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CHAPTER 1

# INTRODUCTION TO SINGAPORE INCOME TAX

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## Learning objectives

**After studying this chapter, you should be able to:**

1. Understand the hierarchy of source of tax legislation in Singapore and explain the importance of each source of tax law and their *application in practice*.
2. Explain the scope of charge of Singapore income tax.
3. Identify the key stakeholders and their roles in the Singapore tax system.
4. Define the various terms used for the purposes of Singapore taxation.
5. Explain how tax residency in Singapore is determined for individual taxpayers.
6. Explain how tax residency in Singapore is determined for businesses.
7. Identify the different forms in which a business can establish its presence in Singapore and explain the implications behind each form of business presence.
8. Describe the tax rates applicable to individuals, companies, clubs and associations and the types of income tax exemptions that may be applicable to reduce tax exposure thereon.





## ¶1.01 Objective and scope

Dear Reader,

Welcome to the "Essential Guide to Income Tax in Singapore".

This first chapter will introduce you to the notion of income taxation[1] and how the machinery of the Singapore income tax law carries out the taxation of income in Singapore. The chapter will also give you a broad overview of some basic concepts of income taxation.

**Let's begin.**

## ¶1.02 What is a tax?

The expression "tax" is a derivation of the Latin term *taxāre* which means to "censure, charge".

According to the Oxford English Dictionary, tax is defined as "…to estimate or determine the amount of (a tallage, fine, penalty, damages, etc); to assess; rarely, to impose, levy (a tax); also, to settle the price or value of."

### Brief look at the beginnings of taxation

Historical records show that the Egyptians were the earliest to subscribe to the concept of taxation. Archeological evidence shows that Egyptian Pharoahs appointed "scribes" as tax collectors and imposed a tax on cooking oil. The scribes even conducted an audit to ensure that citizens consumed the appropriate amount of cooking oil instead of other substitutes to avoid paying cooking oil tax.[2] The Greeks too, implemented a tax known as "eisphora" to pay for special wartime expenditures. Interestingly, this system of taxation was capable of administrating tax refunds to citizens from the excess tax and resources gained from the war effort.[3] Biblically, Saint Matthew was known as a tax collector from Capernaum during the reign of Caesar Augustus, who instituted the first known form of inheritance tax to provide retirement funds for the military.

What then, do these instances tell us generally about the purposes and notion of taxation?

1 What is income taxation about, why it was implemented and who it applies to.

2 http://www.taxworld.org/History/TaxHistory.htm.

3 Adams, Charles, 1993, For Good and Evil: The Impact of Taxes on the Course of Civilization, Madison Books.

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### General observations on taxation

These three historical instances allow us to draw the following observations about the purpose of taxation:

I. It is an organised effort on the part of the administrators of a prevailing government or authority. The administrators impute a rate of tax upon a given taxable base, say amount of oil consumed in the case of the Egyptians so as to *raise revenues* so that the government can *fund the initiatives of a collective, say, a state,* such as war efforts, the operation of the government, welfare. and public services (eg infrastructure, defence, etc).

II. A tax system may be designed to *effect a re-distribution of wealth* among different classes of a given population of citizens in a state as seen in the example of Caesar Augustus who introduced inheritance taxes to provide retirement funds for the military. Inheritance tax may be structured as a progressive tax (ie tax rate increases in tandem with the increase in taxable base).

The "father" of modern economics - Adam Smith, advocated a progressive system of taxation in his famous work "The Wealth of Nations" based on his observation that:

> *"...The necessaries of life occasion the great expense of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expense of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess. A tax upon house-rents, therefore, would in general fall heaviest upon the rich; and in this sort of inequality there would not, perhaps, be anything very unreasonable. It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion"*

III. Most notably, the collection of taxes is usually administered by the government of the time with the aid of *legislative machinery, say tax laws*. In general, the imposition of income tax by most jurisdictions can only be allowed if it has been introduced, debated and agreed upon in Parliament.

The position in Singapore is thus no different.

## ¶1.03 Singapore legislative framework of income taxation

Taxes in Singapore can only be imposed in accordance with the constitution[4] of Singapore. Singapore has a written constitution[5] which is regarded as the

4 According to the Oxford English dictionary, the constitution refers to: "A body of fundamental principles or established precedents according to which a state or other organization is acknowledged to be governed".

5 As opposed to an *unwritten constitution* (or *uncodifed* constitution – the terms unwritten and uncodified are typically used interchangeably) (*which according to Johari, J.C (2006) New Comparative Government, Lotus Press, New Delhi, p167-169*) refers to *"...a type of constitution where*





*supreme* law of Singapore. Supreme law simply means the "law above all laws". Article 4 of the Constitution voids all other laws enacted by legislature if they are found to *contravene* the Constitution.

Article 4 in the Constitution of Singapore[6] entitled "Supremacy of Constitution" provides:

> This Constitution is the supreme law of the Republic of Singapore and any law enacted by the Legislature after the commencement of this Constitution which is inconsistent with this Constitution shall, to the extent of the inconsistency, be void.

It is further provided in Section 143 of the Constitution that unless a law is passed as an *Act* of Parliament, "no tax or rate" will be allowed to be levied.

*Section 143*, Part XI – Financial Provisions of the Singapore Constitution states:

> "No tax or rate shall be levied by, or for the purposes of, Singapore except by or under the authority of law."

***Income tax is therefore a creature of Statute.***

### Income tax law in Singapore

### Singapore Income Tax Act (Cap. 134, 2014 Ed.)

The Singapore Income Tax Act ("the Act"), provides the principal legislative literature for the taxation of income. The Act is also accompanied by *subsidiary legislation*.

Subsidiary legislation is *not* an act of Parliament.

### Subsidiary legislation

According to Section 2 of the Interpretation Act[7] of Singapore, subsidiary legislation is defined as follows:

> "subsidiary legislation" means any order in council, proclamation, rule, regulation, order, notification, by-law or other instrument made under any Act, Ordinance or other lawful authority and having legislative effect;

In practice, *subsidiary legislation* refers to the details of schemes and arrangements authorized under the provisions of the main Act (also known as the "parent Act") which are written by administrative agencies (ie government agencies and statutory boards) and relevant Ministers. These are referred to as "Rules"

*the fundamental rules of government take the form of customs, usage, precedent and a variety of statutes and legal instruments."*

6 (Original Enactment: S 1/63), [9th August 1965].

7 (Chapter 1), (Original Enactment: Act 10 of 1965), Revised Edition 2002 (31st December 2002).



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and "Regulations". Section 19C of the Interpretation Act sets out the general provisions with respect to the power conferred upon any authority to make subsidiary legislation.

For subsidiary legislation to have the force of law, it must be published in a Gazette unless otherwise expressly provided either in *any* statute or the subsidiary legislation itself. Consequently, the prevailing rule in Article 4 of the constitution still applies regarding development of subsidiary legislation, ie that it must not contravene any provisions of any Act[8]. Appendix A provides a list[9] of the subsidiary legislations that have been published to date. Above all, the Subsidiary legislation must be made under the authority of the principal Act, ie the Income Tax Act.

Apart from the Act, another large body of statute that is relevant to income taxation in Singapore is that of the *Economic Expansion Incentives (Relief from Income Tax) Act or "EEIA".*

## Economic Expansion Incentives (Relief from Income Tax) Act (Cap. 86, 2005 Rev. Ed.)

The Economic Expansion Incentives (Relief from Income Tax) Act ("EEIA") provides specific legislation on the administration of tax incentives for the promotion and furtherance of economic and industrial development in Singapore.

Although the EEIA is a body of statutes in its own right, it is to be read in conjunction with provisions of the Act. This is literally implied in Section 2 of the EEIA which is entitled "Act to be construed as one with Income Tax Act".

Section 2 of the EEIA reads:

> This Act shall, unless otherwise expressly provided for in this Act, be construed as one with the Income Tax Act (Cap. 134).

As a broad overview, the tax incentives covered under the EEIA include:

- pioneer incentives (concerning the tax administration of pioneer industries and pioneer service companies);
- investment allowances (IA);
- development and expansion incentive (DEI);
- foreign loans for productive equipment;
- royalties, fees and development contributions;

8 Section 19(c), Interpretation Act (Chapter 1), (Original Enactment: Act 10 of 1965), Revised Edition 2002 (31st December 2002).

9 Source: IRAS website/tax Acts/subsidiary legislation. See http://www.iras.gov.sg/irashome/page04.aspx?id=900. IRAS has advised that it will make updates to the listing of subsidiary legislation on its website on the first Friday of every month.


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- overseas enterprise incentive;
- enterprise investment incentive, and;
- integrated investment allowances (IIA).

## Avoidance of double taxation agreements (DTAs)

Last but not the least, the ambit of income tax legislation of Singapore also includes avoidance of double taxation agreements ("tax treaties"). Singapore's tax treaties are an integral part of domestic tax law by order of Section 49(1) "Avoidance of double taxation arrangements" of the Act. Tax treaties are negotiated by the Ministry of Finance with the governments of the respective foreign countries.

Section 49(1) reads:

> —(1) If the Minister by order declares that arrangements specified in the order have been made with the government of any country outside Singapore with a view to affording relief from double taxation in relation to tax under this Act and any tax of a similar character imposed by the laws of that country, and that it is expedient that those arrangements should have effect, the arrangements shall have effect notwithstanding anything in any written law.

In the age of cross-border transactions, the incidence of double or multiple taxation is not uncommon. The ultimate aim of double taxation agreements is to secure some level of tax certainty through clear allocation of taxing rights on a given income or a taxpayer.

Tax treaties typically contain provisions to alleviate tax exposures for the tax residents of the contracting states in the agreement, in the form of tax credits or tax exemptions on the incidence of double taxation in the two states. More about tax treaties can be found in the chapter on relief from double taxation.

According to its 2012/2013 Annual Report, the Inland Revenue Authority of Singapore (IRAS) has concluded a total of 75 comprehensive tax treaties to date, of which 69 are in force. Apart from the comprehensive tax treaties, the IRAS has also concluded a total of eight limited treaties which cover the taxation of income from shipping and/or air transport.

## IRAS e-Tax Guides

You have so far been introduced to the various sources of legislative support in respect of the imposition of income taxation in Singapore. There is however, one other important source of reference for the purpose of income taxation and it concerns the *practice* of the Comptroller of Income Tax (CIT). The e-Tax Guides provide a source of administrative and interpretive guidance. It also communicates whatever administrative tax concessions the Comptroller has allowed for the purposes of income tax treatment.



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The CIT's practice in Singapore is reflected in the "e-Tax Guides" which the IRAS publishes on an electronic basis on its website. Formerly known as "Interpretation and Practice Notes", the IRAS has been issuing such circulars since 1993. The e-Tax Guides are not statute and hence they do not have the force of the law. They reflect the practices of the CIT. As noted by Chief Justice Yong Pung How in *Comptroller of Income Tax v GE Pacific Ptd Ltd*[10]:

> "Before concluding, we feel it necessary to note that counsel for the Comptroller repeatedly referred to the fact that the practice of the Comptroller has always been to give the balance of the capital allowances to the related buyer in a section 24 situation. This, though an interesting fact, has had no effect on our decision whatsoever. *That this has been the practice of the Comptroller does not in any way illuminate the question of whether this should be the practice of the Comptroller.* ***Practice is not law***[11]. *[Emphasis added].*

## ¶1.04 Interpretation of statutes

In Singapore, the interpretation of any statute is bound by the Interpretation Act (Cap. 1, 2002 Rev. Ed.) ("IA"). The IA is likened to an instruction manual on how law is to be interpreted in Singapore. For example Section 2 of the IA, entitled "Interpretation of certain words and expressions" provides definitions to a list of terms that are commonly applied in the body of legislation in Singapore. So, for example, the expression "Act' is defined as follows,

> *"...Act" or "Act of Parliament" means an Act of the Parliament of Singapore and includes any Ordinance or Act of Singapore or Malaysia having the force of law in Singapore; and "Act", when used in any subsidiary legislation, means the Act under the authority of which the subsidiary legislation was made;"*

### Purposive approach in statute interpretation

The most important feature of the IA is that it prescribes a purposive approach toward the interpretation of a written law. Section 9A entitled "Purposive interpretation of written law and use of extrinsic materials" of the IA reads:

10 [1994]2 SLR(R) 948 at [35].

11 Interestingly, the Act regards the IRAS as an agent of the Minister as seen in Section 92 "Remission, reduction or refund of tax "which provides the Minister with wide powers. Section 92(2) reads: *The Minister may at any time, in his discretion and subject to such conditions as he may impose, remit, reduce or refund, wholly or in part, the tax that is or will be payable or that is paid by any person. [29/2010 wef 22/11/2010].*


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> *.—(1) In the interpretation of a provision of a written law, an interpretation that would promote the purpose or object underlying the written law (whether that purpose or object is expressly stated in the written law or not) shall be preferred to an interpretation that would not promote that purpose or object.*
>
> *[11/93]*

As such, there are two rules of thumb regarding the purposive approach required in Section 9A(1):

- When interpreting a particular provision of written law, one is expected to determine the purpose or the object underlying the written law.
- Where the interpretation derived does not promote that underlying object or intention of the written law, the interpretation is to be rejected.

Perhaps the best approach to interpreting a provision of written law was articulated by VK Rajah JA in the case of *Public Prosecutor v Low Kok Heng*[12] who observed the following:

> *Section 9A(1) of the Interpretation Act requires the construction of written law to promote the purpose or object underlying the statute. In fact, it mandates that a construction promoting legislative purpose be preferred over one that does not promote such purpose or object: see Brady Coleman, "The Effect of Section 9A of the Interpretation Act on Statutory Interpretation in Singapore" [2000] Sing JLS 152 at 154. Accordingly, any common law principle of interpretation, such as the plain meaning rule and the strict construction rule, must yield to the purposive interpretation approach stipulated by s 9A(1) of the Interpretation Act. All written law (penal or otherwise) must be interpreted purposively. Other common law principles come into play only when their application coincides with the purpose underlying the written law in question, or alternatively, when ambiguity in that written law persists even after an attempt at purposive interpretation has been properly made.*

***General principles regarding statutory interpretation prior to Section 9A***

Prior to the codification of how statute should be interpreted, the general principles which were the modus operandi for statutory interpretation included the following:

I. Clear words are required for a tax to be imposed.

II. There should be no intention for equity in the Act. For example, a tax cannot be imposed where revenue authorities cannot bring the subject to be taxed within the words of the statutes.

III. Where ambiguity exists in the law, such an ambiguity should be resolved in favour of the taxpayer.

### Doctrine of Precedent

Also known as Doctrine of *Stare Decisis or judicial precedent.* The doctrine prescribes that case law discovered in one hierarchy of law will bind the courts

12 [2007]4 SLR(R) 183 at [50], [2007] SGHC 123 at [41].



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in the same hierarchy and only persuasive authority in another hierarchy. Generally, it also prescribes that the rulings in the higher courts are binding on the lower courts where it is established that the factual matrix are materially similar. As such, lower courts should arrive at the same conclusion if such an approach is adopted.

### Ratio decidendi

Also referred to as the "Ratio" of a case, this points to the material facts and decision of a given case.

### Obiter dicta

By referring to something as *obiter*, just means that it is a "saying by the way", ie you are showing "a dicta" from another case or instance, by way of illustration to facilitate your interpretation of a given issue.

This is usually used to refer to an earlier opinion observed by a Judge for the purpose of interpreting a given issue. Obiter dicta does not bind any court but should be accorded proper reverence (given its potential influence) when cited.

### Frequently applied common law rules for statutory interpretation

As you will notice by now, income taxation is indeed a creature of the law and thus statutory interpretation is a necessary skill in the practice of taxation. The following table highlights the frequently applied common law rules for statutory interpretation in the absence of Section 9A of the IA.

| Frequently applied method/rules | Explanation |
|---|---|
| Literal rule | • Also known as the plain meaning rule.<br>• Requires that words are to be construed in their plain meaning. |
| Golden rule | Allows the Court to depart from the "prima facie" or plain meaning of the words of a statute; so as to prevent an Act of Parliament to be interpreted or read in a way that results in absurdity or injustice. |
| Mischief rule[13] | The objective of this rule is to prevent abuse of the true intention of the statute and to provide a remedy if this has occurred. Four key considerations are taken to prevent "mischief":<br>• The common law position before the Act was passed;<br>• The shortcomings of the common law position which was not dealt with then;<br>• The proposed "will" or intention of Parliament when the Act was passed;<br>• The purpose of the proposed remedy. |

13 Also known as the "Rule in Heydon's case".

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Aside from the above frequently applied methods of statutory interpretation, there are three other commonly accepted presumptions which the courts apply for the purposes of interpretation. These presumptions are:

| Common presumptions applied | Explanation |
|---|---|
| Ejusdem generis<br>"of the same kind, class or nature" | Presumes that a general word will take its meaning from particular or specific words that precede it. For example, "applies to roses, tulips, orchids or other flowering plants". Consider also Section 15(1)(g) of the Act which provides:<br>*—(1) Notwithstanding the provisions of this Act, for the purpose of ascertaining the income of any person, no deduction shall be allowed in respect of —*<br>*—(g) any amount paid or payable in respect of income tax in Singapore, or in respect of any tax on income (by whatever name called) in any country outside Singapore* |
| Noscitur a sociis | Presumes that the word will take a specific meaning within the context of its usage even if it is capable of other meanings. For example, "The "call" took all of an hour to conclude" or "It's really anyone's "call" with regard to how this situation should be handled". |
| Expressio unius est eclusio alterius | Presumes that the express mention of one or more things will preclude or exclude other members of the same class. For example, Section 15(1)(i) provides:<br>*—(1) Notwithstanding the provisions of this Act, for the purpose of ascertaining the income of any person, no deduction shall be allowed in respect of*<br>*—(i) any payment to any provident, savings, widows' and orphans' or other society or fund, including the Supplementary Retirement Scheme, except —...* |

### Extrinsic aids v intrinsic aids

#### *Extrinsic aids*

Apart from applying the interpretation of words for the purposes of interpreting written law, statutory interpretation also requires the application of extrinsic and intrinsic materials. Sections 9A(2), (3) and (4) of the IA specify how extrinsic materials should be applied for the purposes of purposive interpretation of Singapore law.



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CHAPTER 3

# INCOME


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## Learning objectives

**After studying this chapter, you should be able to:**

1. Discuss how the charging section is applied.
2. Discuss what income means.
3. Distinguish between receipts of a capital vs. receipts of a revenue nature.
4. List the types of receipts that are chargeable to Singapore income tax.
5. Discern on the taxability of a given payment received by a taxpayer.
6. Further articulate what is meant by territorial and remittance nature of the Singapore tax system.
7. List the characteristics of trading activity being carried on.
8. Discern if a taxpayer is carrying on a trading activity by applying the badges of trade test.
9. Define what a dividend means for the purposes of Singapore income tax and the tax implications arising thereon.
10. Define what a receipt of interest means for the purposes of Singapore income tax and the tax implications arising thereon.
11. Define what a royalty means for the purposes of Singapore income tax and the tax implications arising thereon.
12. Identify and define what rental receipts refer to for the purposes of Singapore income tax and the tax implications arising thereon.
13. Identify the various forms of investment income and the tax implications arising thereon.
14. List the various forms of exemptions relating to investment income.
15. List the various forms of receipts which may be regarded as exempted for the purposes of Singapore taxation.

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## ¶3.01 Part 1 – Understanding the charging Section of the Act

The Income Tax Act[1] ("the Act") is an Act promulgated to "impose a tax upon incomes and to regulate the collection thereof."[2]

Therefore, income tax is a tax on *income* and *income* alone.

### What is the charging Section? – objectives and organization

Aptly entitled "Charge of income tax", Section 10(1) of the Act is the relevant legislation in the Singapore Income Tax Act that brings a charge to tax on *income*. It is also commonly referred to as *"the charging section"*.

The charging section sets out the scope of taxation in Singapore with regard to:

- when tax will be imposed;
- how tax will be imposed;
- who is liable to tax; and
- what is liable to tax.

Section 10(1) reads:

> 10.—(1) Income tax shall, subject to the provisions of this Act, be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in or derived from Singapore or received in Singapore from outside Singapore in respect of —
>
> (a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised;
>
> (b) gains or profits from any employment;
>
> (c) [Deleted by Act 29/65]
>
> (d) dividends, interest or discounts;
>
> (e) any pension, charge or annuity;
>
> (f) rents, royalties, premiums and any other profits arising from property; and
>
> (g) any gains or profits of an income nature not falling within any of the preceding paragraphs.
>
> "Heads of charge" [(a)–(g)]

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1 Income Tax Act (Cap. 134, 2014 Ed).

2 Ibid.

## Observations about the charging Section – key words/phrases and what they mean

The following words and phrases provide good clues on the spirit and intention of Section 10(1):

1. *Income*
2. *Person*
3. *Accruing in or derived from*
4. *Received in Singapore from outside Singapore.*

An overview of the key words and phrases applied in Section 10(1) is given in the chart below:

Four key observations about the scope of taxation provided in Section 10(1)

***Observation 1 – "Income"***

- "Income" is not defined in the Act.
- Only "income" is taxable. Any amounts that are not regarded as income falls outside the scope of the charging section. *An example of this is gains from disposal of assets, eg capital gain, ie a capital receipt.*
- It is therefore important to distinguish revenue receipts from capital receipts as only revenue receipts are taxable.

***Observation 2– "Person"***

Refers to the statutory definition provided in Section 2 of the Act which includes:

- An **individual**;
- A **company** which is registered in Singapore or elsewhere;
- A **body of persons** including clubs or similar institutions; Trade associations; Management corporations and Town councils; and
- A **Hindu joint family**.

*"Income tax shall ... be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in or derived from Singapore or received in Singapore from outside Singapore in respect of: ...*

***Observation 3 – "accruing in or derived from"***

Refers to the *"first limb"* of the Singapore tax system, ie the **Territorial nature**.

- Territorial means that tax is imposed in so far as income is found to be sourced in/from a particular territory, ie must have a domestic source, ie Singapore.
- **Consider:**
  - the originating cause of the income;
  - whether the taxpayer was trading "in" Singapore, ie look at place where the contracts of sales were made, the location where the operations from which the profits arose were carried out, the place where the title of goods passes from seller to buyer and the place where payments were made;
  - "Accruing" implies that the "person" has already acquired the right to receive the income receipt in question, ie is legally entitled to receive the income or where the debt in question has been legally constituted.

***Observation 4 – "received in Singapore from outside Singapore"***

Refers to the *"second limb"* of the Singapore tax system, ie the **remittance nature**.

- Remittance refers to an event when income has been received into or "paid into" Singapore from a source outside Singapore.
- Section 10(25) of the Act specifies the scenarios in which the following amounts derived from outside Singapore are regarded as "received in" Singapore.

Essentially these are:

- Any amount physically brought into or telegraphically or electronically transmitted; Any amount transferred into a Singapore account;
- Any amount applied toward the repayment of a debt in respect of a trade carried on in Singapore;
- Any amount applied to the purchase of movable goods that are or have been brought into Singapore.


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## Some further thoughts about "income"

On closer reading of the provision, you will note that Section 10(1) does *not* provide a definition for the term "income". Neither is there a definition for this term in Section 2 – "Interpretation" or anywhere else in the Act.

It is therefore presumed here that we are *"asked"* to apply our ordinary understanding of the meaning of the term. As observed by *Jordan* CJ in ***Scott v Commissioner of Taxes (New South Wales)*** **(1935) 35 SR (NSW) 215 at 219**:

*"The word income is not a term of art, and what forms of receipts are comprehended within it, and what principles are to be applied to ascertain how much of those receipts ought to be treated as income, must be determined in accordance with the ordinary concepts and usages of mankind..."*

To address this ambiguity and the breadth of the subject matter, our study of how income should be regarded for the purpose of Singapore taxation shall involve the following:

1. Statutory interpretation of the term "income";
2. Considering other perspectives on the definition of Income – Economic, Accounting and Tax Law;
3. Taxable receipts, ie income, must have a "revenue" quality;
4. Determining *the revenue quality of a given receipt using three key concepts:*

a. *Tree and Fruit Analogy;*
b. *Fixed Capital vs. Circulating Capital analogy;*
c. *Five Propositions on the taxability of receipts.*

### *Statutory interpretation*

As you have observed by now, taxation is a creature of statute. On this basis, it begs that we apply some techniques established for the purposes of statutory interpretation. Such techniques were developed over time and over multitudes of case law experiences and reflect the different approaches applied by judges and courts for the purposes of construing the intent of the taxing Act.

The first and most common approach is known as the *"literal rule"*. The literal rule simply provides that statute is to be interpreted based on the "literal construction,', ie ordinary and natural meaning of the words used in the statute. In other words, the literal rule requires one to consider the language of the statute on a "stripped down" basis, ie its ordinary and natural meaning.

According to *Rowlatt* J in *Cape Brandy Syndicate v Inland Revenue Commissioners*[3], the literal rule involves the following:

*"(In a taxing Act) one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing to be read in, nothing to be implied. One can only look fairly at the language used."*

In the Singapore case of *Comptroller of Income Tax v GE Pacific Pte Ltd*[4], Chief Justice Yong Pung How observed that *"...(in any question) of statutory interpretation, the first and most important factor is the literal meaning of the words of the provision".*

Therefore, it is not counter-intuitive to apply one's ordinary understanding of terminology in the absence of statutory reference or definition.

In short, the literal rule implies that the income would take its meaning from how a layman would regard it to be, intuitively or superficially.

### *What then, is the ordinary definition of the term "Income"?*

Let's put the literal rule to the test.

For a start, the Oxford English dictionary provides 10 different entries for "income". Superficially, the term income may be defined as *"...Coming in, entrance, arrival, advent; beginning (of a period of time, or an action)."* Interestingly in the 17th century, income was referred to as *"... [T]he coming in of divine influence into the soul; spiritual influx or communication"*. These two definitions clearly do not relate to the context of the question. This implies that there is room for misinterpretation if the literal rule is not applied properly.

3 [1921] 1KB 64 at 71.
4 [1994] 2 SLR 948 at [23].


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## Interpretation Act (Cap. 1)

In Singapore's context, the Interpretation Act (Cap. 1) provides the necessary guidance for the "avoidance" of potential misinterpretation. In particular, Section 9A(1) of the Interpretation Act mandates a *"purposive"* approach towards the interpretation of legislation.

**Section 9A(1) "Purposive interpretation of written law and use of extrinsic materials" of the Interpretation Act** reads:

– In the interpretation of a provision of a written law, an interpretation that would promote the purpose or object underlying the written law (whether that purpose or object is expressly stated in the written law or not) shall be preferred to an interpretation that would not promote that purpose or object.

Accordingly, the key to purposive interpretation is that it requires one to look at *"that underlying purpose or object"* of a given piece of legislation. This is regardless of whether *'that purpose or object"* has been *expressively* stated in the written law. In accordance with Section 9A(1), the above definitions for the term "income", would obviously not apply in the context of Section 10(1) which seeks to impose a tax on a form of *receipt*, which may refer to a gain or profit. As such, we look to the *other* two definitions prescribed by the Oxford English dictionary which provides as follows:

- *"...That which comes in as the periodical produce of one's work, business, lands, or investments (considered in reference to its amount, and commonly expressed in terms of money); annual or periodical receipts accruing to a person or corporation; revenue. Formerly also in pl. = Receipts, emoluments, profits; but the plural is now used only in reference to more than one person. (The prevailing sense.)"*; and
- *"Profit, proceeds; result, 'harvest'. Also in pl. (obs.)".*

On this basis, it is thus "safe" to conclude that income could be ordinarily construed as having the following qualities:

- Regular or periodical *receipts* as a result of *"one's work, business, lands, or investments";*
- *Referred to collectively as "gains"* harvested *or* "profit and proceeds".



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**Additional statutory interpretation tip**

We learnt in Chapter 1 – Introduction that Singapore is a common law jurisdiction. It is typical in common law jurisdictions to cite foreign authority and hence adapt decisions from the common law world as a form of ***persuasive*** authority. Sections 3(1) and (2) of the Application of English Law Act (Cap. 7A, 1994 Rev Ed.) allow for this:

***Application of common law and equity***

*3.—(1) The common law of England (including the principles and rules of equity), so far as it was part of the law of Singapore immediately before 12th November 1993, shall continue to be part of the law of Singapore.*

*(2) The common law shall continue to be in force in Singapore, as provided in subsection (1), so far as it is applicable to the circumstances of Singapore and its inhabitants and subject to such modifications as those circumstances may require.*

## Other observations on the definition of Income – economic, accounting and tax law

As observed before in ***Scott v Commissioner of Taxes (New South Wales)* (1935) 35 SR (NSW) 215 at 219,** income *"must be determined in accordance with the ordinary concepts and usages of mankind…"*.[5]

The phrase "in accordance with the ordinary concepts and usages of mankind" implies the "broad" and "inclusive" nature of the term "income". We thus look at the three traditional perspectives on the definition of income:

- the economic perspective;
- the accounting perspective; and
- the tax law perspective.

**Economic and accounting vs. tax law perspectives**

***Economic perspective***

The economists hold several distinct and differing views on the concept of income and how it should be subject to taxation. A prime example is the notion of income according to *Haig*[6], who proposes that *"[the economic income concept] has the effect of taxing the recipient of income when he receives the power to attain satisfactions rather than when he elects to exercise that power." Haig* implies here the notion of income refers to the accretion of wealth which will allow a taxpayer to control goods and services at his bidding.

While there are a myriad of views expressed by economists on the notion of income, a common observation is that the economic perspective does not make a distinction between gains made and income earned – it "lumps" both of these together and thus runs against "philosophy" behind taxation laws since the capital and revenue divide is central to the concept of income taxation.

5 CJ Jordan.

6 Robert M Haig (ed), *The Concept of Income: Economic and Legal Aspects* (The Federal Income Tax, Columbia University Press, 1921).





***Accounting perspective***

Accounting principles and standards drive the computation of profits for the purposes of financial statement reporting. Such principles and standards ignore compliance to tax rules and tax law. In addition, for accounting purposes, income is recorded as earned on an accrued basis regardless of receipt. However, for the purposes of taxation in Singapore, income is not liable for taxation until the receipt becomes a legal obligation to be fulfilled. As such, the definition of accounting profit or gain would certainly differ from the notion of taxable receipts and profits.

***Tax law perspective***

Tax law is constructed upon a foundation of economic and social demographic policies. Tax statutes which prescribe how taxable income should be derived and computed therefore precede both the economic and accounting perspectives on how taxable income is to be construed. Income is taxed on a net basis for the purposes of Singapore income tax. This implies that the computation of taxable income requires the discernment of the deductibility of an expense among other considerations (which cannot be intuitively arrived upon without specialized knowledge of local income tax laws). Moreover, the scope of Singapore income tax <u>excludes</u> the taxation of windfall gains, capital gains and provides for the exemption of certain forms of revenue receipts.

*Conclusion: Only **<u>revenue</u>** receipts of an income nature are assessable to tax.*

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## Understanding the capital and revenue divide

How does one go about discerning between receipts[7] of a capital and revenue nature? Several "first' principles have evolved from a substantial body of case law. There are however, <u>three</u> key classic concepts which are commonly applied for the discerning of this divide. These are:

1. **Tree and fruit analogy;**
2. **Fixed capital vs. circulating capital;**
3. **Five propositions on the taxability of receipts.**

### Concept 1 - *Tree and fruit analogy*

In reality, the task of discerning the difference between capital and revenue receipts may not be as challenging as it appears to be. In *Eisner v Macomber* (1919) 252 US 189, the Supreme Court of the United States of America observed as follows:

"The fundamental *relation of "capital" to "income" has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop: the former being depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time …'.*

7 By now you would have realized that the term receipt has been applied in the preceding paragraphs to ensure "neutrality" in this discussion.

On the basis that an asset is regarded as a non-good[8] ie something one acquires without the intention of making a *quick sale* for a *quick gain* , capital gains may be regarded as the **difference** between the original value of an asset and the price at which the asset is sold for. Goods, on the other hand, are defined in the Oxford English dictionary as merchandise or "articles of *trade*". It is therefore generally accepted that any receipts derived from transactions involving goods or merchandise would naturally be regarded as revenue in nature thereby constituting an income receipt.

**Application example:**

Commercial office space that is let out could be regarded as the tree from which the rental income, the fruit, is derived. Similarly, a fixed deposit could be seen as the capital that yields the interest income. The commercial office space and the fixed deposit are capital; the rent and interest are income.

### Concept 2 – Fixed capital v circulating capital

This concept requires the identification of fixed and circulating assets deployed in a business.

An example of fixed capital is that of plant and machinery employed in a business to produce income. Consequently, disposal proceeds from the sale of plant and machinery are therefore regarded as capital receipts. Circulating capital however refers to inventory or stock (such as raw materials) that is sold or used in the manufacturing of products such as stock-in-trade. Proceeds from the sale of goods are therefore revenue receipts and hence have an income quality.

**Singapore position – *Comptroller of Income Tax v BBO* (2013) MSTC 70-020 ("BBO")**

This High Court case concerned the question of whether gains derived by a taxpayer (engaged in the business of insurance) from the sale of core shares held in three companies of the taxpayer's business were taxable under Section 10(1)(a) of the Act as trade income. The Comptroller had appealed against the decision of the Board of Review who held that the gains arising from the disposal of such shares constituted capital gains. Following appeal, the High Court upheld the decision of the Board of Review and concluded that the gains were of a capital nature and therefore not subject to corporate income tax.

8 See further explanation below in the discussion "Fixed Capital vs. Circulating Capital".


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*"I say po-tay-toe, you say po-tA-to..."*

**Observation: What is fixed capital for one business may be circulating capital for another.**

For example, the proceeds from the sale of a refrigerator constitute a capital receipt for a restaurant as the refrigerator is its fixed asset, while for the refrigerator distributor, it would constitute revenue receipts to the distributor as the refrigerator distributor is in the business of selling refrigerators.

### Concept 3– Five propositions on the taxability of receipts

*Whiteman and Wheatcroft's[9] 5 propositions on the taxability of receipts*

Whiteman and Wheatcroft used a collection of UK case decisions to advance their five propositions on the taxability of receipts. The five propositions were first introduced in 1971 in Whiteman and Wheatcroft's joint publication "Whiteman and Wheatcroft on Income Tax and Surtax (1st Edition). Till today, these five propositions are still relevant and often relied upon to discern the taxability of receipts.

These propositions are discussed in turn below.

*Proposition 1– Payments for sale of business assets are prima facie capital receipts*

Prima facie, when the assets of a business are sold, the resultant gain or profit is not of a trading nature but rather that of a capital nature. Trading profits are derived from the sale of circulating capital.

*Proposition 2 – Payments received for the destruction of the recipient's profit making apparatus are capital receipts*

To demonstrate this, consider the example of a restaurant. Suppose a restaurant is part of a franchise operation. The franchise agreement would therefore be regarded as the restaurant's profit making apparatus. As such, the termination of the franchise agreement could be described as the destruction of the restaurant's profit making apparatus. Assuming that the restaurant was compensated for the loss of operating the franchise, this compensation amount could then be regarded as a capital receipt, if its profit making apparatus is severely affected by the termination.

Two UK cases support this proposition:

1) *Van Den Berghs Ltd* v *Clark* [1935] AC 431; and
2) *Barr, Crombie & Co Ltd* v *IRC* (1945) 26 TC 406.

9 Derived from Whiteman and Wheatcroft's book "Whiteman and Wheatcroft on Income Tax and Surtax" 1st edition published by Sweet & Maxwell, Limited, 1 Jan, 1971.



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It is observed that the decision arrived in each case was polarized, even though both cases concerned the termination of commercial agreements.

***Van De Berghs Ltd v Clark* [1935] AC 431**

**Facts:** The taxpayer had entered into a market-sharing agreement with a competing Dutch company in 1912. The agreement provided for the sharing of profits of their respective margarine businesses in specified proportions, the creation of joint arrangements regarding prices and limitation of areas of supply, and a restriction on the parties preventing them from entering into any pooling arrangements with third parties which could injure the interests of the allied businesses. Following a dispute, the companies agreed to terminate the agreement on condition that the Dutch company paid a sum of money to the taxpayer.

**Decision:** The House of Lords held that the receipt was capital in nature and therefore not taxable. Lord Macmillan said:

*"[T]he cancelled agreements related to the whole structure of the appellants' profit-making apparatus. They regulated the appellants' activities, defined what they might and what they might not do, and affected the whole conduct of their business".*

> ***Observation:*** *Compensation received as a result of the termination of commercial contracts which form a substantial part of a firm's profit-making apparatus, may be regarded as receipts of a capital nature and therefore not taxable.*

***Barr, Crombie & Co Ltd v IRC* (1945) 26 TC 406**

**Facts:** The taxpayer carried on business as ship owners, shipping managers and agents. It entered into a 15-year agreement with their client, a shipping company. Eight years before the agreement ended, the client went into voluntary liquidation and terminated the agreement. The agreement provided that, in such an event, payment must be made for the unexpired term of the agreement, and the client duly paid the taxpayer a sum of £16,000. The taxpayer had derived 88% of its income from managing the ships of this client. Following the termination, the taxpayer steadily reduced the size of its premises and staff and eventually lost its entire business.

**Decision:** It was held that the receipt was not taxable as the company's profit-making apparatus was severely affected by the termination of the agreement. The description of the payment as "remuneration" in the agreement was not conclusive of whether the payment was income or capital to the taxpayer.


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> ***Observation:***
> *A similar observation can be made in this case as seen before in the Van Den Berghs case. However, the point to note here is that one should not be fixated on the label which the payment bears but to look beyond the label to see the true nature of the payment received – which in this case refers to the compensation for the termination of the ship management agreement upon which the taxpayer relied upon for 88%of its business income.*

***Proposition 3 – Payments in lieu of trading receipts are revenue receipts***

This refers to instances where a taxpayer receives a payment in lieu of a receipt which ordinarily, would have formed part of the taxpayer's trading profits. It is arguable that such receipts are revenue in nature and therefore taxable. The following three cases demonstrate this point.

**Proposition 3, Case 1 - *London and Thames Haven Oil v Attwooll* (1967) 43 TC 491**

**Facts:** A jetty of the taxpayer was damaged and out of use for a period of time due to the negligent handling of a tanker. The taxpayer received compensation which exceeded the repair costs by £21,404.

The Special Commissioners found that the sum of £21,404 was "to fill the hole created in the company's profits" and therefore taxable as a trading receipt. The Court of Appeal upheld this finding.

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**Proposition 3, Case 2 *Gray v Lord Penryhn* (1937) 21 TC 252**

**Facts:** Two employees of the respondent trader had misappropriated money by falsifying the wages accounts. The respondent's auditors admitted negligence on their part in not making certain enquiries, and paid the respondent a sum equal to the amount misappropriated. It was held that this sum was a trading receipt.

> ***Observation:***
> *It can be seen in these two cases that that the compensation payments bear a similar quality of being compensation for tortious act committed against the taxpayer. The compensation payments could be regarded as trading receipts since they were paid as compensation for the loss of trading profits resulting therefrom.*

**Proposition 3, Case 3, *Wiseburgh v Domville* (1956) 36 TC 527**

**Facts:** The taxpayer depended upon two agency agreements as the "capital structure" of his business. Taxpayer subsequently received compensation for the loss of a contract which constituted 60% of his trading profit.

**Decision:** Interestingly, the courts here concluded that compensation received for the loss of that contract was held to be a revenue receipt, as the loss was not sufficiently damaging to the business.

***Other scenarios where compensation received by a taxpayer may be regarded as revenue in nature and therefore taxable receipts***

**Insurance contracts**

Based on UK case law, insurance money received for the loss of trading stock destroyed by fire was a trading receipt.

> ***Practice note:*** *There is specific legislation in Singapore which deals with this. Section 10(3) provides that any sum realized under any insurance against loss of profits shall be taken into account in ascertaining any profits or income.*

**The Singapore position - compensation for non-performance of trading contract**

Two notable scenarios here concern the compensation for non-performance of trading contracts and insurance recovery received on a "keyman" insurance policy.

**Compensation for non-performance of trading contract**

It is probable that compensation received by a taxpayer for the cancellation of a contact may be regarded as a capital receipt, if it can be shown that the contract consisted of the whole, or a substantial part of the whole structure of a trader's profit-making apparatus.

In practice, it is quite commonly found that such compensation is regarded as a receipt of revenue nature and hence taxable. This is particularly so where it cannot be shown that the taxpayer's business was heavily dependent on the contract in question.

**Compensation received under a "keyman" insurance policy**

The objective of a "keyman" insurance policy is to safeguard the company against potential loss of profits due to the death or disability of a "keyman", ie a key company employee whose special qualifications and experience are of irreplaceable value to a business. In practice, the recovery of sums insured (on the loss of profits) received by a business is regarded as a taxable receipt.

The case law support for this IRAS practice is found in *Gray & Co Ltd v Murphy*[10].

Here, two payments as a result of a fatal accident to a company employee were considered. The first payment concerned the insurance recovery payment received by the taxpayer company as a result of the incident which was held to be a taxable receipt. The second payment concerned ex-gratia payments made by the taxpayer company to the employee's widow which was regarded as a non-deductible expense.

10 (1940) 23 TC 225.



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***Proposition 4– Payments made in return for the imposition of substantial restrictions on the activities of a trader are capital receipts.***

In two cases given below, Whiteman and Wheatcroft highlighted two key forms of substantial restrictions, namely:

(a) Restrictive covenants; and

(b) Sterilization of assets.

***Higgs v Olivier* 33 TC 136**

**Facts:** Sir Laurence Olivier entered into a restrictive covenant with a film company. He agreed not to act in, produce or direct any film for a period of 18 months, in return for a lump sum of £15,000[11] payment following the making of the film - "Henry V".

**Decision:** The payment was held to be capital in nature as it was made to compensate him for the loss of a source of income.

> ***Observation:*** *Where it is shown that the taxpayer had received payment in the form of compensation in respect of a restrictive covenant entered into, it is likely that the amount in question will be regarded as capital in nature and therefore not liable to a charge of income tax.*

***Glenboig Union Fireclay Co Ltd v IRC* (1922) 12 TC 427**

**Facts:** The taxpayer carried on business as manufacturers of fireclay goods and as merchants of fireclay, and was a lessee of fireclay fields in the neighbourhood of a railway. It later received compensation from the railway company for not working these beds of clay which might have caused the railway line to subside.

**Decision:** It was held that the compensation was for the sterilisation of a capital asset and was therefore not taxable. This was despite the fact that the amount was calculated based on the net profits that otherwise would have been earned from exploiting the asset. The basis upon which the amount of compensation was calculated is not conclusive of the nature or quality of the compensation (ie whether revenue or capital) to the recipient.

11 *The lump sum amount here refers to compensation received. As noted by Sir Raymond Evershed MR in the case, the compensation payment received by Sir Laurence Olivier did not constitute earnings received by him as part of the ordinary course of his profession. Therefore, the amount received was regarded as capital in nature and therefore not taxable.*



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# CHAPTER 5

# CAPITAL ALLOWANCES


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## Learning objectives

After studying this chapter, you should be able to:

1. Discuss the rationale for capital allowances in the context of Singapore income taxation.
2. Identify and discuss the key tests in case law principles applied to determine if an item can be classified as plant.
3. Identify the different approaches to determining if an item can be classified as plant in Singapore.
4. Identify the correct form of claim for various classes of assets and compute the capital allowance claim applicable thereon.
5. Provide the correct tax treatment in respect of an asset item classified as plant or machinery in the event of a write-off of the asset or a disposal of the asset and compute the tax liability or effect thereon.
6. Optimise claim on capital allowance or minimize tax liability for a taxpayer in the event of a write-off of an asset or the disposal or an asset.
7. Discuss the implications on capital allowances claim on assets which are deployed in another location other than Singapore.

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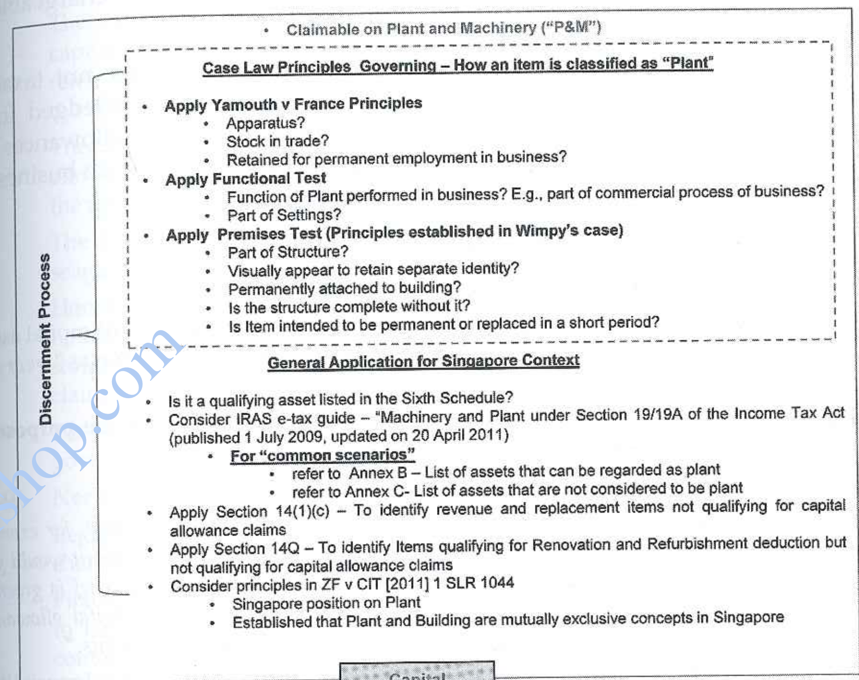
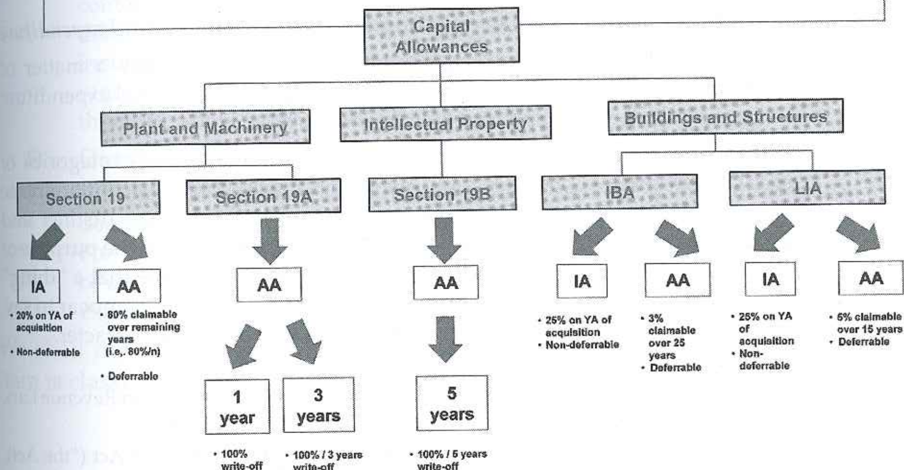
## ¶5.01 Introduction – overview of discussion on capital allowances

The diagram below provides a map on our discussion of capital allowances.



## ¶5.02 Background and rationale

The term "capital allowances" simply refers to allowances that are given in respect of expenditure of a capital nature for set-off against the statutory income of a taxpayer (in this case a business) , thereby reducing income chargeable to tax (ie tax base).

In the context of Singapore income taxation, capital gains are not taxable. Neither are expenditures or losses of a capital nature acknowledged for a deduction claim against statutory income. Nonetheless, capital allowances are granted to businesses in respect of such expenditure to incentivise businesses to industrialize and to promote industry and commerce.

The following can be said about capital allowances:

1) **Recognition of wear and tear of capital assets**

   Capital allowances are granted to recognise the wear and tear of capital assets deployed in a business. Hence, capital allowances are also known as "wear and tear allowances".

2) **To reflect a realistic view of the cost of doing business for the purpose of assessing *business profits earned to tax***

   As observed by Easson[1]:

   *"...a total disallowance of expenditure (of a capital nature) incurred, for example in the acquisition of capital assets such as buildings, machinery or plant would give a misleading and unrealistic assessment of a trade's profits. Thus relief is given in respect of certain classes of capital expenditure by a system of capital allowance claims, whereby the appropriate allowances are set against taxable profits."*

3) **Capital allowances claims can only be made on *qualifying capital expenditure***

   While the method of computing capital allowances is usually a matter of simple arithmetic, the key is to correctly identify an item of capital expenditure as a qualifying item of claim for capital allowances.

   Traditionally, capital allowances are typically granted for two categories of capital expenditure, ie building and plant and machinery. It is commonplace to be inclined to accept that structures such as buildings are distinct and separately identifiable from plant and machinery[2]. However, for the purpose of a capital allowance claim, it would be presumptuous to assume that a "thing" (as it were) should be classified as structure or building should it appear to say, provide some form of shelter[3] or appear to be "permanent" in character.

1 Chapter 10 – Profits, Part 6 – Capital Allowances, Easson: Cases and Materials on Revenue Law, Second Edition by David Salter and Julia L.B. Kerr, Sweet and Maxwell (1990).

2 As there is no statutory definition of the term "machinery" in the Income Tax Act ("the Act), one needs to look at its ordinary meaning. The Oxford English Dictionary defines 'machinery' as follows: "an apparatus using or applying mechanical power and having several parts, each with a definite function and together performing a particular task: (such as) *a fax machine or a shredding machine*".

3 See *Commissioners of Inland Revenue v Barclay, Curle & Company* [1969] 1 WLR 675. See also *Portland Pty Ltd v Federal Commissioner of Taxation* (2008) 73 ATR 990.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The notion of "plant" is a subjective one. It is subjective perhaps because it concerns the nature of the taxpayer's trade or the usual perception of the item to a layman. The reasons for subjectivity may be wide and varied. That said, the classification of a capital asset as "plant" is usually a matter of keen contention where capital allowance claims are concerned.

There is a generally accepted view of what "plant" means for the purposes of capital allowance claims. It is the view that an item classified as "plant" would refer to an asset that has played an essential role in the commercial process[4] of the business.

Therefore, in unique scenarios, the immediate task in a claim for capital allowances is to identify exactly **what is** attributable to commercial process (ie the application of the business use test) of a taxpayer's trade.

The 1982 UK case of ***I.R.C. v Scottish and Newcastle Breweries Ltd***[5] ("the seagulls" case) is an interesting study.

Here the taxpayer (who was engaged in the trade of owning and managing hotels and licensed premises"[6]) was entitled to treat *"two elaborate metal sculptures said to represent seagulls in flight"* as plant and hence was allowed to claim capital allowances thereon.

We shall discuss the sea gull case in the next section - "Case law principles governing how an item is classified as plant".

4) **Need for contemporaneous capital allowance legislation**

   Legislation governing the claiming of capital allowances usually has two key characteristics.

   Firstly, it is timeless. The "timeless" fashion in which it was drafted in order to remain relevant. And yet, secondly, capital allowance legislation is also contemporaneous in nature (ie having regard for the nature of the trade or industry it was drafted for and perhaps within the context of technological innovation at the time). For example, such legislation is typically drafted to recognise "the normal wear and tear of assets" deployed in a business and therefore allow for write-off of such assets.

5) **Quantum of claim**

   Whether the quantum of claim allowable on capital expenditure is reasonable depends on the technology and time under which the claim had been allowed. For example, granting immediate write-offs, eg a 100% write-off in the year of acquisition vs a write-off over a three-year period based on 100% of capital expenditure incurred.

We shall now discuss the commonly applied case law principles on how an item is classified as "plant".

4 Ie satisfies the business use test

5 *I.R.C. v Scottish and Newcastle Breweries Ltd*, House of Lords [1982] 1 W.L.R. 322

6 Ibid.

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## ¶5.03 Case law principles governing how an item is classified as "plant"

The Oxford English dictionary defines "plant" as follows:

*"...a place where an industrial or manufacturing process takes place" or "...machinery used in an industrial or manufacturing process".*

For the purposes of Singapore income tax, the term "plant" (although applied in income tax legislation) is *not* defined in the Income Tax Act ("the Act"). This means that one is to apply the ordinary meaning of the term (and perhaps in this case it is apt to say, *within the context of the capital allowance claim and the confines of the Act).*

For this reason, the determination of how an item of capital expenditure may be termed as "plant" for the purposes of capital allowance claims will require a study of principles that have evolved in case law in this regard. As a common law jurisdiction, several guiding principles derived from UK case law have been referred to for their relevance to the Singapore context. Three key case law principles have developed in the UK in regard to how an item is classified as "plant" for the purposes of a capital allowance claim.

These are the principles established in the case of *Yamouth v France* and a body of case laws which have resulted in the development of the "functional test" (also known as the "business use test") and the "premises test". We shall discuss these in turn in the following sections.

### Guiding principles established in *Yamouth v France*[7]

The 1887 case of *Yamouth v France* is the *foremost* reference on how an item may be identified as "plant" for the purposes of a taxpayer's trade. In *Yamouth v France*, Lord Justice Lindley noted the following:

*"There is no definition of plant in the Act; but in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying on his business, - not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business."*

Three key principles outlining whether an item can be identified as plant were formulated and are discussed in the table below:

7 [188] 19 QBD 647.



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| | Principle | Interpretation |
|---|---|---|
| 1 | **It is an apparatus used by a taxpayer for the purposes of carrying on his business.** | The "apparatus" in question is *actually* or must be deployed in the taxpayer's business, for the purposes of his trade. |
| 2 | **It is *not* stock-in-trade which the taxpayer buys or makes for sale.** | The "apparatus" does not refer to any form of circulating capital which is *not* retained in the taxpayer's business and is usually disposed with the intention of profit. For example, to a legal firm, books are regarded as plant but to a book retailer, books are regarded as part of stock-in-trade intended for sale as part of the business. |
| 3 | **It is kept for permanent employment in the taxpayer's business.** | "Permanent employment" connotes that the quality of "apparatus" possesses a certain degree of durability[8] and is retained in the business to fulfill commercial objectives. |

In other words, the functionality of the item, ie whether it performs any function in the taxpayer's business is a key consideration when discerning if an item should be regarded as "plant" in the a taxpayer's trade. Hence, the application of the functional test.

In a number of cases, the courts had to discern if the item in question *merely* formed part of the settings of the taxpayer's business or could be separately identified as "plant".

8 Refer to Lord Reid who observed in *Hinton (Inspector of Taxes) v Maden & Ireland Ltd* regarding a decision on whether knives and lasts should be regarded as plant to a shoe manufacturer for the purposes of receiving investment allowances: "The point is the durability of these articles... When Lindley LJ used the phrase "permanent employment in his business", he was using it in contrast to stock-in-trade which comes and goes, and I do not think that he meant that only very long-lasting articles should be regarded as plant. But the word does, I think, connote some degree of durability, and I would find it difficult to include articles which are quickly consumed or worn out in the course of a few operations. There may well be many borderline cases, but these articles have an average life of three years and, if their cost can fairly be called capital expenditure I cannot refuse them the description of "plant" unless the Act discloses some special reason for doing so."



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These cases are discussed in the table below.

| Index | Case | Matter of contention | Conclusion |
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| 1 | *Jarrold v John Good & Sons* (1963) 40 TC 681 | Whether moveable partitions used by a company to adapt to changes in use of office accommodation could be regarded as plant. | **Held to qualify as plant.**<br>*Pearson* LJ held the view that: "the respondent company, instead of having internal walls in their office building, needs to have, and does have, for the special requirements of their business, movable partitioning by means of which they can, in response to changing volumes of business in their departments or to the cessation of departments ... rapidly and cheaply and without much interruption of business alter the subdivisions of their office building. On that view of the facts, the partitioning undoubtedly can be regarded as 'plant'". |
| 2 | *IRC v Barclay & Co* (1968) 45 TC 221 | Whether a dry-dock installation qualified as plant. The installation of the dry-dock required the excavation of a basin in order for the dry-dock to be built. | **Held to qualify as plant.**<br>*Lord Reid said* ""It seems to me that every part of this dry dock plays an essential part in getting large vessels into a position where work on the outside of the hull can begin. And that it is wrong to regard either the concrete or any other part of the dock as a mere setting or part of the premises in which this operation takes place. The whole dock is, I think, the means by which, or plant with which, the operation is performed". |
| 3 | *Schofield and R&H Hall Ltd* (1974) 49 TC 538 | Whether grain silos should be treated as plant. | **Held to qualify as plant.**<br>Since it was observed that the grain silos were "primarily used not for storing but for receiving grain ships and discharging from lorries". |


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| Index | Case | Matter of contention | Conclusion |
|---|---|---|---|
| 4 | *Cooke v Beach Station Caravans* (1974) | Whether a swimming pool and a paddling pool provided as amenities on the premises of a caravan park operator should be regarded as plant. | **Held to qualify as plant.**<br>*Megarry J said* "...Firstly, the two pools should be considered as a unit, with all the attendant apparatus for purifying and heating the water and so on: for it is as a unit that they were constructed and as a unit that they are run. Second, the pools should be considered not on their own but in relation to the business carried on by the company, namely, running its caravan park. It is plain that the pools were provided in order to attract customers to the caravan park of which they form part...Third, I do not think that the pools can be regarded as being merely passive in any relevant sense of the word...The purpose of the pool is to provide and retain a suitable body of water which is circulated, cleansed and heated , and so will provide a medium in which the visitors to the caravan park can safely disport themselves, affording them a pleasurable and safe buoyancy . I do not think that the water that the pool is designed to contain can be divorced from the structure of the pool and its apparatus. What the company intended to provide, and did provide, was a filled pool, not an empty pool...Nobody could suggest that the principal function of the pool was merely to protect the occupants from the elements. If I may use a relatively modern slang expression the pools are not merely "where it's at". They are part of the apparatus used by the company for carrying on its businesses as caravan park operators. The pools are part of the means whereby the trade is carried on and not merely at the place at which it is carried on." |



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| 5 | *Benson v Yard Arm Club Ltd* (1979) STC 266 | Whether an old barge kept moored and used as a floating restaurant can be regarded as plant. | **Held to qualify as plant.**<br>*Buckley* LJ made a distinction between "something by means of which the business activities are in part carried on" and a structure which "plays no part in the carrying on of those activities, but is merely the place within which they are carried on". |
| 6 | *IRC v Scottish & Newcastle Breweries Ltd* (1982) STC 296 | Whether capital expenditure on electric light fittings, electric wiring, décor and murals, and metal sculptures (representing seagulls in flight; one of them hung from the ceiling to which it was bolted and was supported by steel rods) and wall décor consisting of pictures, plaques, tapestries, plates, horse harnesses, stags' heads, metal ware, swords, axes, bagpipes, and deer skins should be regarded as plant. | **Held to qualify as plant.**<br>• Lord *Wilberforce* said: "In the end, each case must be resolved, in my opinion, by considering carefully the nature of the particular trade being carried on, and the relation of the expenditure to the promotion of the trade … It seems to me, on the Commissioners' findings, which are clear and emphatic, that the taxpayer company's trade includes, and is intended to be furthered by, the provision of what may be called 'atmosphere' or 'ambience', which (rightly or wrongly) they think may attract customers. Such intangibles may in a very real and concrete sense be part of what the trader sets out, and spends money to achieve. A good example might be a private clinic or hospital, where quiet and seclusion are provided, and charged for accordingly. One can well apply the 'setting' test to these situations. The amenities and decoration in such a case as the present are not, by contrast with the *Lyon's* case, the setting in which the trader carries on his business, but the setting which he offers to his customers for them to resort to and enjoy".<br>• Lord *Lowry as observed in the same case that*: "… the Crown's primary fallacy, in my opinion, was to identify 'setting' inevitably with 'premises' or 'place' … And even if one assumes that 'the setting' is the same thing as 'the premises', it is fallacious to say that articles used to adorn the setting thereby ceased to be apparatus used by the taxpayer company for carrying on their business …" |



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| 7 | *IH v CIT* (2010) MSTC; [2005] SBITBR | Whether electrical switchgear, electrical door operating systems were regarded as plant for a taxpayer whose business was that of letting shops, offices and clubs. | • The Board viewed that the "business use", "premises" and "completeness" tests were tools to assist it to form the view whether, on the facts of the case, the items in dispute were plant or machinery provided by IH for the purpose of its business. In the context of the taxpayer's business, the Board accepted that IH's business required it to expend capital in the provision use of certain plant or machinery for, or in, or as part of, the building. The fact that the plant or machinery is attached to a building does not, of itself, disqualify it as plant or machinery. However, if the item serves or functions as the building or premises on or at which the business is carried on, that item would not be plant or machinery qualifying for capital allowances as seen in *Wimpy International Ltd* v *Inspector of Taxes* 1989 STC 273.<br>• However, the Board held the following items **not** to be plant:<br>  • Mechanical door closers.<br>  • Decorative fountains and water features located in the front and side of the building as distinguished in IH's case from the decision in *IRC* v *Scottish & Newcastle Breweries*, where the décor and murals were used by the hotelier as part of the setting to create atmosphere and make the interior of the hotel attractive to guests and visitors to the hotel.<br>  • Sanitary fittings - the Board applied the "completeness test" and held the view that the identity of the sanitary fittings was not separate from the toilet and that the toilet would be incomplete without the sanitary fittings. The Board viewed that the judgment in *CIT* v *Taj Mahal Hotel* 1971 82 ITR could not be applied in IH's case. IH's business of owning and letting a good class office building in the prime business district, although sharing some characteristics with that of the hotelier assesse in the *Taj Mahal* case, was nevertheless not the same as a hotel business. |

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| | | | • In addition, the IRAS conceded on the building automation system wiring as being "plant". The building had an automation system which controlled the air conditioning. The wiring linked certain mechanical and plant components, such as pumps and motors, to the main control centre.<br>• Most notably, the IRAS, gave the following criteria that it had adopted when determining whether items in the building qualified as plant:<br>  • whether the items fell within the Sixth Schedule to the Income Tax Act<br>  • whether the items were considered as standard items in a general commercial building. Non-standard items were not part of the premises and would qualify as plant<br>  • whether there were case law precedents<br>  • whether the items were considered by the IRAS as plant, and<br>  • whether a concession for claim had been granted by the IRAS.<br>• The Board commented that it was "unable to distil much benefit from the Revenue's application of the law" and made no decision with regard to the applicability or non-applicability of the Sixth Schedule with regard to this case. |
| 8 | *Wimpy Int'l Ltd v Warland* (1988) | Whether a shop front, wall tiles, false ceilings, floors and stairs can be regarded as qualifying plant for a taxpayer whose business was that of an operator of fast food restaurants. | **Held not to qualify as plant.**<br>• However it was held that only the light fittings were plant. The Commissioners had found that the taxpayer considered the volume of light important for the purposes of their business and that it had been progressively increased for business reasons. The light fittings could not, therefore, have been for general illumination only but were apparatus used in the trade, ie plant.<br>• *Hoffman* J examined the definition of "plant" given by *Lindley* LJ in *Yarmouth* v *France* (see above) and opined that for an |

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| | | | asset to qualify as "plant", it must therefore satisfy the "business use" test and it must not be stock-in-trade. Moreover, an item that is used in carrying on the business is excluded if such use is as the premises or place upon which the business is conducted — he referred to this as the "premises" test where he quoted Lord *Lowry* in *Scottish & Newcastle Breweries* [1982] STC 296 at 304: "something which becomes part of the premises, instead of merely embellishing them, is not plant, except in the rare case where the premises are themselves plant, ..."The question of how one applies the "premises" test to items which were not incorporated as part of the original building but have been added by way of subsequent improvement was also considered. ***Adopting the words of Lord Lowry, Hoffman J who said*** that *the question is whether it would be more appropriate to describe the item as having become part of the premises than as having retained a separate identity.* This is a question of fact and degree, to which some of the relevant considerations will be whether the item appears visually to retain a separate identity, the degree of permanence with which it has been attached, the incompleteness of the structure without it, and the extent to which it was intended to be permanent or whether it was likely to be replaced within a relatively short period.<br>• **In the same case,** *Fox* LJ also applied Lord *Lowry's* above formulation in *Scottish & Newcastle Breweries*, and said (at 278–280): "I would agree with *Hoffman* J that the question is whether it would be more appropriate to describe the item as part of the premises rather than as having retained a separate identity. It seems to me that items such as fixed floor tiles and shop fronts are more naturally to be regarded as part of the 'housing' of the business than as mere embellishments having a separate identity". |