BLP *v* Comptroller of Income Tax
[2014] SGHC 127

Case Number : Tribunal Appeal No 21 of 2013

Decision Date : 01 July 2014

Tribunal/Court : High Court

Coram : Choo Han Teck J

Counsel Name(s) : Tan Kay Kheng, Novella Chan Yandian and Jeremiah Soh Zi Qing (WongPartnership LLP) for the appellant; Julia Mohamed and Michelle Chee (Inland Revenue Authority of Singapore) for the respondent.

Parties : BLP — Comptroller of Income Tax

Revenue Law – Income taxation

1 July 2014 Judgment reserved.

Choo Han Teck J:

1 Were a management corporation to raise money from its members, the subsidiary proprietors, for the purpose of retrofitting and upgrading the common property, should that money be considered "revenue" or "capital"? That was the question before this court. From this, a related legal question followed: should the purpose to which the money was put even be relevant in deeming it revenue or capital?

2 Sometime in 1997, the appellant sought to retrofit and upgrade its premises ("the Complex"). To finance the project, the appellant obtained a loan of $11,600,000. As the sums in the existing management and sinking funds were inadequate to finance the loan, the appellant resolved, via a special resolution, to collect a "special levy" from each of the subsidiary proprietors. The special levy was collected for the sole purpose of financing that loan. This levy was payable monthly over a period of 13 years, between 1 August 1997 and 31 July 2010. Over the period of the 13 years, an amount of about $16.4m was collected.

3 When the appellant filed its tax computation pursuant to s 11(1) of the Income Tax Act (Cap 134, 2008 Rev Ed) ("ITA") for the year of assessment 2006, it did not include the special levy contributions. Section 11(1) stipulates how the income of institutions such as management corporations should be ascertained. It reads:

> Where a body of persons, whether corporate or unincorporated, carries on a club or similar institution and receives from its members not less than half of its gross receipts on revenue account (including entrance fees and subscriptions), it shall not be deemed to carry on a business; but where less than half of such gross receipts are received from members, the whole of the income from transactions both with members and others (including entrance fees and subscriptions) shall be deemed to be receipts from a business, and the body of persons shall be chargeable in respect of the profits therefrom.

The operative equation in s 11 is: revenue receipts from members divided by total revenue receipts. If the result is half or more (or the equivalent percentage 50% or more), the management corporation will not be considered a business, and will not be tax liable within meaning of s 11(1).

4 The appellant argued that the special levy was capital, not revenue. This means the relevant portion of the special levy for the year of assessment 2006 ($1,483,197) would not be included in the equation. The appellant argued that the figures in the equation should be $2,548,138 (gross receipts from members) and $5,253,491 (total gross receipts), yielding a proportion of 48.5%. The result is that the whole of its income would be deemed to be receipts from a business, and subjected to income tax. This depicts the appellant as – bizarrely – fighting to pay more tax. That, however, is not the case. The appellant wanted to be deemed a business because, it submitted, it would then be able to claim tax deductions for expenses such as wear and tear pursuant to s 19A of the ITA.

5 The respondent, on the other hand, argued that the special levy was revenue and should be included in the equation. For completeness, the respondent also pointed out that the sinking fund contributions ($710) should have been included as well. However, the sinking fund contributions were relatively insignificant, and would not have materially changed the resulting percentage. The respondent's figures were $4,032,045 (gross receipts from members – including sinking fund and special levy) and $6,737,398 (total gross receipts), yielding a proportion of 59.8%. The result is that the appellant would not be deemed to carry on a business, and its income will not be subjected to income tax.

6 This matter was first raised in a letter by the respondent to the appellant dated 3 July 2007. The figures in [4] and [5] were taken from this letter. The appellant replied, through its solicitors, on 8 October 2007, seeking that the respondent amends the assessment to exclude the special levy. The parties exchanged letters, arguing this point. In the meantime, the respondent had raised an additional assessment in its letter dated 16 June 2011. Nevertheless, the sole point of contention was the inclusion of the special levy. The respondent wrote to the appellant on 21 October 2011 with a notice of refusal to amend (pursuant to s 76(6)(*b*) of the ITA). The appellant appealed to the Income Tax Board of Review ("the Board"). The Board, in its decision dated 14 October 2013 (*BLP v The Comptroller of Income Tax* [2013] SGITBR 2), found in favour of the respondent. The appellant appealed to this court, pursuant to s 81(2) of the ITA, seeking that:

(a) The whole of the decision of the Board be reversed; and

(b) The appellant's appeal against the Board be allowed, with costs here and below.

7 Before deciding the question of whether the money paid by the subsidiary proprietors to the appellant was revenue or capital, I will first consider the context, namely, s 11(1). Section 11(1) is found in Part III of the ITA, entitled "Imposition of Income Tax". Section 11 is entitled "Ascertainment of income of clubs, trade associations, etc." It is clear that s 11(1) is meant to ascertain if, and when, incomes of bodies of persons such as management corporations should be liable to income tax.

8 Management corporations are made up of subsidiary proprietors (also called "members"). Management corporations usually collect money from their members for the purpose of maintaining and repairing common areas of their property. This money is generally either put into a "sinking fund" or a "management fund". On the face of it, it would seem absurd to argue that if there is money leftover in either fund after all expenditures are accounted for, that amount should be considered the management corporation's profit and hence liable to income tax. This is because that argument contravenes the basic principle of mutuality, which states that a man cannot make a profit by paying himself or trading with himself. However, complexities arise because management corporations may receive money from sources other than their members. Section 11(1) hence assists in the application of the mutuality principle in such instances. In essence, the principle prevails if a specific condition is satisfied. The condition is that 50% or more of its gross revenue receipts must come from its members. If the condition is satisfied, any profits (surplus of contributions over expenditure) will not

be taxable. If not satisfied, the whole of the income from transactions both with members and non-members will be deemed to be receipts from a business, and liable to tax. In this case, there was no dispute that the special levy came from the appellant's members. The point of contention was whether the special levy was revenue or capital.

9 The Court of Appeal in *Comptroller of Income Tax v IA* [2006] 4 SLR(R) 161 ("*IA*") dealt with the revenue-capital divide. *IA* concerned ss 14(1) and 15(1)(*c*) of the Income Tax Act (Cap 134, 2004 Rev Ed). The issue was whether borrowing expenses incurred by the respondent, a property developer, were revenue expenses. The Court of Appeal identified two tests to help distinguish between revenue and capital. The first was the "purpose test" – if the purpose of the expense or transaction was to acquire a new building for rental purposes, for example, it would be capital. The second was the "temporary and fluctuating test" – if the payment was temporary and fluctuating in nature, it would be revenue. Having considered these two tests, the court went on to state as follows (at [79]):

(a) First, ascertain the purpose of the transaction. To do so, go through steps (b) to (d).

(b) To determine the purpose of the transaction, first, ascertain if there is a sufficient linkage or relationship between the loan and the main transaction or project for which the loan was taken.

(c) If there is no linkage, the loan would merely add to the capital structure of the taxpayer and is therefore capital in nature. It may be proved that only parts of the loan do not have a linkage to the main transaction. One main indicator of this absence of a linkage is that those particular parts of the loan are not temporary and fluctuating in nature but are, instead, of a permanent (and therefore capital) nature.

(d) On the other hand, if there is a sufficient linkage, proceed to ascertain if the main transaction is of a capital or a revenue nature. If it is of a capital nature, then, given the linkage to the loan, so too is the loan. Likewise, if the main transaction is of a revenue nature.

10 The Board applied this approach. The transaction was the special levy. The loan was the $11,600,000 that the appellant borrowed. In this case, however, there was also the underlying project of retrofitting and upgrading the Complex, the very purpose of the loan. The Board noted that the appellant itself argued that these three were inextricably linked, and seemed to take a similar view (at [21] and [36]). As such, the Board was of the view that the purpose of the project would be similar to the purpose of the transaction. In ascertaining the purpose of the project, the Board had (further) regard to the "Composite and Integrated Approach" proposed by the High Court in *ABD Pte Ltd v Comptroller of Income Tax* [2010] 3 SLR 609 ("*ABD*") to differentiate between revenue and capital. The two relevant questions were (*ABD* at [71] – [75]):

(a) First, did the expenditure create a new asset, strengthen an existing asset or create new fields of trading not hitherto available to the taxpayer? If so, the expenditure would be capital in nature.

(b) Second, in answering the first question, regard must be had to factors such as the "manner of the expenditure" and the "consequence or result of the expenditure". A one-time expenditure, as opposed to recurrent expenditures, would suggest the expenditure is capital in nature. Similarly, if the expenditure tends to strengthen or add to the taxpayer's core business structure, it is more likely to be capital in nature.

11 The Board came to the conclusion that the purpose of the project – retrofitting and upgrading of the Complex – was revenue in nature. It found that the project related to repair, maintenance and improvement of the Complex. Its analysis, however, was not entirely clear. This seemed to have been the approach it took:

(a) First, the Board turned to s 29 of the Building Maintenance and Strata Management Act (Cap 30C, 2008 Rev Ed) ("BMSMA") and found that repair, maintenance and improvement of the Complex were within the duties of the appellant.

(b) Second, the Board noted that the appellant was statutorily mandated by s 38 of the BMSMA to establish and maintain a management fund and a sinking fund.

(c) Third, the Board cited the Court of Appeal decision of *Tan Hee Liang v Chief Assessor* [2009] 1 SLR(R) 335 ("*Tan Hee Liang*"). In that case, a special levy was collected over a period of three years from July 2005 to June 2008 for external upgrading works. The Court of Appeal (at [82]) found that the special levy in that case was for the purpose of maintenance or repair. The Board then found, as a matter of fact, that the project in this case was suitably characterised as "maintenance and repair works" (albeit major works). It was not clear if the Board came to such a finding on analogy of *Tan Hee Liang* or independently. If an analogy was drawn, it was not entirely clear how the works for which the special levy in *Tan Hee Liang* was collected were similar to the project in the present case.

(d) Fourth, the Board looked at the elements of the project (which included the replacement of communal areas adjacent to the upper floor lift lobbies of the residential tower with ten new studio apartments) and reiterated that, contrary to the appellant's characterisation of them as constituting a "one-time overhaul", they were simply in the nature of replacement and improvement. The Board further clarified that terms such as "one-time" or "overhaul" were "merely indicative of the fact that the repair, maintenance and improvement works to the Complex which had deteriorated over 25 years were long overdue and had to be substantial" (at [53]).

(e) Fifth, the Board distinguished the decision of the House of Lords in *The Seaham Harbour Dock Co v Crook (HM Inspector of Taxes)* (1913) 16 TC 333. In that case, the English Court of Appeal held that government assistance granted to the taxpayer, a dock company, which was used to build an extension of the dock, was considered capital. The House of Lords upheld the decision. The Board found that in that case, the payments related to the building of an extension of a dock, which it classified as a new asset. Further, the payments were made under statutory authority for unemployment relief purposes. Also, dock construction had nothing to do with the taxpayer's trade, which was simply to utilise docks.

(f) Sixth, the Board distinguished the Canadian case of *St John Dry Dock v Minister of National Revenue* 2 DTC 663. In that case, the taxpayer received a subsidy from the government to aid in the construction of a dry dock. The court held that the subsidy was a capital receipt because its purpose had "nothing whatever to do" with the trade or business profits or gains of the taxpayer. This case was different because there was no creation of a new asset (such as a dock) and the special levy had everything to do with the appellant's "trade", namely, maintaining the Complex (at [59]).

(g) Seventh, the Board distinguished the case of *Commissioner of Income Tax v Beldih Club* [1986] 161 ITR 861 ("*Beldih*"). In that case, the taxpayer club received a donation for major repairs and renovations. The court found that was a capital receipt. It reasoned that major

repairs and renovations may be treated as capital expenditure, and the donation should accordingly be treated likewise. The Board found that a major factor in the court's decision was that the donation depended entirely on the whim of the donor, and as such could not be treated as income. In contrast, the Board found, the special levy was not dependant on the whim of the subsidiary proprietors (at [62]).

12 The reasoning of the Board can hence be summarised as:

(a) If the project relates to maintenance and repair, it is revenue in nature.

(b) The project in this case relates to maintenance and repair.

From these premises, it concluded that the project – and the special levy – was revenue in nature.

13 With regard to the first premise, it is generally uncontroversial that funds relating to maintenance and repair works, raised by a management corporation, constitute revenue. However, I found that the second premise was not substantiated. It was not clear whether the Board came to such a finding based on an analogy of *Tan Hee Liang* (see above at [11(c)]). If so, the analogy was not adequately explained. Further, it was not clear how the Board distinguished the cases cited by the appellant. For instance, why is it that building an extension of a dock would constitute the creation of a new asset (which the Board seemed to agree with), whereas creating ten new studio apartments would not? Furthermore, as noted in *ABD*, for an expenditure to be capital in nature, it was not necessary for a new asset to be created. The mere strengthening of an asset could suffice (see above at [10(a)]).

14 Also, the Board's (and respondent's) reliance on the BMSMA (see above at [11(a)] and [11(b)]) was not entirely clear. The Board seemed to take the view that any transaction that the appellant engaged in, pursuant to its duties under the BMSMA, would be of a revenue nature. This would mean, the appellant submitted, all transactions involving the management and sinking funds would invariably be of a revenue nature, and management corporations would generally not be able to hold any capital receipts.

15 This reliance on the appellant's duties under the BMSMA for the purpose of determining if the special levy was revenue or capital seemed like the argument of the appellant in *Comptroller of Income Tax v BBO* [2014] 2 SLR 609 ("*BBO*"). *BBO* dealt with the issue of whether gains arising from the respondent insurance company's disposal of shares were revenue or capital in nature. The appellant argued that the shares were attributable to the respondent's business as they were acquired in the course of the insurance business and were at all times in its insurance funds pursuant to s 17 of the Insurance Act (Cap 142, 2002 Rev Ed). As such – the appellant argued – the gains realised in the disposal of the shares were revenue in nature. The Court of Appeal dismissed this argument as flawed (at [44]). It held that the purpose of the Insurance Act was the regulation and not the taxation of the insurance industry, and that the insurance fund spelt out in s 17 of the Insurance Act was merely part of the regulatory framework for insurance companies and was not determinative of their tax treatment (at [45]). Similarly, in this case, provisions of the BMSMA do not determine the question of whether the special levy was capital or revenue in nature.

16 On the contrary, the appellant argued that the special levy had all along been intended to finance the loan, which in turn financed the project. It argued that the project was capital in nature because it "was a one-time overhaul of the Complex encompassing a range of permanent works that involved major upgrading works to the façade, the internal structure as well as the functionality of the Complex" and "[n]ew assets were also created, for example, the construction of ten new units of

studio apartments". By extension, the loan, and consequently the special levy too, must be capital in nature.

17 The appellant also cited s 14Q(1) of the ITA, which allowed any person carrying on a trade, profession or business to claim a deduction in respect of renovation or refurbishment for the purposes of that trade, profession or business. The appellant further cited from the accompanying e-tax guide by the Inland Revenue Authority of Singapore (Income Tax: Tax Deduction for Expenses Incurred on Renovation or Refurbishment Works Done to your Business Premises), which stated (at [3.1]):

> 3.1 Businesses often need to renovate or refurbish their business premises to remain competitive and to attract customers. Expenses incurred on such renovation or refurbishment works ("R&R costs") are generally capital expenses unless they relate to repairs or replacement works on the premises with no improvement element. Such capital expenses are not permissible deductions under [ss 15(1)(*c*) and 15(1)(*d*) of the ITA] unless specific provisions are made to allow them.

As such, it argued that the operation of s 14Q(1) supported the notion that renovations and refurbishments of business premises are capital in nature, and so was the project in this case.

18 The respondent's reply was that the appellant's reliance on s 14Q (and the e-tax guide) was misguided because it was a management corporation, whose very duties were to maintain and repair the common property. As such, the e-tax guide "was not applicable to the factual matrix of the present case".

19 This reply from the respondent showed that much of the dispute between the respondent and the appellant concerned the respondent's focus on what the appellant's duty was. Having established that this duty was to maintain and repair the Complex (based on s 29 of the BMSMA), the respondent argued that any transactions relating to its performance of its duty should be classified as income. In dealing with this contention, it is important to remind ourselves of the principle of mutuality (above at [8]). A man cannot make profit trading with himself. The complication in this case (and in this particular point of disagreement between the respondent and appellant) is that the appellant is a management corporation. The modified principle of mutuality as such, of a management corporation making profits by trading with its members, is dealt with in s 11(1). The point of determining whether the special levy was capital or revenue was to answer the question (pursuant to s 11(1)) of whether the principle of mutuality should prevail, or whether appellant is deemed to carry on a business. As the appellant argued, the respondent's approach seems to have pre-determined this very issue to be resolved. It classified the appellant as being in the "business" of maintaining and repairing the Complex, and seemed to have conflated statutory duty with business. This leads to the result that the management committee was not, in fact, a business for the purpose of s 11(1) (as the Board found).

20 To further illustrate this point, the converse of pre-determining that the management committee was a business would be to presume that it was merely a sum of its parts, taking on the characteristics of its members (proprietors in the Complex). In that analysis, any transaction relating to the maintenance of the premises would seem capital in nature, as those transactions would be wholly removed from the members' day to day businesses. Thus, the reference to the BMSMA, the classification of the appellant as a "business", and conflation of its duties under the BMSMA with its "business" distracted from the question at hand: whether the special levy was capital or revenue in nature.

21 To answer that question, pursuant to the approaches in *IA* and *ABD*, the purpose of the

transaction must be looked at. If the transaction creates a new asset, or enhances an existing asset, it is likely of a capital nature. In this case, the special levy was sanctioned for the sole purpose of repaying the loan which financed the project. The special levy, loan and project were hence inextricably linked. The project, aside from the construction of ten new units of studio apartment, included the following:

(a) Replacement of floor finishes at common areas, parapet walls, wall finishes in toilets and ceiling finishes at common areas;

(b) Installation of new building logo and external building name sign, along with floodlights and decorative motifs;

(c) Repainting of concrete panels on the exterior of the building;

(d) Improvement of lift lobby and entrances to the residential block with new wall treatment, floor finishes, lighting, etc;

(e) Installation of new lift openings at third storey, and 6 new escalators at the concourse; and

(f) Upgrading of one existing transformer (to cater for the retrofitting works and future extensions).

The Board seemed to have trouble with some of the items, such as (c). Repainting of the exterior of a building would typically be classified as maintenance work, which management corporations routinely undertake. Repainting could hardly be said to involve the strengthening of existing assets, let alone the creation of a new asset. Also, some of the items were simply motivated by a need to comply with regulatory standards. Could they, then, be said to amount to strengthening the Complex? Or were they simply cases of maintenance or repair? What, then, of the ten new units?

22 Dissecting the project and scrutinising each item may lead to contradictory outcomes. Considering the project as a whole would be a more coherent approach. In its letter to the subsidiary proprietors dated 12 June 1997 titled "Notice of extraordinary general meeting", the appellant stated:

[The Complex] was built more than 25 years ago.

Throughout these years, no major retrofitting has been undertaken to improve the image of the building and upgrade its facilities/services…

The letter went on to elaborate on the scope of the project, as well as the details of the special levy. Given the circumstances, the project seemed more like a one-time overhaul than routine maintenance and repair. It was targeted at the strengthening of the Complex, and even the creation of new assets (in the ten units of studio apartment). Although contributions to the special levy were not donations dependent on the whim of the subsidiary proprietors, I did not find this minor difference sufficient to amount to a "point of departure" from the *Beldih* case, as determined by the Board (at [62]). Neither was it fatal to the appellant's case that the contributions to the special levy were of a recurring nature. The crucial detail in this case was the purpose to which the special levy was put. It was inextricably linked with the project, which strengthened existing, and created new, assets and should thus be treated as capital and not income.

23 One of the concerns raised by the Board was that management corporations could simply label

funds that they raise from their members as "special levies" – rather than management or sinking funds – in a bid to attract favourable tax implications. That was an unwarranted fear. First, the appellant's decision to term its fund raising effort as a "special levy" did not mean that it was wholly distinct from a management or a sinking fund. In fact, as pointed out by the appellant, s 38 of the BMSMA only provides for the establishment of management and sinking funds – not special levies. In this case, it would be more coherent to consider the special levy as constituting parts of the management and sinking funds respectively. Second, a mere label does not conclusively determine the nature of a transaction. The purpose of the transaction, its characteristics, and the surrounding circumstances must be regarded before determining if the transaction is capital or revenue. This should assuage any concern of tax-evading attempts merely by using labels.

24 For the reasons above, I allow this appeal. I will hear the question of costs at a later date if parties are unable to agree.