

Technical Group Discussion

Capital and Revenue Gains and Budget 2012

27 April 2012, Friday



The lively Q&A session saw a range of scenarios being discussed.

The Singapore Institute of Accredited Tax Professionals organised, in partnership with LexisNexis, another fully subscribed technical discussion facilitated by **Mr Tang Siau Yan, Partner of Allen & Gledhill LLP.**

In the discussion, Mr Tang gave his valuable analysis, through case laws, on the badges of trade. He also shed light on the complication and confusion

that arise in determining whether a gain is capital or revenue and the possible implications on the non-taxation of companies' gains on disposal of equity investments following the announcement made during Singapore Budget 2012.

Badges of Trade

Kicking off the presentation, Mr Tang took a back-to-basics approach of first reviewing the definition of badges of trade.

The badges of trade were first coined by the UK Royal Commission on the Taxation of Profits and Income in 1955 and they are as follows:

- Subject matter of realisation
- Length of period of ownership
- Frequency or number of similar transactions by same person
- Supplementary work on or in connection with property realised
- Circumstances responsible for the realisation
- Motive

According to the Royal Commission, the badges of trade are objective tests of what constitutes a trading adventure. Mr Tang explained that a trading adventure refers to an isolated transaction that is regarded as one that amounts to a trade or business. The badges of trade serve as factual indicators of the nature of this isolated transaction - whether it is a trade or an investment for the taxpayer.

Mr Tang opined that the last badge of trade (i.e. motive) is always a relevant factor in determining whether a transaction amounts to a trade or business. This is supported by Lord Wilberforce in *Simmons v Inland Revenue Commission*, who placed emphasis on the intention at the time of asset acquisition.

In this regard, Mr Tang concluded that in lieu of a taxpayer's admission of this motive at the time of acquisition of the asset, the definition of the badges of trade apply in determining if the gain, when the asset is subsequently sold, is revenue or capital in nature.

Section 10(1)(g) of the Income Tax Act

Section 10(1)(g) is a "sweep-up" section in that it captures all gains or profits of an income nature that does not fall under the preceding paragraphs (i.e. Sections 10(1)(a), (b), (d), (e), and (f)) of charge.

Section 10(1)(g) was enacted a few years after the decision in *DEF v Comptroller of Income Tax* and it had been thought to be enacted as a result of the *DEF*'s case until the Income Tax Board of Review's decision in *IB v Comptroller of Income Tax*.

In *DEF*'s case, the Court of Appeal held that an isolated transaction would generally not amount to trading and that the concept of "adventure in the nature of trade" does not exist under the Income Tax Act. The Court of Appeal also held that regardless of whether an isolated transaction is a business transaction or a scheme of profit-making, the profits or gains from the transaction are not taxable unless the taxpayer carries on a business.

It was however noted from the case of *IB v Comptroller of Income Tax* that Section 10(1)(g) was not confined to gains from adventures in the nature of trade or isolated transactions. The Income Tax Board of Review in *IB*'s case explained that Section 10(1)(g) can apply to profits arising out of a transaction which is not an activity in the ordinary course of trade or business, or an ordinary incident of some other business activity, which the taxpayer had the intention or purpose of making a profit from it (the transaction) when this transaction was originally entered into. It was further explained that the words "gains or profits of an income nature" stated in Section 10(1)(g) mean that the gains would only be considered as capital gains if the appellant could prove that these assets (properties in *IB*'s case) were acquired with the intention of being held as long-term investments. Otherwise, the gains would be revenue in nature.

It was opined that the Income Tax Board of Review appeared to imply that a person that had an intention of holding a short-term investment would be taxable under Section 10(1)(g). This is even though the transaction would not amount to a trading transaction (which would otherwise be taxable under Section 10(1)(a)). The precise scope of Section 10(1)(g) would be somewhat nebulous if the Income Tax Board of Review was suggesting that a person who intends to acquire an investment may be taxable on the gains on the disposal of the investment if he had contemplated the possibility of a short-term sale.

The scope of Section 10(1)(g) could be one area that IRAS may wish to provide more clarity on and provide more certainty to taxpayers.

Last Words on Badges of Trade

Mr Tang noted that the true purpose of the application of the badges of trade is sometimes overlooked. The consideration on the intention of the taxpayer is hardly pondered on. He reiterated that the intention of the taxpayer should be the fundamental consideration and the badges of trade are proxy indicators of the intention.

He further elaborated that taxpayers often faced practical problems to prove their intentions. As such, the badges of trade are always relevant as they prove the intentions of the taxpayers, but effort should be made to understand their proper context. The badges of trade should be used as an exercise to ascertain taxpayer's intention, instead of a test in itself.

Typically, the attention is often focused on the sale and the circumstances that lead to the sale. The intention of all sellers is to maximise their gains and as such, attention should instead be given to the intention for its purchase (instead of sale).



Participants stayed back and leveraged on the networking opportunities to exchange ideas after the presentation ended.

Tax Treatment of Companies' Share Disposal Gains Announced during the Singapore Budget 2012

It had been announced during the Budget 2012 that gains derived from the disposal of equity investments by companies will not be taxed if:

- i) The divesting company holds a minimum shareholding of 20% in the company whose shares are being disposed; and
- ii) The divesting company maintains the minimum 20% shareholding for a minimum period of 24 months just prior to the disposal.

For share disposals in other scenarios, the tax treatment of the gains/ losses arising from share disposals will continue to be determined based on the facts and circumstances of the case.

It was opined that generally, this tax change appears to be a simple rule that will not affect the ordinary analysis. However, the existence of such "safe harbour" rule may distort the commercial activities undertaken and result in abuses by the taxpayers.

For example, a company may hold 100% shareholding in shell companies. After 2 years, the company may inject valuable assets into the shell companies for the purpose of issuing additional shares and thereafter, sell the shareholding in the companies. In this scenario, the divesting company will not be taxed on the share disposal gains based on the new tax treatment.

The Inland Revenue Authority of Singapore (IRAS) may then invoke Section 33 litigation on such abuse cases and hence, more Section 33 cases may emerge upon the implementation of this new tax treatment.

The necessity to implement this new tax treatment was also raised as a company would not usually acquire 20% shareholding in a private company with the intention of trading since there is no market for the shares. It is also unlikely that a company would acquire 20% shareholding in a listed company and maintain a minimum holding for 2 years unless it has a capital intention. Thus, the new tax treatment may provide certainty in limited situations only.

With IRAS' initiative to provide certainty on companies' gains on disposal of equity investment to taxpayers, it could consider providing more clarity on the guiding principles that differentiate a revenue gain from a capital gain.

The session ended with a presentation of token of appreciation by SIATP Board Member, Mr Yee Fook Hong, to Mr Tang.