# Capital or Revenue?

*Gains On Disposal Of Shares And Section 10(1)(g)*

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"Singapore does not impose taxes on capital gains. Strictly, the Comptroller of Income Tax (CIT) can only impose tax on a gain if it is within the ambit of Section 10(1) of the Income Tax Act (ITA).

Sections 10(1)(a) to (f) pertain to specific taxable gains or profits, while Section 10(1)(g) acts as a "catch-all" provision that taxes "any gains or profits of an income nature" that do not fall within the heads of charge under the preceding paragraphs.

Until the recent case of *GBU v CIT* [2017] (*GBU*) where the CIT sought to apply section 10(1)(g) to gains derived from the sale of shares, Section 10(1)(g) has only been applied in cases involving gains from the disposal of properties.

At a recent *Tax Excellence Decoded* session by the Singapore Institute of Accredited Tax Professionals (SIATP), Liu Hern Kuan, Consultant at Tan Peng Chin LLC, who successfully argued the *GBU* case, shared his insights on this "catch-all" provision in the first non-property related case involving Section 10(1)(g).

## GBU V CIT [2017]

In *GBU*, the taxpayer is a company in the business of operating supermarkets. At the time of the acquisition of the shares, the taxpayer had substantial cash reserves of over $76 million which was generating a meagre interest of 0.78% per annum in year 2008. To improve its rate of return from the cash reserve, the taxpayer made a series of buy and sell transactions in shares within a two-year period, which resulted in several millions of dollars in gains.

### RELEVANT CHARGING PROVISION

Gains on sale of shares are traditionally brought to tax under Section 10(1)(a) of the ITA, which states that income tax shall be payable in respect of "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".

Practically, gains are unlikely to be taxed under Section 10(1)(a) if the transaction is an isolated transaction in the context of the taxpayer's business. The Court of Appeal remarked in *DEF v CIT* [1961] that the words, "trade" and "business" in section 10(1)(a) connotes "habitual and systematic operations, a continuity or repetition of acts in carrying on, or carrying out a scheme for profit-making".

As the taxpayer in *GBU* did not buy and sell shares as part of its principal business activity, its activities are unlikely to constitute a trade or business in shares under Section 10(1)(a). Instead, the CIT sought to subject to tax the taxpayer's gains under Section 10(1)(g).

## THE CIT'S ARGUMENTS

The CIT argued that as the taxpayer had the intention to make a profit when it acquired the shares, section 10(1)(g) applied, subjecting the gains to tax.

In justifying its assertion, the CIT submitted that the appropriate test, derived from two previous Income Tax Board of Review (ITBR) decisions, *IB v CIT* [2004] (*IB*) and *HZ & Anor v CIT* [2004] (*HZ*), is two-pronged. First, the gain derived from the transaction would prima facie be taxable under Section 10(1)(g) if the taxpayer had an intention to profit from the transaction at the time the transaction was entered into, and second, only if the taxpayer satisfied the ITBR that the acquisition was intended to be held as a long-term investment would it be considered a non-taxable capital gain.

The CIT went on to argue that there was a lack of intention by the taxpayer to hold the shares as long-term investments, as the taxpayer had bought the shares with the intention of selling them prior to listing on the Singapore Exchange (SGX) or after "sufficient" appreciation in value. The lack of intention to hold was further demonstrated by the fact that the taxpayer did not conduct any feasibility studies prior to their share purchase, and that some share counters purchased by the taxpayer did not yield any dividends.

Liu Hern Kuan, Consultant at Tan Peng Chin LLC, shared his insights on the first non-property related case involving Section 10(1)(g) of the Income Tax Act.

## THE TAXPAYER'S ARGUMENTS

The taxpayer argued that the main motivation behind the share purchases was to improve the rate of interest on the company's cash reserve than that offered by the bank. The shares were acquired with the intention of being held as long-term investments, and the resulting gains were therefore capital in nature.

On the CIT's proposed two-pronged test, the taxpayer reasoned that it could not be applied to the case of share portfolio investors, as practically any share portfolio investor would purchase shares in expectation of profit from appreciation and hence would be subject to tax under this test.

In addressing the CIT's assertion that it lacked the intention to hold the shares as long-term investments, the taxpayer argued that the absence of dividend yields would not make the share counters any less of an investment, and the lack of feasibility studies was also irrelevant in demonstrating its intention (as each share purchase was carefully considered).

The taxpayer also submitted that while it had the intention to sell the shares prior to its listing on the SGX, there was no definite timeframe to sell the shares at the point of purchase as the process of listing was "long, tedious, involving numerous stakeholders, and subject to volatile market conditions".

## THE ITBR'S DECISION

On the CIT's proposed test, the ITBR commented that while both *IB* and *HZ* only identified the concept of "long-term investments" as being an exception to the rule, the ITBR did not take this to mean that if the taxpayer were unable to prove that the acquisition was for the purpose of a long-term investment, it must necessarily mean that the gain derived from the subsequent sale would be a taxable income gain.

In other words, the concept of "long-term investments" is merely a safe harbour to show that a gain was capital in nature. It does not automatically render a gain derived without the intention to hold the purchase as a long-term investment as being an income gain. All facts and circumstances of the case must be considered.

Given that the taxpayer's submissions on the facts of the case were that the shares acquired were for the purpose of long-term investment, the ITBR's assessment of the case did not turn on any dispute that may exist between the parties on the legal test to be applied.

Instead, the key question was whether the taxpayer intended to hold the shares as long-term investments which would render the gain derived from the disposal of the shares a capital gain. To this, the ITBR agreed with the taxpayer's submissions, and found that the gains derived from the sale of the shares did not fall within Section 10(1)(g) of the ITA.

## *Key Highlights*

### PREREQUISITE FOR SECTION 10(1)(G)

While Section 10(1)(g) acts as a "catch-all" provision that taxes "any gains or profits of an income nature" even where such income does not fall within the heads of charge under the preceding paragraphs, its prerequisite is that the gains or profits must be of an "income nature".

The challenge remains that the term "income" is not defined in the ITA. There is also no extensive or authoritative case law clarification on the term. It is therefore noteworthy that the ITBR in *IB* has attempted to define the ordinary meaning of "income" as encompassing "the amount of money or its equivalent received during a period of time in exchange for labour or services, from the sale of goods or property, or as profit from financial investments."

### INTENTION IS NOT ALL

The test laid down by *IB* and *HZ* (and adopted by the CIT in *GBU*), where a gain would be regarded as income gain (and therefore taxable) once there is an intention to make a profit when a transaction is entered into, while easy to apply, is not the sole test of taxability for Section 10(1)(g).

The judgement in *GBU* shows that the intention to profit from a particular transaction does not mean that gains from that transaction will necessarily be caught under Section 10(1)(g). All facts and circumstances have to be considered in determining whether a taxpayer had an intention to make an investment (or not).

### "LONG-TERM INVESTMENT" AS A SAFE HARBOUR

The ITBR accepted in *GBU* that the concept of "long-term investment" is a safe harbour which would satisfy the Board that the gain was capital in nature.

In arriving at its decision, the ITBR also observed that the concept of "long-term" cannot be applied to the facts of any given case without taking into account the distinctions that may arise between different types of assets. What may constitute a capital gain for a share portfolio investor may look different from what may constitute a capital gain for an investor in real property.

Liu Hern Kuan, Consultant at Tan Peng Chin LLC, clarifying queries posted by participants during the Q&A segment.

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