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Brevity and control in the Singapore Income Tax Act in relation to capital allowances upon transfers

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In Singapore, where assets enjoying a capital allowance are sold above their tax-written-down value, a balancing charge may arise.

However, there is an exception in Section 24 of the Income Tax Act (ITA) where the buyer or seller controls the other, or both are under common control.

In *BZZ v Comptroller of Income Tax [2019] SGHC 252*, FCL owned 100 percent of BZZ and of a real estate investment trust (REIT) manager, FCAM. It also held 22 percent of the units in the REIT, FCOT. BMT, an independent licensed trust company, was the REIT's trustee.

BZZ sold a property attracting capital allowances to BMT as trustee of the REIT.

S$48.48m of balancing charges arose, unless Section 24 applied.

The Comptroller of Income Tax (CIT) took the view that Section 24 did not apply and was upheld by the Income Tax Board of Review and now by Choo Han Teck J. in the High Court on 24 Oct 2019.

The case turned on the meaning of "control".

Choo J. is known for the extreme brevity of his judgments.

This was 4 1/2 pages.

This note seeks to briefly summarize the judgment and also to explain why, with great respect, the preference of the learned judge for very brief judgments and eschewing analysis did not quite do justice to the issue and left significant points unanswered.

What is the general test for control in Section 24 and whether common economic/beneficial ownership must be shown?

Choo J. agreed with CIT that Section 24 should apply "... only if the transaction would be as if there were no sale ...", seemingly also approving the CIT's description, in idiomatic terms, that what the section was meant to cover would only be transactions that are merely a transfer "... from the right pocket to the left."

This suggests, firstly, that common economic/beneficial ownership is an essential element of the meaning of control for the purposes of Section 24.

This was not the common law meaning of control in tax cases, or even consonant with the legislative history behind the introduction of Section 24, which CIT had presented before the ITBR.

Before the ITBR, the counsel for CIT explained that Section 24 was adopted from Section 59 of the UK Income Tax Act, 1945. In the UK Act, there was a statutory definition of the word "control" found at Section 68 of the UK Act. This provided that "control", in relation to a body corporate, means:

"... the power of a person to secure, by means of the holding of shares or the possession of voting power in or in relation to that or any other body corporate, or by virtue of any powers conferred by the articles of association or other document regulating that or any other body corporate, that the affairs of the first-mentioned body corporate are conducted in accordance with the wishes of that person…".

It is evident that in the UK Act, the test of "control" is not a test based on economic/beneficial ownership, but on the power to dominate decision-making.

Yet, the ITBR cryptically asserted that:

"The Board takes the view that whilst the statutory definition is not binding, it is persuasive of the meaning of ‘control’ as it was understood in the UK Act. It is in line with the Board’s view that the relationship and level of control must certainly be a close relationship, with a high degree of control."

A substantial string of UK cases on the meaning of "control" in the tax context also do not support the existence of common economic/beneficial ownership as a requirement of the word "control".

For example, in *Inland Revenue Commissioners v J. Bibby & Sons, Ltd [1945] 1 All ER 667*, the House of Lords held that shares in a company were controlled by trustees, rejecting the argument put forward by HMRC that the term "control" connoted some necessary element of beneficial ownership. Lord Simmonds said:

"... Those who by their votes can control the company do not the less control it because they may themselves be amenable to some external control. Theirs

is the control, though in the exercise of it they may be guilty of some breach of obligation whether of conscience or law."

Lord Simmonds went on to give, as one key reason for not accepting an economic/beneficial ownership requirement, the fact that this would create complications:

"... if this argument is to be effective, it is not sufficient to say that the controlling interest lies not with the legal owner, but with the beneficial owner; the next step is to determine who, amidst all the complexities of successive interests, discretionary interests, mortgage and other interests, is for this purpose to be regarded as the beneficial owner. I must decline to admit such an alternative construction which, departing from the plain and simple meaning of familiar words, requires such an unravelling."

Ironically, then, Choo J. defended his common-control-means-there-is-no-transaction theory on the same grounds, saying that if the argument of the taxpayer's counsel were accepted, that would:

"... give rise to a myriad of exceptions that will tax the simple and sensible application of the section."

So, despite the lack of clear judicial analysis, current Singapore law as it emerges from the High Court decision in BZZ would seem indicate that a common economic/beneficial ownership requirement is part of the "control" test under Section 24.

Level of required common economic/beneficial ownership.

But what level of common economic/beneficial ownership is needed?

In the BZZ case, FCL held 22 percent of FCOT and 100 percent of BZZ and it follows as a corollary from the judgment that this level of common economic/beneficial ownership was plainly not enough.

Interestingly, from an accounting perspective, FCT's interest in FCOT, when coupled with its interest in the manager FCAM, was sufficient to give rise to accounting consolidation under IFRS 110 , which is itself also based on a concept of "control".

Paragraph eight of the judgment notes that the taxpayer's counsel had informed the Court that "... the accounts of FCOT are consolidated with those of FCL."

This suggests that the meaning of "control", as used in the relevant accounting standards, does not govern in the context of Section 24.

Next, if the test in the Section 24 context is whether there is economically any transaction at all, or whether the transaction is basically merely a left-pocket-right-pocket transfer, this suggests a very high degree of common economic/beneficial ownership, perhaps 90 percent to 100 percent even.

For example, if two companies have 51 percent common economic/beneficial ownership, can it be said that a transfer of an asset between them is economically not a transaction at all, or merely a "paper" transfer from one pocket to another? Surely the obvious answer is no. A transfer between two companies related by a majority (51 percent or more) common

economic/beneficial ownership has real and substantial economic consequences.

Therefore, is the Court's conclusion on the meaning of "control" in Section 24 right?

In the author's view, and with great respect, it must be very doubtful that the word "control" carries the meaning given in the judgment.

It is not backed by any case authority, it does not accord with the plain meaning of "control", and the judgments of the High Court and the ITBR contain no detailed analysis of the threshold of common economic/beneficial ownership required to give rise to "control".

A more comprehensive resolution, in the author's view, would thus have to await another case.

How should a control test apply when one party is a trustee?

Another interesting question which arose in BZZ is how the "control" test should work in the case where one party acts as a trustee.

Here, again, the very brief judgment of the High Court lacked conspicuous clarity (with great respect), but nonetheless it appears to the author that some insights can be derived.

Given that BMT was not owned or managed by FCL or someone controlled by it, it was clear on the facts that FCL could not control BMT as a corporate entity in a general sense.

However, it would appear that the case wasn't decided on such a simple footing, although there were the odd allusions to it in that the judge (cryptically) observed that:

"Legally, FCL does not control the buyer. The fact that FCL controls FCOT, the beneficiary, is another matter, and that is a crucial break in the chain of control."

"... the fact that FCL indirectly controls the beneficiary does not mean that it controls the trustee buyer, which is a separate legal.

The author was unable to fully grasp the points which the learned judge was pursuing above in speaking of FCT controlling FCOT, but not the trustee, because (1) the REIT itself (i.e., FCOT) is not a legal person and the beneficiaries of the trust are in fact the unitholders, and (2) BZZ's argument appears in fact to have been that FCAM controls the trustee, BMT, in relation to the conduct of its activities as trustee, via its powers as manager under the trust deed; and (3) the judge in the end also denied that FCL controlled FCOT, saying that FCL only had significant influence but not the dominance required to establish control over FCOT.

Some of the words used in the judgment must therefore be taken to have been used casually, rather than with the precision one would might have wished for.

Nevertheless, and albeit with a bit of hesitation and effort, one can ultimately gain some insight into how trustees (and their direct and indirect shareholders) may be treated for the purposes of the control test.

In this regard, it may as a preliminary point be usefully noted that in the BZZ case, the shareholders of the trustees (BMT) were unrelated to the shareholders of BZZ, and the taxpayer's assertion was that control over the trustees could be established via some external means (being in this case the powers of the manager under the trust deed).

However, sometimes the position will be the reverse and the seller and the trustee buyer would have the same shareholders, and the question will be whether the shareholder of the trustee controls the trustee, having regard to the fiduciary duties, which the trustee has to third party unitholders.

So who controls a trustee? The above-cited English cases on control suggest that direct, or facial, control by a trustee is "control", and if this is correct, then one could easily apply the same principle to argue that the control which a shareholder of the trustee has over the trustee—comprising the indirect and ultimate power to appoint all the directors, employees and agents of the trustee—should likewise be enough.

However, it is fair to say that it remains an interesting open question whether this line of analysis would be followed in Singapore.

If these cases are not followed, then it may lead to the result that, unless a person both holds shares in the trustee and all or substantial beneficial interests under the trust, no-one controls the trustee and therefore where assets are acquired under a trust or disposed of by a 'trustee', common 'control' may prove harder to establish.

In the BZZ case, the taxpayer sought to address this difficulty (i.e., of the trustee's fiduciary duties to the unitholder) by relying on the fact that a REIT (in Singapore) does not operate under a single trustee-manager paradigm but instead engages two separate fiduciaries, i.e., the manager and trustee. In a REIT, the manager has primary responsibility for the investments and operations of the REIT, whereas the trustee has 'custodial' and 'safeguarding' functions.

As between the manager and the trustee, it would be true (generally) to say that the manger has a more "active" role in managing the REIT.

Nonetheless, the functions of a REIT trustee are not just that of a bare trustee or a person discharging purely administrative or ministerial functions only, but involve some level of substantive residual discretion. Indeed, the FCOT trust deed provided that the BMT could act if "... “in its absolute discretion, act without or contrary to a direction of the Manager if it considers it necessary to do so”. This was also reflective of the law, e.g. Regulation 8(2)(b)(i) of the Securities and Futures (Offers of Investments)(Collective Investment Schemes) Regulations 2005, which provides that a trustee of a collective investment scheme must "... exercise all due diligence and vigilance in carrying out its functions and duties and in safeguarding the rights and interests of the participants in the scheme".

In BZZ, the taxpayer sought to argue that the trustee could be regarded as subject to the control of the manager, notwithstanding that it was subject to

its own trustee duties at the level of the irreducible core of trusteeship (in accordance with the principle in the case of *Armitage v Nurse [1998] Ch 241*).

Choo J. called the argument "intriguing" but rejected it. The judge's reasoning is, as noted above, a bit obscure, but the judge did observe that:

"... FCL is only a 22.2 percent owner of FCOT. BMT thus has core duties in a much more complex situation, some it may not fully discharge if it is to be constrained to just irreducible core duties."

In the author's view, the reference to the concept of the "irreducible core of trusteeship" by the taxpayer was a red herring on the facts, because it is plainly not the case that a REIT trustee's duties are so limited.

The BZZ case, however, is suggestive that, assuming the direct/facial control test favoured in the English cases is not followed in Singapore and assuming that we are not dealing with trustees whose duties are limited to the irreducible core (which appears to the author to be an uncommon scenario), then it may not be trivial to successfully argue that a shareholder of a trustee controls it, and that the trustee's duties to the beneficiaries can be dismissed as irrelevant.

Does the Section 24 analysis of control apply to other situations e.g. transfer pricing or QDS where the legislation applies a control test?

In BZZ, the term "control" was seemingly given a narrow meaning covering only no-transaction or right-to-left-pocket scenarios.

This favours the CIT.

However, the term "control" is also used in other situations, e.g. there is a definition in Section 13(16) of the ITA which applies for transfer pricing and qualifying debt securities (QDS) purposes.

Would a similar narrow meaning apply?

Doing so would not favour CIT.

It is in the author's view doubtful that a similarly stringent test would apply, although BZZ may suggest that some degree of economic/beneficial ownership requirement would be read into the test in other contexts in the ITA as well.

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