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Singapore Tax News

At a glance

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Singapore case law

During the last 12 months, the Income Tax Board of Review (BOR) and the High Court handed out decisions on cases dealing with amongst others, the deductibility of losses in different circumstances. We set out below a summary of those decisions that may be of interest and relevance to corporate taxpayers.

Appeal concerning a waiver from the shareholders' test

In *AVD v CIT*[1], the BOR was asked to consider whether the Comptroller of Income Tax (CIT) had properly exercised his discretion in not allowing the appellant a waiver from the shareholders' test[2] in respect of the carry forward of its unabsorbed losses.

AVD was a member of a group of companies which was a family business. It was involved in a restructuring exercise pursuant to a family arrangement, which resulted in a substantial change in its shareholders and their shareholdings. AVD applied to the CIT for a waiver of the shareholders' test on the grounds that the restructuring exercise was due to a family arrangement, and not "for the purpose of deriving any tax benefit or obtaining any tax advantage".

The CIT refused to grant the waiver as the case did not fall within any of the circumstances[3] where CIT would generally regard as not being for the

[1] AVD v The Comptroller of Income Tax [2011] SGITBR 3

[2] The carry forward and carry back of losses and capital allowances are subject to the shareholders remaining substantially (50% or more) the same at the relevant comparison dates. If the shareholder of the loss company is itself another company, look-through provisions apply through the corporate chain to the final beneficial shareholder.

[3] The circumstances are set out in an Inland Revenue Authority of Singapore (IRAS) circular entitled "*Utilising unabsorbed capital allowances, trade losses and donations*" updated on 29 June 2012.

purpose of deriving any tax benefit or obtaining any tax advantage. In addition, IRAS viewed the restructuring as for personal rather than for commercial reasons. Being dissatisfied with the CIT's decision, AVD appealed to the BOR.

In allowing the appellant's appeal, the BOR expressed that the list of circumstances stated in the IRAS circular was not exhaustive. The BOR found that the CIT did not challenge whether the restructuring arrangement was tax motivated or not. It was of the view that the CIT had not applied his mind to the governing consideration of whether the substantial change of shareholders was "for the purpose of deriving any tax benefit or obtaining any tax advantage". The CIT seemed impervious to the company's arguments and submissions, and did not consider the possibility that a private or family arrangement could be made for purposes other than for deriving tax benefit or obtaining tax advantage. Moreover, the CIT did not offer any explanation or reasons for the rejection of the waiver application other than merely stating that there was no genuine commercial basis for the substantial change in the company's shareholders.

The above decision serves to highlight that the CIT should let the taxpayer know precisely the grounds of its rejection or disallowance in a dispute resolution process. In addition, the case reinforces that the governing consideration in any waiver application should always be whether a substantial change in shareholders was "for the purpose of deriving any tax benefit or obtaining any tax advantage" rather than a rigid reliance on the IRAS' list of circumstances.

Deductibility of losses caused by a fraudulent director misappropriating company funds

In *AQP v CIT*[4], the High Court dismissed an appeal by a company and disallowed its claim under section 93A of the Income Tax Act (ITA) for a loss incurred as a result of the misappropriation of company funds by its ex-managing director (MD).

AQP, a listed company, began as a sole proprietorship established by its founder before it was incorporated as a company. One of the founder's children took over the management of the company and he served as MD and as a member of the Board of Directors from October 1995. On 1 December 1999, the MD was dismissed as both Director and MD for misappropriating the company's funds as revealed by the investigations of the Commercial Affairs Department.

After the misappropriation came to light, the company made provisions for doubtful debts (inclusive of the loss) in its statutory accounts, and proceeded to institute legal proceedings against the ex-MD. The debt was eventually not recoverable as he was adjudged bankrupt. The company made an "error or mistake" claim in its tax return for the loss incurred but it was disallowed by the CIT as it was of the view that there was no "error or mistake" within the meaning of section 93A of the ITA.

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[4] AQP v Comptroller of Income Tax [2011] SGHC 229

The company appealed to the BOR but was unsuccessful. Relying on the case, *Curtis v J & G Oldfield Ltd*[5] (Curtis), the BOR concluded that the loss was not tax deductible. It reasoned that the ex-MD had an overriding power and control in his position.

The company appealed to the High Court on two issues. First, whether the BOR was correct in its decision that the loss incurred by the company was not wholly and exclusively incurred in the production of its income. Second, whether the BOR was correct in holding that an erroneous opinion or a grossly negligent error, such as a mistake of law, could constitute an "error or mistake" under section 93A of the ITA.

The High Court upheld the BOR's decision. It set out its understanding of the test in the Curtis case (Curtis test) to be as follows: "Did the defalcator possess an 'overriding power or control' in the company (i.e., in a position to do exactly what he likes) and was the defalcation committed in the exercise of such 'power or control'? If so, the losses which result from such defalcations are not deductible for income tax purposes." It concluded that the ex-MD had overriding power or control and the defalcations were committed as a result of such power or control.

Given the above conclusion, there was no need to deal with the second issue. Nevertheless, the Court went on to deal with it. It agreed with the BOR that an "error or mistake" under section 93A of the ITA should not be limited to merely "ignorance or inadvertence" and should be wide enough to cover genuine mistakes of law. However, there is an important caveat to this general rule. Section 93A(3) of the ITA provides that "No relief shall be given under this section in respect of an error or mistake as to the basis on which the liability of the applicant ought to have been computed when the return or statement was in fact made on the basis of or in accordance with the practice of the Comptroller generally prevailing at the time when the return or statement was made". In this regard, the taxpayer would not be entitled to relief for having made a genuine mistake of law if the CIT, at the material time, was also operating under the same mistake.

The decision reinforces that not all defalcations are permissible deductions. Losses arising from defalcations committed by a person who by virtue of his position of power or control is able to "do whatever he likes", would generally not be deductible.

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[5] In *Curtis v J & G Oldfield Ltd (9 TC 319)*, the MD of the company was in sole control of the company's business. An investigation after his death showed that an amount was due from the deceased, arising from many payments and some receipts not related to the company's business but to his private affairs, having been passed through the company's books. The amount was not recoverable and was subsequently written off by the company. The company claimed that it should be deductible but the judge ruled that it was not a trading loss and thus not deductible. A distinction has to be made between defalcations by a subordinate and defalcations by a person who "in virtue of his position [of power or control] was in a position to do exactly what he likes". If the business employs subordinates and owing to the negligence or dishonesty of the subordinates some of the receipts of the business do not find their way into the till or some of the bills are not collected at all, or something of that sort, that may be an expense connected with and arising out of the trade. However, it was not so in the Curtis case as the MD made away with the receipts of the company in virtue of his position as MD and being in a position to do exactly what he likes.

Deductibility of losses of a deregistered branch against the profits of a new branch

In *AYN v CIT*[6], the BOR allowed a company to carry forward its unabsorbed losses incurred from its Singapore operations before it was deregistered as a foreign company, for offset against the profits made from its Singapore operations after being re-registered as a foreign company and carrying on business through the newly-registered branch.

The CIT had disallowed the company's claim for deduction of its old branch losses against the profits earned by its newly-registered branch, as its stand was that any unabsorbed losses of a deregistered branch would be disregarded on cessation of the branch's operations and business in Singapore.

The main issue was whether the company's old branch and the new branch was the same person for purposes of deducting the old branch losses.

In the BOR's view, a branch is an extension or arm of a foreign company in Singapore and exists to carry on the business of the foreign company in Singapore; it has no separate legal personality. It felt that whether the foreign company's business was carried on in Singapore by an old branch or a new branch, it was the same foreign company which carried on the business. Hence, any profits and losses incurred by a branch of the foreign company would be the profits and losses of the foreign company, not of the branch. It follows that the unabsorbed losses incurred by the old branch before deregistration are those of the foreign company. Such unabsorbed losses would be available for set-off against the foreign company's future profits, provided there is no substantial change in the foreign company's shareholders and their shareholdings.

As the foreign company was a resident of Japan, the BOR also considered the provisions of the Business Profits Article in the double tax treaty between Singapore and Japan. It ruled that the determination of the profits of the new branch as provided for in the treaty, did not override the utilisation of the losses against profits of the new branch.

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[6] AYN Corporation v The Comptroller of Income Tax [2012] SGITBR 1

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