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General deduction formula[1]

GENERAL DEDUCTION FORMULA

¶7-300 General deduction formula

Section 14(1) sets out the general deduction formula, which reads:

> "For the purpose of ascertaining the income of any person for any period from any source chargeable with tax under this Act (referred to in this Part as "the income"), there shall be deducted all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of the income, including. . .".

Some aspects of this general deduction formula are discussed below.

¶7-310 "Any person . . . from any source"

The formula is to be applied when determining the income of "any person . . . from any source". Its application is therefore not restricted to any particular class of taxpayers or to any particular source of income. The formula also requires a source-by-source concept to be applied — expenses incurred in the production of each source of income must be matched strictly against that source. In other words, expenses are not deductible on an aggregated basis to be deducted against the total of all sources of income. Example 2 illustrates:

Example 2

Adjusted trade income (s10(1)(a))		$	**28,900**
Dividends (s10(1)(d))		$ 6,700	
Less loan interest		(4,300)	2,400
Rental (s10(1)(f))		$22,000	
Less property tax	(18,000)		
repairs and maintenance	(3,500)		
loan interest	(4,600)		
insurance expenses	(1,900)	(28,000)	NIL*
Statutory income			31,300

(*The excess amount of rental expense of $6,000 is disregarded as the rental income is not a sec 10(1)(a) source of income.)

The concept of "source" in relation to dividend income was examined in *JD Ltd v CIT* [2005] SGCA 52 and is discussed in ¶7-410.

[1] Angela Tan & Tan How Teck, Singapore Master Tax Guide, (Singapore:Seng Lee Press Pte Limited,2006)pp.139-187.

¶7-320 Income chargeable with tax

All outgoings and expenses claimed must be related to a source of income that is chargeable to tax under the Act. If an income is not chargeable to tax, eg exempt income, no related expenses can be deducted.

Liberalised tax treatment for repatriated foreign income

Where expenses are incurred in the production of foreign income that is not repatriated to Singapore, they are not deductible because there is no income chargeable with tax. A strict interpretation of sec 14(1) requires a matching of the expenditure incurred with the receipt of foreign income in Singapore. Expenses incurred in the production of income that is not repatriated to Singapore within the same year are therefore not allowed to be carried forward to set off the foreign income repatriated in subsequent years.

A person deriving foreign income may, in certain cases, have genuine reasons for not repatriating his foreign income to Singapore. As a concession, with effect from the year of assessment 1996, allowable expenses incurred in Singapore to produce foreign income that is not repatriated to Singapore in the same year, may be carried forward and deducted against the foreign income when it is repatriated in subsequent years (IRAS e-Tax Guide 1996/IT/3 published on 22 January 1997).

The following conditions apply:

- in the case of allowable expenses incurred to produce foreign investment income (eg foreign dividends), only allowable expenses incurred on income-producing investments may be carried forward for set-off (an investment is regarded as "income-producing" from the date it commences to produce income if it continues to be held for the purposes of earning income); and
- to qualify to be carried forward for set-off, the expenses must not have already been claimed as a deduction in the foreign tax jurisdiction (the IRAS may require an external auditor's certificate to this effect before allowing a deduction).

The IRAS provides the following two methods for computing the amount of expenses that can be deducted against foreign income repatriated in any year:

- *Direct method* — This method requires detailed accounting of the expenses and the corresponding income for each year. In any year that foreign income is repatriated to Singapore, the actual expenses that were incurred to earn the foreign income will be allowed as a deduction.
- *Indirect method* — Under this method, the allowable expenses and the non-repatriated foreign income are aggregated. In any year that foreign income is repatriated to Singapore, the allowable expenses are computed by the formula:

$$\frac{A}{B} \times C$$

where A = the amount of foreign income repatriated to Singapore in the year

B = the aggregate of the foreign income derived during the liberalised tax treatment period up to and including the year concerned which has yet to be repatriated to Singapore plus "A";

C = the aggregate of the allowable expenses incurred to produce foreign income during the liberalised tax treatment period up to and including the year concerned which have yet to be allowed as a deduction against foreign income repatriated.

Further administrative details and specific applications relating to the election and revocation of this liberalised tax treatment can be found in the IRAS e-Tax Guide 1996/IT/3.

¶7-330 Wholly and exclusively

"Wholly" refers to the quantum of the expenditure (ie the sum of money spent) and "exclusively" has reference to the motive or object behind the expenditure (*Romer* J, in *Bentleys, Stokes and Lowless v Beeson* (1952) 2 All ER 82 at 85).

Generally, where the expenditure is incurred for the sole objective of income production and some other objectives inherent in the business activity necessarily result or are also attained, the expenditure will not be disqualified. Difficulty arises, however, when an activity is undertaken with more than one motive. For example, an activity could be undertaken with the object of both promoting business and some other purpose (eg indulging in an independent wish to entertain a friend or stranger, supporting a charitable or benevolent object, etc). Although the taxpayer may think that the business motive predominates, the expenditure still fails the "wholly and exclusively" test. Thus, the taxpayer's intention for incurring the expenditure is an important consideration.

It is generally accepted that where a taxpayer's intention behind an expense is to procure a purely business benefit but an incidental benefit of a personal nature arises, a deduction is allowed. However, where both benefits are present in the taxpayer's mind when he incurs the expense, deduction is not allowed. The case of *Mallalieu v Drummond (Inspector of Taxes)* [1983] STC 665, however, cuts across this accepted tax concept. In that case, a practising lawyer incurred expenditure on the cost of clothes for court wear in accordance with the Bar Council's relevant guidelines. She claimed a deduction for the clothes and other related expenses that included laundering and cleaning expenses. The House of Lords held that while the taxpayer might well only have had the professional purpose in her conscious mind, another object, though not a conscious motive, was the provision of the clothes that she needed as a human being. The expenses were therefore not deductible. The decision would appear to suggest that if there is a conscious business motive and a subconscious personal motive, the whole of the expenditure will not rank for deduction.

In Singapore, the words "wholly and exclusively" have been interpreted stringently. In *Re D & Ors* (1969) 2 MLJ xvi, it was held that the cost of air travel incurred by the taxpayers had not been wholly and exclusively incurred in Singapore as they had been on a Far East tour. In *TGLR v CIT* (Appeal Nos 7, 8, 9 & 10 of 1996), the taxpayer was a lawyer who was an employee of a law firm. The Board of Review found that her purchase of a notebook computer and a briefcase were not expenses that had been incurred wholly and exclusively in the production of her income. Instead, the Board found that the items she had purchased could have been and were capable of other uses not connected to the production of income.

In *UDPL v CIT* (ITBR Appeal No 14 of 2000), the Income Tax Board of Review held that a payment of $475,400 made by the taxpayer to a financier under a recourse agreement was not deductible as there was a duality of purpose. The decision was delivered on 29 April 2004.

In the above case, the taxpayer was a Singapore-incorporated company and a subsidiary of a public listed company. The taxpayer was incorporated for the purpose of developing a condominium project for sale. It entered into a recourse agreement with a financier, a related company, where the financier would lend an amount in excess of a basic loan of 70% of the purchase price of the unit to a purchaser of a unit in the condominium. The taxpayer also undertook to guarantee repayment to the financier of this excess amount. A purchaser who bought 9 units in the condominium development defaulted and the taxpayer paid $475,400 to the financier in accordance with the agreement.

The Board found that the payment served two purposes: one was to attract buyers to take loans from the financier (which the taxpayer preferred) for that property development, and another was to attract sales by helping the buyer to obtain more finance. The Board also found that the giving of such guarantees were not an essential part of a housing developer's normal business and the guarantee expenses were not ordinary or usual working expenses that would be normally incurred in a developer's production of income. Accordingly, the expenditure was not deductible, not being wholly and exclusively incurred in the production of the taxpayer's income.

Apportionment

In principle, dual-purpose expenditure would fail the "wholly and exclusively" test. However, the Comptroller may apply the following rules of apportionment:

- where a taxpayer incurs dual-purpose expenditure and the amount is divisible, an amount of the expenditure that is apportioned on a reasonable basis is allowed. Examples of these expenses include entertainment and travelling expenses incurred by a sole-proprietor, and the costs of airfares incurred by an artiste who performed in Singapore as part of her regional tour; and
- where a taxpayer derives income from different sources taxable under sec 10(1) or from both taxable and non-taxable sources (eg exempt pioneer income), common expenses are apportioned among the relevant sources on a fair and agreed basis.

Reasonableness or magnitude of expenditure

The Comptroller can probe into the reasonableness or magnitude of an expenditure only for purposes of determining whether, in fact, the amount is spent. A taxpayer is entitled to conduct his business as he thinks fit. If a transaction is at arm's length, the Comptroller cannot disallow any part of the expenditure on the basis that the taxpayer could have incurred a smaller amount.

¶7-340 Incurred during that period

Regarding the meaning of the word "incurred", the following dictum in *New Zealand Flax Investments Ltd v FCT* (1938) 61 CLR 179 is helpful:

> "... 'incurred' does not mean only defrayed, discharged or borne, but rather it includes encountered, run into or fallen upon. It is insufficient to attempt excessive definitions of a conception intended to have such a various or multifarious application but it does not include a loss or expenditure which is no more than impending, threatened or expected."

The word "incurred" was also examined by the Privy Council in *CIR (Hong Kong) v Lo & Lo* (1984) WLR 986:

> "an expense incurred is not confined to a disbursement, and must at least include a sum in which there is an obligation to pay, that is to say an accrued liability which is undischarged".

The accrual basis of accounting also requires companies to accrue for expenditure in which the legal liability to pay arises or crystallises in the subsequent accounting period. Examples include provision for leave passages, leave pay, retiring benefits, etc. However, for tax purposes, provisions for such expenditure are not deductible.

Expenses incurred before the commencement of business, or after the termination of the business, would therefore not satisfy the general deduction formula. The reason is that these expenses are incurred before or after (and not in the production of the income respectively.

With effect from the year of assessment 2004, as a concession, all expenses of a revenue nature and not prohibited under sec 15 (so-called "revenue expenses") that are incurred from the first day of the accounting year in which a business derives its first dollar of trading receipt will be deductible. The concession, however, does not prevent a business from claiming a deduction for revenue expenses even earlier if it can prove that it has started trading before that year. The concession also does not extend to companies to which sec 10E applies (ie investment holding companies). This concession addresses, to some extent, the difficulty of determining when a source of business or trading income could be said to have commenced. Refer to IRAS e-Tax Guide 2003 IT 4 published on 14 March 2003 for further details.

¶7-350 In the production of the income

Section 14 states that the expenses must be incurred "in the production of the income". This wording clearly requires a sufficiently close nexus between the expenditure incurred and the income produced for a deduction to be available.

Nexus between expense incurred and income produced

It is necessary to evaluate the closeness or remoteness of an expenditure to the income earning operations. The Malaysian Board of Review has held that the words "in the production of income" are not the same as "in order to produce income" (Note that sec 33 of the Malaysian *Income Tax Act* is worded as "in the production of gross income".) In one case, expenses incurred by a Supreme Court judge on his judicial robe acquired when he was appointed a judge were not deductible (*Re AB* (1960) FB XXIII).

May relate to future income

It is generally accepted that the words "in the production of the income" do not mean that before any expenditure can be deducted, it must have produced income in the year in which it is incurred; the expense would be deductible if the source of income to which it relates has already commenced. In the *Jalanthrosa* case (see ¶7-220), the expenses claimed included maintenance, weeding and pest control expenses that were incurred on the whole of a rubber estate. Only one-seventh of the rubber trees in the estate at the relevant time were rubber-producing (Rubber trees take about six years before they reach maturity and begin to produce rubber). The Revenue therefore disallowed 6/7 of the expenses as this amount was not referable to the profit earned within the year. The court held that the expenses were fully deductible. Lord *Johnson* said:

> "It appears to me that, . . . , the trade . . . of the company is the cultivation and production for sale at profit of rubber and other tropical products. For this purpose, land had to be acquired, cleared, and drained, roads made, and buildings erected, before the cultivation began. What was expended for these purposes was I think capital expenditure. But once the cultivation began with the planting, expenditure on cultivation, production and marketing was I think revenue expenditure for the purpose of the trade."

Includes all closely connected expenses

In *Port Elizabeth Electric Tramway Company Ltd v CIR* 8 SATC 13, the taxpayer was a transport company and one of its drivers was killed in an accident. The taxpayer was required to pay compensation and it incurred legal costs to contest the claim of the deceased's representatives. The issue was whether both the compensation and legal expenses were deductible. *Watermeyer* AJP applied the following principle:

> "The purpose of the act entailing expenditure must be looked at. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductible . . . The other question is, what attendant expenses can be deducted? How closely must they be linked to the business operations? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it."

The court held that the need to make compensation arose from the employment of drivers to run the company's vehicles for the purpose of earning income. The compensation payment was therefore closely linked to the income-earning operations and qualified for deduction. On the other hand the legal expenses were not closely linked and were therefore not deductible.

The recent case of *KD v CIT* [2005] SGITBR 3 adopted a broader view of deduction under sec 14(1), specifically the meaning of the term "in the production of the income" in sec 14(1).

In this case, the taxpayer was a company incorporated in Singapore in 1984 and its business included the business of developing, manufacturing and selling in-vitro diagnostic tests for the detection of human infectious diseases. The products manufactured and sold by the taxpayer included certain diagnostic kits using a laboratory technique to detect HIV-2 (or both HIV-1 and HIV-2).

The taxpayer was engaged in legal proceedings to determine whether B, a non-profit private foundation registered in France, had a valid patent for the HIV-2 retrovirus capable of inducing the Acquired Immune Deficiency Syndrome (AIDS) and the antigenic and nucleic acid components thereof. B had granted an exclusive licence in respect of the above patent to C, a company incorporated in France.

On or about 8 September 2001, the taxpayer settled the matter by paying $5,220,900 (or US$3 million) pursuant to a settlement agreement made with B and D (formerly known as C). The taxpayer also incurred total legal expenses of $1,547,257 over the years of assessment 1999 to 2002. The settlement sum of US$3 million was calculated, using a rate of US$2.20 for every HIV test sold by the taxpayer for the period 6 October 1992 to 3 February 2000 (the period of infringement), to work out the compensation payable to B and C. The rate of US$2.20 for every HIV test was what an unrelated party would pay as royalties to the licensor for the grant of a limited non-exclusive sub-licence at the time of making the settlement agreement. The taxpayer appealed to the Board of Review against the Comptroller's disallowance of the settlement sum and the legal expenses.

Taking a broader view of deduction, the Board said that, in determining whether an expenditure was incurred in the production of income, it is necessary to look at the business as a whole set of operations directed towards producing income. No expenditure, strictly speaking, in itself actually gains or produces income. It is an outgoing, not an incoming. Its character can be determined only in relation to the object which the person making the expenditure has in view. If the actual object is the conduct of the business on a profitable basis, then the expenditure is an expenditure incurred in producing the income. The Board held that, for an expenditure to be incurred in the production of income, it is both sufficient and necessary that the occasion of the expense should be found in whatever is productive of the income.

Applying this principle to the facts, the Board accepted the taxpayer's view that the settlement sum was incurred to deal with the liability arising out of the taxpayer's business activities, namely the manufacture and sale of the HIV test kits without a licence for the relevant period. Such activities were carried out with the objective of producing income. The legal expenses were also incurred for the purposes of the taxpayer's business activities, namely the manufacture and sale of the HIV test kits which were carried out with the objective of producing income.

DEDUCTIONS SPECIFICALLY ALLOWED

¶7-410 Interest

For interest expense to be deductible under the specific requirement of sec 14(1)(a), it must be payable on capital employed in acquiring the income.

Some principles on the deductibility of interest expense are summarised below.

Application of principal amount

The purpose to which the principal amount of the loan has been applied will determine whether or not interest is deductible. If the money borrowed is used for the purchase of business assets, in meeting outgoings incurred in carrying on the business or for the purchase of property from which income is derived, the interest expense is deductible (*FC of T v Munro* (1926) 38 CLR 153).

Interest incurred before commencement of business

Expenses incurred before the commencement of a business are not incurred in the production of the income.

Where a company acquires land for the purpose of constructing a building and carrying on a property letting business, the company will have started business only on the date the temporary occupation permit (TOP) is issued or a tenancy contract is entered into. Any interest expenses incurred during the construction of the building will not be deductible.

In *TML v CIT* (Appeal No 20 of 2000), the taxpayer was a property investment company. The taxpayer claimed deduction for interest expenses (as well as other expenses such as property tax and administrative, marketing and advertising expenses) incurred from 28 October 1993 to 15 November 1995, which was the date it was granted TOP. The taxpayer then secured the first tenant. The issue was whether these expenses could be set off (as losses brought forward from the construction period) against the taxpayer's rental income for the year of assessment 1997.

The Board applied the test in *Mitsui-Soko International Pte Ltd v The Comptroller of Income Tax* (1998) MSTC 7349 and held that where a taxpayer acquires or constructs a building for the business of letting out the premises to earn rent, its business would commence when a profit making structure is established. The structure is established when it is ready or capable to earn income and ordinary current business operations have begun. On the facts, the taxpayer's capability to earn rental income from the letting out of the building would arise only once the building is ready and TOP has been issued. Before the TOP date, the premises would not be fit for occupation and so it could not be let out. The Board also held that, in any event, the interest expenses incurred before the TOP date were capital in nature.

The High Court dismissed the taxpayer's appeal on the basis that the taxpayer's business had not commenced before the TOP date: the pre-commencement losses could not, therefore, be carried forward for deduction. Based on a close examination of the wording of sec 14(1)(a) and 15(1)(c), however, the High Court said that sec 15(1)(c), the prohibition for capital expenditure, did not apply to the interest expenses (see *T Ltd v CIT* [2005] SGHC 115). The High Court's view that sec 15(1)(c) did not apply to interest expenses was approved by the Court of Appeal in *JD Ltd v CIT* [2005] SGCA 52.

Link between money borrowed and income produced

In Singapore, for interest expenses to be deductible under sec 14(1)(a), they must have been payable on capital employed in acquiring "*the* income", not just "*income*" or "*any* income" (*Andermatt Investments Pte Ltd v Comptroller of Income Tax* (1994) MSTC 7,261 and (1995) 2 MSTC 7287).

In the *Andermatt* case, the sequence of events was as follows:

- On 28 November 1987, the taxpayer company was incorporated for the purpose of carrying on the business of investment holding. (The shareholders of the taxpayer company also owned the shares of Wan Holdings Pte Ltd (WHPL), the company that originally owned a property at Hillview).
- On 8 December 1987, the taxpayer purchased all the issued shares of WHPL, paying $1 million from its paid-up capital of $1 million; the remaining $19 million stood as a debt owing to the vendors.
- On 31 December 1987, the taxpayer passed the resolutions to initiate a winding up of WHPL by way of a members' winding up and to appoint liquidators.
- On 5 January 1988, the taxpayer (as sole shareholder of WHPL) received dividend income of $4,620,007 from WHPL.
- On 8 February 1988, the taxpayer obtained an overdraft facility of $6 million from OCBC.
- On 31 March 1988, the liquidators of WHPL distributed the Hillview property to the taxpayer as a return of capital *in specie*. Thereafter, the taxpayer as landlord commenced to receive rental income.
- On various dates in May and June 1988, the taxpayer drew down a total of $5.8 million from the OCBC overdraft facility. This was used to pay off part of the existing debt to the vendors of the WHPL shares.
- During its accounting period 28 November 1987 to 31 December 1988, the taxpayer derived total rental income of about $600,000. Besides this rental and the dividend income received on 5 January 1988, the taxpayer did not have any other sources of income for the period. It incurred a total of interest expenses of $201,172 on the drawdown of $5.8 million from the OCBC facility.
- The taxpayer claimed a deduction for the interest expenses under sec 14(1)(a). The courts held that since the overdraft on which the interest was payable had not been used to acquire the property from which the taxpayer's rental income was derived, the interest was not deductible.
- The High Court stated that sec 14(1)(a) provides that interest is *deductible from income* if it is payable on "capital employed in acquiring the income". The expression "the income" in sec 14(1)(a) refers to the income from a specific source for a specific period and not the total income from all sources for that period: it refers to income from the source in relation to which the relevant capital has been employed. Interest on such capital can be deducted only from income from that source and not from any other income or from total income.
- On appeal, the Court of Appeal upheld the High Court's decision. In order for the interest to be deductible, there must have been a direct link between the money borrowed and the income produced: the deduction could only be allowed if the overdraft had been employed in acquiring the taxpayer's income. Since the overdraft had been used to pay part of an existing debt rather than to acquire the taxpayer's property, the interest was not deductible.

Deductibility of interest on refinancing loans

Based on the decision in *Andermatt*, interest expenses incurred on refinancing loans would not be deductible under sec 14(1)(a). This is because a refinancing loan is taken up to repay an existing loan and the interest incurred on the refinancing loan is, technically, not payable on capital employed to acquire the income. This strict interpretation may, however, not reflect commercial reality in certain cases.

As a concession, the IRAS may allow the deduction of interest payable on refinancing loans if the taxpayer can establish that the refinancing has been effected for genuine commercial reasons, for example:

(a) if the refinancing has been effected to achieve an overall reduction in finance costs; or

(b) if the refinancing was necessary due to the taxpayer's financial position (eg the taxpayer may be in financial difficulties and need to restructure the loan in the interim) (IRAS e-Tax Guide (1995/IT/3) published on 17 April 1995).

The taxpayer has the onus of proving that a refinancing arrangement has been entered into for commercial reasons. The concession does not preclude the Comptroller from disallowing interest incurred:

(a) on a subsequent loan against income derived from an asset purchased with an original loan where the proceeds from the second loan are used to finance another asset (ie where the first asset is security for a loan to purchase the second asset); or

(b) in relation to non-income producing assets.

Apportionment

Where interest is paid on borrowed money used partly for business and partly for non-business purposes, the Comptroller disallows the proportion of interest applicable to the latter. The Comptroller usually applies either of the following methods of apportionment to calculate the *non-deductible* amount:

(a) $$\frac{\text{Amount due from non-trade debtors} \times \text{Interest expense}}{\text{Cost of fixed assets} + \text{Current assets} - \text{Cash \& bank balance}}$$

(b) $$\frac{\text{Non-income producing assets} \times \text{Interest expenses}}{\text{Total assets at cost}}$$

In *HHCL v CIT* (Appeal Nos 12 to 23 of 1999), an issue before the Income Tax Board of Review was whether interest expenses were deductible against dividend income derived by the taxpayer.

In the above case, the taxpayer's principal activity for the years of assessment 1985 to 1996 (the years of assessment in dispute) consisted of investing in shares, with substantial long-term investments in various subsidiaries and associated companies.

Both the taxpayer and the Comptroller were agreed on the use of the total assets method as a method of apportioning the interest expenses to be deducted. In relation to the expression in sec 14(1), "source chargeable with tax under the Act", however, the taxpayer argued that all its share investment counters formed one source of income. The Comptroller, on the other hand, took the view that each share investment constituted a separate source of income.

The Board found that the word "source" in sec 14(1) means a channel or stream of income and the dividends of each of the distinct share counters could constitute a distinct source of income for the purpose of deductibility. The Board cited with approval the Indian High Court case of *Seth Shiv Prasad v Commissioner of Income Tax, UP* [1972] 84 ITR 15. In the latter case, the Indian High Court said that it is the shareholding held by the taxpayer that constitutes the source of dividend income, and that there can be as many sources of income as there are shareholdings. Shareholdings in different companies constitute different sources of income. The shares of one company may be treated by the taxpayer as a single shareholding. The taxpayer may also, for good reason, treat the shares of the same company as constituting a number of separate and distinct shareholdings. The shares may be dividend into groups defined by reference to the circumstances in which they were acquired, or to the purpose for which they were purchased (see also chapter 6 at ¶6-100ff and ¶7-310). The Board said that the concept of "source" as a channel or stream of income is consistent with the principle that sec 14(1)(a) requires a direct nexus between expenses incurred and the source of income produced. Hence, only the interest expense incurred in producing the income from a separate counter of shares can be deducted against the dividend income generated for that respective shareholding.

The Board also said that the total assets method that the CIT adopted was legally tenable and reasonable and had been properly applied.

The taxpayer's appeals to the High Court and thereafter to the Court of Appeal were dismissed. The Court of Appeal agreed with the High Court that the heads of income enumerated under sec 10(1) of the Act are simply descriptions of the types of income that sec 10(1) enacts as being chargeable to tax, one of which is dividend income. The key is to look at the taxpayer's activities and/or property as the originating cause of income or the means by which the different types of gains or rewards enumerated and classified as "income" are derived.

The Court of Appeal approved of the principle in *Seth Shiv Prasad* (see above), and also rejected the taxpayer's submission that interest expenses are not deductible only in situations where the expenses are incurred in the gaining of tax-exempt income or where the investment or capital itself has been extinguished. The Court held that where the taxpayer has borrowed funds, paid interest on these funds, and invested these funds, these investments must produce income for the interest expense to be deductible. Where the investment does not produce income, the interest expense on those investments is not deductible. The Court found that the Comptroller's adoption of the interest adjustment formula showed him to be mindful of the practical tax consequences faced by taxpayers and that he had not abused the administrative discretion conferred upon him by sec 14(1)(a). See *JD v CIT* [2005] SGCA 52.

Interest paid to a non-resident lender

Where a Singapore borrower is liable to pay interest to a non-resident lender, and such interest is deductible as an expense in Singapore, the borrower is obliged to withhold tax at the applicable tax rate or at a lower rate where indicated by the Comptroller (sec 45(1)).

Interest paid by a person outside Singapore to another person outside Singapore is not deductible unless withholding tax has been deducted from that interest under sec 45 (sec 15(1)(j)) (see chapter 14 at ¶14-100ff for details on the withholding tax).

Examples of deductible and non-deductible interest expense

Examples of deductible interest expense include interest incurred:

- on money borrowed to purchase shares that provide dividend income (note that interest deduction is limited to the amount of income from the investment if the source of income is not a sec 10(1)(a) source);
- on loans acquired to purchase revenue and fixed assets used in an existing business, including assets acquired on hire purchase;
- on borrowings for business purposes; and
- on loans provided by a partner to a partnership for business purposes.

Examples of non-deductible interest expense include interest incurred:

- on money borrowed to acquire shares in the company in which the taxpayer was employed (ie not deductible against the taxpayer's employment income);
- on loans raised specifically to pay dividends (this is an expense relating to the distribution of profit rather than an expense of earning profit);
- on money borrowed to acquire private assets (eg a house, car or television set) — but mortgage interest on residential property is deductible in calculating the net annual value of property under sec 10(10) (the amount of net annual value of one owner-occupied property in excess of $150,000 is deemed to be income); and
- on money borrowed to pay income tax.

¶7-420 Rent

Rent payable in respect of any land or building or part thereof occupied for the purpose of acquiring income is deductible (sec 14(1)(b)). Where part of the premise is occupied for non-business purposes (eg upper floor of a shop-house is the taxpayer's residence), apportionment of rental expense is required.

¶7-430 Repairs and renewals

Case principles suggest that a repair is the replacement of a subsidiary part whereas a renewal is the replacement of the whole, or substantially the whole, subject matter (*Lurcott v Wakely & Wheeler* (1911) 1 KB 905). A renewal is therefore, at common law, capital in nature. What is substantially the whole and what is merely a subsidiary part is a question of degree and must be determined according to the facts in each case. In *CIT v Rubber Co Ltd* (1961) MLJ 191, the construction of a new water-gate to replace one (out of ten) that leaked was held to be a repair of part of a drainage system. The High Court of Malaya held that the vital consideration is:

> "the size, extent and importance of that work done in relation to the taxpayer's whole income producing undertaking and whether or not it can be said that such work has resulted in the creation of a new asset".

Section 14(1)(c) provides a deduction for expenses incurred for repair of premises, plant, machinery or fixtures employed in acquiring the income, or for the renewal, repair or alteration of any implement, utensil or article so employed". However, no deduction will be made:

(i) for the cost of renewal of any plant, machinery or fixtures for which capital allowances under sec 19 or 19A have been granted on the initial purchase; or

(ii) for the cost of reconstruction or rebuilding of any premises, buildings, structures or works of a permanent nature.

Section 14(1)(c) therefore explicitly allows a deduction for certain types of renewals — this is also known as the replacement basis of deduction. If a replacement asset contains an element of improvement over the replaced asset, in principle, an amount that represents the improvement will not be allowed as it is prohibited under sec 15(1). For example, if a landlord replaces an air conditioner (cost $2,000) in his rented property with a different model that costs $2,300 but is otherwise similar in function or efficiency (eg in terms of energy consumption), the full amount of $2,300 will be deductible.

Generally, repairs or replacements to any income-producing property, which do not materially add to its value or appreciably prolong its life but merely keep it in good and efficient operating condition, are deductible. However, improvements, additions and alterations to property will not qualify for deduction (but see exception under sec 14H in ¶7-850).

Repairs of recently acquired assets

Repairs are sometimes incurred on an asset that has been acquired second hand; they are commonly referred to as initial repairs.

If the repairs are incurred to put the asset in a position ready to produce income, ie to render the asset in a working condition, they would be of a capital nature and are not deductible. A case authority is *Law Shipping Co v IR Commrs* (1924) 12 TC 621. In that case, the taxpayer had purchased a steamship for £97,000 at a time the ship was due for a "Lloyd's survey", which is carried out to ascertain that the ship was in a seagoing condition. As the ship had already been loaded with cargo at the time of purchase, an exemption from the survey was granted and the ship set out on a voyage to Port Said. On the return of the ship, the taxpayer undertook the Lloyd's survey and incurred £51,558 to restore the ship to the condition it was in at the time of the previous survey. The court held that only that proportion of the repairs that was referable to the period beginning from the time when the taxpayer became the ship owner was deductible (£12,000). The balance was in effect capital expenditure — the purchase price of the ship was lower to the extent that the repairs had been allowed to accumulate.

It follows that if a taxpayer incurs repairs on a machine he has purchased to put it in a position ready to produce income, the repairs would not be deductible. To be deductible, the repairs must make good the defects in an asset that arise from the claimant's profit-earning operations.

The *Law Shipping* principle could be applied to repairs to leased assets. In *S Ltd* (1953) SB XII, the taxpayer incurred repair and renovation expenses to premises it had recently leased. It was held that the taxpayer had effected improvements and the whole expenditure was capital in nature.

Not all repairs that are made to a newly acquired asset, however, are of a capital nature (*Odeon Associated Theatres Ltd v Jones* [1972] 1 All ER 681).

In the *Odeon* case, the taxpayer, who was a cinema theatre exhibitor in England, purchased a cinema for £240,000 in January 1945. During the preceding war years, owing to wartime restrictions, owners of cinema theatres in England could spend only a small amount of money on repairs and so cinemas in England were generally in a state of disrepair. The purchase price that the taxpayer paid for the cinema was therefore not affected by the fact that it was in disrepair on the date of its acquisition. Despite the state of disrepair, the taxpayer put the cinema to use as an income-earning asset immediately and continued to do so for several years before it incurred deferred repairs. The dispute was whether these deferred repairs were deductible. The courts held that they were deductible, and distinguished the *Law Shipping* case on the following grounds:

(a) the purchase price was substantially lower than if the vessel had been in good repair at the date of purchase;

(b) the asset was not in a profit earning state at the time of purchase; and

(c) the courts did not then have evidence of accounting practice

Approved expenditure on any addition or alteration to business premises owned or leased by a person for the purposes of facilitating the mobility or work of any disabled employee qualifies for a special deduction under sec 14H (see ¶7-850). In the absence of sec 14H, such expenditure, being capital in nature, would not deductible.

¶7-440 Bad and doubtful trade debts

For income tax purposes, a debt is a legally enforceable obligation for payment of money. Section 14(1)(d) uses the terms "bad debts" and "doubtful debts". A "bad debt" is not a debt that is merely doubtful (eg a debt owed by a bankrupt individual with no assets would qualify as a bad debt). As for "doubtful debts", business prudence and the *Companies Act (Cap 50)* require adequate provision to be made for debts of a doubtful nature when determining the financial results for a particular period. Section 14(1)(d) allows a deduction for bad trade debts and for specific provisions for doubtful trade debts.

Bad trade debts

The following conditions must be satisfied before a debt that has become bad can be deducted:

- *A debt incurred in respect of section 10(1)(a)*

  To be deductible, a debt must have been incurred in any trade, business, profession or vocation (sec 14(1)(d)) and on revenue account (*Curtis v J&G Oldfield Ltd* (1925) 9 TC 319).

  In *X v CIT* (1950–1985) MSTC 525, a loan made by a building contractor that had become irrecoverable was not deductible as it was not an essential part of the taxpayer's business or necessary for the business. The taxpayer's counsel had also failed to prove that there was a practice or custom in Singapore among building contractors of borrowing and lending money not for profit but as an activity ancillary to their business.

- *Debt must be included as a trading receipt*

  Section 14(1)(d)(ii) requires that any claim for deduction must relate to a debt that had been included in the income of a trader in the year it was derived. For example, where goods are supplied to a customer and the debt has become bad, the bad debt is deductible. In contrast, for finance and money lending businesses, loans to clients are not included in the income of the year in which the loans are made. If the loans become bad, they would not qualify for deduction under sec 14(1)(d) (The write-off of these loans would be deductible under sec 14(1), however, on the basis that the loss relates to money that is their stock-in-trade or circulating capital).

- *Debt has become bad during the basis period*

  The debt must have become bad during the basis period relating to the year of assessment in which the claim for deduction is made.

- *Debt must be bad*

  For commercial reasons, a taxpayer may decide not to take any action to recover an outstanding trade debt because he has assessed the chances of recovery to be slim. In practice, however, IRAS normally asks whether the taxpayer has taken any legal action and, if so, what the outcome of the legal action is.

- *Business must be carried on in the basis year*

  A bad debt cannot be deducted if it is in respect of a business that has closed down or has been discontinued.

  In a reorganisation or purchase of business, a purchasing company may take over the debts of the vendor company. If such debts subsequently become bad, a claim by the purchasing company for deduction will not be admitted because the debts, when they were incurred, had not been included as a trading receipt of the purchasing company. Conversely, the purchasing company will not be taxable on any recoveries of trade debts that had been written off by the vendor company. In both instances, the debts were owed by the vendor company and the loss or gain did not relate to the business of the purchasing company.

  In the case of a continuing business, any recoveries made in respect of trade debts previously written off are included in the calculation of sec 10(1)(a) income for the basis period in which the recovery is made (sec 14(1)(d)(i)).

Provision for doubtful trade debts

Specific provisions for doubtful trade debts are deductible (sec 14(1)(d))

General provisions made for bad and doubtful debts are, however, not deductible under sec 14(1). General provisions are arbitrary and are normally made by taking a percentage of the total outstanding trading debts and debiting this amount to revenue account.

Example 3

The profit and loss account of a manufacturing company has been debited with a bad and doubtful debt expense of $9,700 comprising:

		Allowed	*Not allowed*
	$	$	$
Loans to staff written off	2,000		2,000
Bad debts written off (trade)	4,000	4,000	
Trade debts recovered	(1,000)	(1,000)	
Increase in specific provision	1,500	1,500	
Increase in general provision	3,200		3,200
Per profit and loss account	9,700	4,500	5,200

The following are examples of deductible and non-deductible debts:

(a) Deductible debt:

- A customer who owed $4,300 to a company has been killed in an accident or has become a bankrupt.

(b) Non-deductible debt:

- A loan by a manufacturing company to an employee that has become bad because the employee has absconded and could not be traced (such a debt is a non-trade debt).
- Where there is a guarantor to a trade debt, the Comptroller may refuse to allow a taxpayer's claim for deduction under sec 14(1)(d). The debt would not have been proved to the Comptroller's satisfaction to have become bad if the taxpayer can recover the debt from the guarantor.
- Where an advance has been made to a partner of a firm and it is written off on the partner's retirement, the write-off is not deductible.
- The mere fact that a debtor is in financial difficulties will not by itself satisfy the Comptroller that the debt is bad and qualifies for deduction.

Provisions made by banks and finance companies

Specific provisions for doubtful debts made by banks and finance companies do not represent losses incurred and are not deductible under sec 14(1)(d) as the debts incurred do not constitute a trading receipt to them. However, as an administrative concession, the Comptroller allows banks and finance companies to deduct specific provisions for doubtful debts under some conditions (IRAS e-Tax Guide 1999/IT/6 published on 31 August 1999). For banks and qualifying finance companies, the special deduction under sec 14 allows a restricted deduction in respect of general provisions made for doubtful debts from loans, and provisions for the diminution in value of investments in securities.

¶7-450 Contributions to pension or provident funds

When an employer contributes to a pension or provident fund for employees who are engaged in activities connected with the production of the employer's income, such contributions are deductible if:

(a) the fund is an approved pension or provident fund or a fund constituted overseas; and

(b) the contributions are obligatory according to any employment contract, or the rules of a fund (sec 14(1)(e)).

When an employer contributes to the Central Provident Fund (CPF) or a designated approved pension or provident fund, the deduction allowed is *limited to the amount of statutory contributions*. The statutory CPF contributions for each year from 2001 are shown in Table 1 of chapter 5 at ¶5-240. From 1 January 1999, CPF contributions made by an employer in respect of any employee who holds an employment pass, professional visit pass or work permit are not deductible (sec 14(1)(e)(iii)).

Medisave contributions

From 1 January 2003, an employer can deduct contributions made to the CPF Medisave account of an employee in lieu of hospitalisation benefits or outpatient medical benefits that the employer is obliged to provide under the employee's contract of employment. The deduction is subject to an annual limit of $1,500 (sec 14(1)(f)).

Medisave contributions in respect of any employee who holds an employment pass, professional visit pass or work permit are not deductible to the employer (sec 14(1)(f) proviso).

¶7-460 Religious dues

Deductions are allowed for *zakat*, *fitrah* or any religious dues, payment of which is made under any written law (sec 14(1)(g)). *Zakat* is the tithe payable annually in accordance with Muslim Law. *Fitrah* is the amount of rice or equivalent value in money payable annually at the end of the month of Ramadhan (the fasting month).

EXPENSES THAT ARE DEDUCTIBLE SUBJECT TO RESTRICTION

¶7-500 Expenses that are deductible subject to restriction

The following types of expenses are deductible subject to restriction:

(a) payments to related employees;

(b) expenses for certain types of motor cars; and

(c) medical expenses.

¶7-510 Payments to related employees

Salaries, wages or similar payments, compensation payments for injuries or death, and death gratuities that are made by employers to certain employees are deductible only to the extent that the payments are reasonable having regard to the services performed by the employees (sec 14(2)). This restriction applies to payments made to any employee who is the husband, wife or child of:

- the employer;
- any partner of the employer;
- any individual who controls the employer (either alone or with his spouse and/or child); or
- any individual whose spouse and/or child controls the employer

¶7-520 Motor car expenses

In March 1998, the Land Transport Authority rationalised the vehicle tax structure in Singapore and introduced two significant changes. First, fixed statutory taxes (ie registration fees, additional registration fee, customs duty, certificate of entitlement and road tax) were standardised for all categories of motor cars. Second, all new motor cars registered on or after 1 April 1998 were to bear S-plate registration. However, companies replacing their company-registered cars (ie cars bearing Q-plate registration) could opt to retain the Q-plate registration even though the replacement cars were registered under the new tax structure.

Arising from these changes, the tax provisions relating to motor cars were amended (IRAS ~~e-Tax Guide 1999/IT/1 published on 1 June 1999~~). The tax treatment for expenses (see chapter 8 at ¶8-100ff for capital allowances) in respect of the following categories of motor vehicles effective from 1 April 1998 is discussed below and set out in Table 1.

Table 1: Summary of Income Tax Treatment for Motor Car Expenses

Type of Motor Car	*Tax Treatment on Car Expenses Incurred*
Q-plate cars	
• Registered before 1 April 1998	If the car costs $35,000 or less, expenses incurred are *fully* deductible If the car costs more than $35,000, deductible expenses is *restricted* to: Expenses incurred × ($35,000 ÷ actual cost of car)
• Registered on or after 1 April 1998	No deduction
Private registered cars (S-plate)	No deduction
Taxis	Expenses incurred are *fully* deductible
Foreign registered cars (used exclusively outside Singapore)	
• Own car	If the car costs $35,000 or less, expenses incurred are *fully* deductible If the car costs more than $35,000, deductible expenses is *restricted* to: Expenses incurred × ($35,000 ÷ actual cost of car)
• Rented car	Expenses incurred are *fully* deductible
Cars used for instructional purposes	
• Registered before 1 April 1998	Full deduction for expenses incurred on Q-plate cars No deduction for expenses incurred on S-plate cars
• Registered on or after 1 April 1998	Expenses incurred are *fully* deductible
Rental cars (private hire cars)	
(a) Lessee	No deduction
(b) Lessor	Expenses incurred by lessor are *fully* deductible

Q-plate cars

Before 1 April 1998, motor cars registered as business service passenger vehicles (BSPV) under the *Road Traffic Act* carried number plates beginning with the letter "Q" (hence, known as "Q-plate cars").

For Q-plate cars *registered on or after 1 April 1998*, expenses no longer qualified for deduction (sec 15(1)(k)).

For Q-plate cars *registered before 1 April 1998*, expenses incurred were deductible as follows (sec 14(3), (3A) & (4) and 15(1)(k)(iv)):

- If the car cost $35,000 or less, all expenses incurred in running and maintaining it were deductible.
- If the car cost more than $35,000, deduction of the expenses would be restricted to the proportion that $35,000 bears to the actual cost.
- Where a claim for cost of renewal (as opposed to a claim for capital allowances) was made before 1 April 1998, deduction would not exceed $35,000.

Example 4

Motor car QBC8110 (cost $45,000) was registered in 1997. Expenses incurred to run it amounted to $10,000 in 2005. For the year of assessment 2006, the deductible amount of expenses will be:

$$\frac{\$35,000 \times \$10,000}{\$45,000} = \$7,778$$

The balance of $2,222 will be disregarded.

Private registered cars (S-plate)

No deduction for expenses is allowed regardless of when the car was registered (sec 15(1)(k)).

Taxis

Expenses incurred in respect of taxis are deductible in full.

Foreign registered cars

Expenses incurred in respect of a foreign car used exclusively outside Singapore are deductible subject to a $35,000 capping as for Q-plate cars (sec 14(4)(b) and 15(1)(k)(ii)).

No deduction is available for expenses incurred in respect of a foreign car not used exclusively outside Singapore. However, any outgoings and expenses incurred in respect of any hired foreign cars used exclusively outside Singapore are fully deductible regardless of the period of use (sec 15(1)(k)(ii)).

Motor cars used for instructional purposes

The tax treatment for a motor car that is used principally for instructional purposes (tuition car) by a person who carries on the business of providing driving instruction depends on the type of registration for the car. Such a person must hold a driving school licence or a driving instructor's licence issued under the *Road Traffic Act* (sec 14(4)(a)).

- For tuition cars registered before 1 April 1998 as Q-plate cars, expenses were fully deductible. Where the tuition car was registered as an S-plate car, expenses were not deductible.
- For tuition cars registered on or after 1 April 1998 in the name of the business concerned or in the name of an individual, expenses incurred are fully deductible.

Rental cars (private hire cars)

Private hire cars were registered as SZ-plate before 1 April 1998 nd as S-plate on or after 1 April 1998. Expenses incurred by a lessee in respe of a private-hire car are not deductible anymore.

rom the year of assessment 2000, *lessors* of private hire cars who carry on the usiness of hiring out cars an fully deduct expenses incurred in respect of hese cars regardless of the period of hire (sec 15(1)(k)(iii)).

¶7-530 Medical expenses

Employees' medical expenses are deductible if they are wholly and exclusively incurred in the production of the employers' income. However, from the year of assessment 2005, the employers' deduction for medical expenses is capped at the specified percentage (the cap was 2% before the year of assessment 2005) of the total remuneration paid to employees (sec 14(5)).

For this purpose, "medical expenses" means expenses incurred in or in connection with the provision of medical treatment and includes:

- maternity health care, natal care and preventive and therapeutic treatment expenses;
- expenses for the provision of a medical clinic by the employer;
- cash allowance in lieu of medical expenses;
- expenses for the provision of insurance against the cost of medical treatment; and
- Medisave contributions deductible under sec 14(1)(f).

The "remuneration" of employees includes wages, salaries, leave pay, fees, commissions, bonuses, gratuities, allowances, other olument paid in cash by or on behalf of the employer and contributions n e to approved pension or provident nds by the employe which are d ictible under the Act.

Employees' remuneration excludes any director's fee, medical expenses, cash allowance in lieu of medical expense or benefit-in-kind (sec 14(8)).

For companies that enjoy concessionary tax treatment, any "excess" of medical expenses over the specified percentage (from the year of assessment 2005) of total remuneration is regarded as income chargeable to tax at the full corporate rate (sec 14(6)).

The meaning of "specified percentage", for purposes of sec 14(5) and 14(6), for any year of assessment is set out in a new sec 14(6A), which applies to the year of assessment relating to the basis period commencing on or after 1 April 2004 and any subsequent year of assessment. Consequential to these tax changes was the insertion of detailed definitions for the terms "gross rate of pay", "local employee", "specified amount", and "specified insurance plan" in sec 14(8), to which the reader is referred.

OTHER COMMON DEDUCTIBLE/NON-DEDUCTIBLE EXPENSES

¶7-610 Entertainment expenses

The deduction of entertainment expenditure is governed by sec 14(1) subject to sec 15. The activities must therefore have a "business perspective" for the expenditure to be deductible. Such expenses may be incurred to entertain current or prospective business associates and customers, eg food and drinks incurred in the local pub or the premises of a country club of which the taxpayer is a member.

The taxpayer is advised to keep proper records with notes on the direct relation of the expense to the business (eg date and place of entertainment, names of persons entertained, amount spent, business discussions that took place, etc).

Where a company incurs an entrance fee to obtain a club membership, the entrance fee (being a capital payment) is not deductible. However, club subscription fees are deductible.

¶7-620 Payments made to employees

Payments made to employees would include salaries, bonuses, commissions, gratuities, allowances, payments in lieu of leave or notice, leave passages, travelling expenses, employee's life insurance premiums, cost of food, provident fund contributions, etc. These payments are deductible if they are incurred in the production of the employer's income. However, certain payments are deductible subject to a restriction, if sec 14(2) applies to them (see ¶7-510).

Examples of other deductible expenses include:

- Payments made to terminate an employee's service contract for the benefit of the business, eg owing to the employee's 'inefficiency, insubordination or dishonesty.

- Employee welfare expenses that are not of a capital nature, eg rent and other costs incurred to maintain a canteen, staff sports club and restrooms, costs of providing uniforms and laundering, tuition fees paid for staff to attend technical or educational classes, and operating costs of child-care centres in the workplace.

Examples of non-deductible payments include:

- Sometimes, a payment may be made to an employee for agreeing to enter into a restrictive covenant. The payment may require the employee not to perform activities in competition with the employer over a specified location and/or for a period of time after the employment. Such a payment will generally not be deductible to the employer as he would be regarded as having acquired an enduring benefit.
- Payments made to employees on the closing down of a business are not deductible. Such payments are capital in nature and are not incurred in the production of the income from the business. Payments made in connection with a corporate reorganisation by a company to the employees of another company it has taken over are not deductible (*H Rubber Estates Bhd v Director General of Inland Revenue* (1950–1985) MSTC 214; (1979) 1 MLJ 115).
- Premiums or contributions made to an unapproved provident fund or scheme constituted in Singapore for the benefit of an employee (sec 15(1)(i)).

¶7-630 Trading stock

Under the accrual basis of accounting, changes in the value of trading stock and work-in-progress between the beginning and end of a trader's financial year are taken into account in arriving at trading profit. The valuation of trading stock and work-in-progress therefore affects the determination of profit.

The term "trading stock" is not defined in the Act and therefore takes its normal commercial meaning. It refers to all goods or commodities in which the particular person deals, in the sense of buying and selling in the course of this business activity. It does not include a commodity that is acquired for the purpose of being let to hire (*H Mohamed & Co v CIT* 107 ITR 637). It includes all raw materials and supplies acquired for sale that will, at some stage, become part of the product intended for sale and all finished or partly finished goods (ie work-in-progress). Only goods in which the title is vested in the taxpayer are taken into account. Hence, goods received by a retailer on consignment are not his trading stock.

The Act does not specify the basis of stock valuation for tax purposes. The Comptroller accepts stock valuation based on the lower of cost and net realisable value, which is the basis prescribed by the local accounting standard. This basis of stock valuation has case law support in *Whimster v Commrs of IR* (1925) 12 TC 813 and *Duple Motor Bodies Ltd v Osliine* (1960) 39 TC 537.

However, in the determination of "cost", the local accounting standard permits the use of more than one method of calculating cost of trading stock. The methods include specific identification, "first in, first out" ("FIFO"), and "weighted average cost". The Comptroller accepts any of these methods, but the taxpayer must show that the method he has adopted for valuing trading stock fulfils the following conditions:

- it must clearly reflect income;
- it must conform to commercial and accounting practice; and
- it must be consistently applied from year to year.

Where a trader changes the method of valuation of trading stock, he must make this apparent in the accounts or notify the Comptroller of the change. The Comptroller will normally accept a change if it does not frustrate the principles of ascertaining trading income.

In *Sharkey v Wernher* (36 TC 275), the House of Lords ruled that a stud farm owner who had transferred some horses to her private stables was required to take in the market value of the horses in the stud farm accounts. The IRAS accepts this principle, and trading stock that is appropriated from a business for private enjoyment must be brought in as a trading receipt at the market value prevailing on the date of appropriation.

Valuation on discontinuance of business

Section 32 governs the situations where stock valuation has to be made on the discontinuance or transfer of a trade or business. If:

(a) the trading stock is sold or transferred for valuable consideration to a person who carries on or intends to carry on a trade or business in Singapore; and

(b) the cost of the stock is deductible in computing the profits of the latter's trade or business,

the closing stock in the sellers' accounts is taken to be the amount realised on the sale or the value of the consideration given for the transfer (sec 32(1)(a)).

If the above conditions are not both satisfied, the value of the closing stock will be taken to be the open market price at the discontinuance or transfer of the trade or business (sec 32(1)(b)).

Trading stock means property of any description, whether movable or immovable, being either:

(a) property such as are used in the ordinary course of trade or business or would be sold if it were mature or if its manufacture, preparation or construction were complete; or

(b) materials such as are used in the manufacture, preparation or construction of any such property in (a).

The aim of sec 32 is to prevent tax avoidance by manipulating stock values on the cessation of one business and the commencement of another. In *HC & Anor v CIT* (1950–1985) MSTC 656; (1970) 2 MLJ 259, the court held that the trading stock (comprising land that was neither sold nor transferred for valuable consideration) of the taxpayer upon its discontinuance of trade had been correctly valued by the Comptroller under sec 32(1)(b) at market value on the date of transfer.

¶7-640 Losses through theft, misappropriation, etc

A taxpayer may incur losses through theft, embezzlement, defalcation or misappropriation. Where the loss is of a non-capital nature and it is incidental to the business carried on, it will be deductible.

In an Australian case, a taxpayer was robbed of the day's takings on his way to the bank. Such loss was held to be deductible because it was the kind of casualty, mischance or misfortune that was a natural or recognised incident of the taxpayer's operations (*Charles Moore & Co (WA) Pty Ltd v FC of T* (1956) 95 CLR 344). A New Zealand court relied on the *Charles Moore* decision and allowed a deduction in *Gold Bank Services Ltd v Commr of IR* (1960) 13 ATD 160 where a seven-day 24-hour service station was robbed of its weekend cash trading receipts.

Losses suffered by a trader through the negligence or dishonesty of his employees are deductible, if the losses arise from the need to assign certain duties to employees and are therefore incidental to the trade (*Curtis v J&G Oldfield Ltd* (1925) 9 TC 319). Examples of deductible losses include embezzlement of cash by an employee, bills collected but not accounted for, and pilfering of trading stock. Any recovery from an employee of embezzled money that has previously been allowed a deduction is taxable (*Re AA* (1960) FB XXIII).

By contrast, where a loss arises from a theft or misappropriation by a person who has control of the business operations, the loss may not be deductible. For example, if a company has incurred a loss arising from an overdrawn account that a controlling director has with it, the loss would not be deductible because it could not be said to have been wholly and exclusively incurred in the production of the trading income.

¶7-650 Legal and professional expenses

Generally, legal and professional expenses in respect of litigation or advice are deductible if they are incurred as an ordinary incident of the taxpayer's business and are not capital in nature (unless a special deduction such as sec 14A applies — see ¶7-850). For example, legal fees incurred to recover outstanding trading debts are deductible.

In practice, the Comptroller allows a deduction for expenses incurred by a person carrying on a trade, business, profession or vocation for the preparation of tax returns and computations and, generally, for tax advice. But professional expenses incurred in connection with an income tax appeal are not deductible (see also *Smith's Potato Estates Ltd v Bolland* (1948) 30 TC 267).

Examples of deductible legal or professional expenses are:

- accounting fees for preparation of accounts;
- legal fees for drafting agreements of sale of trading goods;
- fees relating to acquisition, development and sale of properties in the case of a property dealing business;
- fees for renewal of leases and licences;
- subscriptions to professional bodies;
- fees to recover trade debts;
- fees to contest employees' claims for arrears of remuneration;
- fees incurred by taxpayer to obtain refunds of sums paid for goods or to enforce delivery of goods; and
- seeking an advantage that can be identified with the day-to-day running of the business, ie extension of trading hours.

Examples of non-deductible legal or professional expenses are:

- costs for increase or reduction of share capital or for altering the memorandum and articles of association of a company;
- fees relating to the flotation, registration, winding up or liquidation of a company;
- fees relating to the formation, variation or dissolution of a partnership;
- fees to obtain a trading licence;
- fees to obtain a new lease;
- fees relating to mortgages and issue of debentures; and
- fees in relation to income already earned, for example, income tax appeals.

¶7-660 Head office and management expenses

Management services include investment management, financial management, personnel management, company secretarial services, company payroll management, company tax and tax planning services.

Where the "head office" of a group of companies provides services to the group, the Comptroller accepts that a partial recoupment of the expenses from the group members is justifiable and acceptable. This is because a centralised "expertise" results in more effective research, economy and the ability to stay abreast of competitors in production, marketability, public relations and effective management. The conditions for deduction are that:

(a) the arrangements are at arm's length; and

(b) the allocation of expenses is consistent

The allocation of administrative expenses by way of a management fee or charge should adhere to the following rules:

(a) all direct expenses applicable to each territory must be charged to that territory; and

(b) all indirect common expenses should be allocated using a practical and fair basis, and be charged by way of a management fee to the relevant territory.

Where there is a formal agreement between the parties concerned, the agreement can spell out the type of services to be provided, the basis of arriving at the consideration for the services rendered, and the mode of payment. However, where companies are members of a group or where branches are involved, since one party has apparent or clear control over the other, any such agreement may be subject to the Comptroller's scrutiny. The absence of a formal agreement will not, however, in itself jeopardise deductibility.

There is no single accepted method or formula for allocating head office expenses, and the Comptroller may scrutinise the appropriateness of any method adopted by a taxpayer. Some common bases of allocating total head office expenses to a Singapore branch are:

- gross profits or turnover;
- net profits (using this basis, no expenses will be allocated to the branch if the branch is operating at a loss); and
- total asset basis using the formula:

$$\frac{\text{Total Singapore assets} \times \text{Total head office expenses for branches}}{\text{Total head office assets}}$$

¶7-670 Taxes paid

The Act specifically prohibits the deduction of:

- amounts paid or payable in respect of income tax in Singapore or tax on income (by whatever name called) in any country outside Singapore (sec 15(1)(g));
- amount of goods and services tax (GST) paid or payable by a taxpayer who is required to register under the GST Act but has failed to do so, or who is entitled to credit the amount of GST payable as an input tax (sec 15(1)(h)); and
- amount of output tax paid or payable under the GST Act that is borne by a person registered as a taxable person under that Act (sec 15(1)(m)).

Property tax and other levies

Taxes paid upon any property (land and buildings) that is used for the purpose of producing income will be deductible under the general deduction formula. Where no income is derived in respect of a vacant property awaiting development, any tax or quit rent paid thereon would not be deductible. Property tax is levied on the annual value of a property.

Levies and dues such as import/export duties, renewal of licence fees, surcharges, etc, are deductible.

Stamp duties

Generally, stamp duty incurred in respect of a capital transaction is not deductible. Conversely, if it was incurred for a revenue transaction, it is likely to be deductible. For example, stamp duty charged on the conveyance of land is not deductible if the purchase or sale of land is a capital transaction. Stamp duty levied in respect of a first tenancy agreement is not deductible if it is of a capital nature. Any stamp duty levied on the renewal of a tenancy is, however, deductible by concession. A similar treatment is accorded to stamp duty levied on a loan agreement taken for business purposes and to stamp duty on renewal of the loan.

¶7-680 Other miscellaneous expenditure

Pre-commencement and incorporation expenses

Expenses incurred before the commencement of business are not deductible. If a business consists of a continuous process of several activities and each one of them is an integral part of the business, the business commences when an essential activity of the business is started, and not necessarily when the business is established (*CIT v Saurashtra Cement and Chemical Industries* (1973) 91 ITR 170; (1975) ITR 502).

Expenses incurred on the following activities are not deductible if the business has not commenced:

- preparing of feasibility reports;
- preparing of project reports; and
- conducting market surveys or other surveys to gauge the viability of the proposed business.

Note that the IRAS allows, as a concession, a deduction for certain pre-commencement expenditure incurred in the context of a trade or business (see ¶7-340).

Incorporation expenses are not deductible. Examples include:

- legal charges for drafting of memorandum and articles of association;
- costs for printing of the first/initial sets of memorandum and articles of association;
- fees for company registration;
- costs relating to the issue of shares or debentures, underwriting commission or brokerage; and
- charges for drafting, typing, printing and advertisement of the prospectus.

"Keyman" insurance

In determining whether keyman insurance premiums are deductible, the IRAS has clarified the following (IRAS e-Tax Guide (1993/IT/3) published on 25 February 1993):

- The onus is on the company to show that the life insurance policy was bought to secure compensation for the company if profits were lost as a result of the death of the insured. The policy must remain the property of the company, ie the benefits under the policy should not be assigned to the insured or to the insured's family.

- The insured must be a key person in the business of the taxpayer. The company must show that the insured possesses special qualifications, and that the loss of the insured would significantly affect the company's business. It must show that the insured's special qualities have been pivotal in bringing profits to the company. Professional qualifications, special abilities, personal connections, business acumen and experience may qualify as "special qualifications".
- The capital sum insured must be directly related to the profits attributable to the services of the insured. Reference is made to the responsibilities of the insured for the company operations. The responsibility could be prime, shared or contributory.

If the insurance premiums qualify for deduction, any insurance recovery will be regarded taxable as a trading receipt.

In response to enquiries received, the IRAS has further clarified the tax treatment on keyman insurance premiums in its e-Tax Guide 2004/IT/12 dated 22 October 2004. These include:

(a) where the policy is to insure the company against the loss of profits arising from the disability of the keyman, the premium would also be deductible, subject to the same condition that the capital sum assured must not exceed the annual profits of the company that is attributable to the keyman (being insured against disability);

(b) where the policy provides for a cash surrender value or an investment value, the premium would be regarded as not wholly and exclusively incurred in the production of the company's income and therefore not deductible. This is regardless of the type of insurance the policy is classified under (eg life insurance, endowment insurance, crisis cover plus, group personal insurance, etc);

(c) where the benefit from the policy accrues to the keyman in his personal capacity (such as in cases where the keyman is the sole-proprietor of a business, or the shares of the company are substantially owned by the keyman together with his relatives), the premium would be regarded as not wholly and exclusively incurred in the production of income and therefore not be deductible;

(d) where the policy provides for a capital sum assured that exceeds the company's annual profits, the premium would not be deductible for the same reason as in (b) and (c); and

(e) where the loss of the keyman would affect the company's entire business structure such that the company could no longer carry on its business, the premium would be in respect of the capital structure of the company and not merely for the loss of profits and therefore not deductible.

Overseas travelling expenses

Generally, overseas travelling expenses that relate to the taxpayer's current business activity are deductible under sec 14. The Comptroller may request evidence (eg dates of travel, places visited, persons interviewed, business negotiated, etc) before allowing the expenses. If a holiday is included in the trip or if a wife accompanies the taxpayer in a private capacity, a proportion of the expenses claimed could be rejected.

A taxpayer who carries on a business in Singapore may incur deductible overseas travelling expenses, such as those expenses incurred:

- to attend to the complaints of an overseas customer of an existing product; or
- to secure potential customers for an existing product.

Overseas travelling expenses would not be deductible if they are incurred:

- to set up a new manufacturing facility for a different product line;
- to acquire a new technique for establishing a new service or business;
- to secure a prospective buyer of an existing business;
- to investigate the purchase of a new business;
- to raise money for a new business; or
- to conduct market research for a new product line.

Costs of refresher courses and conference expenses

The Comptroller, in practice, allows expenses incurred by doctors, dentists, engineers and other professional persons in connection with refresher courses attended in Singapore or overseas. The allowable expenditure would include travelling, course fees, accommodation and other incidental disbursements. Where an overseas trip is made partly for attending a refresher course and partly for other purposes (eg a holiday), the proportion of expenses applicable to the latter are not deductible.

Expenses incurred for attending conferences are deductible if they are closely connected to the taxpayer's business operations. The conference ought to have the sanction of the professional body to which the individual belongs. Where expenses are incurred in acquiring additional professional qualifications, ie specialisation in certain fields of the profession, they will be treated as capital outlays. Where the taxpayer is a resident individual, however, he may qualify for a personal relief under sec 39(2)(k) for such expenses (see ¶12-290).

Expenses relating to violation of law

As a general rule, fines and penalties imposed on a taxpayer for violating the law are not deductible as they are not disbursements incurred in the production of the income. Income tax penalties for late submission of returns or failure to comply with the provisions of the Act are therefore not deductible. In *Mayne Nickless Limited v Federal Commissioner of Taxation* 84 ATC 4458, the Australian court held that there was no distinction between fines relating to a serious offence and fines for minor regulatory offences.

Foreign exchange losses

Strictly speaking, realised exchange losses on revenue account that arise in the course of a taxpayer's business operations are deductible. The transactions giving rise to the loss must be closely connected with his income-producing activities. Exchange losses that are unrealised or that relate to capital expenditure are not deductible. For example, if a loss is incurred in the purchase of fixed assets from overseas, the loss will not be deductible, being of a capital nature. However, if the loss arises from the purchase of trading stock, it is deductible.

See ¶4-520 for the IRAS treatment of foreign exchange gains and losses that took effect from the year of assessment 2004. If the taxpayer does not opt out of the IRAS treatment, the IRAS will accept the taxpayer's accounting treatment for tax purposes so long as the foreign exchange gains or losses are on revenue account and the accounting treatment for them has been consistently adopted. The IRAS treatment will apply regardless of whether the gains or losses are realised. Taxpayers who opt out of the IRAS treatment will be assessed according to the realisation principle.

Company's general meeting expenses

Generally, expenses incurred in arranging, conducting and concluding meetings of shareholders and directors are deductible. In Malaysia, however, the High Court has ruled that although the expenses (comprising postage and food costs) relating to a company's annual general meeting were part of its working expenses, they did not form part of the profit earning process of the company and, hence, did not rank for deduction (*Sharikat KM Bhd v Director General of Inland Revenue* (1950–1985) MSTC 332; (1972) 1 MLJ 224).

DEDUCTIONS SPECIFIC TO INCOME SOURCE

¶7-710 Deductions against employment income

Because of the nature of an employment, employees qualify for few deductions. An employer is likely to pay for an employee or reimburse him all the expenses he incurs in the discharge of his duties.

If an employee is required to meet certain expenses out of his remuneration, the onus is on him to prove to the Comptroller's satisfaction that the expenses are incurred wholly and exclusively in the performance of his duties.

Specific expense items

Travelling expenses

Expenses incurred in travelling between one's home and the place of employment (eg an office, site, estate, etc) are not deductible because they are incurred before/after the performance of employment duties. In *Parikh v Sleeman* (1988) BTC 224, a doctor who held part-time employment at three hospitals was not allowed to deduct expenses incurred in travelling between his home or surgery and the hospitals. The reason was that he did not start to perform his employment duties until he had arrived at the respective hospitals.

But if a taxpayer can show that his home is the principal place where he carries on his employment, he may be able to deduct the expenses of travelling from his home to his engagements in other locations.

Expenses incurred in travelling between two places of employment or a place of employment and a place of business are deductible if the taxpayer does not live at either of the places and the travelling enables him to engage in income-producing activities. In *Re S* (1953) SB VIII, the pilot of a ship was allowed to deduct expenses incurred in travelling from his office to his ship but not expenses incurred in travelling from his house to the ship. The reason was that his house was not treated as an office despite frequent travel from it.

Entertainment expenses

An employee's entertainment allowance forms part of his employment income and is taxable as such. He may be able to claim deduction for entertainment expenses incurred out of the allowance. The Comptroller may reject entertainment claims if, eg the business element is only incidental to the entertainment.

Professional subscriptions — books, journals, etc

In practice, employees can claim deduction for subscriptions to professional bodies, professional journals and the costs of replacement of technical books. These expenses are deductible if, in the course of his employment, an employee is required to apply his professional knowledge and there is a close nexus between the expenses and the production of the employment income.

Education expenses

Many employees incur expenses to attend general courses and seminars to upgrade their skills and knowledge. These expenses are not deductible against the employment income as they are not wholly and exclusively incurred in the production of the income; in any case, they are private in nature and are therefore not deductible. To promote Singapore's knowledge economy, these expenses may qualify for personal relief under sec 39(2)(k)(see ¶12-220).

Cost of clothing

If an employee incurs expenses on clothing to comply with a certain dress code at work, the expenses are not deductible to him. The reason is that the clothes serve both business and personal purposes. Therefore, it cannot be said that the employee has incurred the clothing expense wholly and exclusively in performing his employment duties (*Hillyer v Leeke* (1976) STC 490; *Woodcock v IRC* (1977) STC 405).

Non-deductible disbursements

The following are other examples of non-deductible expenses. The expenses are either private or domestic in nature and therefore prohibited by sec 15(1)(a), or do not satisfy the general deduction formula of sec 14(1):

(a) domestic telephone expenses where an employee receives instructions from his employer over the telephone;

(b) cost of domestic servants employed so that a husband and wife can go out to work;

(c) cost of litigation to recover outstanding remuneration;

(d) relocation costs incurred upon a change of employment;

(e) subscriptions to social or sporting clubs;

(f) expenditure incurred on account of a physical disability;

(g) fee paid to an agency to obtain employment;

(h) payment made to an employer in lieu of notice, to secure immediate release from employment (*CIR v Sin Chun-wah* (1989) 1 HKRC ¶90-010); and

(i) costs of preparing tax returns and computations. Only a person who derives a sec 10(1)(a) source can, in practice, deduct these expenses.

¶7-720 "Group treatment" for dividend income

For dividend income assessed under sec 10(1)(d), all expenses wholly and exclusively incurred in the production of the dividend income are deductible. For example, interest incurred on a loan to purchase shares is deductible against dividend income from those shares. However, where the expenses incurred exceed the dividend income from a block of shares, the excess cannot be set off against dividend income from another block of shares.

As an administrative concession, the IRAS has introduced a "group" treatment whereby the excess expenses incurred in respect of a block of shares may be deductible against the dividend income from other blocks of shares within the same group (IRAS e-Tax Guide (1996/IT/1) published on 22 January 1996).

Basically, under the "group" treatment, all of a taxpayer's investments in shares are divided into the following groups:

Group 1	Non-income producing shares (whether local or foreign).
Group 2	Shares which produce dividend income for which tax exemption or remission has been granted, including overseas dividend income remitted to Singapore that is exempt from tax under sec 13(12).
Group 3	Income producing shares in unrelated Singapore companies.
Group 4	Income producing shares in related Singapore companies.
Group 5	Income producing shares in overseas companies where no dividend income is remitted to Singapore in the year.
Group 6	Income producing shares in overseas companies where dividend income is remitted to Singapore in the year and chargeable to tax in Singapore.

Shares are regarded as "non-income producing" if they have not yielded dividend income to their beneficial owners since the date of their acquisition. Shares are regarded as "income producing" if they have yielded dividend income. A company is regarded as being "related" to the shareholder if the shareholder beneficially owns, directly or indirectly, at least 25% of the company's issued share capital.

In the case of shares in Group 1 or 5, the expenses incurred are not deductible because there is no dividend income that is taxable in Singapore. However, as an concession, expenses incurred in any year in respect of shares in Group 5 may be carried forward for set-off against the foreign dividend income of this group that is subsequently remitted to Singapore.

In the case of shares in Groups 2, 3, 4 and 6, any deficit arising from any block of shares within any group may be set off against the net dividend income of other blocks of shares within the same group. If, after such set-off, any group has a net deficit, that deficit is not deductible against the net dividend income of any other group or any other sources of income derived by the taxpayer and will be disregarded for tax purposes.

The IRAS view that the group treatment for dividend income represents a concession is supported by the Court of Appeal decision in *JD Ltd v CIT* (see ¶7-410). In that case, the Court of Appeal upheld the view taken by the Board of Review and the High Court that the dividends on each shareholding constituted a separate source of income for purposes of deduction under the general deduction formula of sec 14(1) (see also ¶6-150). This means that if a taxpayer had incurred interest expenses of $100 to finance the purchase of UOB shares which give rise to dividends taxable under sec 10(1)(d), he could deduct the interest expenses only against (and up to) the dividend income from the UOB shares and not against dividend income from all his shares generally.

SPECIAL, FURTHER AND DOUBLE DEDUCTIONS

¶7-810 Overview

Sections 14A, 14B and 14D–O provide for the following tax incentives:

- certain expenditure not deductible under sec 14 qualifies for a *special deduction* (eg sec 14A, 14D, 14F, 14H, 14I, 14N and 14O);
- certain expenditure that is deductible under sec 14 or as a special deduction qualifies for *further deduction* (eg sec 14B, 14C, 14E, 14J, 14K, 14L and 14M); and
- certain expenditure not deductible under sec 14 qualifies for double deduction (eg sec 14K).

Being tax incentives, these provisions contain detailed conditions for eligibility.

Further deduction account and tax-exempt account

Companies that are allowed a further deduction or a double deduction under the following tax incentives are required to maintain a "further deduction account" (sec 14B(5), 14K(4) and 14M(8)):

- section 14B (expenses relating to approved trade fairs, trade exhibitions, trade missions, trade promotion activities, market development or overseas trade offices);
- section 14E (expenditure on research and development projects);
- section 14J (expenditure on research and development of new financial activities);
- section 14K (overseas investment development expenditure);
- section 14L (expenditure on relocation or recruitment of overseas talent); or
- section 14M (hotel refurbishment expenditure).

The further deduction account is to be credited with the full amount of further deduction (or alternatively double deduction under sec 14K) allowed for the year. To the extent that any amount of further deduction or double deduction is utilised (ie allowed to be set off) against chargeable income for the year of assessment, the further deduction account is debited and a "tax exempt account" is credited with the amount of set-off (sec 14B(7) and (8), 14M(8)). The credit balance in the tax-exempt account is available for payment as exempt dividends. The tax exemption does not, however, apply to dividends paid on any share of a preferential nature.

If a shareholder who receives an amount of exempt dividends under sec 14B, 14E, 14J, 14L or 14M is a company, it may in turn pay exempt dividends to its shareholders out of such exempt dividends received (sec 14B(9) and sec 14M(8)(f)).

The *Income Tax (Amendment) Act 2004* introduced a further deduction incentive for approved logistics expenses incurred by an approved company (sec 14C). It appears, however, that there are no requirements for the approved company under sec 14C to maintain a further deduction account and a tax-exempt account in the manner outlined above. See ¶7-850 below for more features of this new incentive.

¶7-820 Export promotion and market development expenditure

Under sec 14B, a further deduction in addition to the deduction allowed under sec 14, is allowed for expenses incurred in relation to:

- establishing, maintaining or participating in an approved trade fair, trade exhibition, trade mission or trade promotion activity;
- maintaining an approved overseas trade office; or
- market development expenditure for the carrying out of any approved marketing project (sec 14B(2)).

To qualify for the further deduction, the taxpayer must be an approved company or firm that has incurred the expenses for the primary purpose of:

- promoting the trading of goods or the provision of services; or
- providing services in connection with the use of any right under a master franchise or master intellectual property licence where the company or firm is the holder of the franchise or licence (sec 14B(1)).

The Minister may specify the maximum amount of expenses to be allowed a further deduction.

Only those expenses that qualify for deduction under sec 14 will qualify for a further deduction (sec 14B(4)(a)). However, in the case of approved trade fair, trade exhibition, trade mission, trade promotion activity or marketing project, further deduction for the travelling, accommodation and subsistence expenses or allowances is available only for an approved number of employees (sec 14B(4)(b)).

Section 14B is administered by the International Enterprise Singapore ("IE Singapore", formerly Trade Development Board). From 1 April 2004, applications for further deduction for local trade fairs are processed by Singapore Tourism Board.

Overseas trade office expenses

The period of eligibility for further deduction is subject to approval and will run from the date of establishment of the approved overseas trade office for an approved number of years. The following expenses do not qualify for further deduction:

- expenses for establishing the overseas trade office;
- remuneration, travelling, accommodation and subsistence expenses or allowances for more than the approved number of employees of the overseas trade office; and
- any expenses that are specifically excluded as a condition for approval (sec 14B(4)(c)).

An overseas trade office must not constitute a permanent establishment in the foreign country where it is located. If it is found to be carrying on business in that country and is taxable there, it will be disqualified from further deduction (sec 14B(4)(c)).

Marketing project expenses

Further deduction available in respect of market development expenditure refers to the following:

- approved expenses directly attributable to the carrying out of market research or obtaining of market information, including any feasibility study;
- expenses for advertisements placed in approved media;
- expenses incurred on approved promotion campaigns; or
- approved expenses incurred in the design of packaging, or in the certification of goods or services where such certification is carried out by an approved person (sec 14B(11)).

¶7-830 Research and development expenditure

Section 14D provides for the deduction of research and development expenditure incurred by a qualifying taxpayer. The research and development activity may be undertaken by the taxpayer or by a research and development organisation on his behalf.

The term "research and development" is defined as any systematic or intensive study carried out in the field of science or technology, the results of which are to be used for the production or improvement of materials, devices, products, produce and processes (sec 2). Quality control, routine product testing, research in the social sciences or the humanities, routine data collection, efficiency surveys, management studies, market research and development services are specifically excluded from the definition.

Qualifying persons and expenditure

Section 14D deduction is available to a person carrying on:

- a manufacturing trade or business, or
- a trade or business for the provision of any services.

Section 14D provides for the deduction of research and development expenditure except for capital expenditure:

- on plant, machinery, land or buildings (including alterations, additions or extensions to the buildings); and
- in the acquisition of rights in or arising out of the research and development activity.

Where the research and development activity is undertaken by a research and development organisation outside Singapore on behalf of a taxpayer, the taxpayer can claim deduction only if:

- he gives an undertaking that any benefit which may arise from the research and development activity shall accrue to him; and
- his claim is made in such manner and subject to such conditions as the Comptroller may require (sec 14D(3)).

Expenses incurred before the commencement of the taxpayer's trade or business are deductible as they are deemed to have been incurred on the first day the trade or business is carried out (sec 14D(2)).

Further deduction under sec 14E

A further deduction is allowed for qualifying taxpayers who incur expenditure on approved research and development projects carried out in Singapore (sec 14E). Qualifying taxpayers are:

- persons carrying on a manufacturing trade or business who either undertake the projects themselves or pay a research and development organisation to undertake the projects;
- research and development organisations undertaking the projects; or
- persons carrying on a trade or business for the provision of any services who either undertake the projects themselves or pay a research and development organisation to undertake the projects.

Only one person can claim a further deduction for the expenditure incurred on a project or on another project of which the first project forms a part. Hence, where a research and development organisation undertakes an approved project for and on behalf of a manufacturer, either person (but not both) can claim further deduction in respect of the expenditure incurred.

Further deduction is only given for expenditure that is deductible under sec 14 or 14D. The Minister may specify the amount of expenditure that qualifies for further deduction and the period of time for which the further deduction will be allowed. If there is insufficient income in one year to offset the further deduction, the expenses will be allowed to be carried forward.

EDB administers this scheme and the criteria for determining the eligibility for companies applying for the further deduction include:

- the level of sophistication of the research and development report;
- the level of expertise and qualifications of the researchers; and
- the level of R&D activities measured in terms of research and development expenses.

Research and development of new financial activities

Section 14J allows a financial institution to further deduct, in addition to sec 14 deduction, the following expenses incurred:

- salary, wages and other employment benefits (except directors' fees) paid or granted to an approved employee who is engaged in researching and developing any approved new financial activity;
- legal expenses (excluding litigation expenses) directly attributable to the research or development of an approved new financial activity; and
- expenses incurred on an approved training course conducted in Singapore by an approved employee (sec 14J(1)(a)–(c)).

A further deduction may be allowed for fees or other benefits paid under a contract for financial consultancy services. To qualify, the fees or benefits must have been paid to an approved consultant engaged in researching and developing an approved new financial activity under a contract extending over at least six months. The further deduction will not be granted if the consultant is absent from Singapore for more than a total of 30 days during the contract (sec 14J(1)(d)).

A "new financial activity" is a new or innovative financial activity or instrument falling within one of the following categories:

- derivatives trading including share options, currency options and interest rate options;
- swap transactions, excluding plain vanilla swaps;
- technical trading computer systems and software;
- risk management services which employ sophisticated hedging techniques and instruments;
- development of synthetic securities and instruments linked to derivatives; or
- research on foreign securities (sec 14J(6)).

Additional categories of activities or instruments may also be prescribed.

To qualify for further deduction, the relevant expenses must qualify for deduction under sec 14. The maximum amount of further deduction allowed is capped at 30% of the financial institution's statutory income before the further deduction. The amount in excess of this limit cannot be carried forward for deduction in future years (sec 14J(2), (3) and (5)).

A financial institution may be a bank, merchant bank, securities dealer, investment adviser or futures broker approved by the Minister. The Minister may grant approval for up to five years and extend approval for further periods not exceeding five years on each occasion (sec 14J(4) and (6)).

¶7-840 Overseas investment development expenditure

As an incentive for companies to venture overseas, approved firms or companies resident and carrying on business in Singapore are allowed a further or double deduction for approved overseas investment development expenditure (sec 14K). A further deduction is allowed if the expenditure is allowable as a deduction under sec 14. Where the expenditure is not deductible under sec 14, a deduction double the amount of the expenditure is allowed (sec 14K(1)).

Expenditure qualifying for further or double deduction includes:

- investment development expenditure for the carrying out of an approved investment projects overseas; and
- expenses incurred in the maintenance of an approved overseas project development office (sec 14K(1)).

"Investment development expenditure" means expenses directly attributable to the carrying out of any study to identify investment overseas, and any feasibility or due diligence study on any approved investment overseas (sec 14K(7)). No further or double deduction is allowable for travelling, accommodation or subsistence expenses or allowances for more than two employees taking part in an approved investment project overseas (sec 14K(3)(a)).

An "overseas project development office" is an office established to identify, initiate and develop any approved investment overseas (sec 14K(6)). The following expenses for the maintenance of an approved overseas project development office do not qualify for further or double deduction:

- expenses incurred in establishing the office;
- remuneration, travelling, accommodation and subsistence allowances for more than three employees of the office; and
- expenses specifically excluded from eligibility as a condition of approval of the office (sec 14K(3)(b)).

Further or double deductions are only allowed for expenses incurred in the first six months after the establishment of the office. If the firm or company setting up the office has a permanent establishment in the country in which the office is located, which is chargeable to tax, no further or double deductions will be allowed (sec 14K(3)(b)).

¶7-850 Others

Patenting costs

To encourage more companies to patent their inventions and to make Singapore an attractive base for intellectual property management, sec 14A was introduced. A person who is carrying on a trade or business may be able to deduct patenting costs incurred during the period 1 June 2003 to 31 May 2013. Patenting costs means the fees paid to:

(a) the Registry of Patents in Singapore or elsewhere for the:
  (i) filing of a patent;
  (ii) search and examination report on the application for a patent; and
  (iii) grant of a patent; and
(b) any registered patent agent for:
  (i) applying for any patent in Singapore or elsewhere;
  (ii) preparing specifications or other documents for the purposes of the *Patents Act (Cap 221)* or for patents law of another country; or
  (iii) giving advice (other than advice of a scientific or technical nature) about the validity or infringement of the patent.

To qualify, the person must give an undertaking that he would be the proprietor of the patent when the patent is granted and make a claim in such manner and subject to such conditions the Comptroller may require.

Claw-back provisions apply. Where any person who has been allowed a deduction for patenting costs:

(a) sells, transfers or assigns all or any part of the rights for which the patenting costs were incurred, he is deemed to have derived income equal to the price for which the rights were sold, transferred or assigned, or the deduction allowed, whichever is the less; or

(b) fails to obtain a patent in any country, he is deemed to have derived income equal to the deduction allowed to him in respect of the patenting costs incurred for that country under this section.

Building modifications for disabled employees

Where a person, being the owner or lessee of any premises and carrying on a trade, business or profession at those premises, has incurred approved expenditure on any addition or alteration to those premises to facilitate the mobility or work of any disabled employee, the expenditure qualifies for a special deduction under sec 14H. The maximum cumulative deduction allowed under sec 14H is $100,000. If an amount of expenditure has been allowed a deduction under sec 14H, that same amount will not qualify for deduction under any other provisions of the Act.

Provisions by banks and qualifying finance companies for doubtful debts and diminution in value of investments

A special deduction is available for provisions made by banks and qualifying finance companies for doubtful debts and diminution in value of investments. Conditions apply, and the reader is referred to sec 14I for details.

Relocation or recruitment of overseas talent

Section 14L provides for further deduction in respect of "prescribed expenses" incurred in relocating or recruiting any "prescribed employee" from outside Singapore to be employed in Singapore. The expenses must be incurred by a taxpayer in relocating or recruiting such an employee for his trade, profession or business (see the *Income Tax (Further Deduction for Expenses Incurred in Relocation or Recruitment of Overseas Talent) Regulations 1999*).

Only "prescribed expenses" incurred between 1 October 1998 to 30 September 2003 qualified for further deduction. The amount of further deduction is to be reduced by the amount of any government grant received under a recruitment or relocation assistance scheme in respect of prescribed employees. The total amount of further deduction allowed to any person for any year of assessment is restricted to $150,000. The cap has been increased to $275,000 for expenses incurred on or after 28 February 2003.

A "prescribed employee" is a person who:

- has been recruited from outside Singapore;
- has not been employed by his current (or a related) employer during the period between his last employment in Singapore and the current employer; and
  - (i) holds an employment pass (type P1 or P2); or
  - (ii) is a Singapore citizen or permanent resident whose employment status is equivalent to a P1 or P2 employment pass. During the 18 months immediately before his being employed by the current employer, he must have been employed by a person outside Singapore for at least 12 months in aggregate.

A "current employer" refers to the taxpayer claiming the sec 14L deduction. A "related employer", in relation to a current employer, means any person who controls, or is controlled, by the current employer, or where both are under the control of a common person.

"Prescribed expenses" means:

- in relation to a type P1 employment pass holder (or approved equivalent status), the recruitment and relocation expenses incurred in respect of that prescribed employee, subject to a maximum of $5,000; and
- in relation to a type P2 employment pass holder (or approved equivalent status), the relocation expenses of incurred in respect of that prescribed employee, subject to a maximum of $5,000.

From 28 February 2003, the further deduction limits for the above have been increased to $25,000 for P1 employment pass holders and $15,000 for P2 employment pass holders (see Table 2).

Table 2: Further deductions for relocation or recruitment expenses (from 28 February 2003)

Description	*P1 Employment Pass (or equivalent)*	*P2 Employment Pass (or equivalent)*
Relocation expenses for employee	$15,000 (includes recruitment expenses)	$5,000
Relocation expenses for spouse	$5,000	$5,000
Relocation expenses for unmarried children under the age of 21 years	$2,500 per child (maximum of 2 children)	$2,500 per child (maximum of 2 children)

Recruitment expenses incurred in respect of a prescribed employee includes:

- fees paid to an employment agency; and
- return air fare incurred in bringing the prescribed employee for recruitment interviews.

Relocation expenses is expenses incurred in relocating a prescribed employee from outside Singapore to be employed in Singapore and includes:

- one-way air fare to Singapore for the prescribed employee to commence his employment;
- in respect of any spouse and any unmarried child (below the age of 21 years), one-way air fare to Singapore for each person with the trip to be made within one year from commencement of employment;
- baggage allowance;
- expenses incurred in providing temporary accommodation in Singapore for the prescribed employee (period not to exceed 30 days) or an allowance for that purpose, before the prescribed employee obtains his own place of residence; and

- allowance for furnishing the prescribed employee's place of residence in Singapore.

Hotel refurbishment expenditure

A person carrying on a hotel trade or business can deduct expenditure incurred on the refurbishment of hotel premises, if it is a project approved by the Minister (sec 14M). The deduction (at a rate to be specified of between 100% and 150%) is available on the qualifying expenditure incurred during the qualifying period commencing on or after 1 July 1998. The deduction is given, on due claim, on a straight-line basis over five years (not necessarily consecutive years) against the income from the hotel trade or business. Once any qualifying expenditure is allowed as special deduction under sec 14M, no deduction will be allowed under any other provisions of the Act.

A further deduction account is to be maintained and it will be credited with an amount equal to the excess of sec 14M deduction allowed over qualifying expenditure incurred.

During the qualifying period, and up to five years after the completion of the project, the Minister's written approval must be obtained if the person carrying on the hotel trade or business decides to:

- sell, lease out or otherwise dispose of any asset in respect of which a sec 14M deduction has been given;
- cease using the hotel premises or any part of it for his hotel trade or business; or
- sell, lease out or otherwise dispose of the hotel premises or any part of it.

The tax recovery provisions will apply if any of the above events occurs. The person will be deemed to have derived income equal to the total amount of deduction allowed in respect of the assets or any part of the hotel premises to which the event relates. However, the Minister may reduce the amount of deemed income.

Upfront land premium

Section 14N provides for the deduction of upfront land premium paid by a lessee to the Housing Development Board (HDB) or the Jurong Town Corporation (JTC) in respect of a designated lease for the construction or use of a building or structure on industrial land if:

- the lease is granted by HDB or JTC for a maximum period of 60 years on or after the first day of the lessee's basis period for the year of assessment 2004 but before 29 February 2013 (the maximum period was formerly 30 years); and
- the building/structure is used for a qualifying activity at the end of the respective basis period.

The upfront lease premium paid is deductible on a straight-line basis over the term of the lease. Similar to the requirement for industrial building allowance, if more than 10% of the built-up area of the building/structure is not used for any qualifying activity, the deduction is not allowed in respect of that non-qualifying part.

Where an assignee has acquired the remaining lease term, the assignee can deduct the lower of:

- the residual expenditure immediately after the assignment; or
- the upfront land premium at the time of the assignment, divided by the remaining number of whole years of the term of the lease for which the premium was paid.

Special reserve of approved general insurer

From the year of assessment 2005, an approved general insurer, carrying on the business of insuring and reinsuring offshore risks, can deduct the prescribed amount of special reserves it had set aside for prescribed offshore risks (sec 14O). The deduction is allowed for a period of 10 years. The approved status is granted by the Minister or such person as he may appoint. An "insurer" is a company registered under the *Insurance Act* to carry on insurance business in Singapore; or a person (including a partnership), other than an individual, permitted under the *Insurance Act* to carry on insurance business in Singapore under a foreign insurer scheme.

Logistics expenses

Approval for deductions of approved logistic expenses will be granted until 30 June 2009. This further deduction is available for up to 10 years of assessment to an approved company for specified logistics expenses that it incurs. To be considered for approval, the company must be resident in Singapore, and undertake logistics activities in-house in support of its business activities or outsource its logistics activities to a service provider. Logistics expenses are expenses incurred by an approved company that are:

(a) directly attributable to the carrying out of logistics activities by the company in Singapore; or

(b) paid to a service provider that carries out the company's logistics activities in Singapore,

but excludes such expenses on international freight.

¶7-900 Donations

Being an application of income, donations are not incurred in the production of the income and are therefore not deductible under sec 14.

To encourage charitable giving, however, the Act allows a deduction for certain donations under sec 37(3). Because donations are not deductible as an expense under sec 14, they do not follow the preceding accounting year basis even if the donor is a trader who adopts an accounting year ending on a date other than 31 December. Instead, donations are deductible on a preceding calendar year basis (but see e-Tax Guide 2004/IT/7 below). They are deductible to the extent of the donor's statutory income for the relevant year of assessment after the deduction of sec 10(1)(a) losses, if any (sec 37(7)). A person who has not utilised any donation made on or after 1 January 2002 can carry forward the unutilised amount for up to five years of assessment (sec 37(8)). Companies are allowed to carry forward unutilised donations if there is no substantial change in the company's shareholders and their respective shareholdings on the relevant dates (sec 37(12)) (see chapter 9 at ¶9-100ff for details regarding the carry forward).

A measure reflected in e-Tax Guide 2004/IT/7 dated 21 July 2004, "Assessment of non-trade income and deduction of approved donations on an accounting year basis" was undertaken by the IRAS to reduce taxpayer compliance costs. As part of the measure, entities, including companies, sole-proprietors and partnerships, whose accounting year ends on a date other than 31 December can elect for their donations to be deducted on a preceding accounting year basis beginning from any of the years of assessment 2005 to 2008. The purpose is to avoid the need for such entities for re-computations on a calendar year basis. The election is not revocable. Transitional rules apply for the first year of assessment they elect to go on the new basis. It is also stated in the Guide that from the year of assessment 2009, the deduction of donations on a preceding accounting year basis (as well as the taxation of non-trade income on such basis) will be provided for under the law (chapter 12 of the e-Tax Guide).

Table 3 sets out all the types of donations that qualify for double deduction. Donations before 1 January 2005 with a naming opportunity qualify for single deduction only. From the year of assessment 2006, all donations to institutions of a public character (IPC) and other approved beneficiaries made on or after 1 January 2005, whether or not they involve naming opportunities, will qualify for double deduction.

Table 3: Donations that qualify for double deduction

Type of donation	*Which date does double deduction apply from?*	*Who grants the approval that is required?*	*Other conditions or features*
Cash donations made to the Government or any approved IPC in Singapore (sec 37(3)(c))	From 1 January 2002	Minister or any Central Fund Administrator	The Minister may appoint any IPC to be a Central Fund Administrator for the purposes of approving IPCs and regulating the administration of donations made to an approved IPC (sec 107).
Donation of shares in a company listed on Singapore Exchange (sec 37(3)(e))	From 1 January 2002	Minister or any Central Fund Administrator	See above. Donor must be an individual. The deductible amount is twice the value of the shares or the unit trusts donated.
Donation of units in unit trusts traded in Singapore or listed on Singapore Exchange to any approved IPC in Singapore (sec 37(3)(e)).			• The value of shares and of units in a unit trust traded on Singapore Exchange is their last transacted open-market-price on the date of the legal transfer of the shares or units. • For units in all other unit trusts, the value is their bid price immediately after the date of their legal transfer (sec 37(17)).
Approved donation of any artefact made to an approved museum (sec 37(3)(b))	From 1 January 2002	Minister or his appointee	The deductible amount is twice the value as determined by the Minister or his appointee. The National Heritage Board administers this scheme.
Approved donation of any sculpture for public display outdoors made to an approved recipient that is not an approved museum (sec 37(3)(b)	From 1 July 2003	Minister or his appointee	See above

Type of donation	*Which date does double deduction apply from?*	*Who grants the approval that is required?*	*Other conditions or features*
Approved donation of a computer (including software and peripherals) that is made to a prescribed educational, research or other institution in Singapore (sec 37(3)(d))	From 1 January 2002	Minister or his appointee	Donor must be a company. The deductible amount is twice the value of the computer (including computer software and peripherals) donated. Approved institutions include primary schools and secondary schools, junior colleges, centralised institutes and language centres and other educational and research institutions. See the *Income Tax (Computer Gifts — Educational and Research Institutions) Rules.* From 1 January 2005, approved donations of a computer (including software and peripherals) made to an approved IPC will also qualify for double deduction. Approval may be granted by the Minister, the Comptroller, or the Central Fund Administrator (*Income Tax (Amendment) Act 2005*).
Donation of any immovable property made to any approved IPC (sec 37(3)(f))	From 1 April 2003	Minister or any Central Fund Administrator	The deductible amount is twice the value to be determined by a licensed appraiser and approved by the Chief Valuer. Donors will have the flexibility to decide if they want to donate the sales proceeds of the asset or the asset itself. Both options will give them an equivalent amount of tax deduction.

Donations made before 1 January 2005 that entitle donors to naming opportunities qualify for single deduction only. Section 37(6) provides details of naming opportunity donations:

(a) *Recipient of donation named after an individual*

Where the donation is made while the named donor is alive and is made by him, his immediate family members or any company or organisation related to him.

(b) *Recipient of donation named after an individual donor's family name*

Where the donation is made while the individual donor or any of his siblings with the same family name is alive, and is made by him, his immediate family members, any of his siblings with the same family name or immediate family members of such siblings.

(c) *Recipient of donation named after a company or organisation*

Where the donation is made by the named entity or any person related to the named entity.

(d) *Facility of the recipient of donation named after a person*

Where the donation is made by the named person within a period from two years before to two years after the naming date.

Naming facilities include any building or part thereof or permanent structure, and any scholarship, prize, research fellowship or lectureship (sec 37(18)).

An individual donor's "immediate family member" refers to his spouse, children, parents, grandparents and siblings. A "sibling" is a brother or sister and includes a step-brother or step-sister, or a legally adopted brother or sister. In the case of a related company o, organisation, the determining criterion is the ability to exercise control, directly or indirectly, over the relevant entity (sec 37(18)).

An institution of a public character

Section 2(1) defines "institution of a public character" as an institution or fund in Singapore which is:

- any hospital or public or benevolent institution not operated or conducted for profit;
- public authority or society engaged not operated or conducted for profit that is engaged in research or other work connected with the causes, prevention or cure of diseases in human beings, where the donation is for such activities;
- any university or a public fund for the establishment, maintenance, enlargement or improvement of a university;
- an educational institution not operated or conducted for profit, or a public fund for the establishment, maintenance, enlargement or improvement of such an educational institution;
- a public or private fund for the provision, establishment or endowment of a scholarship, exhibition or prize in a university, or an educational institution not operated or conducted for profit;
- a public fund established and maintained for relief of distress among members of the public;

- a charitable institution or a body of persons or a trust established for charitable purposes only; and
- an organisation not operated or conducted primarily for profit that is engaged in the promotion of culture, arts or sports.

Example 5

The following donations were made by ABC Company during its financial year ended 30.6.05:

Date	*Organisation/Institution**	*Nature of donation*	*Amount* $
1.8.04	Community Chest of Singapore	Cash	500
31.10.04	Nanyang Technological University	10 computers	12,000**
31.12.04	Katong Children's Home	20 beds	2,000
1.2.05	Sunset Home for the Aged	Cash	5,000

* All are approved institutions of a public character.

** Amount, which was twice the value of the computers, has been approved by the Minister.

Allowable donations	*YA 2005*	*YA 2006*
sec 37(3)(c)	$1,000	$10,000
sec 37(3)(d)	$12,000	—