LHAG Insights

Tax, Customs & Trade Practices

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SCIT allows Taxpayer's Section 131 Relief Application: Gains from Taxpayer's Disposal of Real Property held to be Capital Receipts

PR v Ketua Pengarah Hasil Dalam Negeri

Real property disposals by taxpayers are a recurring hotspot in tax audits. The Inland Revenue Board (**IRB**) is known to take an aggressive approach, treating any gains as income to be taxed under the Income Tax Act 1967 (**ITA**), rather than as capital receipts taxable under the Real Property Gains Tax Act 1976 (**RPGTA**). Taxpayers are encouraged to seek timely professional advice as part of their tax audit preparedness strategy.

For taxpayers who have mistakenly and voluntarily declared gains from property disposals as income rather than capital gains, all is not lost. Section 131 ITA allows taxpayers to make an application for relief in respect of an error or mistake to the Director General of Inland Revenue (**DGIR**) within a period of 5 years. The DGIR's rejection of a relief application can also be appealed to the Special Commissioners of Income Tax (**SCIT**).

Recently on 28.4.2022, the SCIT in *PR v Ketua Pengarah Hasil Dalam Negeri* allowed the taxpayer's appeal in such a matter and ruled that the DGIR had no basis in law to reject its relief application.

Brief facts

The taxpayer owned 11 plots of land (**Subject Land**) which it had acquired for the purpose of long-term investment. Some time later, the Subject Land was disposed of through a joint venture agreement (**JVA**) with an associated developer. Pursuant to the

JVA, the developer would develop the Subject Land. In return, the taxpayer would receive a) a fixed entitlement, and b) an agreed percentage from the net sale proceeds of the completed project.

In the first few years of assessment (**YAs**), the taxpayer mistakenly paid income tax on the payments received from the developer company. Subsequently, upon receiving professional legal advice, the taxpayer discovered its error and applied to the DGIR for relief under Section 131 ITA to correct the mistake and to obtain a refund of the taxes paid.

Nonetheless, the DGIR rejected the application, contending that there had not been any "error" or "mistake". The DGIR contended that the gains from the disposal of the Subject Land was properly subject to income tax, as amongst others, the Subject Land had never generated income and had only been held by the taxpayer for a short period of time (3-7 years). Aggrieved by the DGIR's rejection, the taxpayer requested that the application be forwarded for the SCIT's determination under Section 131(5) ITA.

Taxpayer's contentions and the SCIT's Decision

At the SCIT, the taxpayer advanced the following legal arguments:

(a) The taxpayer did not take an active part in the development activities under the JVA. Its role is merely as a passive landowner. The development, finance, constructions, administration, management, marketing, and sales costs were all undertaken by the developer company at its own expense. Of note, the IRB's own Public Ruling 1/2009 – Property Development stipulates that a landowner who does not take an active part in the development activities of a joint venture project is not undertaking a business.

(b) When the Subject Land was acquired, no particular price or time for resale has been fixed by the taxpayer. Land acquired under such circumstances should generally be recognised as investment assets.

(c) The taxpayer was a family company whose principal activity was the investment in landed properties of profits generated from other businesses. The taxpayer had never traded in land, nor did it have any employees or expertise to carry out property development activities.

(d) The taxpayer's accounting treatment of the Subject Land as fixed assets in its audited accounts was consistent with the land being a fixed asset.

(e) The Subject Land were the only lands ever acquired and disposed of by the taxpayer and were disposed of in a single transaction.

(f) The taxpayer did not engage any agents or brokers nor set up any office to sell the Subject Land.

(g) The taxpayer had not carried out any development or improvement work on the Subject Land prior to the sale.

(h) The mere fact that the Subject Land did not generate income is not by itself indicative of an intention to trade.

After hearing submissions, the SCIT decided unanimously in respect of the disposal of the Subject Land that:

(a) None of the badges of trade applied.

(b) The gains were capital receipts taxable under the RPGTA.

Concluding thoughts

The SCIT's decision provides clarity on how the Malaysian tax courts will apply and interpret the "badges of trade" in similar disputes. Amongst others, the IRB's tendency to view land that has not been yielding income as trading assets must be rejected as outdated. More than 3 decades ago, the House of Lords said that[1]:

"*In 1986 it is **not any longer self-evident that unless land is producing income it cannot be an investment**. Since the arrival of inflation and high rates of tax on income **new approaches to investment have emerged putting the emphasis in investment on the making of capital profit at the expense of income yield***".

The taxpayer was successfully represented by Dato' Nitin Nadkarni, Jason Tan Jia Xin and Chris Toh Pei Roo from Lee Hishammuddin Allen & Gledhill's Tax, Customs & Trade Practice.

Chris Toh Pei Roo (tpr@lh-ag.com) and **Ng Miao Ling** (Pupil-in-Chambers)

If you have any queries pertaining to tax treatment and tax relief applications, please contact the author or his team partners, Dato' Nitin Nadkarni (nn@lh-ag.com), Jason Tan Jia Xin (tjx@lh-ag.com) and Ivy Ling Yieng Ping (il@lh-ag.com), at tax@lh-ag.com.

[1] Marson (Inspector of Taxes) v Morton (Brian) [1986] 1 WLR 1343

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