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## High Court Rules Taxpayer's Disposal Of Land Is Not A Trading Activity

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Last week, the High Court affirmed the decision of the Special Commissioners of Income Tax (SCIT) that the gains arising from the disposal of 10 plots of land by an individual were not subject to income tax.

The taxpayer was successfully represented by the firm's Tax, SST & Customs partner S. Saravana Kumar together with pupil Athena Yu Yun Lei.

### Background

The taxpayer is an individual who throughout 2011 to 2013, acquired and disposed of 10 plots of land. Upon the disposal of the said plots of land, the taxpayer filed his real property gains returns. Subsequently, the Revenue issued notices for real property gains tax in relation to the gains arising from the disposals. However, a few years later, the Revenue changed its mind and alleged that the taxpayer was involved in the business of land trading and raised issued notices of additional assessment for income tax with penalty.

The taxpayer disposed 7 out of the 10 plots of land that he owned to finance the acquisition of another plot of land known as Plot HSM 2079. To finance the purchase, the taxpayer took a RM4,000,000.00 loan from a local bank. Meanwhile, the sale of the remaining 3 plots of land was to reduce the limit of the overdraft facility procured from MBB. The taxpayer acquired Plot HSM 2079, which was later rented to XL Aquatic (Shah Alam) Sdn Bhd (XLASA), where the taxpayer had an interest. XLASA was a subsidiary of a listed company, where the taxpayer served as the Managing Director and main shareholder.

### Period Of Ownership And Frequency Of Transactions

The Revenue's main argument was that the short period of ownership of the plots of land gives rise to a factor to indicate that the taxpayer was embarking on an adventure of trade. Nevertheless, the High Court was persuaded that the period

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of ownership of merely 1 to 4 years alone cannot be the only determinative factor to indicate that the taxpayer was indulging in trading. As facts stood, whilst it was true that the taxpayer disposed of the plots of land in less than 5 years of owning them, he had a good explanation for his conduct. The High Court's attention was drawn to a number of reported cases such as *PR Sdn Bhd* where the taxpayer only held the land parcels for about a year or so, the SCIT held that the land was the taxpayer's investment.

### Circumstances Responsible For Sale

In determining whether the disposal of a property is revenue or capital in nature, due regard must be given to the facts of the particular case in a wholistic manner. In this case, there was evidence that the taxpayer was under pressure to purchase the land parcel known as Plot HSM 2079 as the tenancy agreement for XLASA was ending in 2011 and the landowner had refused to renew the tenancy agreement. In the *Lower Perak Co-Operative Housing Society* case, the Supreme Court held that a forced sale meant that there was no trading since the element of compulsion vitiates the intention to trade.

Similarly, in the *Gra Sdn Bhd* case, the disposal of land by the taxpayer was triggered by the taxpayer's ultimate holding company's group restructuring exercise, otherwise the taxpayer would have retained the lands.

### Methods Employed In Disposing Of The Property

The SCIT in examining the case had found that no form of advertising was conducted by the taxpayer in efforts to dispose the land as opposed to the involvement of a well-established broker or a certified property agent. In fact, the sales of land were facilitated through 'words by mouth' amongst the acquaintances of the taxpayer. There was no special exertion was made to procure or attract purchasers such as the opening of a marketing office or extensive advertising. In the *ALF Properties Sdn Bhd* case, it was held that:

*"In respect of the sale of the unused portion, there was no evidence to show that the appellant made*

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*preparation for the sale such as advertising or that the appellant had opened an office just for the purpose of selling the unused portion or other activity pertaining to sale or development of the unused portion. The evidence shows that the sale of the unused portion was by chance in that there was a good offer by Chanrai Investment Corporation and it was on the unused portion which prompted the appellant to sell the land. The badges of trade does not exist in this sale.”*

### Subject Matter Of The Transaction

All the plots of land disposed of by the taxpayer were agricultural land and as such could only be used for agricultural purposes. This position was consistent with the findings of the SCIT that the taxpayer has been principally involved in the cultivation of agricultural land as opposed to the business of trading in land.

### Alteration To Property

Further, the SCIT found that no alterations were made to the plots of land to render it more saleable, in contrary to the allegations of the Revenue. There was no evidence to show any alteration, improvement or changing of the character and quality of the subject land so as to render it more merchantable. The mere fact that the taxpayer installed coops and coop fences was not sufficient to conclude that the taxpayer had taken steps to increase the value of the plots of land.

### Conclusion

In applying the principle enunciated in the *NYF Realty Sdn Bhd* case, the High Court was correct in deciding that the initial intention of the taxpayer in acquiring the said plots of land were for investment purposes. The conduct of the taxpayer in disposing the plots of land were necessary for the sole intention to safeguard the interest of the taxpayer's interest in XLASA, a company in which he had a keen interest. Looking at the facts of this case, the author is of the view that the decision of the High Court mirrors the position

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of the Supreme Court in the *Lower Perak Co-Operative Housing Society* case, which held the following:

*“Trading requires an intention to trade; normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further question: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss...”*

*Intention may be changed. What was first an investment may be put into the trading stock, and, I suppose, vice versa.... What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor for it to possess an indeterminate status, neither trading stock nor permanent asset. It must be one or the other, even though, and this seems to be legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character...”*

As there was no misconception of law by the SCIT and the decision reached was wholly supported by the facts found by the SCIT, the High Court dismissed the Revenue’s appeal and held that the gains arising from the disposal of the 10 plots of land should not be subjected to income tax.

Authored by Athena Yu Yun Lei, a pupil from the firm’s Tax, SST and Custom department.

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