



Crowe Perspectives:

Capital vs Revenue

Disposal of Real Properties, Shares
and Cryptocurrencies

14 July 2022

During this period of stock market volatility and inflation, many investors have diversified their investments into various types of assets. The asset classes preferred by investors are real properties, shares or even cryptocurrencies.

However, on disposal, investors often overlook the taxability of the gains or receipts derived therefrom.

In order to ascertain the taxability of the gains or receipts, the first task is to determine whether such gains or receipts arose from a capital transaction or a revenue transaction.

The taxability of gains or receipts arising from Capital or Revenue transactions

Presently, Malaysia does not impose Capital Gains Tax (CGT) on capital gains arising from disposal of investments or capital assets except for Real Property Gains Tax (RPGT) which is imposed on gains arising from disposal of real property in Malaysia or shares in a real property company in Malaysia. On the other hand, gains arising from revenue transactions will be subject to tax under the Malaysian Income Tax Act, 1967 (MITA).

Whether a gain arising from a transaction is capital or revenue in nature would depend on the facts and circumstances surrounding the transaction.

The famous metaphor being frequently applied in distinguishing capital from income is “capital being likened to the trees and income being likened to the fruits”. Capital is the source whereas revenue is the income.

One of the important criteria in determining the nature of a transaction is the characteristic of recurrence. Capital transactions are usually one-off in nature whilst revenue transactions are recurring in nature. For example, the realisation of a long-term investment in real property is considered to be capital in nature. Conversely, transactions conducted in the ordinary course of carrying on a business or transactions that are adventures in the nature of trade are considered as revenue transactions.



Badges of Trade



The MITA does not prescribe the circumstances under which an income or a gain is considered as capital or revenue in nature. In practice, the principles laid down by the Courts in precedent tax cases collectively known as “badges of trade” are used as a guide in determining whether a person is carrying on trading activities or otherwise.

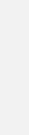
The characteristics of a trading activity, or the badges of trade as listed below, are used to test the existence of a trade or an adventure in the nature of trade:

- Motive or intention
- Trading interests in the same or similar field
- Nature of the asset
- Period of ownership
- Frequency of transactions
- Circumstances responsible for the realisation
- The way the sale was carried out
- Improvement made on the asset
- The method of financing

A discussion on the taxability of gains or receipts from the disposal of three (3) common investment instruments (i.e. real properties, shares and cryptocurrencies) and the important court cases are shown below:



Disposal of Real Properties



Transactions involving a real property may be treated as either a business transaction (i.e. if the property is a trading stock of the business) or an investment transaction (i.e. if the property is held as a long-term investment of the business). Hence, gains arising from disposal of a real property by a company may be subject to different tax treatments as follows:

- If the company is a property dealer, the provisions under the MITA shall be applicable.** In this case, the receipts from the sale of real property are regarded as “revenue receipts” and therefore subject to income tax; or
- If the company is a property investor, the provisions under the Real Property Gains Tax Act, 1976 may be applicable.** In this case, the receipt from the disposal of real property is regarded as a “capital receipt” and therefore subject to RPGT.

The main factor to distinguish between a revenue receipt and a capital receipt would depend on the intention of the person when acquiring the real property, which is usually a question of fact, and the subsequent conduct of that person in regards to the real property. The dominant intention for the acquisition is usually determined by considering the badges of trade.

Tax Case 1 – Disposal of real property is a capital transaction

ALF Properties Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri, Court of Appeal (Putrajaya), Decided on 14 May 2005

i. Brief facts

- On 28 March 1980, the taxpayer had purchased pieces of land with a total size of 190,248.30 sq. ft.
- Subsequently, the taxpayer obtained approval to build a 31-storey office block requiring only 101,004.75 sq. ft. of the land block.
- On 24 April 1985, under the new management, the taxpayer had obtained the approval to amend development plans to build a 30-storey office block building.
- In year 1990, the taxpayer entered into an agreement to sell a portion of the unused land for RM42,500,000.
- The Inland Revenue Board of Malaysia (IRBM) raised additional assessment for the years of assessment 1988, 1989, 1990 and 1991.
- The taxpayer failed to get the additional assessment overturned by the Special Commissioners of Income Tax (SCIT) and the High Court.
- The taxpayer subsequently appealed to the Court of Appeal.

ii. Issue to be determined

The issue before the Court of Appeal was whether the disposal of a portion of the land was a disposal of a capital asset or was it a disposal of stock-in-trade. Both the SCIT and the High Court had ruled that the income from the sale was trading income and assessable to income tax.



Tax Case 1 – Disposal of real property is a capital transaction (cont.)

iii. Held

The Court of Appeal found that the SCIT came to the conclusion that the taxpayer was carrying on the principal activity of land development based on the following grounds:

- The subject land had been converted into land that was ready for development;
- The character of the land as originally purchased had changed; and
- The principal activity of the taxpayer was that of property development.

The Court of Appeal in delivering judgment in favour of the taxpayer found that:

- It was not safe for the SCIT to conclude that the taxpayer's principal activity was dealing in property merely because it was one of the stated objects in the taxpayer's Memorandum and Articles of Association.
- The correct conclusion should be based on the intention of the taxpayer when they purchased the subject land.
- There was no evidence to show that the taxpayer had been dealing in land before they acquired the subject property.
- There was no evidence to show that the taxpayer had made preparations for the sale
- The taxpayer has held the land for more than ten (10) years, and it was a clear indication that the taxpayer had purchased the property for investment purposes.

Based on the above tax case, it is important for taxpayers to always assess the taxability of gains or receipts from the disposal of real properties by using the badges of trade from the landmark tax case of NYF Realty Sdn Bhd v Controller of Inland Revenue.



Disposal of Shares

Generally, any gains arising from the sale and purchase of shares of companies in Malaysia would not be subject to income tax under the MITA because the gains are regarded as capital gains. Nevertheless, disposal of shares under the following circumstances will be taxable under MITA:

- disposal of shares by a share trading / dealing company as the shares are regarded as the stock-in-trade of the share trading / dealing company;
- existence of “badges of trade” on the part of the disposer e.g. profit-seeking motive, short holding period, use of short-term external financing, etc.

In the event a disposal involves Real Property Shares, any gains arising from such disposal should be taxed under the Real Property Gains Tax 1976 (to be discussed in a separate article).



Tax Case 2 – Disposal of shares is a capital transaction

Director-General of Inland Revenue v Hypergrowth Sdn Bhd, High Court, Decided on 9 July 2007 [2008] 1 MLJ 417

i. **Brief facts**

- The taxpayer was a veterinarian and had no expertise in shares trading.
- In year 1994, the taxpayer incorporated a company to undertake investment activities which include the acquisition of shares, hold, sell, realise or to re-invest the proceeds.
- The taxpayer company acquired some shares in Ngiu Kee Corporation (M) Bhd and the company was later listed on the stock exchange.
- Due to a sudden deterioration in economy and fears of further deterioration that might result in total loss, the taxpayer disposed of the shares and make a profit.
- The Director-General therefore sought to tax the proceeds from the disposal of the shares under Section 4(a) of the MITA.



Tax Case 2 – Disposal of shares is a capital transaction (cont.)

ii. Issue to be determined

The issue was whether the taxpayer's purchase of the subject shares and the sale thereafter constituted an adventure in the nature of trade which would require the profits of the sale to be subject to income tax; or whether the transaction was the realisation of capital assets, the proceeds of which were not subject to MITA.

iii. Held

It was held by the High Court as follows:

- The taxpayer was at all material times an investment company and was never shown to be a company trading in shares or had the means, knowledge or expertise in such an area of business.
- The dominant purpose for the purchase of shares was established as a matter of fact for investment purpose.
- Subsequently, it was sold because of unsafe market conditions. This issue was not challenged by the appellant and/or no evidence was introduced by the appellant at least to show that the market was not unsteady.
- The sale of shares was an isolated act and there was no other evidence to think otherwise.
- Every case must be decided on its own facts and there was sufficient evidence to support the decision of the Special Commissioners that the disposal was not an adventure in the nature of trade. The gains from the disposal are therefore not subject to income tax.

Disposal of Shares (cont.)

Generally, the principles indicated in the disposal of real property court cases apply equally to disposal of shares. In a case where the taxpayer acquired and consequently disposed of its shares, the IRB will take into consideration the subject matter of the transaction, the period of ownership, the frequency of transactions, the method used for disposing the shares and the reason for the sale before deciding that the shares acquired are not long-term investments.

On the other hand, an investment holding company is not taxable on the profits arising from the sale of its securities because its investments are considered as fixed capital assets.

In the case of an individual, it is uncommon for the IRBM to tax stock exchange transactions unless the transactions are carried out regularly and systematically. Thus, individuals who speculate in the stock exchange are in a happier position than companies. In many cases, the size and frequency of transactions are usually substantial. Notwithstanding this, clear evidence of a trade being carried on by the individual must be ascertained, otherwise no liability can be attached to the profits that arise.



In addition to the purpose for acquisition of shares, some of the factors that the IRBM takes into account when determining whether a trade is being carried on are:

- what is the normal occupation of the individual (i.e. whether he is an employee, a trader or a professional broker);
- whether he is a true speculator having irregular investment in the stock market;
- whether there are any connections between the individual and the stock market;
- whether his shares trading activities are organised (i.e. he has an office and staff who handle his dealings);
- whether he has expertise in the stock market.

Disposal of Cryptocurrencies

Cryptocurrencies have been in the spotlight over the past few years, with a market capitalisation of over 2 trillion US dollars.

A survey conducted by Luno Malaysia has shown that 62% of Malaysians investors would consider investing in alternative assets like cryptocurrencies as a way to diversify their portfolios. In addition, 37% of these investors noted that utilising cryptocurrencies for long-term investment purposes was an exciting feature of the digital asset while 40% stated that using cryptocurrencies is a favourable alternative store of value.

Since cryptocurrencies are a major asset class for investors, clear tax guidelines are required to be issued to guide investors on the tax implications when they dispose of such investments.

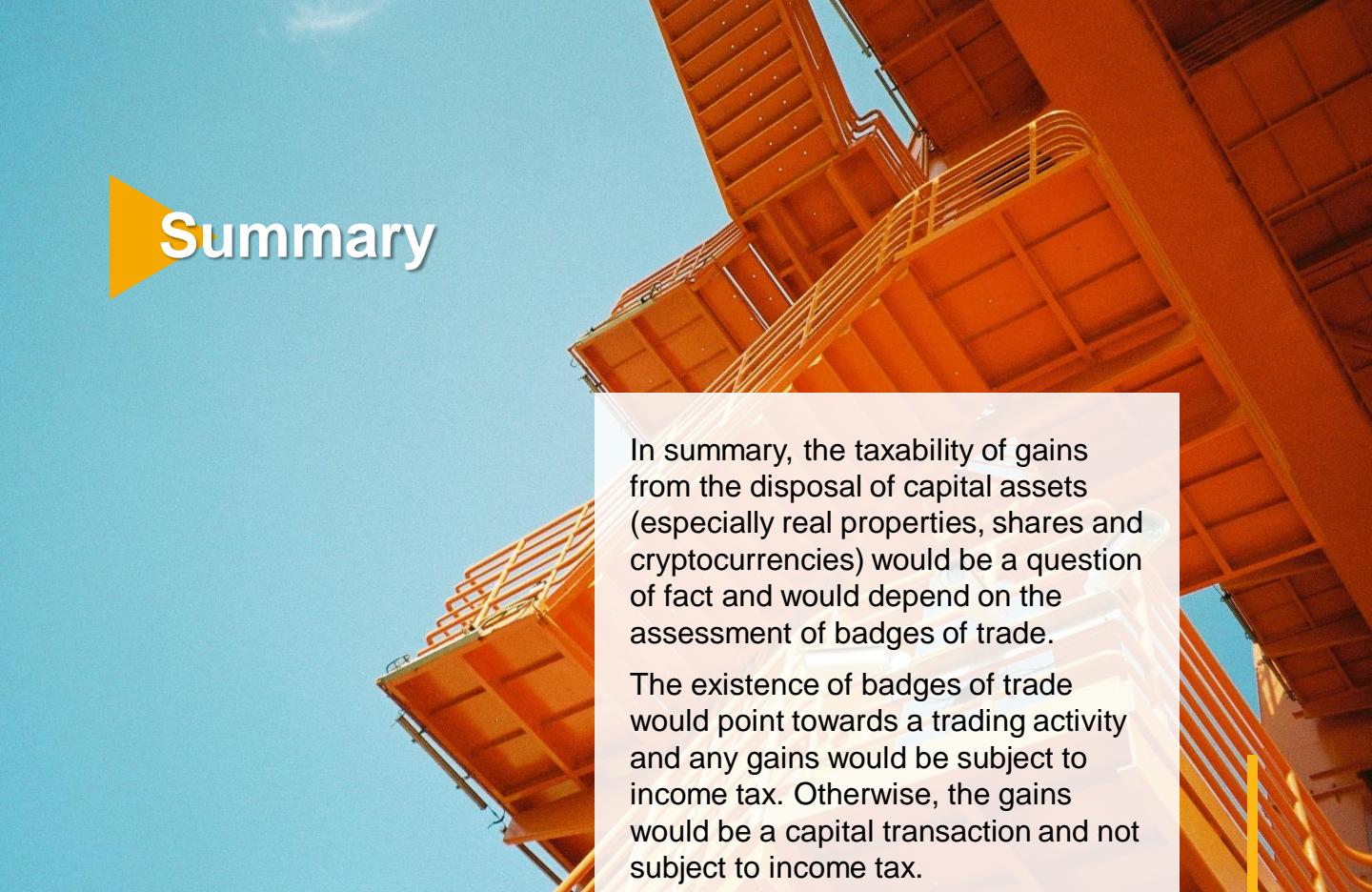
Currently, the IRBM has yet to issue definitive guidelines on how to subject cryptocurrency transactions to tax. However, the IRBM has cited Section 3 of the MITA and indicated that the said provision can be applied to active cryptocurrency traders. The IRBM went on to say that the determination of whether the profits from cryptocurrency activities are taxable would depend on the facts and circumstances of the case and whether badges of trade exist.

Cryptocurrencies are relatively new compared to real properties and shares, and do not have any tax case at the moment.

Since the cryptocurrency market is in the midst of a bearish cycle as investors are largely retreating from risky assets, most investors may be making losses. Nevertheless, some investors may still make gains if their acquisition price had been lower than the current market price. Hence, the assessment of badges of trade is crucial when it comes to determination of the taxability of gains on disposal of cryptocurrencies.



Summary



In summary, the taxability of gains from the disposal of capital assets (especially real properties, shares and cryptocurrencies) would be a question of fact and would depend on the assessment of badges of trade.

The existence of badges of trade would point towards a trading activity and any gains would be subject to income tax. Otherwise, the gains would be a capital transaction and not subject to income tax.

In the event that a transaction is held to be a trading activity, all expenses wholly and exclusively incurred in earning that income will be deductible under Section 33(1) of the MITA provided that they are not specifically disallowed under Section 39 of the MITA.

Hence, it is advisable for an investor to carry out an in-depth analysis of the facts of each case and all the factors have to be viewed in totality when performing the badges of trade assessment.

Do you need help in managing your tax on the disposal of real properties, shares or cryptocurrencies? Please feel free to reach out to us. We will be happy to help you.



This article was written by **Marcus Pua**, a Tax Advisory Senior Manager at Crowe Malaysia. If you wish to seek clarification on any of these issues, please contact marcus.pua@crowe.my



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