

RELEVANT TO ACCA QUALIFICATION PAPER P6 (MYS)

Real Property Gains Tax

There have been amendments to the RPGT Act since this article was originally published in April 2011. This article is updated to include amendments as at 31 March 2012, and is relevant to candidates sitting the exam in December 2012 and June 2013.

General

'Real property' and 'Land'

For purposes of RPGT, 'real property' means:

- any land situated in Malaysia, and
- any interest, option or other right in or over such land.

'Land' includes the following components:

	Comments
<i>The surface of the earth and all substances therein</i>	For example, land includes any clay deposits (with commercial value for the making of bricks) found on the land.
<i>The earth below the surface and substances therein</i>	If a piece of land is found to contain oil, minerals or other valuable substances, the gross sale value of such land, including the value of such deposits, will be the disposal value subject to RPGT.
<i>Buildings on land and anything attached to land, and anything permanently fastened to anything attached to land</i>	A piece of land with a building put up on it will include the land, the building erected, and anything permanently fastened to the building – for example, air-conditioning systems, solar panels etc.
<i>Standing timber, trees, crops and other vegetation growing on the land</i>	If teak trees or rice or any other crops are planted on the land, they form part of land. The operative word is 'standing'. Thus, if the crop is felled/harvested and sold, there is no disposal of land, neither does the felled/harvested crop constitute part of land.
<i>Land covered by water</i>	A piece of land with lakes, rivers or disused mining pools on it would include such water bodies.

Gain defined

'Gain', for purposes of the RPGT Act, must *not* be a gain or profit that is chargeable to or exempted from income tax under the Income Tax Act.

It follows that a gain must be excluded from being 'income' before it is subject to RPGT. The question of capital gains versus revenue income is, therefore, of utmost importance.

Computation of chargeable gain

Section 7 of the RPGT Act states that 'if the disposal price exceeds the acquisition price, there is a chargeable gain'.

Disposal price is defined in Paragraph 6 of Schedule 2, summarised below:

Disposal price is:

Sale consideration for the disposal of the asset
less

- (a) expenditure incurred on the asset *after* its acquisition... for the purpose of enhancing or preserving the value of the asset
- (b) expenditure incurred by the disposer after its acquisition in establishing, preserving or defending his title to, or to a right over the asset, and
- (c) the incidental costs to the disposer of making the disposal.

Note that the manner of arriving at the disposal price is by *deducting* any enhancement, preservation expenses, etc, incurred after the acquisition *from the sale consideration*.

The quirk here is that the expenses (ie items (a) and (b) above) are deducted from the sale price rather than the normal accounting approach of adding the additional cost to the purchase cost of the asset.

Enhancement/preservation expenses

If a property comprising land and building is acquired, the total cost is the acquisition cost. However, if the land is acquired, then subsequently a building is erected on it, or renovations are carried out on a land-with-building, the enhancement or preservation costs must be reflected in the state of the asset *at the time of disposal*.

Paragraph 5(1), Schedule 2:

'... (a) the amount of any expenditure wholly and exclusively incurred on the asset at any time *after its acquisition*... for the purpose of *enhancing or preserving the value* of the asset, being expenditure reflected in the state of nature of the asset at the time of the disposal...'

Note the difference in RPGT treatment in Examples 1 and 2 where the only factual difference is the demolition of the house erected after purchase of the land.

Example 1

A piece of land was acquired at RM100,000 on 1 February 2009, with legal fee and stamp duty of RM2,500. A house was constructed on the land in 2010 at a cost of

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RM300,000. On 1 December 2011, the land with building was disposed of for RM500,000. The disposer paid RM30,000 to the real estate agent for the successful sale.

Chargeable gain is computed as follows:

	RM	RM
Sale price		500,000
Less Enhancement cost (house construction)	300,000	
Incidental cost (real estate agent fee)	<u>30,000</u>	
		<u>(330,000)</u>
Disposal price		170,000
Purchase cost	100,000	
Add Incidental cost	<u>2,500</u>	
Less Acquisition price		<u>(102,500)</u>
Chargeable gain		67,500

Example 2

A piece of land was acquired at RM100,000 on 1 February 2009, with legal fee and stamp duty of RM2,500. A house was constructed on the land in 2010 at a cost of RM300,000. On 1 May 2011, the house was demolished. On 1 December 2011, the land (now vacant) was disposed of for RM500,000. The disposer paid RM30,000 to the estate agent for the successful sale.

Chargeable gain is computed as follows:

	RM	RM
Sale price		500,000
Less Enhancement cost (house demolished)	nil	
Incidental cost (real estate agent fee)	<u>30,000</u>	
		<u>(30,000)</u>
Disposal price		470,000
Purchase cost	100,000	
Add Incidental cost	<u>2,500</u>	
Less Acquisition price		<u>(102,500)</u>
Chargeable gain		367,500

Year of assessment

Pursuant to Section 10 of the RPGT Act, the year of assessment is based on the corresponding calendar year. Therefore the year of assessment 2011 refers to the calendar year 2011 (1 January 2011 to 31 December 2011).

Do bear this in mind when considering the absorption of allowable loss, as seen below.

Allowable loss

Where there are more than one transactions of real property in a year of assessment, allowable loss from one transaction may be set-off against another transaction that yields a chargeable gain.

Question: Must the loss-making transaction be *after* the profitable one in the same year of assessment?

Section 7(4) reads:

'Where there is an allowable loss in respect of a disposal, such allowable loss shall be allowed as a reduction to reduce the total chargeable gain of a person for a year of assessment in which the disposal was made.'

The provision enables the deduction of an allowable loss from a transaction against the total chargeable gain of the person from other transaction/s in the same year of assessment, regardless of whether the loss transaction occurred before or after the profitable transaction/s during that year of assessment.

Of course, Section 7(4)(b) goes on to state that any unabsorbed loss may be carried forward to the subsequent year/s of assessment until it is absorbed.

Do be mindful that, for an individual, any allowable loss is absorbed *after* the exemption under Schedule 4 – ie the greater of 10% or RM10,000. This is provided for in Section 7(5) of the RPGT Act.

Conditional contract

The significance of a conditional contract is that the disposal and acquisition date of the chargeable asset concerned depends on the date the condition or the last of the conditions is/are fulfilled.

A contract is *conditional* for purposes of RPGT if the contract requires the approval of the government or a state government, or an authority or committee appointed by the government or a state government. The date such approval is given would constitute the date of disposal. Where more than one such approvals are required, the date of disposal is deemed to be the date of the later or last of such approvals is obtained.

Example: A sale and purchase agreement for the disposal of a real property was signed on 29 December 2011. It was conditional upon the approval from the Security Commission (SC) as well as the state government. The approval from the SC came on 2 March 2012 while that from the state government was obtained on 30 August 2012. The date of disposal of the real property is deemed to be 30 August 2012.

Inter-company transfer of shares under Paragraph 17

Under Paragraph 17 of Schedule 2, three types of transfer of assets between companies are deemed at no-gain-no-loss. Such transfers must have prior approval of the director-general to avail themselves of the treatment.

	To achieve greater efficiency in group operations	In compliance with government's participation policy	
		Scheme of reorganisation, reconstruction, or amalgamation	Liquidation
Transfer of assets	Transfer between companies in the same group of companies	Transfer between any two companies	Distribution on liquidation
Consideration	75% – 100% in shares	Consideration in any form	No consideration
Transferee	Resident company	Resident company	Resident company
Acquisition date of transferee	Actual date of transfer	Acquisition date of transferor	Acquisition date of transferor
Condition for transferee	Must remain in the same group as transferor for three years after approval	Must remain resident in Malaysia for three years after approval	Must remain resident in Malaysia for three years after approval
Asset is taken in as trading stock by transferee	At the date of taking in, asset is deemed disposed of and any excess is the chargeable gain of the transferee duly subject to RPGT provisions.		

Transfer of fixed assets into stocks

Under Paragraph 17A of Schedule 2, any reclassification of real property from fixed asset to current asset (trading stock) is deemed to be a disposal of chargeable asset for RPGT purposes.

The disposal price is deemed to be at the market value of the asset at the date of reclassification.

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Example 3

Facts

A Sdn Bhd, a plantation company, has a land bank of 500 acres acquired on 10 January 2009 at RM5,000 per acre. The 500 acres were reflected as a fixed asset of the company.

On 19 October 2012, it decided to venture into property development and transferred 100 acres from its fixed asset to current asset. The market value as at the date of transfer into stock was RM20,000 per acre.

Treatment

As at 19 October 2012, the 100 acres were deemed to have been disposed of at RM2m (RM20,000 x 100 acres). The actual acquisition price was RM500,000 (RM5,000 x 100 acres). Therefore, the chargeable gain of RM1,500,000 (RM2m – RM500,000) is subject to RPGT in 2012.

Consequently, A Sdn Bhd will be able take into the stock 100 acres of land at RM20,000 – ie RM2m. In other words, the land cost for the development business is now stepped up to RM2m, but it has to bear a RPGT of RM75,000 (RM1,500,000 x 5%).

No-gain-no-loss transaction

Although this looks and feels like an exemption, it is not. It is a merely a postponement of RPGT liability. Do remember that the acquirer is deemed to acquire at the original acquisition price of the disposer, but the acquisition date is now changed to the later date. This is illustrated in Example 4 below.

Example 4

Mr A transfers his land (which he acquired on 1 February 2004 for RM100,000) to A Sdn Bhd on 1 March 2010 in return for 200,000 shares in A Sdn Bhd. This is a no-gain-no-loss transaction under Paragraph 34: A Sdn Bhd is deemed to have acquired the land for RM100,000 on 1 March 2010.

When A Sdn Bhd subsequently disposes of the land on 3 December 2011 for RM500,000, the holding period is less than two years (1 March 2010 – 3 December 2011) while the chargeable gain of A Sdn Bhd is RM400,000 (RM500,000 – 100,000).

Real Property Company shares

General

Paragraph 34A was introduced as an anti-avoidance measure. Take note that Paragraphs 34 and 34A are mutually exclusive.

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Definition of Real Property Company (RPC):

A company is an RPC if it is:

- a controlled company, as defined, *and*
- owns real property or RPC shares whose combined defined value (market value or in certain cases the deemed acquisition price) is at least 75% of total tangible assets¹ (TTA).

When does one determine whether a controlled company is an RPC?

The answer is:

- on 21 October 1988 (when Paragraph 34A relating to RPC was first introduced)
- if not an RPC on 21 October 1988, when it *first acquires* real property or RPC shares after that date.

When does one re-examine whether a controlled company continues to be an RPC?

Once a controlled company is determined to be an RPC on a given date, it remains an RPC. There is no necessity to re-examine its RPC status thereafter unless the company:

- ceases to be a controlled company, or
- disposes a real property or RPC shares.

When an RPC ceases to be a controlled company², it ceases to be an RPC on that date.

When an RPC *disposes* of a real property or RPC shares, it is necessary to ascertain whether the remaining real property and/or RPC shares continue to make up at least 75% of TTA.

If the percentage falls below 75%, the company ceases to be an RPC on the date of disposal of the real property and/or RPC shares.

If the percentage is 75% or more, the company will remain an RPC.

Thereafter there will be no need to review the percentage and its RPC status until the next time it *disposes* of a real property or RPC shares.

Once RPC shares, always RPC shares

When an RPC ceases to be an RPC, a shareholder who acquires shares after that date will acquire non-RPC shares.

However, existing shareholders who held shares while the company was an RPC would hold RPC shares and continue to hold RPC shares, even after the company had ceased to be an RPC. The RPC shares will not shed its RPC shares nature even though the company had ceased to be an RPC.

When such shares are disposed of (ie after the company had shed its RPC status because it ceased to be a control company or it disposed of real property or RPC

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shares and the percentage falls below 75%), it constitutes a disposal of RPC shares and is duly subject to RPGT provisions. Hence the quote: 'Once RPC shares, always RPC shares.'³

Therefore, it is possible that, in a single and the same transaction, RPC shares are disposed of by the disposer, but the shares acquired by the acquirer are *not* RPC shares.

Acquisition date

If a company was already in existence before 21 October 1988, and on 21 October 1988 it was determined to be an RPC, the shareholders are deemed to have acquired RPC shares on 21 October 1988.⁴

If the shares are acquired at a time when the company is not an RPC, the shares are deemed acquired on the date when the company subsequently becomes an RPC.

Example 5

Facts

XYZ Sdn Bhd was not an RPC when it was incorporated on 1 February 2000 with Mr X, Mr Y and Mr Z each holding 100,000 shares. The shares were, therefore, not RPC shares.

On 31 March 2009, the company acquired its first and only real property (defined value: RM1.2m) when its total tangible assets (including the said real property) stood at RM1.5m.

XYZ Sdn Bhd did not dispose of its real property and it remains an RPC. Mr X disposed of his 100,000 shares on 1 December 2012 for RM1m to Mr D.

RPGT treatment

Mr X, Mr Y and Mr Z are deemed to have each acquired 100,000 RPC shares on 31 March 2009 when the company became an RPC.

Therefore, the disposal of the RPC shares by Mr X occurred in the fourth year (31 March 2009 to 1 December 2012).

As for Mr D, he acquired RPC shares on 1 December 2012 (Paragraph 34A(2)(b)).

Acquisition price

What is the acquisition price of the RPC shares by Mr X in Example 5?

This is dealt with in Paragraph 34A(3)(a) of Schedule 2 and it is computed as follows:

$$A/B \times C$$

where

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A is the number of shares held by the shareholder
B is the total issued shares of the company, and
C is the defined value of the real property at the date of acquisition of the chargeable asset.

The deemed acquisition price of Mr X's 100,000 shares = $100,000/300,000 \times \text{RM}1,200,000 = \text{RM}400,000$ even though Mr X had only paid RM100,000 for the shares.

The disposal price being RM1m, Mr X's chargeable gain is, therefore, RM600,000 (1m – 400,000).

Mr D's acquisition price is the price he paid for the shares – ie RM1m. (Paragraph 34A(3)(b)). The significance of this provision is that bonus shares which are RPC shares are obtained at no cost. Therefore the bonus shares are acquired at zero cost. Any subsequent sale of such shares will mean that the whole of disposal consideration will be the gain.

Withholding of tax at source

Withholding of 2% of the total consideration is applicable only if the transaction is partly or wholly in cash. If the transaction is wholly non-cash, withholding does not apply. If the consideration is partly in cash, compare the 2% of the total value of the consideration and the cash consideration and withhold the lower amount.

Any money thus retained must be remitted to the director general of Inland Revenue within 60 days after the date of disposal. This means the counting of the 60 days starts on the day after the date of disposal.

Exemptions

Exemption where the disposal is made after five years

RPGT (Exemption) (No.2) Order 2009 [P.U (A) 486] provides an exemption for all persons where the disposal is made after five years from the date of acquisition of the chargeable asset. PU(A) 486 of 2009 has been revoked and replaced by PU(A) 434 of 2011. It continues to provide the exemption for a disposal of chargeable asset in the sixth year after the date of acquisition of such chargeable asset or any year thereafter.

However, PU(A) 434 of 2011 introduced a new rate of 10% for a disposal made within two years after the date of acquisition. Any disposal made in the third, fourth and fifth year after the date of acquisition will continue to be effectively charged at 5%.

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Exemption of the difference between the appropriate rate and 10% or 5%

Where a chargeable asset is disposed of within two years after its acquisition date, the abovementioned exemption order grants an exemption of the difference between the appropriate rate and 10% or 5%, so that the final effective RPGT rate is 10% or 5%.

The method by which the exemption is achieved is by way of the formula:

$$A/B \times C$$

where

A is the RPGT charged at the appropriate rate less the RPGT at 10% or 5%;

B is the RPGT charged at the appropriate rate; and

C is the chargeable gain.

Example 6

Facts are as in Example 5.

The computation of RPGT in respect of the disposal of RPC shares by Mr X is as follows:

	RM
Disposal price of 100,000 RPC shares	1,000,000
Acquisition price	<u>(400,000)</u>
Chargeable gain	600,000
Less 10% of Chargeable gain or RM10,000, whichever is greater	<u>(60,000)</u>
Net chargeable gain	540,000
Acquisition date	31 March 2009
Disposal date	1 December 2012
Disposal in the fourth year, appropriate rate is 15%	
Less Exemption per PU order 434 of 2011:	
A/B x C = $\frac{(540,000 \times 15\%) - (540,000 \times 5\%)}{540,000 \times 15\%} \times 540,000$	
= $\frac{81,000 - 27,000}{81,000} \times 540,000$	<u>(360,000)</u>
Chargeable gain after exemption	180,000
RPGT at appropriate rate of 15%	<u>27,000</u>

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Example 7

A chargeable asset was acquired by a company on 1 June 2011 for RM100,000 and is disposed of on 1 November 2012 for RM250,000. The computation of RPGT is as follows:

	RM
Disposal price	250,000
Less Acquisition price	<u>(100,000)</u>
Chargeable gain	150,000
Disposal within two years, appropriate rate is 30%	
Less Exemption per PU(A) order 434 of 2011:	
A/B x C = $\frac{(150,000 \times 30\%) - (150,000 \times 10\%)}{150,000 \times 30\%} \times 150,000$	
= $\frac{45,000 - 15,000}{45,000} \times 150,000$	
= 100,000	<u>100,000</u>
Chargeable gain after exemption	50,000
RPGT at appropriate rate of 30%	<u>15,000</u>

Written by a member of the Paper P6 examining team

References

1. Total tangible assets include real property, stock-in-trade, property plant and equipment, trade receivables, cash at bank and cash in hand, investment in shares, etc, stated at gross (rather than net) value.
2. A controlled company, as defined under the Income Tax Act 1967 – the reader is assumed to have a full understanding of the controlled company concept. Refer to Sections 2 and 139.
3. It has often been erroneously stated as ‘once RPC, always RPC’. Note that the correct quote is ‘once RPC shares, always RPC shares’.
4. The decision in the case of Md Dean v KPHDN is noted but is kept in view pending further clarification/development.