Real Property Gains Tax and the Malaysian Housing Market

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1. INTRODUCTION

In Malaysia, property sector particularly housing is one of important contributors to the national economy. Government uses property sector as a tool to drive the economy when it slows down, and to regulate the economy when there are signs of overheating. Property is identified as supporting 140 other industries in the economy as such when the property thrive, 140 other industries prosper. Underpinning property market activity is the availability of finance to facilitate the activity. Excessive liquidity under accommodative banking system however, may lead to property price increases. On the hand, lack of financial support, may effect property demand and subsequently, dampened market activity. At the same time, being a young nation, Malaysia promotes home-ownership i.e. housing is considered as a shelter for the citizen. The banking system backs this government home-ownership promotion by presenting a supportive financial environment. Hence, regulating property sector is in the government upmost priority list.

One the tools to regulate property sector is by imposing tax on the gain from property disposal within certain holding periods. Since early 1970s, such gains are imposed tax under Land Speculation Tax (LST) 1974 and changed to Real Property Gains Tax (RPGT) 1976. After numerous developments, in 2007, Government repealed RPGT to encourage more investment and businesses into this sector. The strategy was expected to propel construction and property industries since the industries had softened for the past years at 0.5 percent (2006), 1.6 percent (2005) and 1.5 percent (2004). However, in 2013, the RPGT make a comeback with rates of between 10 – 15 percent due to overheating in the market. Under the latest development in 2014, Government reviews RPGT in an effort to increase the ability of the buyer to buy a house and ensure stable house prices, as well as to control excessive speculative activities. A higher rate scale is introduced of between 15 and 30 percent depending on holding period. In addition, foreign buyers are subject to a 30 percent tax on gain within the first five years of holding period and 5 percent beyond 5 years from the date of acquisition.

This paper is written to discuss the trends in the housing market in the past decade against the backdrop of government intervention via RPGT. In doing so, this paper will present the background of RPGT in Malaysia. The second part will highlight the housing market trends by presenting the transaction volume and value as well as the house price index. The third part will be the discussion of the government intervention via supportive financial system. This paper concludes that the housing market responded positively to the two RPGT exemptions in 2003-2004 and 2007-2010 periods with higher transaction volume and value. In other words, government initiative to propel the market via RPGT exemption is timely, i.e. during the country economic slowdown. Added to this, the financial sector that supports the market activity as be seen by the expansion of credit supply to the housing sector.

2. MALAYSIA BRIEF FACTS

Malaysia is a rapidly developing economy in Asia. The country is an open economy where the economic activities involve both domestic and international community. Since 1970s, the country has transformed itself from a producer of raw materials into an emerging multi-sector economy. In 2012, the economy is the third largest economy in South East Asia after Indonesia and Thailand. Malaysia is ranked as the 29th largest economy by purchasing power parity (PPP) with gross domestic product (GDP) stands at US$492.4 billion and per capital US$16,499 by the World Bank Report. The international reserves of Malaysia's Central Bank amounted to RM427 billion (equivalent to USD130.9 billion) as at 30 May 2014 (BNM, 2014).

Malaysia is an upper-income country. On the income distribution, it was estimated that in 2012, there are more than 61.0 percent house-holds having a monthly income more than RM3,000 ($US920) out of which 33.6 percent earn RM5,000 (US$1,533) and above. About 33.8 percent of the house-holds are having an average monthly income between RM 1,000 and RM 3,000 and another 5.0 percent receive monthly income below RM 1,000 (Department of Statistics Malaysia).

Figure 1: **MALAYSIA : BASIC STATISTICS**

	2011	2012	2013 (e)
Population (million)	29.0	29.3	29.7
Labour force (million)	12.6	12.9	13.2
Employment (million)	12.3	12.5	12.8
Unemployment rate (%)	3.1	*3.2*	*3.1*
Nominal GDP (RM billion)	884.5	941.2	1008.2
Nominal GNI (RM billion)	862.6	905.2	981.0
Real GDP growth rate (%)	*5.1*	*5.6*	*5.0~6.0*
Per capita income RM	29,783	30,859	33,010
Per capita income US$	9,733	9,991	10,687
Per capita income PPP(US$)	15,190	15,676	16,499
Inflation (% p.a)	*3.2*	*1.6*	*2.0~3.0*
Merchandise exports (RM billion)	699.6	703.2	713.1
Merchandise imports (RM billion)	548.0	577.6	610.8
Current account of BOP (% of GNI)	*11.9*	*6.3*	*4.4*
Exchange rate (RM/US$)	3.06	3.09	3.09 *

Notes: (e) Estimate (f) Forecast * Data for Jan-July 2013

Economic Planning Unit (EPU), 2013

The country's population size is estimated at 29.7 million with work force of 13.2 million in 2013. The rate of unemployment is less than five percent (3.0 percent as at December 2013), which is comparatively lower than other countries. Figure 1 shows Malaysian economy figures in 2013 by Economic Planning Unit (EPU) of the Prime Minister's Department.

The banking and finance sector is under the control of the central bank, Bank Negara Malaysia (BNM). After the 1997 Asian financial crisis, BNM introduced a financial sector Master Plan in 2001 which gave more importance to Islamic banking. In 2009, government gives licensure to more sectors to increase the opportunities of Islamic Banking and Takaful. As to date, Malaysia is the world's largest Islamic banking and financial center. In business environment, Malaysia ranks 6th out of 189 economies for ease of doing business by the World Bank in 2014.

3. BACKGROUND – REAL PROPERTY GAIN TAX IN MALAYSIA

Real Property Gains Tax, as the name suggests, is a tax on all capital gains made on the disposal of property, interest or rights in property situated in Malaysia. To determine the capital gains, the market value of the property at both dates of acquisition and disposal are established. The difference in market value will determine the gain or loss. The tax is imposed on the chargeable gain. The Act make it compulsory for both the seller and purchaser of chargeable property to inform the Inland Revenue Board within 30 days of making an agreement for the disposal.

Property gain tax, which previously known as Land Speculation Tax (LST) 1974 is introduced to regulate the economy. At that time, there are excessive spiraling of property prices and signs of overheating in the property market a result of speculation in 1973. The robust property market in early 1970s is due to government policy and backing from the financial sector. Commercial banks and finance companies begin to offer bridging finance to housing sector following Bank Negara Malaysia (BNM) directives to extend loans in support of the government policy of promoting home-ownership. In addition, there were rising demand for housing as prolonged healthy economic growth drive higher employment and income level. Government uses LST as a tool to curb property speculation activities. LST has single tax rate of 50 percent on chargeable gains in property disposed within two years from the acquisition date, when the disposal consideration is more than RM200,000 (US$60,600). In 1975, LST is repealed and replaced by Real Property Gain Tax 1976 (RPGT) as the earlier legislation has deterred genuine disposal of property. Since then, RPGT rates have been revised several times in line with the economic activities.

In 1985 and 1986, Malaysia experiences second major economic crisis caused by the prolonged world recession. This economic crisis brings to attention the threat of excessive concentration of credit in the property sector. Banks are faced by high amount of non-performing loans (NPLs) in which property lending account for 40.0 per cent of total loan portfolio in 1988. The stability of financial system is threatened as the value of collateral reduced substantially by the correction in property prices. These loans are collateralised with property at over–inflated prices. The situation thwarts as speculators and consumers begin to lose confidence in the property market. To boost the market, RPGT rates are dropped by 50 percent in 1986. Previously, in 1980, RPGT introduces separate rates for non-citizen and permanent residents, i.e. a flat rate of 40 percent. Nonetheless, in 1986 because of the recession period, the flat rate is replaced by equal rate as the citizen. In 1984, RPGT introduces that companies are charged a flat rate of 5 percent on and after sixth year holding period.

After the mid-1980s' recession, Malaysian economy rebounds with a strong growth of an average rate of over 8.0 per cent. The real GDP growth sustains at 8.6 per cent in 1996. However, with the wake of 1997 Asian financial crisis, Malaysia experiences a negative growth of 7.5 percent in 1998 and thus facing another economic downturn. Banks begin to experience another significant turbulence, which triggered a deflationary impact on the property market. For the second time, the banks suffer significant erosion of their capital attributable to large provisions made against non-performing loans.

Again, in mid-1990s, when there are signs of overheating in the property market, Government review the RPGT rates to regulate the economy. The rates are raised to a range of 15.0 to 30.0 percent for local residents and a flat rate of 30.0 percent for non-residents in 1996. At the same time, purchase of houses by foreigners is limited to those exceeding RM250,000 (US$75,800) per unit and the imposition of a levy of RM100,000 (US$30,300) on foreign purchase of property was enforced. From 1997 onwards, tax rates for foreigners are reduced to 5 percent on and after six years of holding period.

Figure 2: Real Property Gain Tax Rates Timeline & The Economic Crisis

	1973	1975	1977	1986	1995	2003	2004	2007	2010	2012	2014
% RPGT Rates (First 2 years of Holding Period)	50	50	40	20	30	0	30	0	5	10	30

Source: adapted from Abdullah, 2011)

Since 2000, the RPGT rates have been reviewed and amended several times including 2003, 2004, 2007, 2010, 2012 and 2014. During this period, the RPGT exemption occurred in 2003 – 2004) as an initiative by the government to recover the economy from global economic slowdown due to uncertainties in geopolitical development namely the Iraq war and outbreak of Severe Acute Respiratory Syndrome (SARS) across the globe. However, the exemption was only for a period of one year (1st June 2003 – 31st May 2004). The 1996 rates are re-introduced in 2004. The second exemption comes in April 2007 because Government want to boost both property and financial sectors. Later, in 2010, the RPGT rates are re-instated in the efforts to increase government revenue in facing the increased deficit due to the global financial crisis. In 2012, government revises the RPGT rates and holding periods i.e. a 10 percent tax for gains from property held for less than two years; a two percent for properties held between two and five years; and exempted from tax for those who kept it for more than five years. In 2014, the government re-instates the RPGT rates of 30 percent on all properties sold before three years from the date of purchase: 20 percent for holding period up to four years; 15 percent for five years. Whilst for disposals made in the sixth and subsequent years, no RPGT is imposed on citizens. Nonetheless, companies continue to pay 5 percent tax. Figure 2 illustrates the RPGT rates for the first two years of holding period since 1975 and during the three economic crises. Table 1 in Appendix A shows details of the RPGT rates since the Act was introduced in 1975 (adapted from Abdullah, 2011).

4. THE MALAYSIAN HOUSING MARKET TREND

Malaysia experiences an economic boom and underwent rapid development during the late 20th century. Real GDP grows on an average of 7.3 percent between 1985 and 1995. Performance peaks in the early 1980s through the mid-1990s, as the economy sustains rapid growth averaging almost 8 percent annually. After the 1997 Asian financial crisis, the country continues to post solid growth rates. In the past one decade, the economy grows positively except for 2009 (negative 1.5 percent), averaging 5.6 percent per year. The significant economic growth, continuous backing by the banking system, instigates property industry to flourish. Table 2 shows that property transaction value has expanded by more than threefold in the past 10 years i.e. from RM43.43 billion (US$13.32 billion) in 2003 to RM152.37 billion (US$46.73 billion) last year. The GDP grows from RM231.67 billion (US$71.07 billion) to RM655.11 billion (US$200. 95 billion) accordingly. During this period, property transaction value represents an average of 20.4 percent of the GDP ranging from 13.0 percent in 2006 to 24.2 percent in 2004.

Table 2: Gross Domestic Product (GDP), Property Transaction Value and Volume in Malaysia in 2003 - 2013

Year	Gross Domestic Product (GDP) (RM Billion)	*GDP (%) Growth*	Property Transaction Value (RM Billion)	% change pa of Transaction Value	% of Property Transaction Value to GDP
2003	231.674	5.3	43.43	12.4	18.7
2004	248.040	7.1	60.01	38.2	24.2
2005	447.818	5.0	56.78	-5.4	12.7

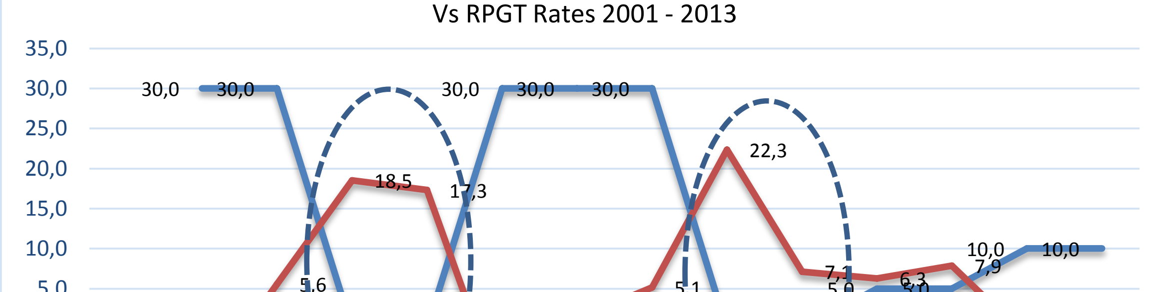
2006	475.192	5.8	61.60	8.5	13.0
2007	505.353	6.3	77.14	25.2	15.3
2008	533.910	5.7	88.34	14.5	16.5
2009	525.901	-1.5	81.00	-8.3	15.4
2010	563.765	7.2	107.44	32.6	19.1
2011	592.518	5.1	137.83	28.3	23.3
2012	625.699	5.6	142.85	3.6	22.8
2013	655.107	4.7	152.37	6.7	23.3
Source: Dept of Statistics Malaysia and NAPIC, 2003-2013)					

In the past decade, the important role of housing sector in property market prevails as indicated in Table 3 in Appendix B. The table illustrates that housing transactions account for 62.6 to 72.6 per cent of the total property transactions volume. In term of value, the market share of the sub-sector ranges between 44.9 and 54.7 per cent. Interestingly, the sub-sector contribution to the market activities and market share of value are at higher rates between 2000 and 2003 i.e. when the country is recovering from the 1997 crisis. In relation to RPGT rates review period, there is a soar in property market activity as indicated by increases in property and housing transactions volume in 2003-2004 and 2007-2008. The two RPGT exemptions are in the period of June 2003 – May 2004 and April 2007 – December 2009.

RPGT is charged on gains made from sub-sales of housing units i.e. from the secondary property market, which is marked as other transfer in Table 4 (Appendix 3) while 1st transfers are those housing units supplied by developers. As abovementioned, the gains affected and rates charged are depending on holding period of the property.

In the past 10 years, the Malaysian housing market is dominated by the secondary market. Sub-sales or transactions lead the market activity by more than 70 percent share whilst for three years the shares are more than 80 percent mainly, 87.0 (2009), 86.2 (2010) and 82.8 (2013). This suggests a matured market where more activities are from the secondary market rather than primary market or housing units offered by developers. It is interesting to note that during the first RPGT exemption (2003 - 2004), when the transaction from developers dropped by 24.0 percent, higher market activity is witnessed in the secondary market (i.e.18.5 and 17.3 percent respectively). Similar trend is seen during the second exemption of 2007 – 2009. Thus, the government intentions to initiate a recovery from global economic slowdown materialises. The initiatives injects more excitement and dynamism into both the property and the financial sectors, which impact positively on the secondary housing market (Abdullah, 2011). On the other hand, in the primary market, it can be viewed that the housing supplier i.e. developers are cautious of the economy as evident by a negative growth for construction sector from year 2004 to 2006 (The Malaysian Economy Report 2006). The Malaysian economy began to slowdown in 2006 prior to the global financial crisis.

Figure 3: Annual % Change of the Secondary Housing Market Activity Vs RPGT Rates 2001 - 2013



2nd exemption

In relation to the amendment of the RPGT rates and the housing market, more vigorous are seen during the two exemption periods of 2003 – 2004 and 2003 – 2004. The market records more than 123,000 and 140,000 sub-sales in 2003 and 2004 respectively. Higher sub-sales are observed during the second exemption period. There are more than 140,000 (2007), 171,900 (2008) and 184,000 (2008) transactions. Figure 3 (Appendix 2) shows that the market ascending from 2001 (negative 7.6 percent) to 18.5 and 17.3 percent in 2003 and 2004 respectively. The market activity is notably high in 2008 i.e. a growth of 22.3 percent (171,891 transactions) from the previous year. This can be viewed that property investors and speculators took opportunities in benefiting the exemption of the RPGT rates to enter the market.

On the house price perspective, discussion is based on Malaysian House Price Index (MHPI). Average House as shows by the All House Price grow by almost two-folds from RM140,690 in 2000 to RM272,168 in 2013. This indicates there is always escalation of house prices in the market. Even in 2003, during the global economic slowdown because of Iraq war and outbreak of severe acute respiratory syndrome (SARS), house prices contiue to expand. Accordingly the market actives sustain as shows by increases in housing transactions from 123,412 (2003) to 144,768 (2004) (refer to Table 6).

Table 6: The Malaysi Price Index, Annual % Change and Average House Price 2000-2013			
Year	Index	% Changes	All Houses Price
2000	100.0	5.9	140,690
2001	101.1	1.1	142,011
2002	103.6	2.5	148,832
2003	107.9	4.2	154,389
2004	113.2	4.9	158,636
2005	115.9	2.4	162,699
2006	118.4	2.2	170,522
2007	123.9	4.6	174,401
2008	129.9	4.8	178,632
2009	131.9	1.5	188,529
2010	140.7	6.7	203,496
2011	154.6	9.9	224,218
2012	172.8	11.8	251,731
2013	192.9	11.6	272,168
(Source: NAPIC, 2014)			

Nonetheless, the market records a hiccupp due to the 2007 Global Financial Crisis in 2009, similar to the declining of the Malaysian economy (-1.5 percent). The annual change slow down to 1.5 percent but keeps on moving up thereafter. In the past two years, the trends touch two digits in 2012 and 2013 at 11.8 and 11.6 percent respectively. Hence during the period, when there are softerning of market activities as indicated by lower transactions, housing prices remain on an upward trend. This can be viewed for three reasons. Firstly the investors are confident of the market and driven by investment fundamentals. Secondly, the general perception of the people that if property is not bought now, the price is going to increase further. Finally, even if there are the housing purchases driven by speculative criteria, they are within manageable numbers as such the owners or speculators are in no rush to sell the houses.

5. GOVERNMENT INTERVENTION IN THE HOUSING SECTOR

The robust performance of housing sector is due to government intevention as it is the government policy to promote home-ownership. The economic direction of the country is heavily influenced by the government through its five years development plans. The government's development plans is known as the Malaysian Plan. Currently, Malaysia is in the Tenth Malaysian Plan. The plans are largely centered on accelerating the growth of the economy by selectively investing in selective sectors of the economy and building infrastructure to support the said sectors. After the 1997 Asian Financial Crisis, property is identified one of the major sector to drive the economy. Property is said to support 140 other industries in the economy. The central to this role is property finance. Commercial banks and finance companies offer bridging finance to housing sector following Bank Negara Malaysia (BNM) directives to support government policy of home-ownership. For the end-financing, the Malaysian housing delivery system of sell-then-build or off-plan sales make this financial product as a relatively less-risk adverse product particularly in an environment of healthy economic growth. Nonetheless, when there signs of overheating in the market, BNM caps the exposure of local banks to property loans to a permissible level.

In the banking system, Table 5 shows, loans to the property sector move from RM188.7 billion (US$57.9 billion) in 2003 to RM620.3 billion (US$190.3 billion) last year. The loans released by banks and finance companies expand by more than two-fold (228.7 Percent) whilst total loan in the banking system spirals by 158.6 percent (RM474.0 billion to RM1,225.8 billion) (US$145.4 billion to US$376.0 billion). For the housing sector, loan released swell by more than 196.0 percent i.e. RM116.3 billion to RM344.3 billion (US$35.7 billion to US$105.6 billion).

At the same time, banks lower the margin of financing for house purchase price such as to address the 1997 Asian Financial Crisis, 60.0 percent of the purchase price of houses and apartments costing RM150,000 (US$46,000) and above (Bank Negara Malaysia, 1996). While in 2014, banks allow 70.0 percent for house value for loan and the calculation for applicants' eligibility is based on net income. The loan margin for first time borrowers are still at 90.0 percent when they are able to service the monthly instalments.

6. CONCLUSION

The housing market performance reacts on an opposite direction against the RPGT rates. During the two RPGT exemptions in 2003-2004 and 2007-2010 periods, the market responds positively as indicated by higher transaction volume and value. In the other hand, market dips when higher RPGT rates are imposed as can be seen by softening of the market activities between 2011 and 2013. Simultaneously, accommodative financial environment facilitate the market to sustain the house prices even when the RPGT rates peak at 30 percent. Average House Price from MHPI moves positively annually in the past 10 years. Hence, housing sector needs certain levels of government intervention to ensure a healthy economic growth and for the well-being of the people. For the past 10 years, RPGT has been one of those players with a strong support from banking sector.

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