



## **INLAND REVENUE BOARD OF MALAYSIA**

### **CONSTRUCTION CONTRACTS**

**PUBLIC RULING NO. 5/2025**

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#### **DIRECTOR GENERAL'S PUBLIC RULING**

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in Respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

**Director General of Inland Revenue,  
Inland Revenue Board Malaysia.**

## **1. Objective**

The objective of this Public Ruling (PR) is to explain the basis in determining the gross income for the purpose of ascertaining adjusted income derived from the business of construction contracts.

## **2. 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 1967 (ITA) related to this PR are paragraphs 4(a) and 23(a), section 24, subsections 33(1) and 33(2), section 35, subsection 36(1), sections 39 and 91 of the ITA.
- 2.3 The relevant subsidiary law referred to in this PR is the Income Tax (Construction Contracts) Regulations 2007 [*P.U.(A) 276/2007*].

## **3. Interpretation**

The terms used in this PR have the following meaning:

- 3.1 “Construction contracts” means the contracts for the performance of construction services specifically negotiated for the construction of an asset or a combination of assets including mechanical engineering, electrical engineering, public utilities projects, project design and consultancy, architectural designing and infrastructural contracts;
- 3.2 “Construction contractor” means a company, an individual, a partnership, a co-operative society, a body of persons, who or which engages in or carries on or undertakes or causes to be undertaken construction contracts;
- 3.3 “DGIR” refers to the Director General of Inland Revenue Board Malaysia;
- 3.4 “Substantially completed” means ninety-five per cent of the total estimated construction costs have been incurred; and
- 3.5 “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. Date of Commencement of Business**

The date of commencement of a construction contract business is a question of fact. It may be -

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

#### **5. Separate Source of Income for a Construction Contract**

In ascertaining the gross income of a construction contractor from its construction contract business, each contract shall be treated as a separate and distinct source of income of the contractor from the construction contract business, although the construction contract business as a whole still constitutes one source of income for the company.

##### **Example 1**

A Consortium Sdn Bhd with accounting year ending 31 December has the following contracts for the year 2023 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 tower	Factory	Bridge
Estimated gross profit (RM)	2,000,000	4,000,000	10,000,000
Allowable expenses (RM)	9,200,000		

Capital allowance in respect of the business of construction contract is RM250,000.

Tax computation for the business of construction contract for the year of assessment (YA) 2023 is as follows:

Details	RM	
Gross income of contract 1	2,000,000	
Gross income of contract 2	4,000,000	
Gross income of contract 3	10,000,000	16,000,000
Less: Allowable expenses		9,200,000
Adjusted Income		6,800,000
Less: Capital allowance		250,000
<b>Statutory income of the construction contract business</b>		<b>6,550,000</b>

### 5.1 Separate construction contract

Where a contract covers a number of assets, 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 in which the contractor 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 2

Company B Sdn Bhd, a building construction contractor, entered into a contract with a university to construct four blocks of buildings - a library, a hall, an administration block and a lecture theatre. Each of the four buildings meets all the three criteria in this paragraph. Hence each building shall be treated as a separate contract, notwithstanding the fact that the contractor has signed one contract only with the university.

### 5.2 Single construction contract

Where two or more contracts are entered into, either with a client or with several clients, those contracts should be treated 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 3

Company C Sdn Bhd signed a contract individually with 10 owners of vacant bungalow lots located near to one another. The owners got together and negotiated with the contractor for a package deal to construct 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 10 contracts should be combined and accounted for as a single construction contract, notwithstanding the fact that different contracts have been signed with different owners.

### 5.3 Additional contract

A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset should be treated as a separate construction contract when:

- (a) the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
- (b) the price of the asset is negotiated without regard to the original contract price.

### Example 4

Company D Sdn Bhd was awarded a contract in June 2023 to build a new block of classrooms for a school. Work on the new classrooms commenced in July 2023. In August 2023, a decision was made to build a surau for the school and the contract was given to Company D Sdn Bhd. Work on the surau commenced in October 2023. If the contract for the surau fulfilled any of the two criteria described in paragraph 5.3 above, then Company D Sdn Bhd would have undertaken 2 separate contracts.

## 6. Recognition of Income Prior to Completion of Contract

- 6.1 The taxation and recognition of gross income from a construction contract business is determined in accordance with section 24 of the ITA, which provides that the gross income from a business shall be assessed on a receivable basis and subject to *P.U. (A) 276/2007*.

- 6.2 Income from construction contract business shall be recognized, as construction contract activity progresses, by reference to the stage of completion of the construction contract activity at the statement of financial position date.
- 6.3 Under this “Percentage of Completion method” of recognition of income, the contract revenue shall be matched with the construction expenditure incurred for the basis period for the YA in reaching the stage of completion.
- 6.4 Estimated gross profit

The estimated gross profit of a construction contractor for the basis period for the YA in respect of a construction contract shall be an amount ascertained in accordance with the following formula:

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

where

- A = the sum of progress billings received and receivable in that basis period (the figures must reflect the actual position prevailing at the statement of financial position date)
- B = total contract price or amount; and
- C = total estimated gross profit from the contract

### Example 5

Company E Sdn Bhd, a construction contractor closes its accounts on 31 December every year. In March 2021, Company E was awarded a RM8,000,000 contract to construct an office building. Construction commenced on 01.07.2021 and is expected to be completed by 31.12.2023. The estimated gross profit for the whole contract is RM1,200,000. For tax purposes, the company has used the progress billings method to compute its estimated profit for YAs 2021, 2022 and 2023.

Progress payments received and receivable are as follows:



<b>Year</b>	<b>Progress Payments Received and Receivable RM</b>
2021	1,500,000
2022	3,200,000
2023	3,300,000
<b>Total</b>	<b>8,000,000</b>

The estimated profit for each YA is computed as follows:

<b>YA</b>	<b>Estimated Gross Profit RM</b>			
2021	$\frac{1,500,000}{8,000,000}$	X	1,200,000	= 225,000
2022	$\frac{3,200,000}{8,000,000}$	X	1,200,000	= 480,000
2023	$\frac{3,300,000}{8,000,000}$	X	1,200,000	= 495,000
<b>Total</b>				<b>1,200,000</b>

## 6.5 Gross income

The gross income of a construction contractor from each construction contract for the basis period for a YA shall be the estimated gross profit of the construction contractor from each contract for the same basis period.

### Example 6

Referring to **Example 5** above, the gross income of Company E Sdn Bhd is as follows:

<b>YA</b>	<b>Estimated Gross Profit RM</b>	<b>Gross Income RM</b>
2021	225,000	225,000
2022	480,000	480,000
2023	495,000	495,000

## 6.6 Fair and reasonable estimates

In computing the estimated gross profit using the formula in paragraph 6.4 above, the construction contractor shall use fair and reasonable estimates.

6.7 Other formula

The DGIR may allow a construction contractor to use a formula other than the formula provided for in paragraph 6.4 above to determine the estimated gross profit from a construction contract. The formula adopted shall be in accordance with the accounting standards or practice applicable during the basis period that relates to the contract. A frequently used method is the cost method where the stage of completion is measured by the proportion of contract costs incurred to date compared with the estimated total contract costs.

6.8 The construction contractor shall ensure that fair and reasonable estimates for the contract are used when applying other formula as described in paragraph 6.7 above.

6.9 Consistency and fair spread

Where the estimated gross profit of a construction contractor has been ascertained in accordance with the formula as described in paragraphs 6.4 or 6.7 above, the construction contractor shall apply the formula consistently throughout the period of its construction contract. The result shall reflect a fair spread of the estimated gross profit for the relevant basis periods.

**Example 7**

In **Example 5** above, if Company E Sdn Bhd wishes to use some other method (for example - cost method) to compute the estimated gross profit, the DGIR may accept the computation on condition that the same method is being used consistently until the contract is completed. The company is not permitted to use one method for a YA and some other methods for other YAs (for example: cost method for YA 2021 and the formula in paragraph 6.4 above for YAs 2022 and 2023) for the same contract.

6.10 Where the method of accounting used results in a distortion of the true and fair spread of the estimated profits for taxation purposes, the DGIR shall review the assessments for all the relevant years to ensure a fair and reasonable spread of the estimated gross profit over the duration of the contract.

6.11 No progress billings issued

Where a contract provides that no progress billings are to be issued by the contractor for the duration of a contract, the DGIR shall direct that a formula in accordance with the accounting practice and standards be adopted for computation of its estimated gross profits from the contract for taxation purpose.

### **Example 8**

Company F Sdn Bhd was awarded a contract in April 2021 to build a warehouse for Company X. It was agreed that no progress billings are to be issued by Company F and Company X would not make any payments to the Company F until the warehouse was completed and handed over to Company X in August 2022.

For income tax purposes, Company F whose accounting year ends on 31 December each year, is required to compute estimated gross profits for the YAs 2021 and 2022 by adopting any formula as described in paragraph 6.7 above, notwithstanding the agreement stipulated that no progress billings were made to Company X.

6.12 This Ruling explains the income tax treatment to be applied for construction contracts where:

- (a) the contract takes more than one accounting period to complete; 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 9**

G Construction Sdn Bhd with accounts ending on 30 June each year, undertakes a contract to build an overhead bridge. The contract price is RM1,000,000 and the contractor expects a profit of RM180,000 from the contract. Construction work which starts on 01.03.2021 is expected to be completed by 31.10.2021. The company applies the formula as in paragraph 6.4 above to recognize its estimated profits from the contract for YAs 2021 and 2022. The computation is as follows:

<b>YA</b>	<b>Progress Billings RM</b>	<b>Estimated Profit RM</b>
2021	250,000	$\frac{250,000 \times 180,000}{1,000,000} = 45,000$
2022	750,000	$\frac{750,000 \times 180,000}{1,000,000} = 135,000$

6.13 Where a construction contractor prepares an account on a completion of contract method, the construction contractor is required to compute his income tax liability for the YA by using the percentage of completion method to determine and recognize the estimated gross profits annually. Construction contractors are not allowed to defer the recognition of income in the accounts until the construction contract is completed.

6.14 The amount of income recognized is determined by reference to the stage of completion of the contract activity at the end of each accounting period. It is also applicable for contracts which are large and segmented into phases and take more than one accounting period or year to complete. Where the contract is segmented into phases, the percentage of completion basis should be applied to each phase separately.

## 7. Estimated Loss from Uncompleted Contracts

### 7.1 Computation of estimated loss

The estimated loss of a construction contractor for the basis period for a YA in respect of a construction contract shall be ascertained in accordance with the formula provided for in paragraph 6.4 or 6.7 above. In applying the formula, the total estimated gross profit in the formula shall be substituted with total estimated loss from the contract.

#### Example 10

H Sdn Bhd was awarded several contracts which are expected to be completed over 4 years. Contract 2 which will take three years to complete is expected to incur an estimated loss of RM100,000.

Contract 2 is 25% completed in the first year. The estimated loss of Contract 2 for the 1st year is computed as follows:

$$[25\% \times \text{RM } 100,000] = \text{RM } 25,000$$

7.2 Where for a basis period for the YA, a construction contractor anticipates that there would be an estimated loss from one or more of its construction contracts for that basis period, the estimated loss or aggregate of estimated loss from those contracts shall be allowed to be set off against the aggregate of the estimated gross profits from the other construction contracts of the construction contractor 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 for the basis period is less than the aggregate estimated gross profit from other contracts, the excess of estimated gross profit is the gross income from the construction contract business.

#### Example 11

J Construction Sdn Bhd has 4 contracts with the following estimated profit or loss for the year ended 31.12.2022:

Details	Estimated Gross Profit or Loss	RM
Contract 1	Estimated gross profit	200,000
Contract 2	Estimated loss	(100,000)
Contract 3	Estimated loss	(50,000)
Contract 4	Estimated gross profit	300,000

The aggregate estimated loss from contracts 2 and 3 totaling RM150,000 is allowed to be set-off against the aggregate estimated gross profit of RM500,000 from contracts 1 and 4. The balance of RM350,000 (RM500,000 – RM150,000) is the gross income from its construction business for the YA 2022.

### 7.4 Estimated loss more than aggregate estimated gross profit

Where the estimated loss or aggregate estimated loss of the construction contractor from one or more contracts for that basis period exceeds the aggregate estimated gross profit from other contracts, the excess shall be disregarded for the purposes of ascertaining the chargeable income of the construction contractor for that basis period and subsequent basis periods until the contracts are completed and actual losses are ascertained.

#### Example 12

K Construction Sdn Bhd with year ending 31.12.2022 has 3 construction contracts being carried out concurrently in 2022. The estimated gross profit or loss of the 3 contracts for the year 2022 are as follows:

Details	Estimated Gross Profit or Loss	RM
Contract 1	Estimated gross profit	110,000
Contract 2	Estimated loss	(50,000)
Contract 3	Estimated loss	(70,000)

The aggregate estimated loss of K Construction Sdn Bhd from Contract 2 and 3 is RM120,000 which is more than the estimated gross profit from contract 1 by RM10,000. Hence, the gross income for the YA 2022 from the construction contract is “Nil”. The estimated loss of RM10,000 shall be disregarded for the YA 2022 and subsequent YAs until Contracts 2 and 3 are completed and the actual loss is ascertained. The estimated loss of RM10,000 cannot be used to offset against other sources of income of the company.

**7.5 Estimated loss shall not be allowed to be set off against actual gross profit**

Estimated loss or aggregate estimated losses from one or more contracts for a basis period shall not be allowed to be set off against the actual gross profit of other contracts for the purpose of ascertaining the chargeable income of the construction contractor for that basis period.

**Example 13**

Company L Sdn Bhd with year ending 31 December has 3 concurrent contracts in 2022. The actual gross profit from the completed Contract 1 and estimated profit or loss from Contracts 2 and 3 for year ended 31.12.2022 are as follows:

<b>Details</b>	<b>Estimated Gross Profit or Loss</b>	<b>RM</b>
Contract 1	Actual gross profit	50,000
Contract 2	Estimated gross profit	20,000
Contract 3	Estimated loss	(25,000)

The gross income of Company L for the year 2022 from the construction contract business is RM50,000. The estimated loss of RM25,000 from Contract 3 can only be allowed to be set-off against the estimated gross profit of RM20,000 from Contract 2 and the excess estimated loss of RM5,000 is disregarded for the YA 2022 and subsequent YAs until the contract is completed and the actual loss can be ascertained.

**8. Revision of Estimate and Tax Computation**

8.1 In the course of a construction, circumstances may arise where the original estimates of a construction contractor are required to be revised. Revision of estimates can be allowed only 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 or amount; or

- (c) any other commercial reasons as may be approved by the DGIR.
- 8.2 Such circumstances may result in a change in the estimated gross profit, thus giving rise to one of the following situations:
- (a) estimated gross profit is reduced; or
  - (b) estimated gross profit becomes estimated loss; or
  - (c) estimated gross profit is increased.
- 8.3 Where the situations in paragraph 8.2 arise as a result of the circumstances as described in paragraph 8.1, the construction contractor may in a basis period for a YA revise the estimated gross profit in respect of its construction contract for that basis period or the immediately following basis periods by using the revised estimated contract value and construction cost. Prior years' assessments made based on the original estimates shall not be reopened since the adjustments shall be made in the basis period when the contract is completed by using actual sales value and construction cost.

#### **Example 14**

Company M Sdn Bhd commenced a construction contract in 2021. The original estimates for the year ended 31.12.2021 at the commencement of the contract are subsequently revised in the year 2022. The reason for the revision is that material costs have increased. The company provides the following particulars:

<b>Details</b>		<b>Original Estimates</b>	<b>Revised Estimates</b>
		<b>RM</b>	<b>RM</b>
		<b>2021</b>	<b>2022</b>
Contract value		8,000,000	8,000,000
Contract costs		5,000,000	6,000,000
<b>Estimated gross profit</b>		<b>3,000,000</b>	<b>2,000,000</b>
Amount receivable	Year 2021	3,000,000	3,000,000
	Year 2022	2,000,000	2,000,000
	Year 2023	2,000,000	2,000,000
	Year 2024	1,000,000	1,000,000

Applying the formula in paragraph 6.4, the estimated gross profit for each year is as follows:

<b>YA</b>	<b>Original Estimate RM</b>	<b>Revised Estimate RM</b>
2021	1,125,000	750,000
2022	750,000	500,000
2023	750,000	500,000
2024	375,000	250,000
<b>Total</b>	<b>3,000,000</b>	<b>2,000,000</b>

Since the revision is made in the year 2022, the revised estimates shall be taken into the computation with effect from the YA 2022. The original estimate in respect of the year ended 31.12.2021 (i.e. YA 2021) amounting to RM1,125,000 is not to be adjusted. Thus, the contractor would have been subject to tax on a total gross profit as follows:

<b>YA</b>	<b>RM</b>	<b>Notes</b>
2021	1,125,000	Original estimate
2022	500,000	Revised estimate
2023	500,000	
2024	250,000	
<b>Total</b>	<b>2,375,000</b>	

Adjustments should be made in the basis period when the contract is completed, when the sales value, development cost and actual gross profit or loss can be ascertained.

### **Example 15**

Referring to **Example 14** above, except that company decides to use the cumulative progress billings as follows:

<b>YA</b>	<b>Cumulative Progress Billings RM</b>	<b>Cumulative Profit RM</b>
2021	3,000,000	$3,000,000/8,000,000 \times 3,000,000 = 1,125,000$
2022	5,000,000	$5,000,000/8,000,000 \times 2,000,000 = 1,250,000$
2023	7,000,000	$7,000,000/8,000,000 \times 2,000,000 = 1,750,000$
2024	8,000,000	$8,000,000/8,000,000 \times 2,000,000 = 2,000,000$



Hence, the construction contractor would be subject to tax on current year profit for each YA as follows:

YA	Cumulative Profit to Date (A)	Cumulative Profit Up to Previous YA (B)	Current Year Profit (A-B)
	RM	RM	RM
2021	1,125,000	0	1,125,000
2022	1,250,000	1,125,000	125,000
2023	1,750,000	1,250,000	500,000
2024	2,000,000	1,750,000	250,000
<b>Total</b>			<b>2,000,000</b>

## 9. Completion of Contract

### 9.1 Date of completion of a contract

#### 9.1.1 A construction contract shall be 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 Where the construction contractor and the client are not dealing at arm's length, any unusual delay in the date of physical completion shall be determined based on the facts of each case. Factors to be taken into consideration which may suggest that the contract is "completed" are 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. It is important that a contractor establish a consistent policy in determining the date on which a contract is completed.

### 9.2 Ascertainment of actual gross profit or loss

Where in a basis period for a YA a construction contract is deemed to have been completed, the construction contractor shall ascertain the actual gross profit or loss from the contract based on the actual sales value and the actual

construction costs in that basis period.

The following situations may arise:

- (a) the actual gross profit from the contract is more than the total estimated gross profit that has been recognized as gross income of the contractor for that period as ascertained using the formula in paragraph 6.4 or 6.7;
- (b) the actual gross profit from the contract is less than the total estimated gross profit that has been recognized as gross income of the contractor for that period as ascertained using the formula in paragraph 6.4 or 6.7; or
- (c) there is an actual loss for the contract.

### 9.3 Tax treatment

Where the estimation of gross profit using the formula in paragraph 6.4 or 6.7 above has been done consistently throughout the period of a contract and results in a fair spread of the estimated gross profit for the applicable period, the following methods of tax treatment may be used:

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

Where the actual gross profit from the contract is more than the total estimated gross profit that has been taxed in the preceding YAs, the difference shall be treated as part of gross income of the contractor for the basis period of contract completion.

#### **Example 16**

Gross profit for each year of assessment is as follows:

Details	RM	RM
Actual gross profit from the contract		1,600,000
Less:		
Estimated gross profit for year 1	500,000	
Estimated gross profit for year 2	600,000	
Estimated gross profit for year 3	400,000	1,500,000
<b>Difference of gross profit</b>		<b>100,000</b>

The difference of gross profit of RM100,000 shall be treated as part of the gross profit in the basis period of the completed contract. Prior

years' assessments shall not be reopened or reviewed.

### 9.3.2 Actual gross profit less than estimated gross profit

Where the actual gross profit from the contract is less than the total estimated gross profit that has been taxed in the previous years of assessment, the actual profit for the basis period the contract is completed and preceding basis periods may be apportioned by applying the formula as in paragraph 6.4 or 6.7. The assessments that have been made can be reviewed or the assessment which will be made can be determined accordingly with this ruling.

In applying the formula in paragraph 6.4 or 6.7 above, the construction contractor shall use the actual contract price, cost, profit or loss from that contract.

#### **Example 17**

A contract commenced in 2020 and is completed in 2023. The actual gross profit for the contract as ascertained in 2023 is RM2,000,000. The estimated gross profit taken into computation for the contract is as follows:

<b>YA</b>	<b>Estimated Gross Profit RM</b>
2020	500,000
2021	1,300,000
2022	800,000
<b>Total</b>	<b>2,600,000</b>

Since the actual gross profit is less than the total estimated gross profit for the YAs 2020 to 2022 of RM600,000, all the prior years' assessments may be reviewed. The actual gross profit for YAs 2020 to 2023 will be ascertained as follows:

Details	RM	RM
Actual gross profit		2,000,000
Less: (by applying formula)		
Gross profit for Y/A 2020 (20%)	400,000	
Gross profit for Y/A 2021 (50%)	1,000,000	
Gross profit for Y/A 2022 (25%)	500,000	
Gross profit for Y/A 2023 (5%)	100,000	
<b>Total</b>	<b>2,000,000</b>	

However, if the company chooses not to review the prior YAs, the DGIR may allow the company to make the adjustment to the gross profit for the YA 2023 on condition that there are no tax implications for all the relevant YAs.

### 9.3.3 Contract with actual loss

Where there is an actual gross loss from a contract, the actual gross loss from the contract may be apportioned by applying the formula as in paragraph 6.4 or 6.7 above. Prior years' assessments that have been made, if any, for those relevant periods may be revised accordingly.

#### Example 18

Referring to **Example 17** above, except that the actual loss for the contract as ascertained in 2023 is RM1,000,000.

Given that the contract has incurred an actual loss, all the prior years' assessments may be reviewed. The actual loss for YAs 2020 to 2023 will be ascertained as follows:

Details	RM	RM
Actual loss		(1,000,000)
Less: (by applying formula)		
Loss for Y/A 2020 (20%)	(200,000)	
Loss for Y/A 2021 (50%)	(500,000)	
Loss for Y/A 2022 (25%)	(250,000)	
Loss for Y/A 2023 (5%)	(50,000)	
<b>Total</b>	<b>(1,000,000)</b>	

However, if the company chooses not to review the prior YAs, the DGIR may allow the company to make the adjustment to the actual profit for the YA 2023 on condition that there are no tax implications for all the relevant YAs.

9.3.4 With effect from the YA 2023, where a construction contract is deemed completed as mentioned in paragraph 9.1, but the final accounts can only be finalized after the date of completion of the construction contract, the construction contractor may ascertain and recognize the actual gross profit or loss in a basis period whichever is the earliest of the following periods:

- i) twelve (12) months after the date of completion of the construction contract; or
  - ii) on the date when the final accounts of the construction contract is agreed upon between the contractor and the employer (i.e., the client).
- a) Where the final accounts is received within 12 months from the date of completion of the construction contract.

### **Example 19**

Company N Sdn Bhd, is a construction contractor with accounts ending 31 December every year. On 1 May 2020, the company secured a contract to construct a school building. Construction work began on 15 September 2020. On 1 August 2022, the construction contract was completed and CPC was issued for the school building. The company provided contract information and reported estimated gross profit for each YA as follows:

<b>Details</b>	<b>RM</b>
<b>Year 2020</b>	
Contract value	20,000,000
Estimated contract costs	15,000,000
<b>Estimated gross profit</b>	<b>5,000,000</b>
Reported estimated gross profit	
YA 2020 (20%)	1,000,000
YA 2021 (70%)	3,500,000

On 30 September 2022, the company received a penultimate

claim including variation works as follows:

<b>Details</b>	<b>RM</b>
Actual contract value	19,800,000
Less: Actual contract costs (including subcontractor claims)	15,000,000
<b>Actual gross profit</b>	<b>4,800,000</b>

The gross profit for each YA is as follows:

<b>Details</b>	<b>RM</b>	<b>RM</b>
Actual gross profit		4,800,000
Less:		
YA 2020	1,000,000	
YA 2021	3,500,000	4,500,000
<b>Difference of gross profit for YA 2022</b>		<b>300,000</b>

The difference of RM300,000 shall be treated as part of the gross profit for the YA 2022. Prior years' assessments would not be reopened or reviewed. Where actual loss has occurred, the treatment for the loss shall refer to Example 18 in paragraph 9.3.3.

On 20 July 2023, the final account for the construction contract was received including the variation works carried out by the company.

<b>Details</b>	<b>RM</b>
Actual contract value	19,800,000
Less: Actual contract costs (including subcontractor claims)	14,000,000
<b>Actual gross profit</b>	<b>5,800,000</b>

The gross profit for each YA is as follows:

Details	RM	RM
Actual gross profit from the contract		5,800,000
Less:		
Estimated gross profit YA 2020	1,000,000	
Estimated gross profit YA 2021	3,500,000	
Gross profit YA 2022	300,000	4,800,000
<b>Difference of gross profit for YA 2023</b>		<b>1,000,000</b>

The difference in gross profit of RM1,000,000 shall be treated as part of the gross profit for the YA 2023.

- (b) Where the final account is received after 12 months from the date of the CPC and outside the first basis period after the basis period in which the CPC was issued.

### Example 20

Referring to **Example 19** above, except that the final account for the school construction contract was only received on 1 April 2024.

On 31 December 2023, the second penultimate claim was received including the variation works carried out by the company.

Details	RM
Actual contract value	20,500,000
Less: Actual contract cost (including subcontractor claims)	15,000,000
<b>Actual gross profit</b>	<b>5,500,000</b>

The gross profit for each YA is as follows:

Details	RM	RM
Actual gross profit from the contract		5,500,000
Less:		
Estimated gross profit YA 2020	1,000,000	
Estimated gross profit YA 2021	3,500,000	
Actual gross profit YA 2022	300,000	4,800,000
<b>Difference of gross profit for YA 2023</b>		<b>700,000</b>

The difference of RM700,000 shall be treated as part of the gross

profit for the YA 2023.

On 1 April 2024, the final account for the school construction contract was received, including the variation works carried out. Information related to the construction contract up to 31 December 2024 is as follows:

Details	RM
The actual construction contract value is based on the final account including the variation works that have been carried out	21,000,000
Less: Actual contract cost (including subcontractor claims)	15,300,000
<b>Actual gross profit</b>	<b>5,700,000</b>

The actual gross profit for each YA is as follows:

Details	RM	RM
Actual gross profit		5,700,000
Less:		
Estimated gross profit YA 2020	1,000,000	
Estimated gross profit YA 2021	3,500,000	
Actual gross profit YA 2022	300,000	
Actual gross profit YA 2023	700,000	5,500,000
<b>Difference of gross profit</b>		<b>200,000</b>

The difference of RM200,000 shall be treated as part of the gross profit for the YA 2023. Where the Income Tax Return Form has been furnished, the revised tax calculation for the YA 2023 must be submitted to the DGIR for the purpose of raising an additional assessment. The issue of penalty imposition does not arise for the adjustment of the excess gross profit that is submitted in the basis period after the basis period in which the actual figures can be ascertained and it is subject to the facts of each case.

#### 9.3.5 Individual contractors

In the case of an individual contractor or a partner in a joint venture contract which is subject to the progressive income tax rate under Schedule 1 of the ITA, the contractor is allowed to review the prior years' assessments upon completion of the contract.



### Example 21

Contractor P commenced a contract in 2021 which was completed in 2023. Contract value was RM15,000,000. The estimated gross profit was RM1,900,000. On completion of the contract the actual gross profit was determined to be RM1,500,000. The estimated gross profit taken into computation for the contract is as follows:

YA	Estimated Gross Profit RM
2021	$\frac{4,500,000}{15,000,000} \times 1,900,000 = 570,000$ (estimated)
2022	$\frac{6,000,000}{15,000,000} \times 1,900,000 = 760,000$ (estimated)
2023	$\frac{4,500,000}{15,000,000} \times 1,900,000 = 570,000$ (estimated)
<b>Total</b>	<b>1,900,000</b>

Considering that the actual gross profit is less than the estimated gross profit taken into account in the YAs 2021 to 2023, the contractor may review all his prior years' assessments.

The actual gross profit for each YA will be recomputed as follows:

YA	Actual Gross Profit RM
2021	$\frac{4,500,000}{15,000,000} \times 1,500,000 = 450,000$ (revised)
2022	$\frac{6,000,000}{15,000,000} \times 1,500,000 = 600,000$ (revised)
2023	$\frac{4,500,000}{15,000,000} \times 1,500,000 = 450,000$ (revised)
<b>Total</b>	<b>1,500,000</b>

## 10. Adjusted Income

- 10.1 In ascertaining the adjusted income from the business of a construction contract for the basis period for each YA, all expenses (other than any construction cost that has been taken into account in ascertaining the estimated gross profit or loss of construction contract) that are wholly and exclusively incurred in the production of that income during that period is allowed under the ITA. However,

adjustments shall be made in the income tax computation for each YA for outgoings and expenses disallowed under section 39 of the ITA.

- 10.2 Where there is an adjusted loss of a construction contract business for a basis period, the adjusted loss shall be deducted from the aggregate income from all sources of income in that basis period under subsection 44(2) of the ITA. If there is no or insufficient aggregate income from all sources of income to absorb the adjusted loss, the loss shall be carried forward and deducted from the total statutory income from all sources of business income in the following basis period until it is fully absorbed as provided in subsection 43(2) of the ITA.

## **11. Construction Expenditures**

- 11.1 Expenses in paragraph 10.1 above means all expenses which are deductible under 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.

- 11.2 In preparing the accounts, a construction contractor must distinguish between direct expenses related to the construction expenditure and operating and administrative expenditure of the construction contractor business and debited to the statement of comprehensive income.

### **11.3 Construction cost**

- 11.3.1 Construction cost comprises all expenses that are directly attributable to construction contract activities or that can be reasonably allocated to such activities.
- 11.3.2 All direct expenses which are related to the construction contract such as land survey fees, soil investigation fee, site overhead expenses, design and technical fees, cost of construction materials etc. are costs attributable to the contract and should be capitalized in the construction expenditure account.
- 11.3.3 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.
- 11.3.4 Where two or more contracts are carried out concurrently, such construction expenditure must be shown separately. The construction expenditure account for each contract should be kept separately and

must be prepared for each YA.

- 11.3.5 A construction contractor is required to make the necessary adjustments for expenses which are reflected in the construction expenditure account. Where costs for other contracts have been included in the construction expenditure account, these costs shall be taken out to arrive at the allowable construction expenditure to be carried forward to the following YA. This is to ensure only the final year's accounts contract needs to be adjusted upon completion of the contract.
- 11.3.6 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. aluminum, 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 demolished after completion of contract are allowed as revenue expenses. Cost of cabins used as quarters are not deductible.

#### 11.4 Fees paid for securing contracts

- 11.4.1 A construction contractor may make payment of fees to certain parties for soliciting and 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.
- 11.4.2 For income tax purposes, the deductibility of such expenses would depend on the purpose, nature and circumstances in which such fees arise. Where the services provided by the recipient are merely to secure the contract, the fees paid will be considered a kick-back and are not eligible for deduction as allowable expenses.
- 11.4.3 However, where the recipient actively engages in the management and

progress of the contract after obtaining the contract, the payment made will qualify as a commission or management fee and can be deducted as part of the administrative expenses.

#### **11.5 Retention sum**

- 11.5.1 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.
- 11.5.2 Construction contracts normally provide for a contractor to render, from time to time, progress billings as work on a contract progresses. Such contracts also normally stipulate that the contractor be paid, usually after the relevant part of the work has been satisfactorily completed, as certified by the client, the client's architect or engineer.
- 11.5.3 The terms of a construction contract may also require the client to withhold a percentage from the payment of each progress billings pending satisfactory completion of the entire contract. This withholding or retention money/sum as it is commonly known, is usually withheld for a period of 6 months after the contract is completed. The retention money/sum withheld is not paid to the construction contractor until the conditions for the payment of the money or sum as specified in the contract are met.
- 11.5.4 For income tax purposes, the amount of the progress billings, including retention money, which becomes receivable must be included in the gross income of the contractor at the date such progress billings are issued.

#### **11.6 Liquidated Ascertained Damages (LAD)**

- 11.6.1 A construction contractor must complete and deliver the completed construction work to the client within the period stipulated in the contract agreement. If the construction contractor fails to deliver the completed work within this period, the contractor shall be liable to pay or allow the client a sum calculated at a rate as stated in the contract agreement as LAD for the period during which the relevant works remain incomplete. The client may deduct such amount from any money due to the contractor.
- 11.6.2 For income tax purposes, the provision for LAD is not an allowable expense under section 33 of the ITA. A contractor's liability only arises

when payment of the LAD is made. The liability is incurred as and when the actual amount of LAD is ascertained and agreed between the contractor and the clients. LAD receivable from subcontractors, less the amount of LAD payable to clients (if any) should be recognized on accrual basis.

- 11.6.3 In the event that LAD due to the clients are not paid, the construction contractor has to reverse the expense in the relevant accounts.

#### 11.7 Warranty or defects liability expenses

- 11.7.1 Where a construction contract agreement provides for a defect 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 apparent within the defects liability period stated in the agreement.

- 11.7.2 Defects liability expenses incurred by a construction contractor are allowed as deduction by any of the methods described below, depending on the circumstances and the choice made by the contractor.

- a) Sufficient gross income from the same construction contract

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

#### **Example 22**

Q Construction Sdn Bhd closes its accounts on 31 December every year. It has a contract which was completed on 30.06.2021. The company incurred expenses on defects liability amounting to RM2,000 on 30.09.2021. The tax computations of gross income are as follows:

#### **YA 2021**

<b>Details</b>	<b>RM</b>
Gross income from Contract 1	8,000
Less: Defects liability expenses incurred	2,000
<b>Gross income</b>	<b>6,000</b>

- b) Insufficiency or an absence of gross income from the same construction contract

Where there is insufficient or an absence of gross income from the same construction contract for that basis period or that following basis periods, defects liability expenses which cannot be deducted in full or in part shall be allowed as a deduction against -

- (i) the aggregate amount of gross income from other construction contract for that basis period or following basis period, as the case may be; or
- (ii) the gross income from the same construction contract for the basis period preceding the basis period in which the expenses are incurred. Where, by reason of an absence or insufficiency of gross income from the same contract for that preceding basis period, the expenses which have not been so deducted shall be allowed as a deduction against the gross income from that contract for the next preceding basis period and so on for the duration of the contract. Where the construction contractor decides to elect this method, the election is irrevocable. This election can be made either in the tax computation for the current year of assessment or in the revised tax computations for prior YAs to the respective branch offices of Inland Revenue Board Malaysia.

### **Example 23**

R Construction Sdn Bhd with accounts ending on 31 December has a few contracts running concurrently. Contract 2 commenced in December 2019 and was completed on 31.01.2021. Company incurred expenses on defects liability of RM4,000 for Contract 2 on 31.03.2021. The tax computations of gross income are as follows:

### YA 2021

Details	RM
Gross income from Contract 2	3,000
Less: Defect liability expenses incurred	4,000
Loss from Contract 2	(1,000)
Less: Aggregate gross income from other contract	5,000
<b>Gross income from the construction contract business</b>	<b>4,000</b>

### **Example 24**

Referring to **Example 23** above, except that the aggregate gross income from the other contract is RM500 for 2021. The tax computations of gross income are as follows:

### YA 2021

Details	RM
Gross income from Contract 2	3,000
Less: Defect liability expenses incurred	4,000
Loss from Contract 2	(1,000)
Less: Aggregate gross income from other contract	500
<b>Gross loss from the construction contract business</b>	<b>(500)</b>

The gross loss of RM500 may be deducted from other sources of income such as dividend, interest etc.

### **Example 25**

Same facts as referred to **Example 23** and the company made an irrevocable election to claim the expenses as it has no gross income in 2022. The tax computations of gross income are as follows:

### **YA 2021**

<b>Details</b>	<b>RM</b>
Gross income from Contract 2	3,000
Less: Defect liability expenses incurred	4,000
Loss from Contract 2	NIL
Less: Aggregate gross income from other contract	5,000
<b>Gross income from the construction contract business</b>	<b>5,000</b>

Unabsorbed defects liability expenses of RM1,000 is carried back to the YA 2020 where the tax computation would be reviewed.

### **YA 2020**

<b>Details</b>	<b>RM</b>
Gross income from Contract 2	500
Less : Unabsorbed defect liability expenses incurred carried back from the YA 2021	(1,000)
<b>Gross income from the construction contract business</b>	<b>NIL</b>

Unabsorbed defects liability expenses of RM500 is carried back to the YA 2019 where the tax computation would be reviewed.

## **11.8 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.

## **11.9 General administrative expenses**

11.9.1 Where non-allowable expenses are charged to the statement of comprehensive income, an adjustment shall be made to the income tax computation to disallow the expenses in accordance with the provisions of the ITA.

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



## 12. Other Issues Related to Construction Contract

12.1 The same principle and similar tax treatment contained in the PR for Property Development (PR No. 9/2022) should apply *mutatis mutandis* to issues not mentioned in this Ruling.

12.2 Contractors who subcontract their work to non-resident contractors are required to comply with section 107A of the ITA. Non-compliance will result in amounts being added back in the tax computation under paragraph 39(1)(i) of the ITA.

## 13. Information Required for Audit

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:
  - i) Letter of Award
  - ii) Progress Billing Certificate
  - iii) Final Account
  - iv) Certificate of Practical Completion
  - v) Bills and receipts of purchases, expenses and payments including wages and salaries of contract workers;
- (b) the type of contract (example - fixed price or cost plus) must be stated and the 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. Updates and Amendments

<p>This PR replaces the PR No. 2/2009 dated 22 May 2009</p>	<b>Amendments</b>	
	The contents of this PR have been amended and updated as follows:	
	Paragraph in this PR	Amendments
	1	Paragraph 1 is amended.
	2	Paragraph 2 is amended and renumbered as subparagraph 2.2.  New subparagraph 2.1 and 2.3 are inserted.
	5	Paragraph 6 is amended and renumbered as subparagraph 5.  Subparagraph 6.1 to 6.3 is amended and renumbered as subparagraph 5.1 to 5.3.  Example 6 to 9 is amended and renumbered as Example 1 to 4.
	6	The title of paragraph 5 is amended and renumbered as paragraph 6.  Subparagraph 5.1 to 5.7, 5.8 to 5.14 are amended and renumbered as subparagraph 6.1 to 6.7 and 6.8 to 6.14.  Example 1 to 5 is amended and renumbered as Example 5 to 9.
	7	Subparagraph 7.1, 7.2, 7.3 and 7.4 are amended.  New subparagraph 7.5 is inserted.  Examples 10, 11, 12 and 13 are amended.

<b>Amendments</b>		
	Paragraph in this PR	Amendments
	8	New subparagraph 8.2(c) is inserted.  Subparagraph 8.3 are amended.  Examples 14 and 15 are amended.
	9	Subparagraph 9.1, 9.2 and 9.3 are amended.  Examples 16 and 17 are amended.  New example is inserted and numbered as Example 18.  New sub-subparagraph 9.3.4 is inserted. This insertion incorporates Practice Note 1/2024: Tax treatment on the recognition of actual gross profit or loss from a construction contract.  New examples are inserted and renumbered as examples 19 and 20.  Paragraph 10 is amended and renumbered as sub-subparagraph 9.3.5.  Example 18 is amended and renumbered as example 21.
	10	The title of subparagraph 11.1 is amended and renumbered as paragraph 10.  Subparagraph 11.1 is amended and renumbered as subparagraph 10.1.  New subparagraph 10.2 is inserted.

<b>Amendments</b>		
	Paragraph in this PR	Amendments
	11	<p>The title of paragraph 11 is amended.</p> <p>Subparagraph 11.2 is amended and renumbered as subparagraph 11.1.</p> <p>Subparagraph 11.3 is amended and renumbered as subparagraph 11.2.</p> <p>Subparagraph 11.4 is amended and renumbered as subparagraph 11.3.</p> <p>Subparagraph 11.4.1 is amended and renumbered as subparagraph 11.3.1.</p> <p>Sub-subparagraph 11.4.2 is amended and renumbered as sub-subparagraph 11.3.2.</p> <p>Sub-subparagraph 11.4.4 is amended and renumbered as sub-subparagraph 11.3.3.</p> <p>Sub-subparagraph 11.4.2 is amended and renumbered as sub-subparagraph 11.3.4.</p> <p>Sub-subparagraph 11.4.5 is amended and renumbered as sub-subparagraph 11.3.5.</p> <p>Sub-subparagraph 11.4.3 is amended and renumbered as sub-subparagraph 11.3.6.</p> <p>Sub-subparagraph 11.5 is amended and renumbered as sub-subparagraph 11.4.</p>

<b>Amendments</b>		
	Paragraph in this PR	Amendments
	11	<p>Sub-subparagraph 11.5.1 is amended and renumbered as sub-subparagraph 11.4.1.</p> <p>Sub-subparagraph 11.5.2 is amended and renumbered as sub-subparagraph 11.4.2 and 11.4.3.</p> <p>Subparagraph 11.6 is amended and renumbered as subparagraph 11.5.</p> <p>Sub-subparagraph 11.6.1 to 11.6.4 are amended and renumbered as sub-subparagraph 11.5.1 to 11.5.4.</p> <p>Subparagraph 11.7 is amended and renumbered as subparagraph 11.6.</p> <p>Sub-subparagraph 11.7.1 to 11.7.3 are amended and renumbered as sub-subparagraph 11.6.1 to 11.6.3.</p> <p>Subparagraph 11.8 is amended and renumbered as subparagraph 11.7.</p> <p>Sub-subparagraph 11.8.1 to 11.8.2 are amended and renumbered as sub-subparagraph 11.7.1 to 11.7.2.</p> <p>Sub-subparagraph 11.8.3 are amended and renumbered as sub-subparagraph 11.7.2(a).</p> <p>Example 19 is amended and renumbered as example 22.</p>

<b>Amendments</b>		
	Paragraph in this PR	Amendments
	11	<p>Sub-subparagraph 11.8.4 are amended and renumbered as sub-subparagraph 11.7.2(b).</p> <p>Sub-subparagraph 11.8.5, 11.8.6, 11.8.7 and 11.8.8 are amended and renumbered as sub-subparagraph 11.7.2(b)(i) and (ii).</p> <p>Example 20 is amended and renumbered as example 23.</p> <p>Example 21 and 22 are amended and renumbered as example 24 and 25.</p> <p>Subparagraph 11.9 is amended and renumbered as subparagraph 11.8.</p> <p>Subparagraph 11.10 is amended and renumbered as subparagraph 11.9.</p> <p>Sub-subparagraph 11.10.1 and 11.10.2 are amended and renumbered as sub-subparagraph 11.9.1 and 11.9.2.</p>
	13	New subparagraph 13(a) (i,ii,iii,iv,v) are inserted.

## 15. Disclaimer

The examples in this PR are for illustration purposes only and are not exhaustive.

**Director General of Inland Revenue,  
Inland Revenue Board of Malaysia.**