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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Real Property Gains Tax v Income Tax

Whether the gains from the disposal of land were trading receipts or capital receipts?

Ketua Pengarah Hasil Dalam Negeri v Gracom Sdn Bhd (2013) (High Court)

Facts:

The taxpayer was incorporated on 11.7.1988. Under its Memorandum and Articles of Association, the principal activity of the taxpayer, amongst others, was an investment holding company. On 23.10.1989, the taxpayer purchased 2 parcels of land registered as H.S.(D) 86910 (No. PT 97) and H.S.(D) 86911 (No. PT 98) from S Resort (M) Bhd. The 2 parcels of land were part of Master Title G 28578, Lot 13567, Mukim Damansara, Selangor. On 15 December 1995, the taxpayer had sold the land held under No. PT 97 to H Dinamis Sdn. Bhd. and the land held under No. PT 98 to S Sdn. Bhd. On 11.4.2000, the Revenue raised a notice of additional assessment for income tax ("Borang JA") for the year of assessment 1997 for the sum of RM8,540,810.70 against the taxpayer for the gains made from the disposal of the two parcels of land. On 21.9.2007, the taxpayer's tax consultants filed a notice of appeal to the Special Commissioners Of Income Tax ("Form Q") against the notice of additional assessment for income tax dated 11 April 2000 on behalf of the taxpayer.

The taxpayer's witness (AW1) said in evidence that he had retired from S Consolidated Berhad as its Director of Business Development in 2010. He said the taxpayer was part of P (Malaysia) Sdn Bhd which was the ultimate holding company of S Consolidated Berhad. Between 1997 and 2003, AW1 was a Director of the taxpayer. Between 1989 and 1999, AW1 was also the Senior Finance Manager in charge of OPD Sdn Bhd, one of the Master Title owners. By virtue of this, he was involved directly in the application for sub-division and development of the Master Title. The relevant testimony of AW1 pertaining to this case was as follows:

(a) The taxpayer did not purchase any other parcels of land except for the two parcels of land [namely H.S.(D) 86910 (No. PT 97) and H.S.(D) 86911 (No. PT 98)] ("the Two Parcels"), which the Taxpayer purchased as an investment.

(b) The taxpayer had consistently held the Two Parcels as "property development expenditure" items, i.e. non-current assets, in its audited accounts from the time the Two Parcels were purchased and sold. Other than holding the Two Parcels and some shares for the purposes of investment, the taxpayer did not have any other business. The taxpayer was then a dormant company.

(c) Although the audited accounts state that one of the taxpayer's principal activities was property development, the taxpayer never undertook any such activity. In fact, even after the

Two Parcels had been disposed of, the principal activity was continued to be stated to be of property development although the taxpayer owned no land.

(d) From AW1's experience having been involved at the time the taxpayer purchased the Two Parcels and managing the various applications and AW1's interaction with the taxpayer's directors then, it was apparent and clear to AW1 that the taxpayer purchased the Two Parcels for investment. It must be noted that at the time the taxpayer purchased the Two Parcels:

(i) The value of the Two Parcels was projected to increase substantially in the future due to the up and coming infrastructure improvements in the surrounding areas;

(ii) The S Golf and C Club, which was located in the same area, was a Government initiative to set up a golf club in Kuala Lumpur to attract investors and industrialists. Given that this was a Government initiative with huge potential for success, the taxpayer was of the view that the Two Parcels were lucrative investments; and

(iii) The Two Parcels were strategically located near the then international airport, Lapangan Terbang Subang.

For the reasons above, the taxpayer purchased the Two Parcels for the purposes of investment.

(e) The taxpayer took no steps to develop the Two Parcels. In fact, nothing was done by the taxpayer to exhibit such intention. The taxpayer was only interested in capital appreciation. This was evident from the fact that the taxpayer had consistently held the Two Parcels as "property development expenditure" items, i.e. non-current assets, in its audited accounts from the time the Two Parcels were purchased and until it was sold. If the taxpayer had intended to develop the Two Parcels, it would have held the Two Parcels as current assets.

(f) AW1 was clear about the taxpayer's intention and purpose, which was to hold the Two Parcels as investment, as besides being the taxpayer's director between 1997 and 2003, AW1 was also the officer in charge of the taxpayer's financial affairs for the years 1994 and 1995. Further, AW1 was also employed by the vendor's then ultimate holding company at the time the Taxpayer purchased the Two Parcels. The taxpayer's intention to hold the Two Parcels as an investment was present from the time it was purchased up until the time the Two Parcels were sold off. There was no change of intention and the taxpayer took no steps to develop the Two Parcels.

(g) The taxpayer did not hold a developer's licence. Undertaking such development activities without a developer's license amounts to an offence and one would be subjected to various civil and criminal sanctions. The taxpayer had no experience in property development. From corporate and financial perspectives, it would have been much easier and efficient to use an existing subsidiary that was in property development to purchase the Two Parcels if the intention was to develop the Two Parcels. This was because the existing subsidiary would have the necessary licenses and permits from the local authorities and professional bodies to undertake the development on the Two Parcels. Prior to the disposal of the Two Parcels, the taxpayer was a loss-making company and with a record like this, the taxpayer could not undertake property development. The taxpayer also had no income whatsoever. With such financial record, it was impossible for the taxpayer to obtain the necessary approvals from the authorities and gain public confidence to undertake property development. No one would take the taxpayer seriously.

(h) At the time of purchase, the Two Parcels were classified as agriculture land and it remained so until the Two Parcels were sold. The taxpayer did not make any application to convert the status of the Two Parcels or to subdivide the Two Parcels. The taxpayer did not engage a

surveyor to survey the Two Parcels. Further, the taxpayer did not make any plan for irrigation and draining on the Two Parcels. The taxpayer did not take any effort to level or clear the Two Parcels and did not employ any engineer, architect or contractor. The taxpayer was not a property developer as the Taxpayer did not do anything to the Two Parcels and did not even submit any plan to the authorities or engage consultants to exhibit intention to develop the land.

(i) The taxpayer sold the Two Parcels on 15 December 1995. At the time the Two Parcels were sold, the Taxpayer was owned by D Sdn Bhd, which was owned by P (Malaysia) Sdn Bhd. Sometime in 1995, P conducted a group restructuring exercise in view of strengthening S Consolidated Berhad's position for public listing purposes. In giving effect to this exercise, the taxpayer was required to sell the Two Parcels to S Sdn Bhd's subsidiaries, namely H Dinamis Sdn Bhd and Se Sdn Bhd. Further, since the Two Parcels had appreciated in value, the taxpayer thought it would be a good time to realise the investment. The Two Parcels remained agriculture land in terms of status and remained untouched since it was first purchased by the taxpayer. The nature and character of the Two Parcels at the time of the sale remained the same as how it was at the time the taxpayer purchased it. The taxpayer did not pay the premium as it never intended to change the nature of the land. But for the group restructuring activity, the taxpayer would not have sold the Two Parcels.

(j) The taxpayer did not appoint any broker or agent to sell the Two Parcels as the taxpayer was not trading in land. The taxpayer kept the Two Parcels for six years. The Two Parcels were meant as an investment and thus, the taxpayer did not do anything to mature the Two Parcels. The taxpayer wanted the Two Parcels to be an investment only. The taxpayer took no steps at all to develop the Two Parcels or commence the business of property development.

Accordingly, the taxpayer contended that the Two Parcels were held as investment and thus, the gains arising from the disposal of the Two Parcels were not subject to income tax. Meanwhile, the Revenue argued that the taxpayer was a property development company, which therefore meant that the gains from the disposal of the two parcels were business income. According to the Revenue, there was profit seeking motive by the taxpayer at the time of the acquisition of the said land since it was foreseeable that various development steps would be undertaken by the Government to develop the area.

Issue:

Whether the gains from the disposal of the 2 parcels of land were trading receipts and taxable under Section 4(a) of the Income Tax Act 1967 as business income or capital receipts and taxable under the Real Property Gains Tax Act 1976?

Decision:

In order to resolve this issue, The Special Commissioners of Income Tax ("Special Commissioners") held that it was necessary to determine the intention with which the taxpayer acquired the subject land. The intention of the taxpayer must be judged against the background of its acts and conduct and the circumstances of the case. The question whether a profit realised on the sale of real estate is a realisation or change of investment or an act done in the carrying on of a business is to be determined in the light of the facts in each case. The intention must be shown to have existed at the time of the acquisition of the asset. It was also of critical importance to note that the intention must amount to an intention in law. Based on this and the facts highlighted

above, the Special Commissioners found that when the taxpayer acquired the subject land, its intention was for investment.

According to the Special Commissioners, the intention must be shown to have existed at the time of the acquisition of the asset. In this respect reference may be made to *Lower Perak Co-operative Housing Society Bhd.* v. *DGIR* (994) 2 MLJ 713 where *Edger Joseph Jr* S.C.J. referred to the judgment of *Lord Wilberforce in Simmon* v. *IRC* (1980) STC 350 as follows:

> "*One must ask, first what the Commissioners were required or entitled to find. Trading requires an intention to trade; normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further question: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intention may be changed. What was first an investment may be put into the trading stock, and, I suppose, vice versa. If finding of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax (of Sharkey (Inspector of Taxes) v. Wernher (1955) 2 All ER 493; (1956) AC 58). What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor for it to possess an indeterminate status, neither trading stock nor permanent asset. It must be one or the other, even though, and this seems to be legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely, that situations are open to review*."

The Special Commissioners added that it is also of critical importance to note that the intention must amount to an intention in law. On the proper meaning of an intention in law reference may be made to *Cunliffe* v. *Goodman* (1950) 1 All ER 720 referred to by Edger Joseph Jr S.C.J. in the *Lower Perak case* where *Asquith* L.J. said at p. 724:

> "*An 'intention' to my mind connotes a state of affairs which the party 'intending' - I will call him X - does more than merely contemplate. It connotes a state of affairs which, on the contrary, he decided, so far as in him lies, to bring about, and which, in point of possibility, he has a reasonable prospect of being able to bring about by his own act of volition. X cannot, with any due regard to the English Language, be said to 'intend' a result which is wholly beyond the control of his will. He cannot 'intend' that it shall be a fine day tomorrow. At most he can hope or desire or pray that it will. Nor, short of this, can X be said to 'intend' a particular result if its occurrence, though it may not be wholly uninfluenced by X's will, is dependent on so many other influences, accidents, and cross currents of circumstances that not merely is it likely not to be achieved at all, but if it is achieved, X's volition will have been no more than a minor agency collaborating, with, or not thwarted by, the factors which predominately determine its occurrence*.
>
> *... This leads me to the second point bearing on the existence in this of 'intention' as opposed to mere contemplation. Not merely is the term 'intention' unsatisfied if the person professing it has too many hurdles to overcome or too little control of events; it is equally inappropriate if at the material date the person is in effect not deciding to proceed but feeling his way and reserving his decision until he shall be in possession of financial data sufficient to enable him to determine whether the*

project will be commercially worthwhile. A purpose so qualified and suspended does not, in my view, amount to an 'intention' of 'decision' within the principle. It is mere contemplation until the materials necessary to a decision on the commercial merits are available and have resulted in such a decision."

Accordingly, the Special Commissioners unanimously held that when the taxpayer acquired the Two Parcels, its intention was for investment based on the following:

(a) The taxpayer acquired the Two Parcels due to its strategic location i.e. near the international airport, Lapangan Terbang Subang and the S Golf and C Club. The value of the land was also projected to increase substantially in the future due to the up and coming infrastructure, and improvement in the surrounding areas.

(b) As testified by AWI, the taxpayer's ultimate holding company P Group had intended, amongst other, that the taxpayer hold the Two Parcels as investment, which is consistent with the taxpayer's principal activity as an investment holding company, as per the Memorandum and Articles of Association.

(c) The Two Parcels were consistently held as non-current assets item in the taxpayer's audited accounts and the taxpayer's auditors agreed to this treatment after making their due inquiry.

(d) The taxpayer held the Two Parcels for almost 6 years before disposal. This was further evidence of its intention to hold the subject land for investment.

(e) As testified by AW1, the taxpayer did not have the finance, relevant experience and expertise, necessary licenses such as a developer's licence for example to undertake property development activities. Apart from acquiring the Two Parcels and after their disposal, the taxpayer did not acquire any other land way before as well as after their acquisitions and sale, nor dealt in the business of real estate. This was further evidence of the taxpayer's intention to hold the Two Parcels as investment before their disposal.

(f) The disposal of the Two Parcels was triggered by the taxpayer's ultimate holding company's group restructuring exercise, otherwise the taxpayer would have retained the land, as per AWI's testimony that was not challenged or contradicted.

(g) The taxpayer did not make any alteration or improvement to the Two Parcels to enhance their marketability. In fact the character or quality of the land had never been changed. For instances, the Two Parcels remained as "agricultural land" on the day it was purchased and later sold; the Taxpayer did not level or clear the land; the Taxpayer did not make any application to convert the status of the land nor made any application to sub-divide the land; no surveyor was engaged to survey the land; nor did the taxpayer submit any development plans or proposal in respect of the land. The land remained in their pristine, untouched state from the date of purchase till the date of their disposals. This was strong evidence of the taxpayer's intention of holding them for investment purposes, as AWI's testimony pertaining to the above was not challenged or contradicted.

(h) The Revenue's contention regarding the accounting treatment can best be answered as follows. In the light of the facts and circumstances of this case, given that there was no frequency of transactions, no physical enhancement to the land, no organised effort to promote sale, the plansible but unchallenged reason stated by AW1 to smooth the way for the public listing of S Consolidated Bhd. etc, the accounting treatment did not alter the nature of the transactions.

The High Court upheld the Special Commissioners' decision and ordered the notice of additional assessment for income tax to be discharged. The Revenue did not appeal to the Court of Appeal against the High Court's decision.

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