The Many Faces of Singapore Tax Cases

Delving Deeply into Recent Tax Cases

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2019 saw several developments in the tax legal scene. A multitude of tax cases spanning different issues in the various areas of tax were played out in the courts. Singapore Institute of Accredited Tax Professionals aims to highlight the salient tax issues and nuances of these cases.

Definition of "Control": BZZ v Comptroller of Income Tax (CIT) [2019]

BZZ v CIT [2019] centred on a taxpayer's appeal against the Income Tax Board of Review (ITBR)'s decision in relation to the CIT's imposition of a balancing charge of over S$40 million arising from the sale of a property.

The taxpayer sold a property to BMT (the "Trustee"), who bought it in its capacity as trustee of the beneficiary, FCOT, a real estate investment trust (the "REIT"). The manager of the REIT is FCAM (the "Manager"). Both the taxpayer and the Manager are wholly-owned subsidiaries of a company called FCL.

Under the Income Tax Act (ITA), a balancing charge will result when the sale proceeds of the capital asset exceed the amount of capital allowances not claimed. This balancing charge will be taxed at the prevailing corporate tax rate unless Section 24(1), which has "the effect of nullifying a balancing charge if a sale in question can be said to be not a true commercial sale in that the seller is under the control of the buyer or, vice versa, the buyer is under the control of the seller, or, in the third situation, both buyer and seller are under the control of a third party", applies.

The taxpayer disputed the CIT's claim that a balancing charge was necessary as it was of the view that Section 24(1) applies. Specifically, the taxpayer contended that both itself and the Trustee were under the common control of FCL.

Some arguments put forward include (a) under the Monetary Authority of Singapore's requirements and accounting procedure, the accounts of the REIT are consolidated with those of FCL, and (b) under the Trust Deed, the Trustee must exercise its powers only as directed by the Manager (which is controlled by FCL).

The High Court rebutted that under the Trust Deed, the Trustee may, in its absolute discretion, act without or contrary to the direction of the Manager if it considers it necessary to do so. The control that the Manager has over the Trustee is therefore not absolute.

The taxpayer also argued that just because the Trustee assumes fiduciary duties to one party (the REIT) does not mean that it cannot be under the control of another (the Manager), as long as it retains an irreducible core of duties to the REIT. The High Court rejected this argument by saying that the control envisaged by Section 24(1) must refer to the buyer and seller, and legally, FCL does not control the buyer (which is the Trustee).

On these facts, the High Court concluded that while FCL may be in control of the taxpayer, it only had (at most) substantial influence and not control, over the REIT. As FCL did not have control over both the taxpayer and the REIT, the taxpayer's appeal was dismissed.

Key Observations

What constitutes "control" under Section 24 of the ITA

"The purpose behind a Section 24 election is to allow the buyer to step into the shoes of the seller as if no sale had taken place. In order to benefit from this special treatment, the relationship and level of control between the seller and buyer should be a close one, with a high degree of control," says Accredited Tax Practitioner (Income Tax & GST) Allen Tan, Principal, Baker & McKenzie.Wong & Leow.

"In the present case, the taxpayer's definition of 'control' as 'the power to direct or influence' or 'substantial influence' was rejected by the High Court on the basis that it was too broad and did not promote the object of Section 24(1). The High Court emphasised the high degree of control required by using the words 'dominance' and 'absolute authority' to describe 'control'", Mr Tan elaborates.

Stamp Duty on Compensation Payment: Ong Beng Chong v Commissioner of Stamp Duties (CSD) [2019]

In *Ong Beng Chong v CSD* [2019], the taxpayer owned a plot of land. The land was rented to tenants who (at their own cost) built terrace houses ("Houses") and paid ground rent to the taxpayer. No land title was issued in respect of the Houses.

Subsequently, the taxpayer sought to recover vacant possession of the land for the purposes of redevelopment. He entered into agreements with the five owners of the Houses for the vacant possession of each house in exchange for a cash payment, and obtained a court order obligating the remaining (sixth) owner to deliver vacant possession of the house in consideration for a payment.

After the taxpayer sold the land and the Houses, the CSD conducted stamp duty audit investigations and determined that stamp duties and penalties were payable.

Pursuant to Section 22 and Article 3 of the First Schedule of the Stamp Duty Act (SDA), and read with the definition of a "conveyance on sale" under Section 2 of the SDA, one of the requirements for stamp duty to apply is that "there is a conveyance, assignment or transfer on sale of the Houses".

The taxpayer argued that the payments were not for the sale of the Houses, but for the satisfaction of the "equity" that each tenant had in their respective Houses.

The High Court noted under equitable principles, the construction of the Houses at the tenant's own costs created an equity which must be satisfied by way of "reasonable compensation".

On the basis that the true and real meaning of the instruments was a compensation payment to satisfy the house owner's equity and obtain vacant possession of the land, the High Court ruled that no stamp duty was chargeable, as the compensation did not fall within the meaning of a "conveyance on sale", nor was it deemed to be one by the SDA.

Key Observations

Where does the "equity" arise from?

"Because of how the tenancy was created, the landowner could have legally recovered possession of its land merely by serving a notice to quit on the tenants. However, under the law of equity, the tenants may raise the doctrine of equitable estoppel to prevent the landowner from exercising his legal rights," says Jeremiah Soh, Senior Associate, Baker & McKenzie.Wong & Leow. "This is because the landowner allowed the tenants to expend their own money to improve the land under an expectation created by the landowner that the tenant would be able to remain there. The doctrine of equitable estoppel therefore kicks in and raises an equity in favour of the tenant."

"Such equity may be satisfied if the landowner made reasonable compensation to replace the cost of the house, adjusted for depreciation and took account of the current age and condition of the land," explains Mr Soh.

In this case, the payments to the tenants were held to be compensation payment to satisfy the house owner's equity and obtain vacant possession of the land.

Determination of Annual Values: HSBC Institutional Trust Services (Singapore) Ltd (Trustee of Capitaland Mall Trust) v Chief Assessor (CA) [2019]

This case revolved around an appeal against the Valuation Review Board's decision in relation to the annual value of a subject property.

The subject property comprised 10 cinema halls and other units in a mall. It was leased to a cinema operator in its original bare condition, and was used as a cinema complex, an office, and a retail space. The cinema operator carried out fitting-out works on the subject property, at a cost of over S$7 million, in order to fit it out as a fully functional cinema complex.

Any fixtures in or on such immovable property would be assessable to tax in accordance with its annual value.

The High Court addressed several issues in this case. First, the taxpayer argued that the CA's approach was wrong when assessing the subject property by separately valuing it as three tenements (cinema, office and retail space) but issuing only one valuation notice for the subject property. The High Court disagreed and held that that the PTA does not prescribe the manner in which the assessment should be carried out, and that the only requirement was that the subject property be sufficiently described and identified in the valuation list. In any case, the taxpayer was not prejudiced by the single valuation notice.

Another issue was whether the fitting-out works installed by the cinema operator amounted to fixtures which ought to be included in the assessment of the annual value. The taxpayer contended that these fitting-out works were not fixtures but chattels, as the taxpayer was merely a temporary occupant of the subject property and did not intend to dedicate the assets to the subject property. In addition, the fitting-out works had to be removed at the end of the tenancy.

The High Court disagreed and held that the fitting-out works were fixtures and should be included in the assessment of the annual value. Specifically, the High Court determined that leasehold improvements were essential works that secured the functioning of the subject property as a cinema complex. For example, the projection systems were integral to the operation of cinemas, and the seats and other items (such as signages and carpets) were there to enhance the use of the property as a cinema.

The taxpayer also argued that the CA's methodology in determining the annual value was flawed. This was because the rental comparison method (based on the actual rent paid by the taxpayer) should have been used.

The High Court rejected this argument as the actual rent paid was based on a lease of the bare shell. This would not be an accurate comparison as the subject property should be valued based on its physical nature and condition as well as its usage.

Separately, the taxpayer argued that it was wrong to use separate methods to assess the value of the property when there was only a single entry and single annual value in the Valuation List. The High Court rejected this argument and highlighted that the PTA does not prescribe the manner in which the assessment should be carried out. Therefore, the CA's methodology was justifiable. In addition, given that the subject property had already been divided into distinct components by the taxpayer, it was reasonable to use different methodologies to assess each distinct tenement, and this was not prohibited by the PTA.

KEY OBSERVATIONS

Fixtures or chattels?

"As noted in the decision of *Pan United Marine Ltd v CA* [2008], the two considerations for determining whether assets are fixtures or chattels are the degree of annexation and the object of annexation. Of the two factors, the courts have indicated that the object of annexation generally takes precedence," says Mr Tan.

"To determine the object of annexation, the relevant question that taxpayers should ask is whether the item in question was placed on the land in order to be enjoyed as a chattel, or whether it enhances the use of the land and therefore its value," he elaborates. "Where the item forms the pith and marrow of the business conducted by the occupier on the property, it supports the conclusion that it is a fixture."

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