IN THE HIGH COURT OF THE REPUBLIC OF SINGAPORE

[1994] SGHC 241

DA 68/1993

Between

Andermatt Investments Pte Ltd

… *Appellant*

And

Comptroller of Income Tax

… *Respondent*

GROUNDS OF DECISION

Revenue Law — Income taxation — Deduction

Version No 1: 29 Oct 2026 (23:45 hrs)

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Andermatt Investments Pte Ltd v Comptroller of Income Tax

[1994] SGHC 241

DA 68/1993
Lim Teong Qwee JC
27 September 1994

1 Cur Adv Vult

2 This is an appeal against the decision of the Board of Review given on 19 August 1993 dismissing the taxpayer`s appeal against the assessment of the Comptroller by notice of additional assessment dated 16 August 1991 for the year of assessment 1989. The facts are agreed and those relevant to this appeal are summarized below:

> (1) The taxpayer, Andermatt Investments Pte Ltd, was incorporated on 28 November 1987 for the purpose of carrying on the business of investment holding including, inter alia, the owning and leasing out of the property at 1 Jalan Remaja (`the Hillview property`).
>
> (2) The Hillview property was originally held by Wan Holdings Pte Ltd (`Wan Holdings`), a company carrying on the business of investment holding. The Hillview property was acquired and constructed by Wan Holdings at a cost of $3,446,630. Wan Holdings obtained a bank overdraft to finance the construction of the Hillview property. The construction of the Hillview property was completed in 1977 and revalued in 1987 to $8.5m. The bank overdraft which was used to finance the construction of the Hillview property was repaid by Wan Holdings in March 1981. At all material times the property was earning rental income.

(3) On 8 December 1987, the taxpayer purchased all the issued shares of Wan Holdings from the shareholders of Wan Holdings at a consideration of $20,000,030 and the taxpayer became the holding company of Wan Holdings.

(4) Both the taxpayer and Wan Holdings are (or were as the case may be) owned by the same members of the Wan family.

(5) $1m of the purchase consideration was paid by the taxpayer from its paid-up share capital of $1m. The remaining purchase consideration of $19,000,030 stood as a debt owing by the taxpayer to the vendors.

(6) On 31 December 1987, the taxpayer, as the sole shareholder of Wan Holdings, passed the requisite resolutions to initiate the winding up of Wan Holdings by way of a members` voluntary winding up and to appoint liquidators forthwith.

(7) On 8 February 1988, the taxpayer obtained an overdraft facility of $6m from the Oversea-Chinese Banking Corp Ltd (`OCBC`). $5.8m of this facility was drawn down by the taxpayer to satisfy part of the remaining purchase consideration as follows:

(a) $2.8m on 23 May 1988;

(b) $1m on 31 May 1988; and

(c) $2m on 30 June 1988.

(8) The Hillview property was distributed by the liquidators of Wan Holdings to the taxpayer on 31 March 1988 as a return of capital in specie.

(9) In the financial period from 28 November 1987 to 31 December 1988, the taxpayer derived dividend income of $4,620,007 from its holding of the Wan Holdings shares. This was received by the taxpayer on 5 January 1988. In the same financial period the taxpayer also derived rental income from the Hillview property in the amount of $599,845.54. Other than the rental and dividend income stated above, the taxpayer did not derive any other income during the said financial period.

(10) In the same financial period the taxpayer incurred interest costs on the $5.8m drawn down on the OCBC facility of $201,172.

(11) The taxpayer, through its tax agents, Boon Suan Lee & Co, submitted a tax computation of the taxpayer`s income tax liability for the year of assessment 1989 in which the interest costs of $201,172 were claimed as a deduction against its trading income from the business of investment holding.

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> (12) By notice of additional assessment No 20-0078762-5 dated 16 August 1991, the Comptroller of Income Tax assessed the taxpayer for the year of assessment 1989 to additional tax in the sum of $62,173.35 on the basis of the interest deduction of $201,172 being not allowable.

3 The notice of additional assessment is an agreed document and it shows that the dividend income of $4,620,007 has been treated as income in respect of dividends and the rental income has been treated as income in respect of gains or profits from trade. The Board of Review confirmed the assessment and in the petition of appeal the taxpayer contends that the interest on the bank overdraft ought to be allowed as a deduction under s 14(1) or s 14(1)(a) of the Income Tax Act (Cap 134, 1994 Ed).

4 Section 14 provides:

> *(1) 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 -*
>
> (a) except as hereinafter provided, any sum payable by way of interest upon any money borrowed by that person where the Comptroller is satisfied that the interest was payable on capital employed in acquiring the income;

5 At the hearing, Mr Gandhi said that he was proceeding under s 14(1)(a) only. His case is that the interest was payable on money borrowed by the taxpayer from the bank (as to which there is no dispute) and that such interest was payable on capital employed in acquiring the income. He submitted that the expression `where the Comptroller is satisfied` did not give him the administrative discretion to decide a substantive issue of law under the Act. This is not one of the grounds of appeal but it is a question of law which may affect the determination of this appeal. Mrs Ang did not take objection to the point being argued but applied for and I granted leave to the Comptroller to support

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the Board`s decision on the ground that on the information provided to him by the taxpayer he was not satisfied that the interest was payable on capital employed in acquiring the income.

6 **Relation between income and money borrowed**

7 Mr Gandhi conceded that for the interest to be deductible under s 14(1)(a) there has to be some link between the rent income and the money borrowed. He referred to where executors withheld realization of income producing assets in view of the depression and borrowed from the bank to pay estate duties and debts of the estate. The executors claimed a deduction from the income for interest paid on the bank borrowing. Section 23 of the Income Tax Assessment Act 1922-1934 (Australia) provides:

> *(1) In calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer shall be taken as a basis, and from it there shall be deducted -*
>
> (a) all losses and outgoings … actually incurred in gaining or producing the assessable income."

8 Reed AJ, in a judgment allowing the deduction, said at p 270:

> *Whatever may be the proper view (and I do not wish to be understood as attempting to lay down an exhaustive test) I am of opinion that I can in this case say that there is a real and substantial relation between the payment of the interest to the banks and the production of the income. Indeed, the relationship is so close that it can be said that if the loans had not been arranged, and the interest had not been paid, the assessable income would not have been nearly so much as it is.*

9 Mr Gandhi submitted that there was a sufficient relationship between the payment of interest on the money borrowed from the bank and the rent income. He said the bank borrowing enabled the Hillview property to be acquired.

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10 In , the taxpayer owned freehold land on which certain buildings were erected and leased to tenants. With the object of starting another business he caused a company to be incorporated and borrowed from his bank to pay for shares in the company and to make advances to it. The land was mortgaged as security. He claimed a deduction for the interest paid on such borrowing. He failed. In the High Court of Australia, Knox CJ said at p 171:

> *In this case the assessable income of the taxpayer was in no way referable to the transaction with the bank out of which the liability to pay interest arose, and the loan by the bank was in no way instrumental in or conducive to the production of the assessable income or that part of it which consisted of the rents of the freehold property. The respondent was, before the mortgage was given, entitled to the whole of these rents, and he did not gain them nor were they produced in consequence of the payment of interest.*

11 Isaacs J said at p 197:

> *It is said for the respondent that, since it was necessary to pay the interest if the taxpayer wished to retain his right to have the income from the property, it was interest by which that income was gained or produced. I am not able to accept that view. The taxpayer had already acquired and held his property as a rent-producing property to the full extent.*

12 Higgins, Rich and Starke JJ concurred. With respect, I agree with Hill J in , at p 4389 that there may be thought to be some difficulties in reconciling what was said in ***Begg`s*** case1 with the decision in ***Munro`s*** case2. While much of the income of the estate in ***Begg`s*** case1 might have been lost if the executors had not borrowed from the bank, it is difficult to see that such income was gained or produced by incurring the interest. The executors were already entitled to the whole of the income before the bank borrowing and they did not gain it nor was it produced in consequence of incurring the interest.

13 In ***Munro`s*** case2, Knox CJ went on to say at p 171:

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> *The debt having been incurred for a purpose wholly unconnected with the production of assessable income of the respondent, I think it impossible to say that the interest paid on the amount of the debt was money wholly and exclusively laid out or expended for the production of his assessable income.*

14 The court applied what may conveniently be called the purpose of the loan test and in , Hill J said at p 4545:

> *In determining deductibility under s 51(1), reliance on the tests both of purpose of the borrowing and of application of the funds present difficulty.*

15 and later at the same page:

> *This is not to say that tests such as the purpose of the borrowing or the use and application of the borrowed funds are irrelevant. Rather, they are tools to assist in the resolution of what is essentially a question of fact. To be deductible the outgoing, or in a case of apportionment a part of an indivisible outgoing, must be seen to be incidental and relevant to the activity which is directed to the gaining or production of assessable income.*

16 Section 51(1) of the Income Tax Assessment Act 1936-1972 (Australia) provides:

> *All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income.*

17 See also . In Latham CJ; Rich, Dixon, McTiernan and Webb JJ said at pp 56-57:

> *For expenditure to form an allowable deduction as an outgoing incurred in gaining or producing the assessable income it must be incidental and relevant to that end. The words `incurred in gaining or producing the assessable income` mean in the course of gaining or producing such income. ...*

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18 In brief substance, to come within the initial part of the subsection it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income.

19 See also ***Robert`s*** case3 and ***Smith`s*** case3 where Hill J said at p 4386:

> *... what is involved is a process of identifying the essential character of the expenditure to determine whether it is in truth an outgoing incurred in gaining or producing the assessable income ... The expenditure must have the necessary connection with the operations or activities which more directly gain or produce assessable income so as to meet the statutory criterion that the outgoing be incurred in gaining or producing the assessable income ...*

20 I am unable to see that it is helpful in determining the question of deductibility in the Australian context to place reliance on a real and substantial relation between the outgoing and the production or gaining of the assessable income. There must clearly be a relation and whether it be real and substantial or not the outgoing has to be `incidental and relevant` to gaining or producing the assessable income and what may be involved in the determination of this question may be `a process of identifying the essential character of the expenditure` or outgoing. That is the question to be determined under the provisions of the Australian legislation. The question before me arises under the Income Tax Act (Cap 134, 1994 Ed)(`the Act`). Even if the Australian decisions are helpful there would be serious difficulties in the taxpayer`s way. When the OCBC loan was drawn down the Hillview property had already been distributed to the taxpayer. It was already an asset of the taxpayer and the taxpayer was already entitled to the rent. The interest was not incidental or relevant to acquiring the rent income. The rent income was not acquired in consequence of the payment of interest.

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21 I turn now to s 14(1)(a) of the Act as I must. The interest was payable upon money borrowed by the taxpayer. This is not in dispute but the deductibility is subject to a further condition. The Comptroller has to be satisfied that the interest was payable on ***capital employed in acquiring the income*** . While I accept that for the interest to be deductible from the rent income some relationship between the rent income and the money borrowed may be necessary I do not agree that any relationship, however substantial, is necessarily sufficient. There has to be a particular kind of relationship. The link is that provided in s 14(1)(a). To be deductible the interest must be payable on ***capital employed in acquiring*** and in acquiring ***the*** income and not just ***income*** or ***any*** income.

22 **The income**

23 Mr Gandhi submitted that `the income` in s 14(1)(a) meant the taxpayer`s assessable income generally and not any specific income or the income of the year in which the expenditure was incurred. The `assessable income` is the remainder of the `statutory income` after deductions under Pt VI of the Act such as losses in trade in prior years and approved gifts and the `statutory income` is the full amount of the income for the basis period from each source of income. See ss 35 and 37. If as in the present case the taxpayer has an income of $428,630 (which includes the net amount of the rent received in respect of the Hillview property) in respect of profits from trade and an income of $4,620,007 (from the shares in Wan Holdings) in respect of dividends for the year of assessment 1989, then the statutory income is the total of $5,048,637 and, since there are in this case no deductions under Pt VI, that would also be the assessable income. For completeness I should mention that under s 38 the `chargeable income` is the remainder of the assessable income after the deductions allowed under Pt VII which are largely of a personal nature

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and under s 42 tax is levied upon the chargeable income in accordance with the prescribed rates.

24 Section 10(1) of the Act provides:

> *Income tax shall ... be payable ... upon the income of any person ... in respect of -*
>
> *(a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised;*
>
> (b) gains or profits from any employment;
>
> (c) (Deleted by Act 29/65).
>
> (d) dividends, interest or discounts;
>
> (e) any pension, charge or annuity;
>
> (f) rents, royalties, premiums and any other profits arising from property;
>
> (g) any gains or profits of an income nature not falling within any of the preceding paragraphs.

25 The statutory income of any person in respect of which tax is payable is the aggregate of the income from each of the sources defined. Under s 14, to ascertain the income from any source certain outgoings and expenses are deducted. These outgoings and expenses include interest on money borrowed where the Comptroller is satisfied that it is payable on capital employed in acquiring `the income`. `The income` in Pt IV of the Act which includes s 14(1)(a) is `the income ... for any period from any source` for the purpose of ascertaining which the interest is to be deducted. The opening words of s 14(1) expressly say so in terms which leave no room for any doubt. The expression `the income` in s 14(1)(a) refers to the income from a specific source for a specific period which is to be ascertained and not the total income from all sources for that period. It refers to income from that source for that period in acquiring which such capital has been employed. What s 14(1)(a) provides is

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that the interest on such capital is to be deducted from income from that source and not any income or the assessable income. Where the interest exceeds the income from that source the excess is not available as a deduction from income from another source. By way of illustration, if in a year of assessment a taxpayer had an income of $100,000 in respect of gains from his employment and paid $10,000 as interest on money borrowed to buy securities from which he received an income of $9,000 in respect of dividends, the interest is deducted from the income in respect of dividends and the excess of $1,000 of interest cannot be deducted from his income in respect of gains from employment. His statutory income is $100,000 and not $99,000.

26 Mrs Ang found a case in point and she referred to where the taxpayer paid interest on money borrowed to purchase shares in a company. He received no dividends or other income in respect of these shares. His only income was from his employment. He claimed a deduction for the interest paid from his gross income. Section 8(1) of the Income Tax Law 1954 (Jamaica) provides:

> *For the purpose of ascertaining the chargeable income of any person, there shall be deducted all disbursements and expenses wholly and exclusively incurred by such person in acquiring the income - ...*
>
> *and such disbursements and expenses may include -*
>
> (a) any sum paid by such person by way of interest upon any money borrowed by him where the Commissioner is satisfied that the interest was paid on capital employed in acquiring the income ...

27 `Chargeable income` is defined in s 2 as:

> *... the aggregate amount of income of any person from all sources remaining after allowing the appropriate deductions and exemptions under this Law.*

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28 The statute also sets out in s 5 the various sources of income upon which tax is levied including gains from employment and dividends among others. See p 183. Marsh J said at p 184:

> *... because of the division of income into sources, this concept of searching for the true or net income, is applied in turn to each separate source of income set out in s 5, from which an income accrues in a given year. Thus, where the source is a trade, all deductions appropriate to that source are to be allowed so as to establish the taxable quantum of income from that source.*

29 I think this case lends some support for the conclusion I have reached. However, it is not entirely desirable to do so as the question of deductibility in the case before me has to be considered by reference to the provisions of the Act which are not exactly in pari materia. In ***Thwiate`s*** case7, the court had to consider what were `appropriate` deductions for the purpose of the definition of `chargeable income`.

30 Although the bank overdraft facility was arranged in February 1988 the drawdowns were in May and June 1988 and interest only became payable then. By this time the Hillview property had been transferred to the taxpayer and the taxpayer was already entitled to the rent. The money borrowed from the bank was used by the taxpayer to pay part of the debt due to the vendors of the Wan Holdings shares. So the bank borrowing was employed in discharging an existing debt. It is apparent that it was not employed in acquiring the Wan Holdings shares and the income in respect of dividends nor was it employed in acquiring the Hillview property and the income in respect of profits from trade from the rent received but Mr Gandhi has an alternative argument. He said that the original asset that was acquired, namely, the holding of Wan Holdings shares has been substituted by the Hillview property (and partly cash) on a distribution in specie in a liquidation and the acquisition which was originally

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financed by deferred payment or a debt due to the vendors has been refinanced by the bank borrowing.

31 **Substitution**

32 Mr Gandhi gave an example of a company undergoing reconstruction resulting in the original shares in the company held by a taxpayer being substituted by shares in another company or other assets but was unable to direct my attention to any authorities on the point. It is an attractive argument but there is a serious difficulty with it. What is deductible under s 14(1)(a) is interest on capital employed in acquiring the income and not the asset from which income is derived. The original asset acquired by the taxpayer was a holding of shares. The income so acquired was income in respect of dividends under s 10(1)(d). The income from this source ceased when Wan Holdings went into liquidation. The substitution of the Hillview property for the shares did not have the effect of continuing the income in respect of dividends. By acquiring the Hillview property the taxpayer acquired income in respect of profits from trade under s 10(1)(a) from the rent received. The substitution of asset in this case has resulted in the original source of income coming to an end and the commencement of a new source of income and the interest on capital employed in acquiring income in respect of profits from trade cannot be deducted from income in respect of dividends nor vice versa. I have not considered whether the debt owing to the vendors of the shares or the money representing such debt or the bank borrowing is `capital` for the purpose of s 14(1)(a) as I have heard no argument on this and in the view I have taken it is unnecessary to come to a decision on this. But see where interest on unpaid balance of purchase price of an income producing asset was held to be deductible under the provision similar to s 14(1) but not under the provision similar to s 14(1)(a) presumably on the ground that no money was in fact borrowed.

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33 **Refinance**

34 Mr Gandhi referred to ` case3 and `s case3. The taxpayer was one of the partners in a firm of solicitors. The partnership borrowed $125,000 from a bank. The purpose of the borrowing was to allow each of the then five partners (which included the taxpayer) to withdraw $25,000 from the bank account thereby reducing the net worth of each partner`s interest. This meant that new partners could buy into the partnership at a reduced cost. The taxpayer claimed a deduction in respect of the interest on the bank loan. Hill J (Jenkinson and O`Loughlin JJ agreeing) said at p 4388:

> *The funds to be withdrawn in such a case were employed in the partnership business; the borrowing replaces those funds and the interest incurred on the borrowing will meet the statutory description of interest incurred in the gaining or production by the partnership of assessable income.*

35 In principle, such a case is no different from the borrowing from one bank to repay working capital originally borrowed from another; the character of the refinancing takes on the same character as the original borrowing and gives to the interest incurred the character of a working expense. Both these cases would equally satisfy the second limb of s 51(1).

36 It will be recalled that under s 51(1) of the Australian legislation losses and outgoings are deductible to the extent that they are (1) incurred in gaining or producing the assessable income or (2) necessarily incurred in carrying on a business for the purpose of gaining or producing such income. was also referred to. In that case the taxpayers had contributed money to the purchase of real estate in the names of members of the family and themselves in circumstances giving rise to the creation of a partnership. The partnership borrowed money at interest and the money was used to repay the taxpayers` original advance. Davies J said at p 4205:

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> *... the funds borrowed from Ozanu Pty Ltd were respresented in the properties owned and leased by the partnership. Therefore, in my opinion, the loan funds should be regarded as having been invested in those properties. As the properties were income earning assets, the conclusion follows, in my opinion, that the moneys are to be regarded as laid out for the purpose of gaining assessable income.*

37 In ***Smith`s*** case3 the court remitted it to the Tribunal to determine if and to what extent funds withdrawn had been employed in the partnership business. In ***Yeung`s*** case9 the original advance had been employed in gaining or producing the income or in carrying on the business for that purpose. In both cases the interest was held to be deductible if the money borrowed replaced the original funds employed in the same business. The facts in the case before me are different. The original financing by means of deferred payment was employed in acquiring income in respect of dividends. The financing by means of bank borrowing was not so employed. There was nothing left to refinance. Income in respect of dividends had ceased before the money was borrowed and even before the banking facility was arranged. It was not a case of refinancing in regard to income in respect of dividends. The money borrowed did not replace original funds employed in acquiring income in respect of profits from trade. The trade commenced when the Hillview property was transferred to the taxpayer. No funds were originally employed in the trade. There were no original funds to be replaced by the borrowed money. There was no refinancing in any sense in regard to income in respect of profits from trade from the Hillview property rent.

38 I have been referred to a number of cases from some other jurisdictions but I do not think that they are particularly helpful in this case. The issue is one that arises under s 14(1)(a) of the Act. In my judgment the Board was right in dismissing the taxpayer`s appeal against the assessment of the Comptroller. The Board was not in error in holding that the link between the rent income derived

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from the Hillview property and the bank overdraft was too tenuous and remote or in holding that the link between capital employed and the acquisition of income was at best tenuous as alleged in paras 4(2)(a) and (c) of the petition of appeal. The Board was not in error in holding that the taxpayer`s trade was the letting of the Hillview property and not the mortgaging of it as alleged in para 4(2)(b). There is no substance in any of the other grounds of appeal. On the information provided by the taxpayer to the Comptroller as appears from the record of appeal the interest on the bank overdraft was not payable on capital employed in acquiring the income in respect of dividends or the income in respect of profits from trade from the Hillview property rent and he could not have been satisfied that it was so payable. In the result the taxpayer`s appeal is dismissed with costs and there will be an order that the deposit be paid to the Comptroller. The assessment by notice of additional assessment dated 16 August 1991 for the year of assessment 1989 is confirmed.

Lim Teong Qwee JC

Nand Singh Gandhi (Nand Singh Gandi & Co) for the appellant
Ang Su-Lin, Tan Kay Kheng and Julia Mohamed (Inland Revenue Authority of Singapore) for the respondent

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