or with several clients, construction companies should treat those contract as a single construction contract when they are:

- a) negotiated as a package;
- b) so closely interrelated that they are in effect part of a contract with an overall profit margin; and
- c) performed concurrently or in a continuous sequence.

#### Example 9

MN Construction Sdn Bhd has signed a contract individually with 5 owners of lands located near to one another. The owners join forces to negotiate with the company for a package deal to build their houses. If the contractor views the individual contracts to be so closely interrelated with the effect of being a single contract and with an overall profit margin, and that the construction can be performed concurrently or in a continuous sequence, then all the 5 contracts should be combined and accounted for as a single construction contract, despite the fact that different contracts have been signed with different owners.

### 6.3 Additional contract

In a contract, it may stipulate an option to the customer for the construction of an additional asset or an additional asset to be constructed by amending the contract. Such construction should be treated as a separate construction contract when either one of the following conditions is met:

- a) The asset varies considerably in design, technology or function from the asset or assets agreed in the original contract; or
- b) The price of the additional asset is negotiated without taking into consideration the original contract price.

#### Example 10

OP Construction Sdn Bhd was conferred a contract in May 2017 to build a new guest room for a house. The construction of the new guest room began in June 2017. Then in July 2017, it was decided that a garage was to be built for the house and the company was awarded with the contract. The construction of the garage began in September 2017. Should the contract of the garage met the either one of the conditions above, then the company is said to undertake two separate contracts.

## 7.0 ESTIMATED LOSS FROM UNCOMPLETED CONTRACTS

### 7.1 Computation of estimated loss

The computation of estimated loss for the basis period for a year of assessment shall be determined according to the formula provided for in paragraph 5.5 or 5.7 above. The total estimated loss from contract should replace the total estimated gross profit in the formula when it is applied.

#### Example 11

QR Construction Sdn Bhd was conferred with a number of contracts which are anticipated to be completed in 4 years. The company expects one of the contracts, contract 2 to complete in 3 years with an estimated gross loss of BND (200,000).

During first year, the company determined that Contract 2 is 25% completed. Therefore, the following is the calculation of estimated loss of Contract 2 for the first year: **[ 25% x BND (200,000) ] = BND (50,000)**

7.2 If a construction contractor foresees there would be an estimated loss from one or more of its construction contracts for a basis period for a year of assessment, the company is allowed to set-off the estimated loss or aggregate of estimated loss from those contracts against the aggregate of the estimated gross profits from other construction contracts 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 contracts is less than the aggregate estimated gross profit from the other contracts, the difference is the total gross profit from the construction contract business.

Example 12

The following are the 4 contracts undertaken by ST Construction Sdn Bhd with the respective estimated profits/losses for the year ended 31.12.2017:

<b>Contract</b>	<b>Estimated gross profit/(loss) BND</b>
1	400,000
2	(200,000)
3	(100,000)
4	600,000

The aggregate estimated loss from contracts 2 and 3 of BND300,000 is permitted to be set-off against the aggregate estimated gross profit of BND1,000,000 from contracts 1 and 4. The remainder of BND700,000 (BND1,000,000 – BND300,000) is the gross profit of ST Construction Sdn Bhd from its construction business for the year of assessment 2018.

7.4 Estimated loss more than aggregate estimated profit

Where the estimated loss or aggregate estimated loss of the construction contractor for that basis period is greater than the aggregate estimated gross profit from other contracts, the excess is to be disregarded for the purposes of determining the assessable income of the company for that basis period and following basis periods until the contracts are completed and actual losses are determined.

### Example 13 – Net estimated loss disregarded

UV Construction Sdn Bhd closes its accounts on 31.12.2017 and has 3 construction contracts performed simultaneously in 2017. The following are the estimated gross profit/gross loss of the 3 contracts for the year 2017:

Contract 1	Estimated gross profit	BND 220,000
Contract 2	Estimated gross loss	BND (100,000)
Contract 3	Estimated gross loss	BND (140,000)

The aggregate estimated loss of UV Construction Sdn Bhd from Contract 2 and 3 is BND(240,000). Such amount is greater than the estimated profit of contract 1 by BND(20,000). Therefore, the gross profit for the year of assessment 2018 from construction contracts is zero. The net estimated loss of BND(20,000) is disregarded for the year of assessment 2018 and following years of assessment until the company completed Contract 2 and 3 and the actual losses have been determined.

### Example 14 – Estimated loss cannot be set-off against actual gross profit

In 2017, XY Construction Sdn Bhd which closes its accounts on every 31 December has engaged in 3 concurrent contracts. The actual profit of Contract 1 which has been completed and estimated gross profit/loss from the Contract 2 and 3 for year ended 31.12.2017 are as follows:

Contract 1	Actual current year gross profit	BND100,000
Contract 2	Estimated gross profit	BND40,000
Contract 3	Estimated gross loss	BND(50,000)

The gross profit of XY Construction Sdn Bhd from construction contracts business for the year of assessment 2018 is BND100,000. The estimated loss of BND(50,000) from Contract 3 can only be permitted to be set-off against the estimated profit of BND40,000 from Contract 2 and the excess of BND(10,000) is disregarded for the year of assessment 2018 and subsequent years of assessment until Contract 3 is completed and the actual loss can be determined.

## 8.0 REVISION OF ESTIMATES AND TAX COMPUTATION

8.1 Original estimates can be permitted to be revised under the following circumstances:

- a) There is a variation in the construction cost in respect of the contract;
  - b) There is a variation in the contract price/amount; or
  - c) Any other commercial reasons as may be approved by the Collector.
- 8.2 The revision affects estimated gross profit, which results one of the following situations:
- a) Estimated gross profit is reduced; or
  - b) Estimated gross profit becomes estimated loss.
- 8.3 If the circumstances of revision are justified as in paragraph 8.1, construction contractor is not allowed to make revision to the prior years' assessments. However, revised estimates can be applied to the current and following years of assessment. This means, the new or changed circumstances can be used as a basis for the assessments of current and following years and will be incorporated to the revised figures for cost and contract price. Since compensating adjustments will be done in the final year of contract when final figures are ascertained, earlier years' assessments based on the original estimates should not be re-opened.
- i) Revision of estimates (progress billings per year)

Example 15

ZA Construction Sdn Bhd began a construction contract in 2017. The company made a revision in the year 2018 to the original estimates of the contract for the year ended 31.12.2017. The company justified the revision was due to material costs have increased. The following particulars are provided by the company:

	<b>Original Estimates (BND)</b>	<b>Revised Estimated (BND)</b>
	<b>2017</b>	<b>2018</b>
Contract price	16,000,000	16,000,000
Estimated contract costs	10,000,000	12,000,000
<b>Estimated gross profit</b>	6,000,000	4,000,000
Amount receivable in		
Year 2017	6,000,000	6,000,000
Year 2018	4,000,000	4,000,000
Year 2019	4,000,000	4,000,000
Year 2020	2,000,000	2,000,000

The company applied the formula in paragraph 5.5 to determine the estimated gross profit for each year:

<b>Year</b>	<b>Original estimate BND</b>	<b>Revised estimate BND</b>
2017	2,250,000	1,500,000
2018	1,500,000	1,000,000
2019	1,500,000	1,000,000
2020	750,000	500,000
<b>Total</b>	<b>6,000,000</b>	<b>4,000,000</b>

Since the revision is made in 2018, the revised estimates will be taken into the computation with effect from YA 2019. The original estimate in respect of year ended 31.12.2017 amounting to BND2,250,000 is not to be adjusted. Thus the contractor would have been subject to tax on a total gross profit as follows:

<b>Year of Assessment</b>	<b>BND</b>
2018	2,250,000 (original estimate)
2019	1,000,000
2020	1,000,000
2021	500,000
<b>Total</b>	<b>4,750,000</b>

The company have to make adjustments in the final year of the contract when the actual figures and profit are known.

ii) Revision of estimates (cumulative progress billings)

#### Example 16

Same fact as in Example 15 except that ZA Construction Sdn Bhd chooses to use cumulative progress billings as follows:

<b>Year of Assessment</b>	<b>Cumulative progress billings</b>	<b>Cumulative profit</b>
2018	6,000,000	$6,000,000/16,000,000 \times 6,000,000 = 2,250,000$
2019	10,000,000	$10,000,000/16,000,000 \times 4,000,000 = 2,500,000$
2020	14,000,000	$14,000,000/16,000,000 \times 4,000,000 = 3,500,000$
2021	16,000,000	$16,000,000/16,000,000 \times 4,000,000 = 4,000,000$

Therefore, the company would be subject to tax for each year of assessment on the respective year profit as follows:

<b>Year of Assessment</b>	<b>Cumulative profit to date</b>	<b>Less</b>	<b>Cumulative profit up to previous year of assessment</b>	<b>=</b>	<b>Current year profit BND</b>
2017	2,250,000	-	0	=	2,250,000
2018	2,500,000	-	2,250,000	=	250,000
2019	3,500,000	-	2,500,000	=	1,000,000
2020	4,000,000	-	3,500,000	=	500,000
<b>Total</b>					<b>4,000,000</b>

## 9.0 COMPLETION OF CONTRACT

### 9.1 Date of completion of a contract

9.1.1 A contract is deemed completed on:

- a) the date on which the Certificate of Practical Completion (CPC) (or any other certification which has a similar effect) is issued; or
- b) the date on which the contract work is substantially completed in the case where no such certificate is issued.



9.1.2 In the case of the construction contractor and the client are not dealing at arm's length, any uncommon delay in the date of physical completion has to be ascertained according to the facts of each case. Factors such as acceptance of the contract work by the client, actual occupancy by the client or the issuance of certificate by the supervising architect or consulting engineer can be taken into consideration which may signify that the contract is "completed". It is crucial that for a company to establish a consistent policy in determining the date on which a contract is completed.

## 9.2 Actual gross profit or loss

The final figures of contract may become available and the actual gross profit or loss for the contract can be determined when a contract is completed. Final account for the contract should be prepared to determine its actual gross profit or loss.

When a contract is completed, the situations mentioned below may surface:

- a) Actual gross profit of the contract exceeds the total estimated gross profit (as determined according to the formula in paragraph 5.5 or 5.7 above) which have been taxed;
- b) Actual gross profit of the contract is less than the total estimated gross profit (as determined according to the formula in paragraph 5.5 or 5.7 above) which have been taxed; or
- c) there is an actual loss for the contract.

## 9.3 Tax treatment

When a construction contractor has applied the formula in paragraph 5.5 or 5.7 above consistently to calculate the estimated gross profit throughout the period of a contract and as a consequence, the estimated gross profit should be spread fairly for the applicable period, the methods of tax treatment mentioned below may be used:

### 9.3.1 Actual gross profit more than estimated gross profit

If the actual gross profit from the contract is greater than the total estimated gross profit which has been taxed, the remainder shall be regarded as gross profit the final basis period.

### Example 17

	<b>BND'000</b>	<b>BND'000</b>
Actual gross profit from the contract		3,200
Less:		
Estimated gross profit for year 1	1,000	
Estimated gross profit for year 2	1,200	
Estimated gross profit for year 3	800	3,000
<b>Excess gross profit from the contract</b>		<b>200</b>

The remaining gross profit of BND200,000 is regarded as the additional gross profit for the final year. Prior years' assessments would not be reopened or reviewed.

#### 9.3.2 Actual gross profit less than estimated gross profit and contract with actual loss

In the event that the actual gross profit of a contract is less than its estimated gross profit or there is an actual loss from the contract, then the difference or the actual loss is to be recognised in the final year.

## 10.0 TREATMENT OF UNSOLD PROPERTY

In a case of property development, the remaining unsold properties are regarded as stock in trade. In the event of subsequent sale or disposal of the property, any profit made is subject to income tax. The cost of the property should be its cost at the date of its acquisition.

### Example 18

BC Development Sdn Bhd, a property developer, completed a project of 20 units of houses in 2020. The cost of building of each house is BND85,000 and the company managed to sell 15 units at selling price of BND100,000 per unit. The profit of BC Development Sdn Bhd from this activity which is subject to income tax in the year of assessment 2021 is calculated below:

<b>Year of Assessment 2021</b>	
Selling Price	BND 100,000 X 15 units = BND 1,500,000
Cost	BND 85,000 X 15 units = BND 1,275,000
Gross profit from property development business	<b>BND 225,000</b>
<i>Cost of unsold property</i>	<i>BND 85,000 X 5 units = BND 425,000</i>

In the event that the remaining units of unsold property are sold to a buyer in the future, the company may sell those at its fair value during the corresponding period however, the cost of those units will remain the same.

#### Example 19

In 2025, BC Development Sdn Bhd managed to sell the remaining 5 units to a buyer with a selling price of BND140,000 per unit. The profit which is subject to income tax from this activity in the year of assessment 2026 is computed below:

<b>Year of Assessment 2026</b>	
Selling Price	BND 140,000 X 5 units = BND 700,000
Cost	BND 85,000 X 5 units = BND 425,000
<b>Gross profit from property development business</b>	<b>BND 275,000</b>

## 11.0 OUTGOINGS AND EXPENSES OF CONSTRUCTION CONTRACTORS/ PROPERTY DEVELOPERS

### 11.1 Income under Section 11 of the ITA

For the purpose of ascertaining the income under Section 11 of the ITA of the business of a construction contractor and 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 the particular period as permitted by the ITA would be allowed as deductions from the income. However, adjustments have to be made in

the income tax or the computations for each year of assessment for outgoings for outgoings and expenses prohibited under section 12 of the ITA.

11.2 Expenses in paragraph 11.1 above means all expenses which are deductible under Section 11 of the ITA including any expenses such as tender fees for second and subsequent contracts in respect of a construction contract which are incurred after the commencement of the construction contract business of the contractor.

11.3 In the course of preparing accounts, the construction contractor has to differentiate direct expenses which are part of the construction expenditure from the expenses which are daily expenditure of the construction contractor business and debited to the Profit and Loss Account.

#### 11.4 Construction Cost

11.4.1 Construction cost includes all expenses which are directly attributable to construction contract activities or that can be reasonably allocated to such activities.

11.4.2 Costs such as land survey fees, soil investigation fee, site overhead expenses, design and technical fees, cost of construction materials etc. which are considered as direct expenses and attributable to the contract should be capitalized in the Construction Expenditure Account. If there are two or more contracts performed simultaneously, such construction expenditure must be shown separately.

11.4.3 Expenses incurred at construction sites such as costs of scaffolding and netting are expenses allowable on replacement basis. Cost of hoarding which are made of durable material, e.g. aluminium, are allowable on replacement basis while the non-durable ones such as wooden hoarding are allowed as revenue expense. Costs of temporary quarters for construction workers which are taken apart after completion of contract are allowed as revenue expenses. Cost of cabins used as quarters are not deductible.

11.4.4 Construction cost includes interest paid or payable on loans taken by the construction contractor to finance the works carried out in relation to the construction contract.

11.4.5 A construction contractor is required to make the necessary adjustments for outgoings or expenses which are reflected in the Construction Expenditure Account. Where costs for other contracts have been included in the Construction Expenditure Account, the costs have to be taken out so as to arrive at the allowable Construction Expenditure to be carried forward to the following years of assessment. This is to ensure that upon completion of a contract, only the final year's accounts need to be adjusted.

## 11.5 Fees paid for soliciting contracts

11.5.1 A construction contractor may make payment of fees to certain parties for soliciting or securing contracts. Such payments may be termed as kick-back, commission, management fee etc. The terms of agreement may provide, amongst 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 contract, during the contract period and/or after completion of contract; or
- c) payments to be made in a lump sum or in instalments or a combination of both.

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

## 11.6 Retention sum

11.6.1 Retention sum is the amount of progress billings which are not paid until the conditions specified in the contract for the payment of such amounts have been met or until defects have been rectified.

- 11.6.2 In a construction contract, it generally specifies that a contractor to deliver progress billings from time to time to customer as work on such contract progresses. In addition, the contract also explains that the contractor is to be paid, typically after the relevant part of the work has been satisfactorily completed, as certified by the client, the client's architect or engineer.
- 11.6.3 It is also stipulated in the contract that the client has to withhold a percentage from the payment of each progress billings dependent upon satisfactory completion of the entire contract. The normal period of withholding or retention money/sum is a period of 6 months after the contract is completed. The construction contractor will not be paid with the retention money until the conditions for the payment of the money or sum as stated in the contract are fulfilled.
- 11.6.4 The amount of the progress billings, which also consists of the retention money and become receivable, has to be taken into account in the income of the contractor at the date such progress billings are issued for income tax purpose.

## 11.7 Liquidated Damages

- 11.7.1 A construction contractor is required to complete and deliver the completed construction work to the client within the time frame specified in the contract agreement. Should the construction contractor unable to deliver the completed work within the time frame, such contractor is liable to pay or allow the client a sum calculated at a rate as stated in the contract agreement as liquidated damages for the period during which the relevant works remain incomplete. The client may deduct such amount from any money due to the contractor.
- 11.7.2 For income tax purposes, the provision for liquidated damages is not an allowable expense under section 11 of the ITA. The liability only arises when payment becomes a fact. The liability is incurred as and when the actual amount of liquidated damages is ascertained and agreed by the contractor and his clients. Liquidated damages receivable from subcontractors on late completion, less the amount of liquidated damages payable to clients for late delivery (if any) should be recognized on accrual basis.

11.7.3 In the event that the contractor does not pay the liquidated damages due to the clients, then construction contractor shall reverse the expense in the relevant accounts.

## 11.8 Warranty or defects liability expenses

11.8.1 Where the term in a construction contract agreement include a defects liability period, the contractor has to undertake to repair or make good at his own cost and expense any defects or faults in the work performed which become evident within the defects liability period stated in the agreement.

11.8.2 Defects liability expenses incurred by a construction contractor are allowed as deduction according to the method described below.

### 11.8.3 Sufficient income from the contract

Where there is sufficient income from the contract, expenses on defects liability shall be allowed as a deduction against the gross profit from the contract for the basis period or the following basis periods.

#### Example 20

DE Construction Sdn Bhd has a year end of 31 December every year. The company engaged in a contract which was completed on 30.06.2017. The company incurred expenses on defects liability amounting to BND4,000 on 30.09.2017. The following is the income tax computation:

Gross Profit from Contract 1	16,000
Less: defects liability expenses incurred	4,000
	<b>12,000</b>

### 11.8.4 Insufficient or no profit from the contract

Where there is insufficient or no gross profit from that contract for that basis period or following basis periods, expenses on defects liability which cannot be deducted in full or in part will be allowed as a deduction against the aggregate gross profit from the other contracts for that basis period or any following basis periods.

### Example 21

FG Construction Sdn Bhd with a year ends 31 December has a few contracts running simultaneously. Contract 2 began in December 2017 and was completed on 31.01.2019. Company incurred expenses on defects liability of BND8,000 for Contract 2 on 31.03.2019. Its income tax computation would be:

<b>Year of Assessment 2020</b>	<b>BND</b>
Gross profit from Contract 2	6,000
Less: defect liability expenses incurred	8,000
Loss from Contract 2	(2,000)
Add: Aggregate gross profit from other contracts	10,000
<b>Gross profit from the construction contract business</b>	<b>8,000</b>

- 11.8.5 In the event that the aggregate of gross profit from other contracts is not sufficient to absorb the losses as explained in paragraph 11.8.4 above, the expenses on defects liability can be deducted against other sources of income of the contractor.

### Example 22

Same facts as in Example 21 except that the aggregate gross profit from the other contracts is BND1,000 for 2019. Its income tax computation would be:

<b>Year of Assessment 2020</b>	<b>BND</b>
Gross profit from Contract 2	6,000
Less: defect liability expenses incurred	8,000
Loss from Contract 2	(2,000)
Add: Aggregate gross profit from other contracts	1,000
<b>Gross profit from the construction contract business</b>	<b>(1,000)</b>

This gross loss of BND1,000 can be deducted against other sources of income of FG Construction Sdn Bhd.



## 11.9 Guarantee fee

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

## 11.10 General administrative expenses

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

11.10.2 General administrative expenses such as audit fees and bank charges are allowable against the income of the construction contract business under subsection 11(1)(g) of the ITA if the business has begun.

## 12.0 OTHER ISSUES RELATED TO CONSTRUCTION CONTRACTORS

12.1 Contractors who subcontract their work to non-resident contractors are required to comply with section 9 of the ITA.

## 13.0 INFORMATION REQUIRED FOR AUDIT

13.1 Information which should be available (for scrutiny or examination for audit purposes) when preparing accounts and returns of construction contractors should include:

- a) appropriate lists of all the contracts carried out;
- b) the type of contract (example - fixed price or cost plus), and value of each contract clearly ascertained;
- c) the expected duration for the completion of each contract carefully determined;
- d) the estimated cost of each contract carefully ascertained; and
- e) the progress billings received and receivable for each contract distinguishable and clearly ascertained.

## 14.0 EFFECTIVE DATE

- 14.1 This Ruling is effective for the year of assessment 2018 and subsequent years of assessment.