

7 MARCH 2022

RP Sdn Bhd v DGIR: Trading Receipts Or Capital Receipts?

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Recently, the High Court allowed the taxpayer's appeal by ruling that the gains from the disposal of 59 apartment units are subject to real property gains tax (RPGT) under the Real Property Gains Tax Act 1976 (RPGTA) instead of income tax under Section 4(a) of the Income Tax Act 1967 (ITA). The High Court set aside the decision of the Special Commissioners of Income Tax (SCIT).

This alert will discuss the key aspects of the case. The taxpayer was successfully represented by our firm's Tax, SST & Customs Partner, S. Saravana Kumar together with tax associate Nur Hanina Mohd Azham.

Brief Facts

The taxpayer is a company incorporated in Malaysia and its principal activities are the letting of properties and property investment. In 2007, the taxpayer entered into a Sale and Purchase Agreement for the acquisition of 59 apartment units in the city centre. The taxpayer's ultimate intention was to place these assets in a real estate investment trust. The assets were consistently treated as the taxpayer's fixed asset in its audited accounts.

In 2010, the taxpayer was approached by a third party who informed the taxpayer that it has potential buyers for the 59 apartment units. The taxpayer then entered an en-bloc transaction for the sale of the 56 apartment units and separate transactions for the sale of the 3 remaining units. The sale of the 3 apartment units was completed in the year of assessment (YA) 2010 and the sale of the remaining 56 units were completed in YA 2011.

In YA 2010, the Director General of Inland Revenue (DGIR) raised assessments for RPGT on the gains derived from the sale of all the 59 apartment units. However, subsequently, the DGIR changed its mind and raised assessments for income tax with a penalty in respect of the gains derived from the sale of the 3 apartment units.

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As for the remaining 56 apartment units, in submitting the taxpayer's income tax return for YA 2011, the taxpayer was advised by its tax consultant to caution as the DGIR in recent tax audits had been subjecting gains arising from property disposals to income tax. Based on the advice, the taxpayer subjected the gains arising from the sale of the 56 apartments in YA 2011 to income tax under protest in its tax return. The tax return for YA 2011 was deemed to be an assessment raised and served on the taxpayer, who duly filed a notice of appeal against the same.

The SCIT heard the taxpayer's appeal and held that the gains from the disposal of the 59 apartment units were subject to income tax.

High Court Ruling

The High Court agreed with the taxpayer that the gains from the disposal of the 59 apartment units should be subjected to RPGT and accepted the following submissions advanced for the taxpayer:

- (a) The main issue in this appeal was whether the taxpayer held the apartment units as investment or trading stock. This determination was crucial as only profit arising from the sale of property acquired for the profit making by sale which is subject to income tax. In this regard, our courts have been guided by the badges of trade as the criteria for distinguishing between taxable and non-taxable profits.
- (b) In *NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182, the High Court has set out the badges of trade as encompassing the following elements: subject matter of transaction, period of ownership, frequency of transaction, alteration of property to render it more saleable, methods employed in disposing the property and circumstances responsible for the sale.
- (c) The badges of trade did not exist in the present appeal due to the following reasons:

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- The apartment units were consistently held as the taxpayer's non-current assets in its audited accounts and the taxpayer's auditors had agreed to this treatment after making their due enquiry. The High Court in *Perak Construction Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* [2001] 8 CLJ 498 has held that due regard must be given to the manner in which the taxpayer treated the land in its audited accounts.
- The taxpayer had decided to invest in the apartment units as they were projected to increase in value due to the up-and-coming developments and infrastructure improvements in the surrounding areas which will potentially spur an increase in value of the properties.
- The taxpayer had held the apartment units for more than 3 years prior to the sale and the taxpayer had only sold the units due to the fact that there was an irresistible offer by the purchasers. The offer by the purchasers would allow the taxpayer and its shareholders to enjoy accretion in the capital.
- The apartment units were the only properties ever purchased by the taxpayer and were at all material times kept as an investment. Since its incorporation, the taxpayer did not acquire any other properties other than the apartment units and the disposal of the units was the first of its kind.
- The character or quality of the apartment units had never been changed to it make them more merchantable. This is evidence of the taxpayer's intention of holding the units for investment purposes.
- No special exertion was made to procure or attract purchasers such as the opening of a marketing office or extensive advertising. Further, no broker or real estate company was employed to sell or dispose of the apartment units.

Based on the above, the High Court agreed with the taxpayer that a proper examination of the badges of trade test shows that the taxpayer was not in the act of trading. Therefore, the

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gains from the disposal of the 59 apartment units were not subjected to income tax under Section 4(a) of the ITA.

Commentary

The appellate court has the power to set aside the decision of the SCIT should the latter misdirect themselves by reaching conclusions inconsistent with primary facts found by them or drew inferences from matters which were of no probative value in supporting their conclusions.

In respect of property transactions, a frequent issue that arises is whether the disposal of the property would be subject to RPGT or income tax. In this regard, it is imperative to determine whether the land transaction has elements of badges of trade. This is because the mere realisation of capital appreciation is not income under the ordinary concepts and usages of civilisation.

In the present matter, since the true and proper examination of the badges of trade test clearly illustrates that the taxpayer was not in the act of trading, the disposal of the 59 apartment units cannot be subject to income tax.

Authored by Ng Kar Ngai, an associate from the firm's Tax, SST and Custom department.

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