KPMG

Tax alert

Issue 10 | July 2024

GHZ v The Comptroller of Income Tax [2023]:

Purposive interpretation of Section 10D in relation to deductibility of expenses

In this tax alert, we examine the case of *GHZ v The Comptroller of Income Tax* [2023] SGITBR 2, whereby the Income Tax Board of Review (the "Board") dismissed the appeal by the taxpayer, GHZ – the trustee of a listed real estate investment trust, on the denial of deduction claim for expenses incurred when its investments (i.e. two retail malls) were closed for redevelopment and did not generate income.

The case dealt with the interpretation of section 10E of the Income Tax Act (Cap 134, 2008 Rev Ed) (the "Act") for the tax years concerned. Section 10E of the Act had since been renumbered section 10D of the Income Tax Act 1947 (without changes to the meaning of the law) as part of the universal 2020 Revised Edition of Acts which came into force on 31 December 2021. For the purpose of this article, reference is made to section 10E of the Act throughout for ease of cross-referencing to the decision published.

Background

- GHZ carries on the business of investing in retail malls which are let out to derive rental and rental-related income. It is not in dispute that GHZ carries on the business of the making of investments within the meaning of section 10E of the Act.

- In 2005, GHZ purchased two retail malls (i.e. ABB and ABC) with existing tenancies, both of which were income-producing from the point of acquisition.

- ABB and ABC were each closed (for the periods from March 2007 to December 2008, and November 2008 to February 2012) for reconstruction and redevelopment, during which the malls did not generate income[1].

- The redeveloped ABB and ABC reopened in December 2008 and February 2012 after receiving the respective Temporary Occupation Permits (TOPs)[2].

- GHZ claimed deduction in YAs 2009 to 2011 for property-related expenses and interest expenses incurred in respect of each of ABB and ABC (amounting to close to a total of S$5.9 million) when they were closed and did not generate rental income. GHZ appealed to the Board, after the deduction claims were denied by the Comptroller.

[1] Except for ABC where the atrium and carpark continued to generate rental income until full operations were ceased in October and November 2009.
[2] Tops were issued for ABB and ABC on 17 December 2008 and 29 February 2012 respectively.

Issues and legislative provisions in question

The main contention relates to whether and to what extent section 10E(1) restricts the deductibility of expenses in respect of ABB and ABC in the relevant YAs when the respective malls did not produce income.

The key provisions being –

10E.—(1) Despite any other provisions of this Act, in determining the income of a company or trustee of a property trust derived from any business of the making of investments, the following provisions apply:

a) any outgoings and expenses incurred by the company or trustee of a property trust in respect of investments of that business which do not produce any income are not allowed as a deduction under section 14 for that business or other income of the company or trustee of a property trust;

b) any outgoings and expenses incurred by the company or trustee of a property trust in respect of investments of that business which produce any income are only available as a deduction under section 14 against the income derived from such investments and any excess of such outgoings and expenses over such income in any year is disregarded.

Positions taken by GHZ and the Comptroller

The positions taken by GHZ and the Comptroller on each of the interpretation of sections 10E(1)(a), (b) are briefly set out in the table below.

	GHZ's position	Comptroller's position
Section 10E(1)(a)	• Investments referred to in section 10E should be read as being organised into two baskets based on whether they have produced "any income" (as referenced in both sections 10E(1)(a), (b)) at any point in time. • Hence, once an investment has produced any income, it must continue to be so classified even when it does not produce income in the basis period in question (i.e. no temporal limit). • Effectively, this means only pre-commencement expenses cannot be deducted under section 14(1) by virtue of section 10E(1)(a).	• Taking a purposive interpretation, section 10E(1)(a) must have been intended to impose further restriction on deductibility over and above restrictions under section 14(1) where expenses incurred by an investment that does not produce income in the relevant basis period shall not be deductible. • GHZ's interpretation of section 10E(1)(a) is too broad and renders the enactment of that provision *otiose*.
Section 10E(1)(b)	• Section 10E(1)(b) refers to "investments" of the business in the plural tense. • Expenses can be deducted against the aggregate income derived from the basket of all income-producing investments, not just the investment to which the expense relates.	• GHZ has placed undue weight on the use of the word "investments" in the plural tense. • An investment-by-investment analysis is required.

The Board's approach in interpreting section 10E(1)

The Board recognises that the key to the determination of the contention between the parties lies in the statutory interpretation of section 10E(1) of the Act.

Pursuant to section 9A(1) of the Interpretations Act 1965, in interpreting a provision of a written law, an interpretation that promotes the purpose or object underlying the written law is to be preferred. The Board set out and applied the statutory interpretation framework laid down in established case law.[3]

Guided by the principles of purposive statutory interpretation, the Board dismissed the taxpayer's appeal after having examined the issues below in determining the proper interpretation and application of section 10E(1).

A. The nature of section 10E companies

The Board stated that it is necessary to understand the nature of section 10E companies (which are in the "business of making investment") and the distinction in their tax treatment from other companies involved in investments, in order to appreciate the rationale behind the differences in how the investment income derived by different types of companies are taxed under section 10(1), as well as the legislative purposes of section 10E(1).

Having regard to established decisions[4], the Board considered the essential characteristic of a company in the "business of making investments" is that of derivation of investment income through the active management of the investments it holds for the long term (i.e. investments are typically of a capital nature). This is to be contrasted with an investment dealing company which carries on the business of buying and selling investments without a view to long-term derivation of investment income, and a passive investment company which derives investment income passively from investments which it holds for long term.

The Board set out in its decision the key differences in the tax treatment for each type of company in terms of taxation of investment income, deduction of expenses, availability of capital allowances, taxation of disposition gains and availability of tax losses.

B. Taxing and deductibility framework under the Act

Based on established statutory framework, the Board emphasised that the interpretation of section 10E must take into account the context of the legislative text within the Act as a whole.

Having regard to the taxing and deductibility framework of the Act within which section 10E(1) operates, the Board disagreed with the taxpayer's interpretation of the words "any income" in sections 10E(1)(a), (b) of the Act.

With reference to the taxing framework under section 10(1), the Board is of the view that as section 10(1) makes it clear that tax is assessed for each YA based on a particular basis period for each YA, it should only make sense that the manner for "determining the income" of a section 10E company (as provided for in section 10E(1)) is with respect to that particular basis period. It naturally follows that the deductibility of expenses for a section 10E company provided for in sections 10E(1)(a) and (b), and which affects the determination of "the income" for each YA (per section 10(1)), is also to be determined with respect to that particular basis period.

In addition, based from a survey of the provisions in the Act, the Board deemed it reasonable to draw the inference that, taking into account the context of the Act as a whole, the words "any income" (in sections 10E(1)(a), (b)) are meant to be read as referring to income in a particular basis period for assessment. This is given the fact that under the Act, tax is payable for income in each year of assessment, which in turn requires "any income" to refer to income in a particular basis period for assessment without having to state the obvious.

[3] See *Attorney-General v Ting Choon Meng and another appeal* [2017] 1 SLR 373 at [59], which was affirmed in later decisions of the Court of Appeal in *Tan Cheng Bock v Attorney-General* [2017] 2 SLR 850 at [37] and *Public Prosecutor v Lam Leng Hung and others* [2018] 1 SLR 659 at [67].

[4] *JD Ltd v Comptroller of Income Tax* [2006] 1 SLR(R) 284 ("*JD Ltd*") at [52] and *Comptroller of Income Tax v VJ* [2009] 2 SLR(R) 91 ("*VJ*") at [20]

In respect of the deductibility framework under section 14(1), the Board pointed out the established principle that deduction claim for expenses is only allowed when an income-producing structure or income-earning investment has been put in place. The Board agreed with the Comptroller that – going by the taxpayer's line of reasoning that only pre-commencement expenses cannot be deducted under section 14(1) by virtue of section 10E(1)(a) – it would have been unnecessary to enact section 10E(1)(a) as it would simply be a re-enactment of section 14(1) and the position that expenses incurred in respect of investment before it starts to produce income (i.e. pre-commencement expenses) are to be disallowed.

Based on the maxim that Parliament does not legislate in vain, the Board held that the more logical and natural interpretation of section 10E(1)(a) is that it provides a further and specific restriction on the deductibility of expenses for a section 10E company over and above the general deductibility rules in section 14(1) – by disallowing the deduction of expenses incurred during the basis period in which the investment is non-income producing in the same basis period. This is regardless of whether income had been produced by that investment in previous YAs.

C. Legislative purpose of section 10E(1)

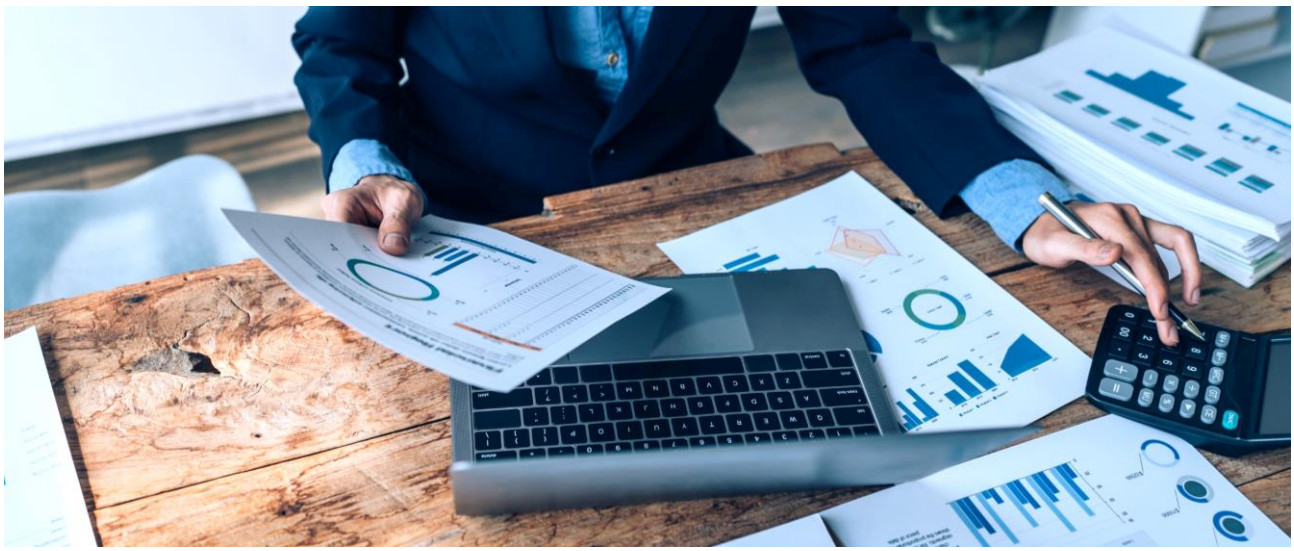
Having dealt with statutory context, the Board then turned to the examination of the legislative purpose of section 10E(1) based on various extraneous materials.

Based on legislative materials (i.e. in this case, draft bill relating to the introduction of section 10E), the Board concluded that there is clear intention by the Parliament to provide for deductibility rules which are specific to section 10E companies.

Aside from legislative materials, the Board placed heavy reliance on commentaries on income tax regime, which the Board established is an extraneous material that is both well-accepted and of persuasive authority in aiding statutory interpretation.

Based on commentaries relating to section 10E[5], it was said that prior to the introduction of section 10E, section 10E companies enjoyed the same tax treatment as investment dealing companies in respect of the deductibility rules under section 14 where the income was assessed under section 10(1)(a); at the same time, while investment dealing companies are taxed on the gains from the sale of investments, section 10E companies are not, reflecting the capital nature of the investments of a section 10E company. Taxpayers who are in the "business of making investment" were thus placed in a more advantageous tax position compared to investment dealing companies before the enactment of section 10E.

The introduction of section 10E – and specifically the more restrictive deductibility rules under section 10E(1), has the effect of achieving greater parity in tax treatment between "investment making" companies and investment dealing companies. Based on the foregoing, the Board came to the view that section 10E was introduced to expressly provide for more specific and restrictive deductibility rules for expenses incurred by section 10E companies over and above the general deductibility rules in section 14.



[5] *The Law and Practice of Singapore Income Tax, Volume I* (2nd Ed, LexisNexis 2013); *LexisNexis Annotated Statutes of Singapore: Income Tax Act and Economic Expansion Incentives (Relief from Income Tax) Act 2015* (2015 Ed)

The Board's decision

Based on the proper interpretation and application of section 10E(1)(a) (based on considerations summarised above), the Board agreed with the Comptroller that as ABB and ABC did not produce any income in the relevant parts of the basis periods in YAs 2009, 2010 and 2011, the corresponding expenses in the same basis periods would not be allowed to be deducted. The appeal was therefore dismissed based on section 10E(1)(a) alone.

Alternative arguments examined

Interpretation of section 10E(1)(b)

Despite the above, the Board went on the address the interpretation of section 10E(1)(b) – which was the Comptroller's alternative argument – for the sake of completeness.

Taking into account the statutory context and legislative purpose (which points towards a more restrictive deductibility formula), the Board is of the view that section 10E(1)(b) should be interpreted to require that the expenses incurred in respect of investments can only be deducted against income produced by the specific investment for which the expenses were incurred in a particular basis period. Hence, if the income of the specific investment is zero in that period, expenses incurred for that investment cannot be deducted against the income of another investment. In other words, an investment-by-investment analysis (as argued by the Comptroller) would be required to be undertaken.

The Board also held that GHZ has paid undue emphasis on the fact that the plural tense is used in describing the "investments" (in section 10E(1)(b)) to be taken into account when determining the scope of investments in respect of which income is produced under section 10E(1)(b).

The Board pointed out that sections 10E(1)(a) and (b) are mirror provisions providing for opposite scenarios in respect of section 10E companies on whether income is generated. The above interpretation requiring a more restrictive investment-by-investment analysis would, in the Board's view, lead to a consistent and harmonious reading of section 10E(1)(a) and (b).

Whether the redeveloped malls were new "investments"

Likewise, for completeness, the Board set out its analysis on whether the redeveloped malls (which were demolished and reconstructed) were new "investments" – that are distinct and separate from the existing malls given the extent of the construction works during the closure period. The issue is that if the reconstructed malls are new "investments", then the expenses sought to be deducted by GHZ should be regarded as pre-commencement expenses and hence cannot be deducted.

Broadly, having regard to case law on the meaning of "investment" and various factors (such as the extensiveness of the nature of work done and associated outlays), the Board concluded that the reconstructed malls are new investments which are separate and distinct from the original malls acquired in 2005. The Board thus agreed with the Comptroller's view that the expenses incurred in respect of ABB and ABC (during the reconstruction phase) were pre-commencement expenses.

Key observations and takeaways

The Board has confirmed that expenses incurred in respect of an investment of a Section 10E business when it did not generate income are non-deductible.

More importantly, the Board's decision is a helpful illustration of the application of the statutory interpretation framework in interpreting section 10E(1) – having regard to the statutory context and the legislative purpose of that section. Similar to the High Court case *Intevac Asia Pte Ltd v Comptroller of Income Tax* [2020] SGHC 218 (which dealt with the interpretation of section 14D[6] in relation to research and development expenses under cost sharing arrangement), the case at hand again bring to fore the importance of interpreting tax provisions in a purposive manner.

How we can help

As your committed tax advisor, we welcome any opportunity to discuss the relevance of the above case to your business, as well as any transactions which your business may be contemplating.

[6] Renumbered as section 14C under the Income Tax Act 1947

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