
Taxes on Property in Malaysia

The property development industry has always been regarded as one of the major economic drivers of a country, especially so for a fast “developing” country such as Malaysia which requires space and infrastructure to meet its development needs. The multiplier effects of the industry through the economy is widespread and can be felt in the whole supply chain from building material suppliers, developers and contractors to the service providers such as architects and engineers. Undeniably, property development not only creates wealth but its products are also a store of wealth for the buyers.

If property is dear to most people’s hearts, then taxation of property is probably one of the biggest dreads on their minds. Property has always been associated with wealth and governments will seek to tax property owners in various ways. In Malaysia, property owners through mere ownership, whether or not there is a derived income, have to pay property tax in the form of quit rent and assessment on an annual and semi-annual basis to the state and local authorities respectively. If they receive rental income from the properties, they are further liable to income tax. Treated as ordinary income, this rental income is to be included in the taxable income of the taxpayer.

The Stamp Duty Encounter

To the average property investor, their first encounter with property taxes is in the form of stamp duty, which is payable on the acquisition of properties at the rate of 1% - 3% of the property value. The 1% rate applies to property value below RM100,000 whilst the 2% applies to the value between RM100,000 to RM500,000, and the 3% to the balance above RM500,000. Buyers will also be required to pay additional stamp duty at the rate of 0.5% of the loan value if their purchases were financed through loans.

On the other hand, the disposer takes home his capital gains free of taxes with the “suspension” of real property gains tax which comes into effect from 1 April 2007. In addition, following the change of the Malaysian tax system to the single tier tax system from 1 January 2008, a disposer which is a company, is able to distribute its capital gains to shareholders in the form of tax free dividends. Under the single tier tax system, a company may distribute dividends without the need for franking tax credits which were previously required.

The Catch in Disposal of Properties

However, one must also be aware that all disposals of properties which were not subjected to real property gains tax, may possibly be subjected to income tax if the disposal is considered an “adventure in the nature of trade”. This insidious term is to catch disposals whether by companies or individuals, who had acquired property with the intention to make quick profits and thereby deriving trading profits as opposed to making long term investments which results in capital gains. Suffice to say that this concept is a major grey area of tax law that has given rise to a significant amount of uncertainty. In the absence of any objective guidelines or clear directions by the tax authorities, every case is considered based on its facts. Disposals of properties for a “quick gain” or after value enhancement activities by the owner such as repeated renovation and sale, conversion, sub-division or development planning, may fall within this category of disposals.

In addition, a taxpayer is frequently at a disadvantage because the tax authorities has the benefit of hindsight where it is able to delve into the intention of the disposer by referring to the conduct of the disposer, even long after the transaction had been consummated. In most instances, the disposers will be oblivious of the tax consequences until challenged by the tax authorities many years later. A good case in point was the tax waiver given by the government in the year 1999, which later became an opportunity for the tax authorities to reap bounties from those who exploited the "tax waiver year" provisions.

Concessions for Property Developers

Whilst property owners gained from the suspension of real property gains tax, the other major beneficiary of the tax change were property developers who had seen an influx of foreign buyers following the suspension of the tax. Property developers being entrepreneurs are taxed on income from their property development activities. In fact, they are regarded by the tax authorities as a unique group of taxpayers and special rules have been formulated to tax their profits. Nonetheless, to appreciate the contribution of this sector to the economy, in 2006 the government introduced several concessions such as allowing "warranty costs" incurred during the defects liability period to relate back to the year of completion of the development. Estimated losses incurred in a year were also allowed tax deduction against estimated profits from profitable projects, with the effect that property developers pay less tax upfront and defer their taxes, thereby improving their cashflow.

One thing that remains unchanged is that property development profits are taxed progressively over the period of development based on the stage of completion, although the meaning on stage of completion had been interpreted differently over the years. By and large, stage of completion is now determined based on the development costs incurred by the developer or based on a survey of the work done in accordance with accounting standards. The tax authorities will also allow the use of progressive billings as a measure of stage of completion provided this is used in a consistent manner.

Reasonable Tax Treatment in Malaysia

A quick overview of the taxes on property therefore shows that Malaysia is relatively mild on taxation of property as compared to many countries which not only impose similar taxes but also capital gains tax on property. The reasonable tax treatment should stimulate the property development and construction industry which is a significant source of jobs, taxes and business opportunities. This is buoyed no less by Malaysians' affinity for property as investments. Many Malaysians would subscribe to the saying by Mark Twain "buy land, they're not making it anymore"! With the continual rise of property values and growing demand by buyers, the property market will be a happy hunting ground for investors, developers and the government alike for many more years to come.

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This article was first published in the April 2008 issue of EUMCCI Review, a quarterly newsletter by the EU Malaysia Chambers of Commerce and Industry.