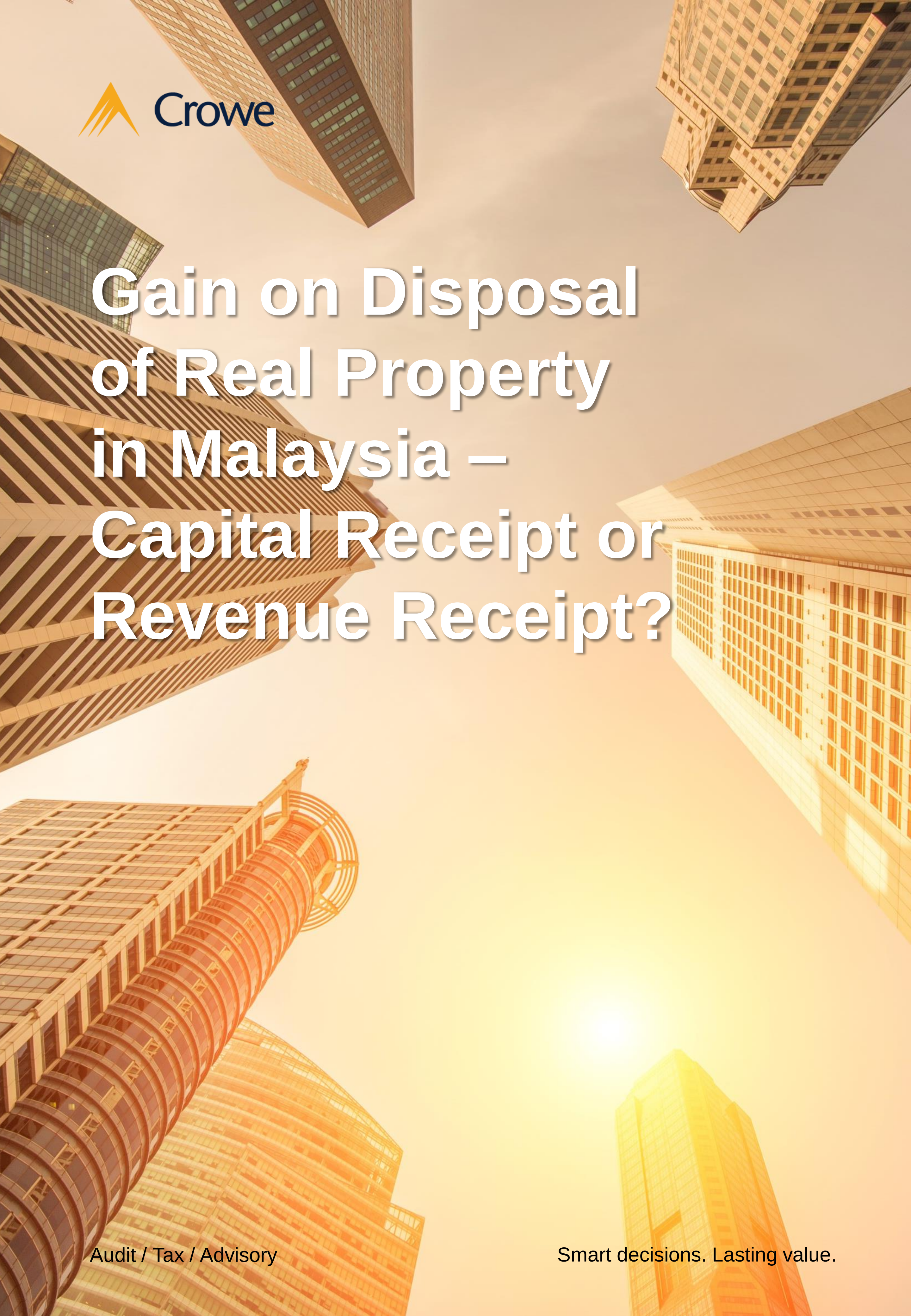

Gain on Disposal of Real Property in Malaysia – Capital Receipt or Revenue Receipt?

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Gain on Disposal of Real Property in Malaysia – Capital Receipt or Revenue Receipt?

Many real property owners, whether an individual or a company, saw their worth increase significantly since the year 2010 due to the bull run in the real property market. Even though the real property market has somewhat started to cool down since 2017, many real property owners are still staring at substantial increases in their real property values.

Those real property owners who are looking at cashing out now will see a substantial gain upon disposal of their real property. Now the question is this: is the gain on disposal of real property a capital receipt or a revenue receipt?

A layman’s answer to that question would be capital receipt. Generally, Malaysia does not impose tax on capital receipts except in certain situations where the receipt arose from the disposal of real property or shares in a real property company, which is taxable under the Real Property Gains Tax 1976 (RPGTA), or where the capital receipt is treated as a revenue receipt.

“Even though the real property market has somewhat started to cool down since 2017, many real property owners are still staring at substantial increases in their real property values”.

Many of us are familiar with the RPGTA that imposes real property gains tax (RPGT) on gains arising from the disposal of real property in Malaysia or shares in a real property company. The RPGT rates vary from five per cent (5%) to thirty per cent (30%), depending on the holding period of the real property.

However, not many are aware that the gain on the disposal of real property in Malaysia could be treated as a revenue receipt and hence, subject to income tax under the Income Tax Act 1967 (ITA) at the prevailing individual income tax rate [i.e. up to twenty eight per cent (28%)] or corporate income tax rate [i.e. twenty four per cent (24%)].

Now, the next question is, under what situation will the gain on the disposal of real property be treated as a revenue receipt instead of a capital receipt.

Generally, if the real property is an investment i.e. capital asset to a person, then the gain on the disposal of such real property is likely to be treated as a capital receipt.

Conversely, if the real property is a stock-in-trade to a person, then the gain on the disposal of such real property will be treated as a revenue receipt.

In order to determine whether a real property is an investment or a stock-in-trade of a person, it is important to analyse the nature of activity carried on by that person. Normally, a person who acquires a real property for personal usage or long term holding to generate rental income is likely to hold that real property as an investment (i.e. property investor). On the other hand, a person who is in the business which deals with real property on a recurring basis is likely to hold that real property as a stock-in-trade (i.e. property developer or property dealer).

However, sometimes it could be difficult to determine the nature of the real property (i.e. investment or stock-in-trade) for a person due to the different nature of each transaction. Hence, one of the common methods employed by the Court in determining the nature of the real property for a person is by looking at the existence of badges of trade. A summary of the badges of trade is as follows:

Badges of trade	Comment	Likely to be	
		Revenue	**Capital**
Intention / profit seeking motive	• Acquired for the purpose of quick resale	/	
	• Acquired for investment purposes		/
Number of transactions	• Single transaction		/
	• Multiple and repeated transactions	/	
Nature of the real property	• Yield rental income		/
	• Does not yield rental income	/	
	• For personal usage		/
	• For trading activity	/	
Method of acquisition of real property	• Inherited / gift		/
	• Acquired in the ordinary course of business	/	

Badges of trade (cont.)	Comment	Likely to be	
		Revenue	Capital
Source of financing	• Long term borrowings • Short term borrowings	 /	/
Alteration, modification or improvement made to the real property	• Subdivision of land • Conversion of land usage • Application for development order • No alteration, modification or improvement	/ / / 	 /
Interval of time between acquisition and sale	• Long period of ownership • Short period of ownership	 /	/
Circumstances surrounding the sale	• Organised sale • Forced sale • Compulsory acquisition of real property by the Government	/ 	 / /

Notwithstanding the above, it should be noted that each badge of trade above should not be analysed remotely. All other factors involving the real property transaction must be taken into account as well, as it is inevitable that several badges of trade may exist in a single real property transaction.

As a general rule, the gain on the disposal of real property will likely be regarded as a revenue receipt if the gain arises from a business activity or if a number of badges of trade exist in the real property transaction. On the other hand, the gain on the disposal of real property will likely be regarded as a capital receipt if the gain arises from an investment activity or it cannot be ascertained that badges of trade exist

As a conclusion, property transactions often involve significant amounts, hence tax inevitably becomes a key consideration. Whilst Malaysia has a generally simple income tax and real property gains tax regime, understanding the tax implications arising from property transactions tend to be challenging especially when the transactions being contemplated do not have clear characteristics of either ‘investment’ or ‘trading’.

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