

# **IRAS e-Tax Guide**

## **Pioneer Incentive: Tax Treatment of Gains and Losses from a Separate Trade (Second Edition)**



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# **Pioneer Incentive: Tax Treatment of Gains and Losses from a Separate Trade**

## **1 Aim**

- 1.1 This e-Tax Guide provides guidelines on the tax treatment of gains and losses from the separate trade carried on by a pioneer enterprise or a pioneer service company<sup>1</sup>.
- 1.2 It is relevant to all businesses that are awarded the pioneer or pioneer service incentive by the Minister for Trade and Industry.

## **2 At a Glance**

- 2.1 Where a pioneer enterprise or a pioneer service company carries on a separate trade, it is required to:
  - (a) Set-off losses arising from the separate trade in any accounting period against the pioneer income for that same period.
  - (b) Deem adjusted profit of the separate trade to be 5% of the gross revenue of the separate trade if it is less than 5% in any accounting period.
- 2.2 The above requirements may however be waived in certain situations set out in paragraphs 6 and 7.

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<sup>1</sup> This e-Tax guide replaces the IRAS' e-tax Guide on "Tax treatment of the gains and losses from the separate trade of a pioneer enterprise" published on 02 Nov 1993

### **3 Glossary**

#### **3.1 Pioneer trade**

Pioneer trade refers to the trade for which a company has been approved as a pioneer enterprise or pioneer service company. The pioneer or pioneer service trade will be set out in the Letter of Offer for the incentive.

#### **3.2 Pioneer income or loss**

Pioneer income or loss refers to income or losses derived by the company from the pioneer or pioneer service trade.

#### **3.3 Separate trade**

Separate trade means any trade or business other than the pioneer trade carried on by the company.

#### **3.4 Adjusted profit**

Adjusted profit refers to the company's profits after all tax adjustments and before deduction of capital allowances, losses and donations.

## **4 Background**

- 4.1 Under sections 5(2) and 17(2) of the Economic Expansion Incentives (Relief from Income Tax) Act ("EEIA"), the Minister for Trade and Industry may approve any qualifying company to be a pioneer enterprise or pioneer service company. Upon approval, the company will enjoy a tax relief period not exceeding 15 years. During the tax relief period, income derived by the company from the pioneer trade will be exempt from tax.
- 4.2 In cases where the company carries on separate trades, it would need to maintain separate accounts for each separate trade.
- 4.3 As the tax exemption is only granted for the pioneer trade and not the separate trades, the company is required to classify separately in its tax computation the income and expenses relating to the pioneer and separate trades. The company must also ensure that the income and expenses have been properly identified to the pioneer and separate trades.
- 4.4 Special rules would apply to the computation of pioneer income where separate trades are carried on. These rules are explained in paragraph 5.

## **5 Special Rules Applicable**

- 5.1 Section 8(2) of the EEIA provides that where the carrying on of a separate trade results in a loss in any accounting period, the pioneer income for that period shall be reduced by the loss. This requirement may, however, be waived if the Comptroller is satisfied that the loss was not incurred for the purpose of obtaining a tax advantage.
- 5.2 Section 8(3) provides that where the separate trade results in an adjusted profit in any accounting period which is less than 5% of the gross revenue, the adjusted profit shall be deemed to be 5% of the gross revenue. The pioneer income shall also be reduced accordingly. The Comptroller may however, accept a lower profit margin.
- 5.3 Sections 8(2) and 8(3) are not applicable to a company whose separate trade is considered by the Comptroller to be subordinate and incidental to the carrying on of the pioneer trade. In such cases, the income or loss arising from the separate trade shall be deemed to form part of the pioneer income or loss.

## **6 Waiver of Section 8(2) Requirement**

- 6.1 The loss from the separate trade may be considered as not incurred for the purpose of obtaining a tax advantage in certain circumstances. These include:
- (a) where the loss incurred was due to depressed sale prices arising from recession, poor market conditions, exceptionally strong competition and substandard products;
  - (b) where the extent of the loss is reasonable, and :
    - (i) direct expenses have been properly charged to both the pioneer and separate trades; and
    - (ii) appropriate and reasonable bases are used in apportioning indirect expenses between the pioneer and separate trades;
  - (c) where the separate trade was already in a loss position before the commencement of the pioneer trade.
- 6.2 If the company satisfies the above conditions, the Comptroller may waive the section 8(2) requirement.

## **7 Waiver of Section 8(3) Requirement**

- 7.1 Depending on the merits of each case, the Comptroller may accept a profit margin of less than 5% of gross revenue of the separate trade and waive the section 8(3) requirement. A number of factors are considered and they include:
- (a) importance of the separate trade to the company;
  - (b) size of turnover of the separate trade;
  - (c) whether the separate trade is a new or established activity;
  - (d) profit margins of the separate trade in the past;
  - (e) whether profit margins of the separate trade follow market trends for that industry.

## **8 Administrative Procedure**

- 8.1 A company need not apply to the Comptroller for waiver of the sections 8(2) or 8(3) requirements. Nonetheless, the onus of proof that income and expenses had been properly classified between the different trades and that any loss from the separate trade was not incurred for a tax advantage rest solely with the company.
- 8.2 The company should state clearly the basis for not applying sections 8(2) and 8(3) in its tax computation. While there is no need to furnish any supporting documents with the tax returns, companies should retain adequate supporting documents and provide them to IRAS upon request.

## **9 Contact Information**

- 9.1 If you have any enquiries or need clarification on this e-Tax Guide, please contact IRAS at 1800 356 8622.



## 10 Updates and Amendments

	<b>Date of amendment</b>	<b>Amendments made</b>
1	6 Aug 2014	<p>This guide has been updated and re-written to reflect the re-numbering of the sections in the EEIA. In addition, the following requirements were removed:</p> <ul style="list-style-type: none"><li>a. Certification from auditor or tax agent that expenses have been properly charged or allocated between the pioneer and separate trades; and</li><li>b. Confirmation from auditor or tax agent that the loss from separate trade was incurred under circumstances stated in paragraph 6 above.</li></ul>