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Greetings from your Tax & Legal team at Deloitte Singapore.

We are pleased to update you on the following:

GHZ v The Comptroller of Income Tax [2023] SGITBR 2

The Income Tax Board of Review (the Board) has recently published its decision in GHZ v The Comptroller of Income Tax [2023] SGITBR 2 on 4 January 2024. All section references are made to the Singapore Income Tax Act 1947 (ITA).

Background

The case involves GHZ, the trustee of a real estate investment trust (REIT) which is listed on the Singapore Exchange. GHZ owns, among others, two retail malls known as [ABB] and [ABC]. It was common ground between GHZ and the Comptroller of Income Tax (Comptroller) that GHZ is in the business of making investments, and hence section 10E (now renumbered as section 10D) applies in determining GHZ's assessable income.

The dispute concerns GHZ's appeal against the Comptroller's refusal to allow tax deductions of property expenses and interest expenses of close to S$6 million incurred by two retail malls during their closure and redevelopment periods during the basis periods from Year of Assessment (YA) 2009 to YA 2011.

The Board dismissed GHZ's appeal with costs, in favour of the Comptroller.

Key issues

Primary issues

a. Whether section 10E(1)(a) only applies to disallow pre-commencement expenses such that once the investment starts producing income, any expenses going forward are deductible even when the investment does not produce income in a particular basis period; and

b. In determining whether the investments of the business of section 10E companies produce income in a particular year, whether this criterion should be assessed with regard to the aggregate of all the investments of the business or should be examined on an investment-by-investment basis.

Secondary issue

c. Whether the extensive reconstruction of the malls constituted asset enhancement works for existing investments or resulted in new, distinct investments.

Disputed amounts and Years of Assessment

It was established that the malls were closed during the following periods:

- [ABB]—5 March 2007 to 21 December 2008; and
- [ABC]—1 November 2008 to 29 February 2012.

YA	[ABB]		[ABC]		Total
	Property expenses (S$) (Note 1)	Interest expenses (S$)	Property expenses (S$) (Note 2)	Interest expenses (S$)	
2009	569,151	1,740,355			2,309,506
2010					216,551
2011			1,718,544	1,663,383	3,381,927
Total	569,151	1,740,355	1,783,911	1,814,567	5,907,984

Note 1: Inclusive of property tax, marketing expenses, maintenance, and insurance.
Note 2: Inclusive of property tax, marketing expenses, professional fees, general and administrative expenses.

Key takeaways

a. Interpretation of section 10E(1)(a):

Section 10E(1)(a) reads (***emphasis added***): "… any outgoings and expenses incurred by a company or trustee of a property trust in respect of investments of that business which do not produce ***any*** income shall not be allowed as a deduction under section 14 for that business or other income of the company or trustee of a property trust."

The taxpayer argues that section 10E(1)(a) only precludes tax deductions for expenses in scenarios where an investment which does

not produce any income. Of note is that section 10E(1)(a) makes reference to ***any*** income and does not contain any explicit indication that the income should be earned in a specific period. The ordinary meaning of the word "any" does not limit the quantity, identity or place a temporal limit on what it is referring to, and when used in the context of "***any*** income", does not inherently limit when the income is earned. Consequently, the taxpayer is of the view that once an investment has yielded income, all subsequent expenses should be deductible.

The Board determined that expenses incurred for investments that do not generate any income within the same basis period are not deductible. This interpretation aligns with the legislative intent to establish more specific and restrictive rules for section 10E companies, contrasting their tax treatment with that of investment dealing companies, which generally are allowed to deduct revenue expenses notwithstanding that their revenue assets did not generate income in that basis period.

The Board also maintained that interpreting section 10E(1)(a) as referring to expenses incurred within the same basis period as the income produced is consistent with section 10E(1)(b).

Section 10E(1)(b) reads (***emphasis added***): "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."

In the Board's opinion, section 10E(1)(b) creates a temporal limit to the income referred to in section 10E(1)(a). In other words, to calculate the assessable income for s10E companies in a particular YA, "it would only make sense that the income produced would have to be in respect of the same basis period as the expenses sought to be deducted."

The Board also stressed that in interpreting the phrase "*any* income", regard must be had to the context in which the provision operates within the Act as a whole. The judgement stated that the Comptroller gave examples of other provisions in the Act in which the words "*any* income" are used without it being expressly articulated in statute that it refers to income in a particular basis period, although the statutory context makes it clear that it is for a particular basis period.

b. Interpretation of section 10E(1)(b)—'Investment-by-investment' approach?

The taxpayer further argued that section 10E(1)(b) should be interpreted such that (***emphasis added***) "in calculating the income against the expenses incurred by the section 10E company which are to be deducted, one should have regard to ***all*** the investments of the section 10E company from which income is derived, not just the investments for which the expenses are incurred". In essence, it is unnecessary to match each expense with a specific investment. According to the taxpayer, support for this reading comes from the use of the phrase "in respect of investment***s*** of that business" in section 10E(1)(b), which notably employs the plural form.

However, the Board disagreed, highlighting the necessity of an investment-by-investment analysis, as already established in section 10E(1)(a). This approach requires each investment of a section 10E company to be individually assessed to determine if it is income-

producing, a principle reinforced by the precedent set in *AYH*. The Board clarified that such detailed analysis is crucial for the correct interpretation of section 10E(1)(a) and, by extension, section 10E(1)(b), ensuring a consistent and harmonious reading of these provisions.

The Board also adopted a purposive interpretation of section 10E(1)(b) and emphasised the legislative intent behind this provision is to enforce a more restrictive formula for the deductibility of expenses for section 10E companies. A broader interpretation that would allow for the aggregation of income from all investments without requiring a direct link between the expenses incurred and the income produced by each specific investment could potentially undermine the legislation's goal by diluting the intended restrictions on deductibility. Thus, an investment-by-investment interpretation for section 10E(1)(b) is preferred.

c. Whether redeveloped malls are 'new' or enhancements to 'existing' investments

The Board's view on whether redeveloped malls are 'new' or 'existing' investments is strictly obiter, given its decision on the interpretation of sections 10E(1)(a) and 10E(1)(b), but a substantial length of the judgement was devoted to it. Based on the facts provided, the malls [ABB] and [ABC] were demolished and reconstructed. The key parameters which collectively guided the Board's determination that the demolition and reconstruction of the malls resulted in the creation of *new* investments rather than being enhancements to existing investments are as follows:

Nature of the outlay and new features: The significant outlay and the completely new features and characteristics of the reconstructed malls were factors supporting the creation of new investment assets, as opposed to mere enhancements of the original malls.

Comparison of outlay to original investment: The demolition and reconstruction costs, being a substantial percentage of the original outlay (87.7% for [ABB] and 294.6% for [ABC]), indicated that such an outlay was not merely for maintaining the original investment, but constituted new investments.

Timing of decision relative to acquisition: The decisions to demolish and reconstruct were made several years after the original acquisitions, suggesting that these were separate investment decisions from the original purchase and thus constituted new investments.

Non-concurrent existence of original and reconstructed malls: The original and reconstructed malls did not exist concurrently. The original malls were demolished and during the reconstruction period, no income was generated, which implies that the reconstructed malls were new investments replacing the original investments.

Structural and conceptual distinctions: The original and reconstructed malls differed substantially in their physical, structural, and conceptual characteristics, reinforcing the view that the reconstructed malls were new, separate investments.

Corporate intention at the time of acquisition: There was no corporate intention at the time of acquisition to undertake the demolition and reconstruction works, indicating that these works resulted in the creation of new assets, separate from the original malls.

Deloitte Singapore's view

The decision in GHZ v The Comptroller of Income Tax [2023] SGITBR2 provides crucial insights into the application of section 10E (now renumbered as 10D) of the Income Tax Act (ITA), focusing on the tax treatment of expenses incurred by investment trusts during periods when their underlying investments do not generate income.

The Board reaffirmed that expenses incurred during periods devoid of income generation are not deductible. This decision underscores the traditional linkage in tax law, where expense deductibility is directly tied to income production within the same period. However, it also highlights a potential area for a broader interpretation that could recognize expenses aimed at enhancing future income generation. Such an interpretation would align with the operational realities of real estate investments that, while temporarily non-income generating due to enhancements or redevelopment, are geared towards boosting future profitability.

Furthermore, the decision leaves open several areas for further legal exploration, particularly concerning the interpretation of what constitutes "new" versus "enhanced" investments. This distinction is critical as it influences the categorization of expenses and their subsequent tax treatment. Although the case sheds light on the application of these rules in scenarios involving significant redevelopment, it does not fully resolve the ambiguities, indicating that future litigation or legislative clarification may be necessary to offer more definitive guidance.

Read more

Contacts

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