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High Court Rules Gains From Land Sale Are Not Subject To Income Tax

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Last week, the High Court affirmed the the Special Commissioners of Income Tax's (SCIT) decision in Ketua Pengarah Hasil Dalam Negeri v Kristal Penaga Sdn Bhd and dismissed the appeal by the Revenue.

The court held that the gains made by the taxpayer from the sale of a piece of land in Mont Kiara are not subject to income tax as contended by the Revenue.

The taxpayer in this appeal was successfully represented by the firm's Tax, SST and Customs Partner, S. Saravana Kumar and senior associate, Dharshini Sharma.

Background

The taxpayer was an investment holding company which acquired a piece of land that was subdivided into 12 parcels by the previous owner prior to the signing of the Sales and Purchase Agreement. The land was intended as a capital investment and kept by the taxpayer for almost 19 years. Upon disposing of land, the taxpayer submitted the real property gains tax (RPGT) returns to the Revenue and the Revenue subsequently issued notice of non-chargeability to RPGT as the disposal took place during the RPGT exemption period.

Subsequent to a tax audit a few years later, the Revenue informed the taxpayer that the gains arising from the disposal of the land were being subjected to income tax under the Income Tax Act 1967 (ITA). The Revenue raised a notice of assessment together with penalty for filing an incorrect tax return

The central question before the High Court was whether the gains arising from the disposal of 12 parcels of land are trading receipts taxable under Section 4(a) of the ITA or capital receipts taxable under the Real Property Gains Tax Act 1976 (RPGTA).

The High Court Appeal: Key Issues & Arguments

Before the High Court, the Revenue argued that the SCIT had misdirected itself in holding that the gains were capital receipts subject to RPGT. The threshold for appellate intervention is such that the High Court will not disturb the SCIT's decision unless it was plainly wrong, involved no or insufficient judicial appreciation of evidence, drew wrong inferences of fact or erred in law. The High Court held that the Revenue was unable to discharge that burden for the reasons discussed below.

Intention To Trade

The taxpayer has at all material times been an investment holding company with no history of trading in land. Before the High Court, it was established and not disputed that the dominant purpose for acquiring the land in 1994 was capital investment. The focal point of enquiry is the dominant purpose for which the property was originally acquired and that the mere presence of an intention to sell at a profit at some future date is not, of itself, sufficient to render the profit taxable.

Subject Matter Of Transaction

The High Court affirmed the SCIT's finding that the land was consistently classified as a non-current asset in the taxpayer's audited accounts throughout the 19-year period of ownership. The taxpayer's auditors confirmed this treatment following their due enquiry. Land held as a non-current asset as opposed to current assets or stock in trade was plainly investment property. Further, the Revenue's own guideline on MFRS 140: Investment Property expressly acknowledges that an investment property may be held for capital appreciation and need not generate rental income.

No Investment Income

A key point of the Revenue's appeal was that the taxpayer generated no investment income from the Land and that this absence of income was indicative of trading. The High Court dismissed this argument.

There is no provision in the ITA and no authority in case law that compels a taxpayer to generate income from an investment asset or which treats the absence of such income as determinative evidence of trading.

Period Of Ownership

The High Court affirmed the SCIT's finding that the 19-yearperiod of ownership was a compelling indicator of investment intent. The lengthy holding period was found to be conclusive that the land was acquired for investment rather than trading purposes, and the High Court had no basis to disturb that finding of fact.

Established case law recognises that even a short period of ownership may suffice to demonstrate investment intent *a fortiori*, a 19-year holding period leaves little room for doubt.

Alteration To Property

The High Court affirmed the SCIT's finding that no alterations were made to the land by the taxpayer to render it more saleable. The land remained vacant and unkept for 19 years, with no access path, drainage or improvement works. Although the land had been subdivided into 12 parcels by the previous owner prior to the signing of the Sale and Purchase Agreement, the High Court accepted that this subdivision and the change of land category from agricultural to residential were not acts attributable to the taxpayer as preparatory steps for trading. The Revenue's own witness conceded this during cross-examination at the SCIT.

Methods Employed In Disposing The Property

The High Court affirmed that the land was disposed of for the sole purpose of restructuring the taxpayer from a Bumiputera company to a non-Bumiputera company. No advertising was conducted, no marketing office was opened and no broker was engaged. The land in fact was sold to a related company only incorporated in 2013 under a single Sale and Purchase Agreement covering all 12 parcels.

Conclusion

The High Court in dismissing the Revenue's appeal affirmed the SCIT's application of the badges of trade test and accepted the facts established by the SCIT ie the taxpayer had acquired and held the land as a genuine long-term capital investment for nearly two decades before disposing of it for the singular purpose of corporate restructuring. There was no advertisement, no improvement, no systematic trading and no reclassification of the land as a trading asset throughout that period.

The High Court's decision is a significant ruling to establish that the Revenue cannot convert a plainly capital receipt into trading income merely by pointing to the absence of rental or investment income.

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