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Advance Ruling Summary No. 8/2022

The Inland Revenue Authority of Singapore (IRAS) published the following advance ruling summary on 1 June 2022. We have provided an overview of the issue, background information, and the outcome, as well as our comments below.

Issue

Whether:

- the transfer of Company A's operating business as a going concern to a newly incorporated Singapore company (NewCo) is regarded as a capital transaction, and accordingly, the gains from the transfer will not be subject to income tax under the provisions of the Income Tax Act (ITA)
- Company A and NewCo will be eligible to make a Section 24 election in respect of the transfer of Qualifying Assets from Company A to NewCo.

Background

Companies X, Y, and Z own Company B, which in turn owns 100% of Company A, a limited liability company incorporated in Singapore.

As part of a group restructuring, Company A will transfer its entire business as a going concern to NewCo, which includes:

- the novation or assignment of Company A's existing employee and commercial/business contracts, and
- the transfer of Company A’s plant and machinery, motor vehicles, computer and office equipment (the “PPE”), inventories, business contracts and goodwill.

Company A had claimed Section 19A capital allowances (CA) for some of the qualifying plant and machinery (Qualifying Assets). The Qualifying Assets are used by Company A (and will be similarly used by NewCo) in the production of income chargeable to tax under the provisions of the ITA. The Qualifying Assets are not leased by Company A to NewCo before the restructuring.

Company X and Company Y would hold more than 50% of the ordinary shares and more than 50% of the voting rights in both Company A (via their shareholdings in Company B) and NewCo at the time of the transfer. There are no plans to change the shareholders’ voting rights in NewCo after the transfer.

Company A’s inventories would be transferred to NewCo at the net book value stated in Company A’s management accounts as at the date of the transfer.

Company A will be liquidated after the restructuring.

Outcome

The transfer of Company A’s operating business to NewCo is regarded as a capital transaction after taking into consideration the following factors: -

- circumstances of the realisation
- nature of Company A’s operating business and assets;
- frequency of similar transactions by Company A
- length of ownership of the business
- Company A’s intention to liquidate upon completion of the restructuring and post-settlement of any outstanding liabilities.

However, the tax implications arising from the business transfer would depend on the nature of the specific underlying assets being divested:

- Inventories

    Section 32 governs the valuation of trading stock on discontinuance or transfer of trade or business. Section 32(1)(a) provides that if the stock is:

    — sold or transferred to another trader in Singapore
    — the cost of the stock is deductible in calculating the latter's trade profits

    then the closing stock in the first trader’s terminal accounts must be taken to be the amount realised on the transfer, or the value of the consideration given for the transfer.

    Section 32(1)(b) provides that if the above conditions are not met, the value of

the closing stock "shall be taken to be the amount which it would have realised if it had been sold in the open market at the discontinuance or transfer of the trade or business".

Because the conditions specified in Section 32(1)(a) of the ITA would be met, the value of the inventories transferred for tax purposes would be the consideration that Company A receives from the transfer.

- PPE

The PPE are fixed capital assets used by Company A in carrying on its trade. Hence, the gain from the disposal of the PPE is capital in nature and is not taxable. The provisions in Section 20 of the ITA will apply to determine the amount of balancing charge/balancing allowance arising from the disposal, where applicable. (Please also consider the Section 24 election, which is discussed further below.)

As a recap, Section 20 governs the adjustments to be made when any one of the following events takes place:

— the plant or machinery ceases to belong to the taxpayer
— the trade is permanently discontinued, and the plant or machinery continues to belong to the trade
— the plant or machinery permanently ceases to be used for the trade.

- Goodwill and Business Contracts

In line with the position taken to regard the transfer of the operating business as a capital transaction, any gains arising from the transfer of goodwill and business contracts are therefore capital in nature and not taxable.

Section 24 election

Where there is a transfer of asset and a balancing charge arises, a tax deferral on the balancing charge can be obtained (from the group's perspective) if both the transferor and transferee jointly make a Section 24 election. Briefly, the effect of a Section 24 election can be summarised as follows:-

Transferor	Transferee
No balancing charge arises	Transferee (NewCo) claims CA based on the Tax Written Down Value (TWDV) transferred from the transferor (Company A).

Section 24 can only be made if:

— the transferor and transferee of plant or machinery are under common control, or if one has control over the other ('control' condition)
— before the transfer in the case of the transferor and after the transfer in the case of the transferee, the asset is used in the production of income chargeable

to tax, and the asset was not leased by the transferor to the transferee before the transfer (Section 24(4) requirement)
— section 33 does not apply (anti-avoidance rules).

An election under Section 24 of the ITA can be made for the Qualifying Assets in view that the above conditions can be met.

More details can be found on IRAS' website

Deloitte Singapore's view

Although payments for the sale of the assets of a business are prima facie capital receipts (one of the 'five basic propositions' laid out in Whiteman on Income Tax as cited by the High Court in ABD v CIT), not every receipt from the sale of a business is necessarily capital in nature. The tax implications arising from the sale depends on the nature of the assets transferred.

A Section 24 election can only be made if the transferor and transferee of plant or machinery are under common control, or if either the transferor or transferee has control over the other. The term "control" is not defined in the ITA. The meaning of this term has been explored in the High Court case of BZZ v Comptroller of Income Tax (SGHC 252) but the Court in BZZ did not lay down a bright-line test for establishing 'control', although it did suggest that control is a function of common economic ownership. Per the ruling summary the IRAS only requires the common shareholders to own more than 50% of shares of the transferor and transferee. Although the facts indicate that the common shareholders also possess more than 50% of voting power in the transferor and transferee, it is not clear voting power is a pre-requisite to establish 'control' for Section 24 purposes.

A transfer of plant or machinery that qualifies for a Section 24 election is nevertheless subject to anti-avoidance provisions in Section 33. The IRAS was of the view Section 33 did not apply as "the transfer is effected pursuant to a corporate restructuring". The underlying reasons for the transfer of business was not provided in the case facts, although interestingly it was indicated that there is no intention for there to be any change to the shareholders' voting rights in the transferee (NewCo) post-transfer. Among others, it can be inferred that the transfer of plant or machinery to a related party which is made as a precursor to a carve-out (i.e., sale of the transferee to a third party) may be subject to a higher level of scrutiny re: application of Section 33.

Contact

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