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Tax Alert

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GBG v The Comptroller of Income Tax [2016] SGITBR 2

Issue before the Board

In this case, the sole issue for determination is whether the facility fees incurred by the taxpayer are tax deductible under Section 14(1) and not disallowable as capital expenditure under Section 15(1)(c) of the Singapore Income Tax Act (ITA).

The case did not concern Section 14(1)(a) of the ITA. Under Section 14(1)(a), a sum payable in lieu of interest or for the reduction of interest is deductible if it is prescribed under the stipulated regulations. To qualify for deduction under Section 14(1)(a), the expense must be payable "upon any money borrowed" and the Comptroller of Income Tax (CIT) must be satisfied that such sum is payable on "capital employed in acquiring the income". There is no money borrowed in this case. The facility fees were paid to the banks for access to funding, should the need arise.

Facts of the case

The Appellant (i.e. the taxpayer) is a Singapore incorporated company which carries on the business of ship and rig repair, building and conversion.

In 2009, the Appellant entered into 3 facility agreements (Facilities) - one of which was to fund capital expenditure and general working capital requirements; another was for general corporate funding; and the third was to serve as standby funds to finance any funding shortfall for the Appellant's yard expansion project. It may be noted that the Facilities were entered into following the onset of the Global Financial Crisis in 2008.

Under the terms of each of the Facilities, front end fees and facility fees (collectively referred to as "Facility Fees" in this document) were paid in order to commit the Facilities obtained from the banks. In consideration of the Facility Fees, the banks would commit the Facilities for availability periods ranging from 1 to about 3 years. However, the Appellant did not draw down on the Facilities during the respective availability period. No monies were borrowed by the Appellant from the lenders pursuant to the Facilities.

Appellant’s contention

The Appellant claimed tax deductions for the Facility Fees against its income for the Year of Assessment 2010. The claim was on the bases that

(1) the Facility Fees were tax deductible under Section 14(1) of the ITA as they were paid for the purposes of the Appellant’s business “looked at as a whole set of operations directed toward producing income”.

(2) the Facility Fees should not be prohibited from tax deduction under Section 15(1)(c) of ITA as they were not incurred for the various capital purposes. The Facility Fees did not create a new asset. They did not strengthen an existing asset. They did not open new fields of trading. Neither did they strengthen nor did they add to the Appellant’s existing core business structure. The Facility Fees were merely business expenses that provided the Appellant with the benefit of being able to draw down on the Facilities for short availability periods of 1 to 3 years, and enabled the Appellant to preserve its business and carry on its existing trade.

More importantly, the Appellant argued that the test in *IA* [2006] 4 SLR(R) 161*, BFC* [2014] 4 SLR 33 *and T Ltd v Comptroller of Income Tax* [2006] 2 SLR(R) 618 should not be applicable in the Appeal as there was no loan in existence and the Facility Fees were not in the nature of “borrowing expenses” (as was in the case of *IA*).

In gist, the Appellant has argued that since there was no loan and no interest payments, one could not look at the purpose of the loan as in the other cases, to determine whether the expenditure is capital or revenue in nature. Fundamentally, one has to look at the purpose of the expenditure of the Facilities Fees in this case. The purpose of the Facilities Fees was to secure the benefit of access to the bank facilities which endured for periods ranging from 1 to 3 years. The short duration of the benefit could not be said to characterise the benefit as “enduring benefit”. On that argument, the Facility Fees could not be said to be capital in nature, and should qualify for deduction under Section 14(1) of the Income Tax Act.

CIT’s contention

The CIT disallowed the claim, on the bases that the Facilities Fees did not meet the requirements for tax deductibility under Section 14(1) as they provided an enduring benefit to the Appellant and had no nexus with the Appellant’s income. The CIT also contended that the Facilities Fees were borrowing costs of the Facilities established to fund capital purposes and should therefore be disallowable under Section 15(1)(c). In this respect, the principles in *IA* should apply to the case for the following reasons:

a. *IA* does not require a complete draw down of the facilities in order for facility fees to be borrowing expenses.

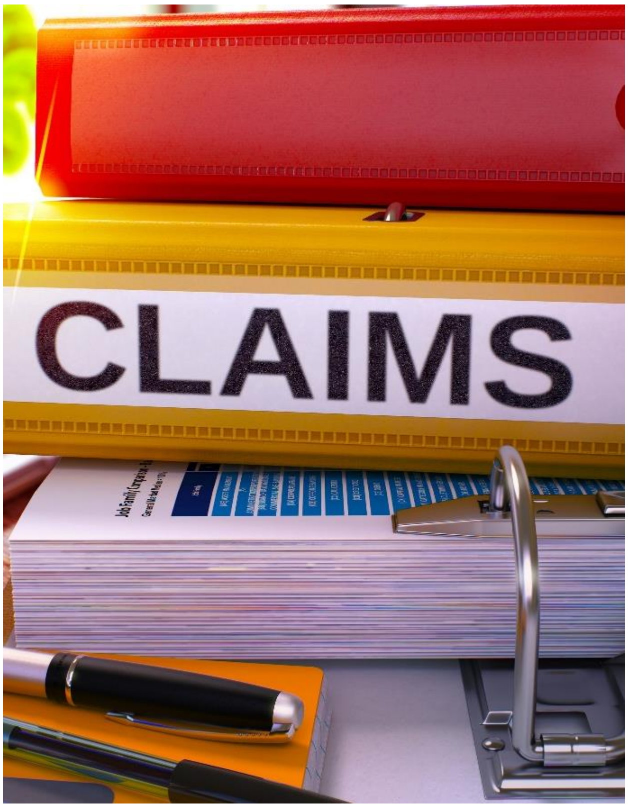
b. The Facilities Fees were incurred in order to obtain the Facilities. They owe their existence to the Facility and derive their capital or revenue nature from the nature of the Facility.

c. The test in *IA* is to examine the purpose of the facility at the time the facility was entered into to determine whether the facility is capital or revenue nature.

Judgment of the Board

The Board stated that Section 14(1) does not depend on whether there was any “money borrowed”. The question for tax deductibility under Section 14(1) is only where the expenses were “wholly and exclusively incurred” “in the production of the income”.

In addition, the Board concluded that there is no necessity for a draw down of the facilities in order for the facility fees to be borrowing expenses.



The Board commented that the Facility Fees in this case were not different in character to that in *IA*. The facts of *IA* indicated that there was no complete draw down of the facility undertaken. Therefore, there is no basis to read into *IA* the requirement that the facility has to be drawn down in order for the facility fees to be considered as borrowing expense.

The Board emphasised that in *IA*, the court did not apportion the facility fee into borrowing expenses and non-borrowing expenses. Instead, the court regarded the entire sum of facility fees payable as borrowing expenses in *IA*. The Board commented that any other results would have been illogical because it would mean that the character of the facility fees would depend on how much the facility has been drawn down. According to the Board, it is *"wholly untenable that the applicability of case law should be decided in such an unprincipled manner"*.

Applying the framework in *IA*, the Board examined the purpose for which the Appellant entered into the three facility agreements. The Board commented that a facility brings to the borrower certainty in the form of a guaranteed source of funds. The Facility Fees were necessary to procure a committed facility and therefore they owe their very existence to the Facilities and derive their capital or revenue nature from the nature of the Facilities.

The general principle is that borrowing by business must prima facie be treated as augmenting the capital structure of the business (and therefore capital in nature), unless the borrowing was for specific revenue purposes such as for the purpose of trading stock. For this case, the stated purposes of the Facilities were for general corporate funding, to fund capital expenditure and general working capital requirements. None of these were specifically revenue purposes.

The Board also did not find any clear change in purpose of the Facilities.

The Board went on to elaborate that, even if an assumption was made that *IA* does not apply to the case on hand, the Facility Fees would still not qualify for tax deduction under Section 14(1). The purpose of the Facility Fees at the outset was to procure for the Appellant the Facilities to strengthen its capital structure. The payment of the Facility Fees at the outset grants the Appellant the once-and-for-all right to draw down on the banks' committed funds during the availability period. The consequence of the Facility Fees is that it procured for the Appellant the option to tap on the funds. The access to a pool of funds for financing of working capital requirements and general corporate funding is clearly an enhancement of the Appellant's general capital funding.

On the Appellant's argument that the Facility Fees were revenue in nature and ought to be tax deductible because they were incurred for the purpose of preserving its existing business or to overcome obstacles or difficulties that would prevent the Appellant from carrying on its existing business, the Board commented that even if the Facility Fees could be said to be expenses incurred to protect the Appellant's business and its assets, such expense have been held to be capital in nature.

For an expense to qualify for tax deduction as expenditure incurred for the preservation of business, there is a very high threshold to cross. The obstacle or difficulty must either be "impeding or threatening to impede the Appellant's existing business, or an "impending 'catastrophic event'". Based on the facts of the case, the Facility Fees were not incurred to save the Appellant from an imminent collapse or a catastrophic event.

For this case, the Board concluded that the claim for tax deduction of the Facility Fees must be disallowed, as they were capital expenditure and prohibited from tax deduction under meaning of Section 15(1)(c) of ITA.

Our Comments

This case has reinforced the principles of judgments in the earlier cases [such as *IA, BFC and ABD*] on tax deductibility of borrowing costs. It has also provided clarity on the application of the related framework and guidelines set out in those cases in determining the underlying nature of the borrowing costs. An important emphasis that came out from this case is the specific clarification, that there is no requirement for loan facility to be drawn down in order for the related facility fees payable to be regarded as borrowing costs, for purposes of determining tax deductibility under Section 14(1) and Section 15(1)(c) of ITA.

However, from the practical and business point of view, the Facilities Fees may be seen as a premium payment for a short-term assurance (ranging from 1 to 3 years) that funds may be made available when required, so as to be deductible. Such practical and business perspectives can legitimately be taken into account in considering a deduction under section 14(1). In this regard, Dixon J, in the Australian case of *Hallstroms Proprietary Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634, said at page 648:

> *" What is an outgoing of capital and what is an outgoing of revenue depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of legal rights, if any, secured, employed or exhausted in the process."*

Likewise, in the Privy Council case of *Commissioner of Inland Revenue v Lo & Lo* [1984] 1 WLR 986 (on appeal from Hong Kong), Lord Brightman said at page 991:

> *" In the opinion of their Lordships, commercial considerations are not wholly to be disregarded in the course of this process [of determining whether an expense is deductible or not]. They are relevant for the purpose of deciding what can properly be treated as "outgoings and expenses ... incurred during the basis period ... in the production of profits in respect of which ..." the taxpayer is chargeable to tax."*

How we can help

As your committed tax advisor, we welcome any opportunity to discuss relevance of the case to your business and transactions.

Contact us

Chiu Wu Hong
Head of Tax
T: +65 6213 2569
E: wchiu@kpmg.com.sg

Toh Boon Ngee
Partner, Tax
T: +65 6213 2052
E: btoh@kpmg.com.sg

Leung Yew Kwong
Principal Consultant, Tax
T: +65 6213 2877
E: yewkwongleung@kpmg.com.sg

KPMG
16 Raffles Quay
#22-00 Hong Leong Building
Singapore 048581
T: +65 6213 3388
F: +65 6227 1297
E: tax@kpmg.com.sg

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