



**REVENUE DIVISION
MINISTRY OF FINANCE
BRUNEI DARUSSALAM**

INCOME TAX PUBLIC RULING

**DEDUCTIBLE AND
NON-DEDUCTIBLE EXPENSES
UNDER SECTIONS 11 AND 12 OF
THE INCOME TAX ACT**

**PR NO. 02/2017
EFFECTIVE DATE: 1 MARCH 2017**

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1.0 OBJECTIVE

The objective of this Public Ruling (PR) is to explain:-

- (a) The tax treatment of business expense as a deduction against gross revenue of a business; and
- (b) Steps to determine the amount of the business expense allowable as a deduction.

2.0 RELEVANT PROVISIONS OF THE LAW

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of the Income Tax Act 1949 (ITA), Chapter 35 related to this PR are Section 11 and Section 12.

3.0 INTERPRETATION

The words used in this PR have the following interpretation:

- 3.1 "Employee", in relation to an employment, means:
 - a) The servant, where the relationship of master and servant subsists;
 - b) Where the relationship of master and servant does not subsist, the holder of the appointment or office which constitutes the employment.
- 3.2 "Employment" means:
 - a) Employment in which the relationship of master and servant subsists;
 - b) Any appointment or office, whether public or not and whether or not that relationship subsists, for which remuneration is payable.

4.0 APPLICATION OF THE LAW

4.1 Deduction Allowed (Section 11)

ITA prescribes the method of ascertainment of income in its Part IV. Accordingly, for the purpose of ascertaining the income of any period from any source chargeable with tax, there shall be deducted all outgoings and expenses which are **WHOLLY AND EXCLUSIVELY incurred in the production of income.**

The words “wholly and exclusively incurred in the production of income” have not been defined in the legislation, but judicial decisions elsewhere have laid down the scope and parameters of the words with the object of allowing expenditure which is not of a personal nature and was incurred wholly and exclusively in the production of income.

The word “wholly” refers to the quantum of expenditure while the word “exclusively” within its ambit includes:

- motive;
- objective; and
- purpose of the expenditure.

The words “wholly and exclusively” having been interjected by the word “and” give ample demonstration to the intention of the legislation that the expenditure must not be for any purpose other than that of business.

Burden of Proof

Burden to prove is on the taxpayer, whether a particular expenditure has been laid out wholly and exclusively in the production of income, in order to claim for a deduction. Therefore, the onus is on the taxpayer that the expenditure is not in the nature of a capital expenditure.

If the taxpayer fails to place sufficient material on record, the Collector of Income Tax (CIT) would be justified in holding that the expenditure is not of revenue nature. Where CIT is in doubt of its nature, it is the duty of the taxpayer to prove by leading evidence that the expenditure was, in fact, incurred and was consequently allowable as a business deduction.

4.2 Deduction Not Allowed (Section 12)

Section 12 is the negative compliment of Section 11 which reads: “... for the purpose of ascertaining the income of any person no deduction shall be allowed...” .

Section 11 provides positively what may be deductible and Section 12 provides negatively what may not be deductible.

Section 12 specifically disallows deductions in respect of the following:

- a) Domestic or private expenses;
- b) Any disbursements or expenses not being money wholly and exclusively laid out or expended for the purpose of acquiring the income;
- c) Any capital withdrawn or any sum employed or intended to be employed as capital;
- d) Any capital employed in improvements, other than improvements effected in the replanting of a plantation;
- e) Any sum recoverable under an insurance or contract of indemnity;
- f) Rent or cost of repairs to any premises or premises not paid or incurred for the purpose of producing the income;
- g) Any amount paid or payable in respect of United Kingdom income tax or surtax, or Commonwealth income tax as defined by Section 40, or in respect of any excess profits tax or profits tax charged in any part of the Commonwealth;
- h) Any payment to any provident, savings, widows' and orphans' or other society or fund, except such payments as are allowed under Section 11(e) and (f).

5.0 PRINCIPLES IN DETERMINING THE ALLOWABLE EXPENSES

In determining whether an expenses can be allowed as deduction and the amount to be allowed as deduction, the expenses have to be adhered to the provision under section 11 and not defined under section 12.

5.1 Bad Debts [Section 11(d)]

This related to the bad debts incurred in any trade, business, profession or vocation which have become bad during period for which income is being ascertained.

5.1.1 Deductible Bad Debt

Trade debts written off as bad are generally allowable as a deduction for the basis period for a year of assessment (YOA).

To qualify for deduction for tax purposes, the decision should be based upon valid commercial considerations and there should be sufficient evidence of reasonable steps taken for recovery, including the following:

- a. Issuing reminder notices;
- b. Rescheduling of debt settlement;
- c. Negotiation or arbitration of a disputed debt; and

- d. Legal action (filing of civil suit, obtaining of judgment from the court and execution of the judgment).

The steps that should be taken depend on the size of the debt and/or the anticipated cost effectiveness of each action. If a decision is made not to take any further action to pursue a debt, the reasons should be documented.

Example 1

Syarikat E Sdn Bhd, a wholesaler, supplied goods worth a total of BND10,000 on various dates in 2015 to F Mini Mart. Various payments totaling BND6,500 were received and the outstanding balance as at 30th June 2015 was BND3,500.

a) For the period from 30th June 2015 to 30th June 2016, there were monthly follow up made by the company by issuing monthly reminder, and subsequently legal action had been taken against the customer. It was later discovered that the mini mart had closed down on 30th June 2016 and the debtor could not be contacted. As Syarikat E was unable to trace the debtor despite visits to his last known business and residential addresses, the company decided to write off this debt in the Profit & Loss account for the year ended 31st December 2016.

A deduction can be allowed for the bad debt of BND3,500 as the debt has arisen from transactions that have been included in the gross revenue and all reasonable steps have been taken to recover the debt.

b) For the period from 30th June 2015 to 30th June 2016, there were no action taken by the company ever since the last payment received from F Mini Mart. It was later discovered that the mini mart had closed down on 30th June 2016 and the debtor could not be contacted. The company decided to write off this debt in the Profit & Loss account for the year ended 31st December 2016.

The bad debt of BND3,500 cannot be allowed as a deductible expense as the company did not take any reasonable steps to recover the debt.

Circumstances when a debt can be considered as bad

After reasonable steps for recovery have been taken, a debt can be considered as bad on the occurrence of any one of the following:

- a. The debtor has died without leaving any assets from which the debt can be recovered;
- b. The debtor is bankrupt or in liquidation and there is no asset from which the debt can be recovered;
- c. The debtor cannot be traced despite various attempts and there are no known assets from which the debt can be recovered; or
- d. Any other circumstances where there is no likelihood of cost effective recovery.

5.1.2 Non-deductible Bad debt

Non-trade/business related debts that are written off as bad, or provisions made in respect of non-trade debts that are doubtful, are non-deductible. Similarly, recoveries relating to non-trade debts written off earlier are not taxable. Suitable adjustments should be made in the tax computation if such amounts are included in the Profit & Loss account.

Example 2

Syarikat G Sdn Bhd takes over the retail business of an existing partnership. Among the assets taken over are trade debts amounting to BND30,000. During its first 2 years of operation, the company manages to collect all the debts that had been taken over from the partnership, except for a debt of BND5,000 as the debtor cannot be traced. The company decides to write off this debt in the Profit & Loss account for the second year.

Although the debt was originally a trade debt in the accounts of the partnership, the amount constitutes a non-trade debt of the company (arising from taking over of the assets of the partnership and not from a transaction included as gross income of the company). Therefore, the amount of BND5,000 written off as a bad debt cannot be allowed as a deduction. Conversely, the recoveries amounting to BND25,000 should not be regarded as taxable.

5.2 Director's remuneration

Directors' Remuneration means payment received for services or employment, which includes base salary, any bonuses and any other economic benefits that an employee or executive receives during employment.

All payments which relate directly to services rendered by the employee and which are in accord with the service agreement are deductible. However, this is still subject to the satisfaction of the collector that the quantum of total director remuneration package (including salary, bonus, fees and any other benefits-in-kind) must be realistic, reasonable and in line with commercial standards.

In the event that the remuneration paid is not commensurate with the services rendered by the directors, Revenue Division will disallow the expenditure to the company. The principle that expenditure will only be allowed if it is "wholly and exclusively incurred in the production of income".

5.3 Entertainment Expenses

Entertainment includes the provision of food, drink, accommodation, travel, recreation or hospitality of any kind for the purpose of facilitating entertainment in promoting or in connection with a trade or business carried on by that person. The expenses must be incurred in respect of sales provided to customers, dealers and distributors but excluding suppliers and employees.

Example 3

A travel agent company held a farewell lunch in their office for Miss Rina, a dedicated employee who is leaving the company in one month time. The company decides to claim this party as an expense in the profit and loss account at the end of the financial period.

The expense incurred on the farewell party is regarded as a miscellaneous/entertainment expense. However, no deduction is allowed because it is not wholly and exclusively incurred in the production of income. Therefore, the expense needs to be added back to its net profit in the tax computation.

Example 4

In conjunction with the company's first anniversary, Izzudin Sdn Bhd held annual dinner for its employees and its existing customers which costs BND 30,000. One-third of the attendees were the existing customers.

Since one-third of the attendees were existing customers, the company can only claim for total amount BND 10,000. No deduction is allowed for its employees because it is not wholly and exclusively in the production of income.

5.3.1 Promotional expenses

Promotional gifts must be company's own product. If not company's product, it should be for existing customer, not potential customer. However, if the promotional gifts are given to both existing and potential customers, the expense should be apportioned accordingly.

Example 5

In conjunction with the company's fifth anniversary, Max Sdn Bhd which is a telecommunication company organized a one day carnival which was opened to the public. During the carnival, there were singing contest held, 50 booths set up for vendors to sell their products and lucky draws for customers who made purchases during the day. The cash prizes of the singing contest amounting to B\$5,000. Lucky draw prizes include prepaid telephone cards and promotional gifts which were affixed with the company's logo. Max Sdn Bhd claimed advertising and promotional expenses amounting B\$50,000.00 which includes the cash prizes.

The expenditure on free sample of the company's own product and promotional gifts with company's logo are fully allowable. However, as this promotion includes existing and potential customers, the cost should be apportioned accordingly. On the other hand, the cash prizes of B\$5,000 is not allowable as this is not wholly and exclusively incurred in the production of income.

5.3.2 Sponsorship

Sponsorship refers to the support given by businesses or members of public. It is either financial or in terms of goods and services, often as a form of

advertising or charity. Public interest event includes any form of events made by businesses which would benefit the general public. Sponsorship is tax deductible if it is sponsorship relates to

- i. National events which includes National Day, HM's birthday, Royal weddings, Maulud Nabi and Nuzul Al – Quran; and
- ii. Public interest events such as Bandarku Ceria, The Run, Larian Amal, Ekspedisi Berbasikal, Royal Brunei Air force Obstacle Challenge, etc.

Example 6

IOU Motors Sdn Bhd carries on a business of selling motor vehicles. As part of corporate social responsibility, IOU Motors held a charity golf tournament in which the proceeds will be donated to Pusat Ehsan Al-Ameerah Al-Hajjah Maryam.

The company incurred B\$1,000 for radio advertisement on the golf tournament and B\$50,000 for venue and other related expenses. The grand prize of the tournament is a semi-detached house costs \$150,000 located in Brunei-Muara district and other prizes which cost another \$50,000.00. The total costs for this event amounted to \$251,000. The company successfully donated \$10,000 to Pusat Ehsan.

The donation expense paid to Pusat Ehsan amounting B\$10,000 is allowed as deduction since it is one of the approved IPC. However, the related expenses to the charity amounting \$251,000 are not allowable as this tournament is not of public interest as it was only participated by certain members of the public.

- 5.3.3 Advertising expenses directly related to the production of income are allowable such as product or service advertisement, job vacancy, etc. However, advertisement in the form of condolences and congratulatory messages in newspapers or mass media is only allowable for the existing customers. Whereas, congratulatory messages for its employees and potential customers associated with advertising the company are not allowable as deduction.

Example 7

ABC Sdn Bhd spent advertising cost of \$10,000 to advertise its congratulatory messages for its employee, Awg Muhammad and also its existing customer,

Awg Sabtu, on award of honorary titles and also to promote the company's name with its expertise in civil engineering. The logo and the company's name along with the services provided were printed in the local newspaper.

As the newspaper advertisement incorporate the logo, name of the company and type of services, this showed the company's intention to promote the company's services in addition to convey its congratulatory message. However, this advertising expense is only allowable for existing customers and not for its employees. Hence, company is to apportion its expense accordingly.

5.4 Rental expenses

Rental of premises or hire of motor vehicles, plant and machinery are normally tax deductible, provided that the rental charges stipulated in the stamped lease or tenancy agreement is based on market rate or fair value.

Example 8

ABC Sdn Bhd planned to rent a van from a shareholder for transporting the goods from warehouse to the shop. The company had researched and found out that if it were to rent the same van from a car rental company, it would cost \$250 per month. The company and the shareholder signed an agreement to rent the vehicle for 3 years with a rental of \$230 per month. Since the rental has an agreement (legal binding), rented at a reasonable rate and with the purpose to produce income, it is tax deductible.

Example 9

ABC Sdn Bhd entered into an agreement between the company and a shareholder to rent a premise owned by the shareholder to the company for 5 years. However, the tenancy agreement was not stamped (not legalised). The company cannot claim for the rental expenses as it was not legalised.

Example 10

ABC Sdn Bhd entered into an agreement between the company and a shareholder to rent a premise owned by the shareholder to the company for 5 years. However, the tenancy agreement stamped was between the director (tenant) and the shareholder (landlord). The company cannot claim for the rental expenses as the tenancy agreement legally does not involve the company.

5.5 Accrued expenses

An accrued expense refers to any expense incurred and reported during an accounting period, but for which payment has not yet been made.

Example 11

ABC Sdn Bhd has the basis period from 1st January to 31st December. For year of assessment (YOA) 2017, the basis period would be from 1st January 2016 to 31st December 2016. Miss Lim, the accountant, includes accrued telephone expense for the month of December 2016 in the profit & loss account in YOA 2017 of ABC Sdn Bhd.

Since this is for YOA 2017 tax assessment, the company can claim telephone expenses as deduction since the transaction is wholly and exclusively in the production of income for the year of assessment.

6.0 PRINCIPLES IN DETERMINING THE NON-DEDUCTIBLE EXPENSES

Non-deductible expenses under Section 12

Those expenses not qualified for deduction under Section 11 but may fall within the provisions of Section 12.

6.1 Private expense

Any expense incurred which is for personal use and not related to the running of business is disallowed for tax purpose.

Example 12

THR Sdn Bhd, a retail company, purchased vacation package to Belalong, Temburong for its full-time employees and their immediate family members in 2016. The package includes accommodation, transportation, food and drinks and other activities totaling B\$25,000. The company claims these expenses in its profit & loss account for the year ended 31 December 2016.

The purpose of travelling is not wholly and exclusively in the production of income, therefore, B\$25,000 claimed is not allowed as deduction.

Example 13

Azim, the director of THR Sdn Bhd, subscribes Kristal Astro and E-speed with annual charges of B\$10,000 under the company's name for residential use. The company claims the expenses as deduction in its profit & loss account.

The purpose of subscription is for private and domestic use, hence, B\$10,000 is not allowed as deduction.

Example 14

THR Sdn Bhd tenders plate license number for one of its company vehicles. The cost of the tender is \$8,000. The company claims this under motor vehicle expense in its profit & loss account.

The tender is not necessary to incur in the production of income. Hence, the expense is not deductible.

Example 15

DSR Sdn Bhd is engaged as a dealer in electrical goods. As a way to motivate and boost the sales of the business, the company subscribes for Golf & Country Club membership for its employees. The company pays the annual subscription fee of B\$25,000.00.

The purpose of the subscription is not for generating business income, therefore, B\$25,000 cannot be claimed as a deduction.

6.2 Provision for doubtful debts

A provision made at the end of the accounting period for the amount of trade debt that is believe to be doubtful of being recovered is not allowable for tax purposes, because the amount that is reasonably determined to be irrecoverable is based on estimates and has a possibility of recovery in the future.

Example 16

ABC Sdn Bhd, a distributor, supplied goods in credit worth a total of BND50,000 to D Supermarket in 2010. A debt of BND3,500 was written off as bad, as the debtor cannot be traced and legal actions were taken to recover the debt. In 2016, ABC Sdn Bhd supplies goods again in credit totaling BND40,000 to D Supermarket, which was taken over by a different sole proprietor. Due to the debtor's history of bad debts, the

company decides to make a provision for the amount of debt that is not expected to be recovered in its profit & loss account for the year ended 31.12.2016.

The provision of doubtful debt **cannot** be allowed as deductible expense as there is uncertainty in the amount estimated, which may become recoverable in the future.

6.3 Expenses not incurred under company's name

Expenses which are not incurred under company's name is allowable unless it can be proven that the expenses are wholly and exclusively incurred in the production of income.

Example 17

ABC Sdn Bhd is a newly set up wholesale company and do not have any motor vehicles for transporting the goods from warehouse to the shop. During the year 2016, the staff use their private motor vehicles for delivery of goods to customer (business purpose).

The expenses related to motor vehicles can only tax deductible if the private cars have been proven to be wholly and exclusively used for the business purpose.

Example 18

ABC Sdn Bhd is a retail company and own three motor vehicles for transporting the frozen food from warehouse to the shop. In order to claim the expenses in relation to motor vehicles as tax deductible, the company need to prove that the claim expenses for such motor vehicle were not for private use but wholly and exclusively used for the purpose to produce income.

6.4 Expenses not incurred during the year of assessment

Expenses which are incurred wholly and exclusively in the production of income, however, not in the relevant basis year. (e.g. Prepaid expenses, pre-operating expenses)

Example

ABC Sdn Bhd was incorporated on 01st October 2014 and commence the business activities on 1st January 2015 so the company has the basis period from 1st January

to 31st December. For year of assessment (YOA) 2016, the basis period would be from 1st January 2015 to 31st December 2015.

Example 19 (pre-operating expenses)

ABC Sdn Bhd had rented a business premise starting from 1st October 2014. The rental expenses for the period from 1st October 2014 to 31st December 2014 is not qualified for business deduction as the said expenditure was incurred prior to the production of income period.

Example 20 (prepaid expenses)

Miss Lim, the accountant, includes prepaid rental expense for the month of January 2016 in the profit & loss account in YOA 2016 of ABC Sdn Bhd.

Since this is not for YOA 2017 tax assessment, the company cannot claim for the January 2016's rental as an allowable expense for this YOA. This should be claimed in YOA 2018.

6.5 Expenses related to rented property, plant and equipment

The expenses related to rented property, plant and equipment is only allowable if it has been proven that the expenditure were wholly and exclusively incurred in the production of income

6.5.1 Expenses related to rented property or office premises

Example 21

ABC Sdn Bhd had rented a business premise for the period from 1st January 2014 to 31st December 2014. The business premise owned by director and during the year, the company paid the land building tax, insurances, repair and maintenance expenses incidental to the rented premises.

Such expenses can only be allowed as deduction if it has been provide that the expenses were wholly and exclusively incurred in the production of income. The expenditure is to be apportioned accordingly if the expenses is for both private and business purpose.

6.5.2 Expenses related to rented motor vehicles and plant machinery

Example 22

In the rental agreement for the ABC Sdn Bhd to use a forklift (machinery/equipment), it was stated that the ABC Sdn Bhd will bear the costs related to the forklift, which includes the repair and maintenance, and insurance for the period of rental. The costs related to the forklift are tax deductible provided that the expenditure is wholly and exclusively in the production of income.

7.0 DONATION

Donations are non-deductible expenses as they are not incurred in the production of income. However, company can claim tax deduction for donations made to charitable bodies that are recognised by Revenue Division as Approved Institutions of Public Character [Section 31(2)(c)].

The present list of institution of a public character in Brunei Darussalam approved by His Majesty in Council are as follows:

1. Boys Scout Association
2. Brunei Youth Council
3. Girl Guides Association
4. Junior Chamber International
5. Red Crescent International
6. Women's Association, Brunei
7. Dana Pengiran Muda Mahkota Al-Muhtadee Billah untuk Anak-Anak Yatim (as of 25 August 1998)
8. Pusat Ehsan Al-Ameerah Al-Hajjah Maryam (as of 28 January 2008)
9. Hospitals not operated for profit
10. Educational Institutions not operated for profit
11. A public fund established and maintained for relief of distress among members of the public.

An amount of donations & gifts shall not exceed one-sixth of the net statutory income remaining after deductions to the above institutions, is allowed for a deduction for income tax purposes.

8.0 WITHHOLDING TAX

Withholding tax is the collection of tax on income of a non-resident derived from Brunei Darussalam. Any interest, commission, fee, royalties, rent, remuneration, or other payment made to a non-resident which is derived from Brunei Darussalam is subjected to a withholding tax. The payer has to deduct at a stipulated rate from the payment made to a non-resident and remit the tax to the Revenue Department within 14 days after the payment made to the non-resident.

The law requires any person who makes payment of a specified nature to a non-resident to withhold tax at a rate prescribed as percentage of that payment and pay the amount withheld 14 days to the Collector of Income Tax.

Example 23

ABC Sdn Bhd has entered into a rental agreement of moveable properties with XYZ Pte Ltd, a non-resident company based in Singapore. The annual rental amounts to BND 500,000. Rental of movable properties are subject to WHT at 10% which amounts to BND 50,000.

a) Withholding tax is borne by the non-resident

ABC Sdn Bhd should deduct the WHT amount of 10% (BND 50,000) and pay the net amount of BND 450,000 to XYZ Sdn Bhd as follows:

Rental fee	BND 500,000
Less:	
Withholding tax paid to CIT at 10%	(BND 50,000)
Payment due to XYZ Sdn Bhd	<u>BND 450,000</u>

ABC Sdn Bhd will record the expenses for rental of movable properties from XYZ Sdn Bhd in the Profit and Loss Account which is deductible for tax purposes for the Year of Assessment.

b) Withholding tax is not borne by the non-resident

ABC Sdn Bhd is willing to bear and pay the withholding tax cost for XYZ Pte Ltd for the rental agreement out of its own pockets. Therefore, ABC Sdn Bhd claims the additional cost of withholding tax borne in the Profit and Loss account as follows:

Rental fee	BND 500,000
Add:	
Withholding tax paid to CIT at 10%	BND 50,000
Amount of rental expenses claimed in P&L Account	<u>BND 550,000</u>

However, for tax purposes ABC Sdn Bhd is only allowed to claim for the rental expenses fee of BND 500,000. The WHT cost borne by ABC Sdn Bhd of BND 50,000 is not allowed as deduction as it is not incurred wholly and exclusively in the production of income.

9.0 TAX QUERY REPLY NOT SUBMITTED WITHIN STIPULATED TIME

In the event that the taxpayer fails to furnish relevant information or evidences to prove that the transactions were in fact business purpose in nature, then such queried expenses would not be qualify to be claimed as business deduction.

10.0 EFFECTIVE DATE

This ruling is effective from 1 March 2017.