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## Tax Deductibility Of Feasibility Study Expenditure

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Feasibility study is an exercise that businesses sometimes conduct to assess the business efficiency and profitability of a new project. It is an evaluation of the viability of a new project or business opportunity by weighing its benefits and risks. Given that the expenses in relation to a feasibility study are closely related to the production of income, one would expect them to be deductible under Section 33(1) of the Income Tax Act 1967 (ITA).

### Nature Of Feasibility Study Expenditure: Capital Or Revenue?

It is pertinent to note that the ITA does not distinguish between capital and revenue expenditure. Hence, case law principles are used to determine whether feasibility study expenditure is capital or revenue in nature. The distinction between capital and revenue expenditure was initially discussed in *British Insulated and Helsby Cables, Limited Appellants and Atherton Respondent* [1926] A.C. 205, where it was held that when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, the expenditure should be treated as capital and not revenue.

In *Vallambrosa Rubber Co, Ltd, v Farmer (Surveyor of Taxes)* (1910) 5 TC 529, it was held that capital expenditure is going to be spent once and for all whilst revenue expenditure is going to recur every year. This principle has been relied on heavily in Malaysian cases.

In essence, for an expenditure to be revenue in nature, it must be an expenditure that recurs every year. It must not be for the purpose of acquiring or constructing an asset or even for the purpose of providing the business with a consistent advantage.

Feasibility study is mostly commissioned to assess the viability of possible new projects so that the businesses can make an informed decision on the way forward. In

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*Ketua Pengarah Hasil Dalam Negeri v Shell Refining Co (FOM) Bhd* [2014] 9 MLJ 686, the High Court held that feasibility study expenses are deductible as a revenue expenditure under Section 33(1) of the ITA. The High Court, in dismissing the Inland Revenue Board's appeal held the following:

- (a) The main purpose of the taxpayer conducting the feasibility study was to improve the company's business profitability as well as comply with the law in relation to sulphur content in petrol and diesel.
- (b) An expenditure that a taxpayer incurs to improve the profitability of business would be treated as a revenue expenditure and is eligible for deduction under Section 33(1) of the ITA.

Expenses in relation to feasibility study are also treated as revenue expenditure in other Commonwealth jurisdictions.

In *Bowater Power Co v Canada (Minister of National Revenue - MNR)* [1971] FCJ No 361, the taxpayer was in the business of generating electrical power and energy. The taxpayer incurred expenses for engineering studies to examine the potential drainage area and to determine the feasibility of constructing power developments at other sites. The feasibility study expenses were held to be revenue expenditure.

Similarly, in *Yuel v Canada (Minister of National Revenue - MNR)*, [1991] TCJ No 788, the taxpayer was allowed to deduct the feasibility study expenses as a business expense. In *Eastern Business Management Ltd v Minister of National Revenue* (1972) 73 DTC 6, consulting engineers and lawyers were engaged to draw an application for rezoning a business area for high rise building purposes. The expenses incurred for the consultation were held to be tax deductible.

However, in the Australian case of *Federal Commissioner of Taxation v Ampol Exploration Ltd* (1986) 69 ALR 289, the taxpayer claimed a deduction for the survey expenditure and the cost for consultants who interpreted the data obtained from the survey. The Federal Court held that the expenditure was not incurred for the purpose of

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creating or enlarging a business structure or profit-yielding or income-producing asset.

Meanwhile, in the Indian case of *Acit 2(3), Mumbai vs Tata Power Co. Ltd, Mumbai (Income Tax Appellate Tribunal – Mumbai (2019)*, the taxpayer with a view to expand its business activities had incurred expenses such as undertaking preliminarily studies and feasibility reports. The planned expansion projects did not take off or were shelved due to commercial expediency as they were found to be not profitable. The taxpayer claimed that the expenses incurred were connected with its existing business of generation, distribution and transmission of electricity and accordingly, the expenses were allowed for deduction.

## Conclusion

In summary, the taxpayer must demonstrate that feasibility study expenses were made in a continuous manner to improve the company's business efficiency and profitability.

In Malaysia, there is no specific provision in the ITA in relation to the deduction of feasibility study expenses. Hence, the decision in the *Shell Refining (supra)* case discussed above remains the applicable law.

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