RPGT Will Have to Wait

by Chia Oh Sheng and Choy Sher Rin

It is common for a company to charge its land as security for loans granted to them. If the company were to go into liquidation, the liquidator will, in the ordinary course of events, realise the assets of the company, which will involve the sale of the charged land, for the payment of its debts.

Generally, upon disposal of land, the company, being the disposer, will be liable to pay real property gains tax ("RPGT") within the timeframe stipulated in the Real Property Gains Tax Act 1976 ("the RPGT Act").

Where the proceeds of sale of the charged land are insufficient to pay the debt secured by the charge, it leaves the liquidators in a legal quandary — whether RPGT should be paid, notwithstanding that the debt secured by the charge has not been fully paid.

Priority of debts on a liquidation

The debts of a company in liquidation are payable in the following order of priority:[1]

1. Secured debts are paid first.

2. Any surplus after payment of secured debts is used to pay the unsecured preferential debts.

3. Any surplus after payment of the unsecured preferential debts is used to pay the other unsecured debts.

So far as unsecured preferential debts are concerned, they are payable in the order stipulated in the Companies Act.[2] Federal taxes assessed under any written law are ranked sixth in the list of unsecured preferential debts.[3]

Priority ranking of federal taxes

Despite the clear wording in the companies legislation[4] on the subject, the Malaysian government's entitlement to federal taxes over other debts on a liquidation has seen more than its fair share of litigation.

Past court decisions, however, have been centred mainly on the priority of sales tax[5] and income tax[6] in respect of a company in receivership or liquidation. Although it was held in these decisions that the secured creditor of a company in liquidation has a priority over the proceeds received from sale of assets charged to them,[7] the cases did not deal with the issue of priority of debts in the context of RPGT.

An early decision on RPGT was *Raja Arshad Raja Tun Uda,*[8] which concerned a company in receivership, as opposed to liquidation. The court in that case held that for a company in receivership, the question of priority does not arise and RPGT should be paid in accordance with the RPGT Act. The court, however, noted in passing that in the case of liquidation, federal taxes rank sixth as preferential debt by virtue of the Companies Act.[9]

Payment of RPGT

Ordinarily, upon disposal of land, RPGT is payable to the Director General of Inland Revenue ("DGIR") in the following manner:

1. Before any notice of assessment is raised by the DGIR, the acquirer (purchaser) shall retain 3% of the purchase price and pay it to the DGIR on behalf of the disposer (vendor/company) within 60 days after the date of disposal.[10]

1 Companies Act 1965, since repealed by the Companies Act 2016 that came into force from 31 January 2017
2 Companies Act 1965, s 292(1)(*a*) to (*f*); Companies Act 2016, s 527(1)(*a*) to (*f*)
3 Provisions relating to the priorities of debts are binding on the government of Malaysia: Companies Act 1965, s 213; Companies Act 2016, s 434
4 Companies Act 2016, which replaced the Companies Act 1965
5 *Director of Customs, Federal Territory v Ler Cheng Chye (Liquidator of Castwell Sdn Bhd, In liquidation)* [1995] 2 MLJ 600 (SC) ("*Ler Cheng Chye*"); *Kenneth Teh Ah Kiam & Chin Kwai Yoong v Ketua Pengarah Jabatan Kastam & Eksais & Ors* [1998] 1 CLJ 183 (FC); *Abdul Samad Alias (Receivership and Manager of Rajiv Enterprises Sdn Bhd) v Government of Malaysia & Ors* [1996] 4 CLJ 123 (FC)
6 *Lim Tian Huat v Ketua Pengarah Hasil Dalam Negeri* [2002] 4 CLJ 605 (CA)
7 Note, however, that these cases could not agree on whether the secured creditor of a company in receivership also has similar priority over the proceeds received from sale of assets charged to them
8 *Raja Arshad Raja Tun Uda & Anor v The Director of Inland Revenue* [1990] 1 CLJ (Rep) 253 (SC)
9 *Ibid*, at 255
10 Real Property Gains Tax Act 1976 ("RPGT Act"), s 21B(1)

2. After a notice of assessment is raised and served on the disposer (vendor/company),[11] the balance of the RPGT, if any, shall be payable by the disposer (vendor/company), within 30 days of the service of the notice of assessment, whether or not it appeals against the assessment.[12]

3. Failure to pay the 3% retention sum or the balance of the RPGT assessed will attract penalties and consequences under the RPGT Act.[13]

Where a liquidator disposes of a parcel of land subject to a charge, the question arises whether the proceeds of sale should be applied to settle the secured debt due to the bank first or to pay the RPGT assessment immediately pursuant to the RPGT Act.

Chye Hup Heng

In *Chye Hup Heng*,[14] the liquidators disposed of a parcel of land that was charged to the bank.

Although the proceeds of sale of the land were insufficient to settle the debt due to the bank, the liquidators paid to the DGIR, under protest, the 3% retention sum and the balance of the RPGT in order to avoid the penalties and consequences arising from non-compliance of the RPGT Act.

In challenging the DGIR's decision in demanding immediate payment of the RPGT, the liquidators contended that the RPGT, as a form of federal tax, is ranked below the debt secured by the charges. For this reason, the liquidators contended that the proceeds of sale of the land should be first applied towards payment of the debt due to the bank before payment of the RPGT.

The liquidators also sought an order for the refund of the RPGT paid to the DGIR. The DGIR resisted the liquidators' challenge and contended that he is entitled to immediate payment of RPGT under the RPGT Act.

In quashing the decision of the DGIR and ordering a refund of the RPGT paid, the court in essence held that:

1. It is plain from sections 291 and 292 of the Companies Act 1965 that the debt secured by the charges is ranked above the DGIR's claim for RPGT, and therefore must be paid first in preference over RPGT.[15]

2. Although the DGIR is entitled to raise the assessment under the RPGT Act, he is not entitled to immediate payment in cases where the debtor company is in liquidation.[16]

The outcome of *Chye Hup Heng*[17] not only serves as guidance to liquidators in carrying out their duties, it also reassures secured creditors of the protection of their rights and interest in the face of competing claims (including claims by the government) against a company in liquidation.

The decision reinforces the principle that *"A secured creditor is entitled to stand aloof from the liquidation."*[18] It remains to be seen whether a similar principle would apply where the land is disposed of in the course of a receivership.

LH-AG

About the authors

Chia Oh Sheng (cos@lh-ag.com) and **Choy Sher Rin** (csr@lh-ag.com) are associates with the Banking & Insolvency Practice, and are part of a team headed by **Mong Chung Seng** (mcs@lh-ag.com)

11 RPGT Act, s 14(1) read together with s 17
12 *Ibid*, s 21
13 *Ibid*, ss 21(4) and 22(1)
14 *Chye Hup Heng Sdn Bhd (dalam likuidasi) v Ketua Pengarah Hasil Dalam Negeri* [2017] 5 AMR 837 (HC)
15 *Ibid*, at [22] to [29]
16 *Ibid*, at [22] to [29] and [33]
17 *Ibid*
18 *Re Your Size Fashions Ltd* [1990] NZLR 727 at 733, cited with approval by Wan Yahya FCJ in *Ler Cheng Chye*, *supra* n 5, at 612