The Supremacy of the "Taxpayer-Intentions" Approach to the Capital-Income Divide: GBG v The Comptroller of Income Tax

I. Introduction

1. The Income Tax Board of Review ("ITBR") decision in the 2016 case of *GBG v The Comptroller of Income Tax*[1] ("*GBG*") has shed some light on the conditions that must be fulfilled before the costs of debt may be deducted against taxable income. More importantly, it establishes the legal principle that whether expenditure is deemed capital or revenue in nature depends on the purpose of the underlying transaction *ab initio*, regardless of whether or not the purpose of that underlying transaction was subsequently realised.

II. Facts of the Case

2. The Appellant GBG, a Singapore-incorporated company, entered into three loan facilities, in aggregate amounting to $600 million, for the purpose of financing capital expenditures.[2] Substantial fees were paid at the commencement of each facility, amounting to S$7.2 million in total[3] (the "Facility Fees"). Subsequently, GBG did not drawdown on the facilities within the availability periods, but nonetheless sought to claim deductions for the total sum of the Facility Fees against its taxable income in the Year of Assessment (YA) in which the Facility Fees were paid (YA 2010),[4] as a deduction under section 14(1) of the Income Tax Act[5] ("ITA") on the grounds that the Facility Fees were revenue in nature.[6] The Comptroller of Income Tax ("IRAS") disputed the deduction and claimed that the Facility Fees were "sum[s] employed or intended to be employed as capital", which was specifically prohibited under section 15(1)(c) of the ITA.[7]

III. The Grounds for Decision

3. The ITBR found for IRAS on the grounds that:

Gan Ee Kiat, 2nd-Year JD Student, Singapore Management University's School of Law. Edited by Ng Jun Xuan, 3rd-Year LL.B. Student.

[1] *GBG v The Comptroller of Income Tax* [2016] SGITBR 2.
[2] *Supra* n 1 at [3].
[3] *Supra* n 1 at [4].
[4] *Supra* n 1 at [5].
[5] Income Tax Act (Cap 134, 2014 Rev Ed) s 14(1). See also *Supra* n 1 at [8].
[6] *Supra* n 1 at [8].
[7] Income Tax Act (Cap 134, 2014 Rev Ed) s 15(1)(c). See also *Supra* n 1 at [11].

a. The Facility Fees were not incurred in the production of taxable income and were thus capital in nature.[8] Whether or not the Facility Fees are capital expenses, and accordingly not deductible, depends on the nature of the underlying facilities.[9] This further depends on the *purpose* for which the facilities were obtained.[10] The underlying facilities are capital in nature if it has "created a new asset, strengthened an existing asset, or opened new fields of trading".[11] Thus, the test for the capital or revenue nature of the Facility Fees (and therefore its deductibility) is premised on the corresponding purpose of the underlying facilities.[12]

b. The underlying facilities were capital in nature because they provided GBG with the ability to tap on $600 million worth of funds at any time within the availability period: this would constitute a strengthening and enhancement of GBG's capital structure[13]. Moreover, the facilities were taken to provide significant reserves of capital to finance capital expenditures.[14]

c. The obtaining of loan facilities is *prima facie* capital in nature unless it can be shown that the facilities were incurred for a revenue purpose, e.g. the purchase of trading stock,[15] or incurred to save GBG from imminent catastrophe or destruction in order to preserve its existing business.[16] The courts considered each exception in detail and dismissed them on the facts.[17]

---

[8] *Supra* n 1 at [17].
[9] *BFC v The Comptroller of Income Tax* [2014] 4 SLR 33.
[10] *Supra* n 1 at [19].
[11] *Supra* n 1 at [21].
[12] *Supra* n 1 at [26]. Interestingly, the court appears to have implied that an actual incurrence of debt liability is not a necessary component of this test.
[13] *Supra* n 1 at [42].
[14] *Supra* n 1 at [57].
[15] *Supra* n 1 at [35]. See also, *Federal Commissioner of Taxation v Hunter Douglas Ltd* (1983) 50 ALR 97; *IA v Comptroller of Income Tax* [2004] SGITBR 9 at [58]; and *BFC v Comptroller of Income Tax* [2013] 4 SLR 741 at [33].
[16] *Supra* n 1 at [46].
[17] The court found that the facilities could not have been used by GBG for the purchase of trading stock because the stated purposes of the facilities were to obtain working capital and the financing of capital expenditures. See *Supra* n 1 at [35]. The facilities also could not have been taken out by GBG to preserve its business and avert imminent catastrophe or destruction, as GBG was in a net cash positive position throughout the availability periods of the facilities and there were no "serious and imminent threats" to GBG's survival. See *Supra* n 1 at [50].

d. Thus, the facilities were capital in nature.[18] As the nature of the Facility Fees would follow that of the facilities, they were capital in nature as well and accordingly non-deductible.[19]

IV. Commentary

4. The wider implications of the decision in *GBG* are that *actual* utilisation of the debt facilities is irrelevant in assessing the nature of the debt. Rather, the *intention of the taxpayer* for which the debt is incurred is the ultimate determining factor, as shown in this case where the revenue or capital nature of a particular item of expense was objectively determined on pure intention alone.

5. This approach is in line with three prior decisions of the ITBR relating to the "sweeping-up" charging provision in s 10(1)(g) ITA. The "sweeping up" provision is a residual charging provision intended to render *all* gains of a revenue nature exigible to income tax. In *HZ v Comptroller of Income Tax*[20] ("***HZ***"), *IB v Comptroller of Income Tax*[21] ("***IB***") and *GBU v The Comptroller of Income Tax*[22] ("***GBU***"), the courts have consistently decided that the nature of the transaction, i.e. whether it is capital or revenue in nature, depends on the intention of the taxpayer at the point of acquisition.

6. In *HZ*, the ITBR held that the profits from the sale of a HDB property were nevertheless capital gains and not taxable,[23] despite the short holding period of three months.[24] This was because the taxpayer had acquired the HDB property with the intention of conducting a business on the premises,[25] and, accordingly, the intention indicated the capital nature of the gains.[26] In *IB*, a holding period of two years (longer than the three months in *HZ*) did not deter the ITBR from declaring the gains from a sale of properties as income in nature, because the taxpayer did not *intend* to use the properties for the purposes of conducting business activities while he owned them.[27] Rather, he merely intended, at the point of acquisition, to transfer the properties at a market value within

[18] *Supra* n 1 at [59].
[19] *Ibid*; see also *Supra* n 1 at [28].
[20] *HZ v Comptroller of Income Tax* [2004] SGITBR 8.
[21] *IB v Comptroller of Income Tax* [2004] SGITBR 10.
[22] *GBU v The Comptroller of Income Tax* [2017] SGITBR 3.
[23] *Supra* n 20 at [62].
[24] *Supra* n 20 at [61].
[25] *Supra* n 20 at [55].
[26] *Supra* n 23.
[27] *Supra* n 21 at [40].

the short-term,[28] which netted him a profit; the *intention* of the taxpayer to hold the properties for the short-term indicated the gains' revenue nature.[29]

7. Lastly, in *GBU*, the ITBR held that as the taxpayer intended to hold shares for long-term capital appreciation, the gains from the realisation of those shares were capital and not revenue in nature.[30]

IV. Conclusion

8. As shown in the cases cited above, where questions of whether a particular item of gain or expense is taxable or deductible arise, the intention of the taxpayer in purchasing the asset from which that gain is derived, or in incurring that expense, is paramount. The court will determine that intention by considering the circumstances in which the gain was derived and the expense incurred.

9. Where the court considers whether a gain from the realization of assets is revenue in nature and taxable, indications that the taxpayer intended to deal with the realized asset within the short-term at the point of acquisition are likely to be determinative.[31]

10. Where the court considers whether an item of expense is revenue in nature and deductible, the court will principally look at the intentions of the taxpayer behind the underlying activity for which that expense was incurred. If the taxpayer intended to incur the expense in order to acquire, create or strengthen a long-term asset or to create new fields of trading, that expense will likely be deemed capital in nature and, accordingly, not deductible.[32] Alternatively, expenses that have been incurred for short-term purposes such as the purchase of trading stock[33] or to avert the impending financial ruin of the taxpayer will likely be deemed revenue, and deductible.[34]

---

[28] *Ibid*.
[29] *Supra* n 21 at [42].
[30] *Supra* n 22 at [10].
[31] See, for example, *HZ v Comptroller of Income Tax* [2004] SGITBR 8, *IB v Comptroller of Income Tax* [2004] SGITBR 10 and *GBU v Comptroller of Income Tax* [2017] SGITBR 3 discussed at paras 6 – 7. These were cases in which the determining indicium of a non-taxable capital gain arising from the realization of assets was the taxpayer's intention, at the time when the asset was acquired, to hold that asset for the long-term.
[32] *Supra* n 1 at [21]. See, also, *ABD Pte Ltd v Comptroller of Income Tax* [2010] 3 SLR 609 at [71]. In *ABD*, the taxpayer, a proprietary club, attempted to claim the costs incurred for land acquisition and the construction of the club as deductions against its taxable income from membership fees. Andrew Phang Boon Leong JA held that these costs were incurred to construct a completely new, long-term asset (the club) belonging entirely to the taxpayer and were therefore capital in nature (at [77]).
[33] *Supra* n 1 at [18]. Further, Andrew Phang Boon Leong JA suggested in *ABD Pte Ltd v Comptroller of Income Tax* [2010] 3 SLR 609 at [80] that "trading stock" comprises assets which are extinguished or diminished by each trading transaction.
[34] *Supra* n 1 at [46]. There, the ITBR observed that examples of expenses incurred to "avert the impending financial ruin of the taxpayer" would likely include expenses incurred to deal with serious and imminent threats

11. Accordingly, in order to ensure that taxpayers' real intentions are reflected in, and consistent with, the tax treatment applied by IRAS and the courts, taxpayers are advised to document any such intention at the point of asset acquisition or incurrence of expenses (as the case may be) and to arrange their affairs in a manner that is consistent with their desired tax treatment.

---

to the profit-generating assets of the business or expenses incurred to remove some obstacle or impediment to the taxpayer's continued business operations.