Comptroller of Income Tax v IA
[2006] SGCA 24

Case Number : CA 4/2006

Decision Date : 03 August 2006

Tribunal/Court : Court of Appeal

Coram : Andrew Phang Boon Leong JA; Judith Prakash J; V K Rajah J

Counsel Name(s) : Liu Hern Kuan and David Lim (Inland Revenue Authority of Singapore) for the appellant; Loo Lian Ee, Stacy Choong and Seah Ching Ling (Drew & Napier LLC) for the respondent

Parties : Comptroller of Income Tax — IA

Revenue Law – Income taxation – Deduction – Whether borrowing expenses, prepayment penalties, guarantee expenses incurred by taxpayer in connection with repayment of loan for developing property deductible against taxpayer's taxable income for certain years of assessment under s 14(1) Income Tax Act – Whether expenses capital or revenue in nature – Applicable tests for determining nature of expenses – Section 14(1) Income Tax Act (Cap 134, 2004 Rev Ed)

3 August 2006 *Judgment reserved.*

Andrew Phang Boon Leong JA (delivering the judgment of the court):

Introduction

1 It is a notorious and unfortunate fact that the distinction (in tax law) between the concept of capital on the one hand and that of revenue on the other is often elusive and even illusory. Even on the most promising of occasions, there are tremendous difficulties of *application*. This case is, unfortunately, no exception.

2 Indeed, it has often been stated that the difficulties referred to in the preceding paragraph arise precisely because it is all an issue of application. In other words, everything depends on the facts. This is true to some extent but it is, in our view, too facile a position to take without more (see also [65]–[66] below). The law must surely embody guiding principles that are both its lifeblood and hence its essence. The difficulty in discovering and/or stating these principles is no excuse for abandoning the search for them. The law is not – and cannot be – a mere agglomeration of disparate facts lost in the legal desert. To this end, we attempt, in the present proceedings, to both search for as well as state the relevant legal principles that are rooted in both logic as well as justice and fairness.

3 The factual matrix in the present proceedings was a straightforward one.

4 IA ("the respondent") was incorporated as a property development company with a paid-up capital of $77,111,750. It purchased a parcel of land ("the Land") for development into a condominium project ("the Condo Project") for sale. The total purchase and development costs of the Land and the Condo Project amounted to approximately $403m.

5 The respondent had obtained a loan of $113m from a syndicate of banks ("the Syndicated Loan"). The agreement for the Syndicated Loan expressly provided (at cl 1.08 and sched 8 of the agreement) that the loan proceeds could only be used to finance the purchase price of the Land and the development costs of the Condo Project and the Syndicated Loan was so used. The Syndicated

Loan was to be repaid 48 months from the date of the first drawdown of the land loan component or 30 June 1997, whichever was earlier, but there was provision to allow for early repayment.

6 As at 30 September 1994, the respondent had sufficient revenue receipts from progress payments made by purchasers of the apartments in the Condo Project to repay the entire outstanding amount under the Syndicated Loan. To withdraw the sum which was quarantined in the Project Account for the Condo Project ("the Project Account") as required under the Housing Developers (Project Account) Rules (Cap 130, R 2, 1997 Rev Ed), the respondent had to furnish a bank guarantee for an amount equivalent to the amount to be withdrawn to the Urban Redevelopment Authority ("URA"). The respondent incurred the following expenses in obtaining the bank guarantees ("the Guarantee Expenses"):

(a)	Aggregate bank commission for three years (based on the interest rate of 0.875%)	$2,605,750.00
(b)	Aggregate agency fees for three years (based on the interest rate of 0.125%)	$ 383,100.00
(c)	Solicitors' fees and disbursements	$ 9,933.15
		$2,998,783.15

7 For repaying the Syndicated Loan on a date earlier than the next interest payment date, the respondent also incurred a prepayment penalty amounting to $15,570 ("the Prepayment Penalty").

8 The respondent also incurred the following borrowing expenses in connection with the Syndicated Loan ("the Borrowing Expenses"):

(a)	Underwriting fee (based on 0.875% of $113m) payable to Citicorp Investment Bank (Singapore) Limited ("Citicorp") which acted as the arranger of the Syndicated Loan	$ 988,750
(b)	Agency fee payable to Citicorp as the agent for the syndicate of lenders	$ 10,000
(c)	Facility fee (based on 0.125% of $113m) payable to Citicorp upon signing of the Syndicated Loan	$ 141,250

(d)	Solicitor's fees and disbursements in connection with the Syndicated Loan	$ 98,946
(e)	Property Valuer's fees for valuation of the Land and the Condo Project as required under the Syndicated Loan	$ 23,914
		$1,262,860

9 The Comptroller of Income Tax ("the CIT") does not dispute that the interest payable under the Syndicated Loan is deductible against the respondent's taxable income under s 14(1)(*a*) of the Income Tax Act (Cap 134, 2004 Rev Ed) ("ITA"). The issue in the present proceedings is whether (a) the Borrowing Expenses, (b) the Prepayment Penalty and (c) the Guarantee Expenses (collectively, "the Relevant Expenses") incurred by the respondent are revenue expenses and deductible against the respondent's taxable income for certain years of assessment, *ie,* 1998 and 1999, under ss 14(1) and 15(1)(*c*) of the ITA.

10 Section 14(1)(*a*) of the ITA reads as follows:

> (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 provided in this section, 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; …

11 Section 15(1)(*c*) of the ITA reads as follows:

> (1) Notwithstanding the provisions of this Act, for the purpose of ascertaining the income of any person, no deduction shall be allowed in respect of —
>
> …
>
> > (*c*) any capital withdrawn or any sum employed or intended to be employed as capital except as provided in section 14 (1) (*h*); …

12 The CIT disallowed the respondent's claims as he took the view that the Relevant Expenses were capital in nature and therefore were not deductible. The respondent appealed to the Income Tax Board of Review ("the Board"), which dismissed the respondent's appeals.

13 The respondent appealed to the High Court. Woo Bih Li J ("the judge") found that it was not disputed before the Board that the Syndicated Loan was incurred in the production of income (see generally *IA v Comptroller of Income Tax* [2006] 1 SLR 821 ("GD")). The judge found in favour of the respondent as he was of the view that the Borrowing Expenses and Prepayment Penalty were "wholly and exclusively" incurred in acquiring the income under s 14(1) of the ITA. The judge further held that s 15(1)(*c*) of the ITA did not prohibit the deduction of the Borrowing Expenses and the Prepayment

Penalty from the respondent's taxable income.

14 In relation to the Guarantee Expenses, the judge was of the view that while there was, strictly speaking, no second loan, the bank guarantees amounted to a refinancing which enabled the release of funds to pay the Syndicated Loan. Since the Syndicated Loan was incurred in the production of income, the judge held that it thereby followed that the Guarantee Expenses were deductible under s 14(1) of the ITA.

The nature of the syndicated loan

Introduction

15 In the court below, it was not disputed between the parties that the Syndicated Loan was incurred in the production of income as the Syndicated Loan was used to acquire trading stock and that, therefore, the Borrowing Expenses and the Prepayment Penalty were "wholly and exclusively incurred" in acquiring the income under s 14(1) of the ITA. The only remaining issue before the judge, therefore, was simply whether the Borrowing Expenses and the Prepayment Penalty were prohibited from deduction under s 15(1)(c) of the ITA. However, the judge, following the Singapore High Court decision of *T Ltd v Comptroller of Income Tax* [2005] 4 SLR 285, held that s 15(1)(*c*) did not even apply in the first instance as that particular provision applied to the principal loan only and, hence, was not even potentially applicable (in the context of the present proceedings) to the Relevant Expenses. However, we note that the High Court's decision on the interpretation of s 15(1)(*c*) of the ITA has since been reversed by the Court of Appeal in *T Ltd v Comptroller of Income Tax* [2006] 2 SLR 618 ("the *T Ltd* case"). The Court of Appeal held (at [20]) that:

> A plain reading of s 15(1)(*c*) does not compel us to exclude interest expenditure from its scope. The said provision applies to all capital expenditure. Interest in respect of a capital purpose is capital expenditure and is therefore incurred as a "sum employed or intended to be employed as capital" within the meaning of s 15(1)(*c*).

The court held, *inter alia*, that interest was not invariably of a revenue nature. It was *derivative* in nature and owed its existence to the loan: Hence, its nature was dependent on the nature of the loan which was dependent (in turn) on the *purpose* of the loan itself. This is an important *general* principle, to which we shall have recourse in the present proceedings albeit in a somewhat different context. The crucial point to note for the present is that the Court of Appeal in the *T Ltd* case held that there was, in principle, no reason why interest payments could not, depending on the *purpose* of the *loan* to which they were related, be *capital* in nature – having decided (as just noted) that there was *no blanket* rule that interest payments would *always* be revenue in nature.

16 The *T Ltd* case, in our view, settles the Singapore position *vis-à-vis* s 15(1)(*c*), and there is no need to add to the well-reasoned judgment in that case, which was based on *first principles* – an approach that is particularly important in the context of tax cases, which are (by their very nature) apt to be rather technical in nature to begin with. It is therefore essential to cut through, as it were, the thicket of unnecessary complexity, and focusing on first principles appears to us to be the best approach to adopt. Indeed, this is the general approach which we adopt in the present appeal as well. It is also pertinent to note that one of the principal authorities relied upon by this court in the *T Ltd* case will also figure prominently in this particular appeal, *viz*, the Hong Kong Privy Council decision of *Wharf Properties Ltd v Commissioner of Inland Revenue* (1997) MSTC 11,025 ("the *Wharf Properties* case"). This is not surprising in view of the fact that the central inquiry in both the *T Ltd* case and the present case is the same – the attempt to distinguish capital from revenue, utilising the concept of *purpose* as a principal legal tool.

17 Returning to the facts of the present proceedings, and having regard to the decision of the Court of Appeal in the *T Ltd* case, s 15(1)(*c*) is a potential issue which requires our decision *unless* it is proved that the Relevant Expenses are not capital expenditure and so will not be disallowed from being deducted from the respondent's taxable income by virtue of s 15(1)(*c*) in any event. Hence, it is eminently logical to commence with a consideration of what we perceive to be the main issue in the present proceedings, *viz*, whether or not the Relevant Expenses are capital or revenue in nature. One would have thought that this would not be an issue, given the appellant's concession (noted above) to the effect that the Syndicated Loan was in fact used to acquire *trading stock*. However, for reasons that will appear clear in a moment, this particular issue has become very much a live one in the present appeal.

18 It would, at this juncture, be useful to set out the judge's finding in relation to the nature of the Syndicated Loan in full. At [89] of the GD, the judge opined thus:

> The stated and true purpose of the Syndicated Loan was to acquire the Land and also to pay for part of the development costs. The loan was used as such. As I mentioned at the outset, CIT had accepted before the Board, and initially before me as well, that the Land and the apartments were part of IA's trading stock. Therefore, it was not open to the Board to treat the Land as something else other than trading stock. The loan was an integral part of the profit-earning activities of IA. The Land was acquired not as an enduring asset to be kept in IA's possession but to be sold as part of common property with the apartments.

19 Indeed, it was part of the agreed statement of facts between the parties that the land and apartments were part of the respondent's trading stock. Paragraph 3 of the agreed statement of facts states as follows:

> The [Land] and subsequently the buildings and units constructed thereon in connection with the [Condo Project] were recorded as "Property under Development" or "Development Properties" in the [respondent's] accounts and they formed part of the [respondent's] trading stock. The [respondent] has consistently treated all sale proceeds it received from the sale of units in the [Condo Project] as part of its trading gains and has declared them for income tax as such.

Which test is to be applied?

The arguments by counsel

20 Counsel for the appellant, Mr Liu Hern Kuan, was candid and admitted that the appellant accepted (based on its conduct of the case in the court below and as noted above) the fact that the Syndicated Loan was intended to enable the respondent to purchase the land concerned as *trading stock* for the *purposes of developing the Condo Project for sale (as opposed to capital investment by, say, retention for rental purposes) as well as to finance the development costs of the said Condo Project (again, for sale)*. This is, in our view, a crucial fact simply because it means that the main transaction obviously had the character of a revenue (as opposed to a capital) transaction. This was why Mr Liu was compelled to argue that the *purpose* of the respondent in entering into the Syndicated Loan arrangement was *irrelevant*. In essence, his argument in this appeal was that because this arrangement resulted, *in fact*, in an addition to the capital structure of the company, the expenses associated therewith must be in the nature of capital instead of revenue and were, hence, not deductible.

21 Mr Liu argued, instead, that the test ought to be whether the loan was a temporary and fluctuating one. If it was, then it had the character of a revenue transaction; if not, then it

necessarily followed that it had the character of a capital transaction. Although Mr Liu also referred to other features such as the size of the loan and restrictions imposed by the lender on how the loan moneys could be used to determine the nature of the loan, for ease of reference, we will refer to this particular test or approach advocated by Mr Liu as the "temporary and fluctuating test".

22 At this juncture, the approach adopted by the appellant could have been quite different if it had not made the concession to the effect that the *purpose* of the respondent taxpayer in entering into the Syndicated Loan arrangement was in the nature of a revenue instead of a capital transaction. As this point was, in the nature of things, not argued before us, we do not wish to elaborate on it in detail – save for the observation that if a less broadbrush and more nuanced approach had been taken towards the precise elements or parts that constituted the Syndicated Loan arrangement, some of those elements or parts might possibly have been argued to have been in the nature of capital as opposed to revenue. This is an observation to which we shall return briefly below, but only for the purposes of elucidating the general principles that might apply to future cases involving similar issues such as those in the present proceedings.

23 Counsel for the respondent, Ms Loo Lian Ee, on the other hand, argued that the *purpose* of the respondent in entering into the Syndicated Loan arrangement was *crucial*. Her argument ran along the following lines. The "purpose test" adopted by the judge was the correct one. Applying that particular test, it was clear that the purpose of the respondent in entering into the Syndicated Loan was to purchase the land concerned as *trading stock*. This constituted a transaction in the nature of revenue, instead of capital. Hence, it followed that the expenses (in particular, the borrowing expenses) were also in the nature of revenue and not capital and were therefore deductible.

24 Hence, one key question which arose in the present proceedings was this: which test is to be preferred? In other words, is the "purpose test" advocated by the respondent to be preferred to the "temporary and fluctuating test" advocated by the appellant – or *vice versa*? Or are the tests, on occasion at least, consistent with each other? In order to answer these questions, it would be appropriate to turn to the main authorities cited by both Mr Liu and Ms Loo.

25 The first key decision is that of the House of Lords in *Beauchamp (Inspector of Taxes) v FW Woolworth plc* [1989] STC 510 ("*Beauchamp*'s case"). Before proceeding to consider the decision of the House, we turn, first, to the decision at first instance before Hoffmann J (as he then was). We observe at this juncture that the decision of the Court of Appeal (comprising Sir Nicholas Brown-Wilkinson VC, Nourse and Stuart-Smith L JJ) will not be considered as it did not really deal with the substantive issues as such, holding that, taking the case as a whole, it found it impossible to say that the facts found by the Special Commissioners were such that no person acting judicially and properly instructed as to the relevant law could have come to the conclusion that the loans concerned were revenue transactions as opposed to accretions to capital and therefore reversed the decision of Hoffmann J (see generally *Beauchamp (HM Inspector of Taxes) v FW Woolworth plc* [1988] STC 714).

26 In *Beauchamp (Inspector of Taxes) v FW Woolworth plc* [1987] STC 279, Hoffmann J held (as we have noted above) that the loan concerned was in fact a sufficiently permanent addition to the taxpayer company's funds as to be regarded as capital.

27 The facts of this case were straightforward. In 1971, the taxpayer raised a loan of 50m Swiss francs repayable in five years' time or earlier at its option, subject to a premium for early repayment. The taxpayer converted the Swiss francs into pound sterling. In 1976, the taxpayer purchased 50m Swiss francs and repaid the loan. In 1972, the taxpayer entered into a second (similar) transaction and borrowed a further 50m Swiss francs and also converted them into pound sterling. In so far as this latter transaction was concerned, in 1977, the taxpayer purchased and repaid this loan as well.

However, the taxpayer had, with respect to both these transactions, incurred a currency loss as a result of a fall in the value of pound sterling in relation to Swiss currency. This loss was in the region of £11.4m. The taxpayer sought to deduct this loss from the profits of the retail trade it carried on during the period of the loans. The issue that faced the court was a simple one. If the loans (totalling 100m Swiss francs) were revenue transactions, the currency exchange loss just noted would be deductible in computing the profits of the taxpayer's trade. If, on the other hand, the loans were capital transactions, then such currency exchange loss would not be deductible from profits as the loss would be a capital (as opposed to a revenue) loss.

28 An important feature of *Beauchamp*'s case, in our view, is this: The loans, according to its finance director, were required by the taxpayer as it ([26] *supra* at 283):

> [R]equired *increased working capital* for *a great variety of reasons*. The need for finance would largely depend upon the fluctuation of cash balances, which in turn depended upon the state of trading and stock levels. *The taxpayer company was, for example, engaged in an extensive modernisation programme involving the repair, refurbishing and enlargement of premises.* It was intended to finance this programme and the taxpayer company's other requirements out of the cash flow generated by the taxpayer company's normal trading activities. *The inadequacy of the cash flow was largely caused by faulty stock control*. [emphasis added]

29 In point of fact, therefore, the taxpayer in *Beauchamp*'s case was in fact free not only to utilise the funds from the loans for *any* one of several purposes *but had also* intended at least part of these funds to be utilised for what were essentially *capital* purposes. This is an extremely important point which distinguishes, in our view, *Beauchamp*'s case from the present.

30 To return to the facts and the various holdings in *Beauchamp*'s case, the Special Commissioners found in favour of the taxpayer. However, Hoffmann J reversed this decision on appeal. The Court of Appeal, in turn, reversed Hoffmann J's decision. Ultimately, however, the House of Lords restored the decision by Hoffmann J.

31 In the circumstances, therefore, it is profitable, in our view, to review briefly the reasons for Hoffmann J's decision as well, although the focus will of course be on the decision of the House of Lords.

32 By way of brief background to Hoffmann J's decision, the Special Commissioners found that the purpose of the taxpayer in taking out the subject loans was not to add permanently to its capital structure but was, rather, an attempt to tide itself over in the short term as it had a cash shortage. It also found that there was very little prospect of the taxpayer being able to obtain permission to pay off the loans earlier. Its summary is instructive ([26] *supra* at 292):

> To summarise, we find the loans to have been loans arranged to tide the taxpayer company over a short-term problem namely the failure of the taxpayer company's *trading activities to generate* a sufficient cash flow to cover the taxpayer company's *commitments and* day to day needs. We find that more efficient stock control and better trading results were expected within a short time to solve the problem. [emphasis added]

33 This last-mentioned point is also confirmed by Hoffmann J himself, where the learned judge states thus ([26] *supra* at 293):

> The money was raised because the taxpayer company needed additional cash for its business. The *purposes* for which cash was required *included both revenue items*, like financing stock, *and*

capital items, like enlarging shops. [emphasis added]

34 However, Hoffmann J disagreed with the *decision* of the Special Commissioners. The learned judge was of the view that "[n]o one can describe a loan for a fixed term of five years as a mere temporary accommodation" and that "[t]he amount and the term were fixed, and the loan was for a substantial period" (see *ibid*). What, then, about the possibility of *early repayment*? In this regard, Hoffmann J was of the view (see *ibid*) that:

> I do not think it matters that the taxpayer company was entitled to make earlier repayment if it was willing to pay a capital premium. *In practice* it was *not contemplated that the Bank of England would allow payment to be made much earlier than the five-year term of the loan*. [emphasis added]

3 5 With respect, the learned judge was not really addressing the important issue of the possibility of early repayment. This is because the factor centring on a fixed term would be undermined. And this is not an unimportant point simply because, as we shall see, the House of Lords also focused on the importance of the loan being for a fixed term.

36 The following crucial passages from Hoffmann J's judgment also bear quoting ([26] *supra* at 295–296):

> The terms of the loans [in the case] are in my judgment sufficient to make it clear that they constitute additions to the capital employed by the taxpayer company, and it does not matter whether they were intended to be employed in the making of payments of a revenue or of a capital nature. In this case evidence on that question would be of little help *because it is clear from the evidence before the commissioners and the documents to which I have referred that the money was not intended to be used, and nor was it actually used, specifically for purposes of one character or the other. It was simply an addition to the taxpayer company's general funds*. It *follows* that there are in my judgment *no relevant factors pointing to the borrowing being a revenue receipt which can displace the inference to be drawn from the terms upon which the money was actually borrowed*.
>
> …
>
> In deciding whether a loan is on revenue or capital account there can be no question of examining the nature of the asset or advantage gained by the company: *it is always the same, namely, money.* The *only question* is whether *the terms of repayment or the circumstances in which it is likely to be repaid (or the use to which it is put may throw some light)* make it appropriate to treat the money as a sufficiently permanent addition to the company's funds to be regarded as capital, and both the authorities and the practice of the accountants seem to me to show that the loans in this case unquestionably came within that description.
>
> [emphasis added]

37 It is clear (and this is a point we have already stressed in this judgment) that, *unlike* the present case, the loans in *Beauchamp*'s case were intended for *general* use. Indeed, there was ample evidence that part of the loans was intended for a *capital* use. That the loans were intended for general use did weigh heavily with Hoffmann J is evidenced in the passage from his judgment which we have just quoted. Indeed, if the funds from a loan can be utilised for *any* purpose, then the concept of purpose, in our view, *does* become immaterial or irrelevant. This is because something that can be used for anything is not only uninformative but is also (and more importantly) clearly marked

out for one purpose *only* – it is *part of the general capital funding or structure of the taxpayer*. At this point, it is true that there is, literally speaking, a purpose. However, in the nature of things, there is no need for the court to ascertain the specific purpose as such. The court can simply assume what is already obvious – that there is no real specific purpose, with the funds from the loan concerned being available for any purpose and, as such, constituting part of the *capital structure* of the company. This, we reiterate, is clearly *not* the situation on the facts of the present appeal.

38 It is also clear that, even if we accept that a loan for a fixed term is an accretion to the capital structure of the taxpayer company without more, this was *not* the situation here. The respondent in the present proceedings desired to – and did – repay the Syndicated Loan earlier, once sufficient funds had come in from purchasers of the units in the Condo Project. In contrast, in *Beauchamp*'s case, it was clear that although the loans could have been repaid earlier, early repayment was, owing to the existing circumstances, unlikely.

39 It is also important to note that Hoffmann J did *not* eschew the context and (more importantly) the *purpose* of the loans in *Beauchamp*'s case. This is particularly evident from the second paragraph quoted at [36] above. We are of the view that Hoffmann J went no further than emphasising that the inquiry is, in the final analysis, an *objective* one. In other words, whilst the *avowed* purpose for the taking of a loan will be accorded due consideration by the court, the *purely subjective* assertions by the taxpayer are *not conclusive*. If, in other words, the *objective facts* tell a different story, the court is then free to disregard such assertions (reference may be made, in this regard, to the Privy Council decision (on appeal from the Supreme Court of Ceylon) of *Lily Harriet Ram Iswera v Commissioner of Inland Revenue* [1965] 1 WLR 663 at 668). But does this mean that, at this point, the court no longer has regard to the *purpose* behind the loan concerned? We are of the view that nothing could be further from the truth. What would have transpired at this point is simply the fact that the *purpose* of the loan has been ascertained by the court having regard to the *objective facts* that, in the circumstances, *differ and contradict* the *purely subjective* intentions which have been raised by the taxpayer concerned.

40 However, in fairness to Mr Liu, our analysis of *Beauchamp*'s case cannot stop simply at Hoffmann J's decision – although Mr Liu himself also relied heavily upon it. Put simply, is there anything in the decision of *the House of Lords* that contradicts the analysis that we have just set out?

41 Turning, then, to the House of Lords decision in *Beauchamp*'s case, only one substantive judgment was in fact delivered (and in which the remaining law lords concurred). This was the judgment by Lord Templeman. In the interests of clarity (including clarity of analysis), we set out, first, a key passage in the judgment of the learned law lord, as follows ([25] *supra* at 514):

> The temporary and fluctuating borrowings incurred in transacting business are revenue transactions. On the other hand, a trading company which borrows unconditionally a fixed amount for a definite period may use the money generally for the purposes of its business or for any other purpose authorised by its constitution, and even when the money is employed in the business, the money may be laid out on income expenditure or capital expenditure. The taxpayer company could do as it pleased with 100m borrowed Swiss francs, provided that the application of the money was intra vires the objects of the taxpayer company. The commissioners found as a fact that the taxpayer company intended to use the 100m Swiss francs to overcome a difficulty which was hoped to be of short duration and which was caused by the fact that stocks were high and trade depressed. *But there was nothing to stop the taxpayer company spending the whole or part of the money on capital items, and indeed part was spent on capital items*. For my part, I do not attach any importance in the present circumstances to the intentions of the taxpayer company or to the actual use made of the money in the present circumstances. The 100m Swiss

> francs, worth some £10m, were available to the taxpayer company as additional capital. [emphasis added]

42 The passage just quoted speaks for itself. It is even more explicit than the corresponding parts of Hoffmann J's judgment (parts of which are also cited by Lord Templeman (at 518–519)). More importantly, it supports the analysis we have set out above in no uncertain terms. We reiterate that the situation which obtains in the present appeal is *wholly distinguishable* from that which existed in *Beauchamp*'s case. Put simply, *Beauchamp*'s case has no relevance to the present proceedings. This is not to state that we reject, without qualification, the holdings in *Beauchamp*'s case. That would be beyond our present remit. We will decide that issue when an appropriate case arises for the decision of this court.

43 It is true that the last portion of Lord Templeman's judgment quoted above appears to support Mr Liu's argument that the *purpose* of the loan is immaterial. Indeed, the following passage from a later part of the law lord's judgment also appears to support Mr Liu's argument ([25] *supra* at 515):

> The *authorities* do *not* support the proposition that a borrowing of a *definite sum for a fixed term of five years* can be an *income* transaction. [emphasis added]

44 There is another similar passage ([25] *supra* at 517):

> Counsel for the taxpayer company submitted that an asset or advantage which only endured for five years was not enduring, although a loan which endured for 10 years would be sufficiently enduring. But when a taxpayer borrows money for five years, he obtains *an asset or advantage* which *endures for five years* and the *authorities* show that such a loan *increases the capital* of the taxpayer for that period. A loan is only a *revenue* transaction *if* it is *part of the ordinary day to day incidence of carrying on the business*. [emphasis added]

45 However, it is our view that these isolated passages cannot be wrenched from the context of both the judgment as well as the factual matrix concerned. When these passages are viewed in their proper context in the manner which we have sought to explicate above, it will be seen that *Beauchamp*'s case does *not* stand for the *inflexible and blanket* proposition advanced by Mr Liu in the present appeal to the effect that purpose is *never* relevant in ascertaining whether or not a loan is a revenue or a capital transaction. Indeed, the last-mentioned passage quoted (at [44] above) is itself ambiguous. On one reading, it could be argued that the passage does refer to the *purpose* of the loan and that, if the funds are borrowed for the purpose of the day-to-day running of the business, it is a revenue transaction. That is in fact the case in the present proceedings. In this regard, one might also note the following observations by Lord Templeman ([25] *supra* at 518) are in fact consistent with the point just made:

> A loan is not an 'ordinary incident of marketing' unless, as the *authorities* show, the loan is temporary and fluctuating *and* is incurred *in meeting the ordinary running expenses of the business*.
>
> In their stated case, the Special Commissioners … said—
>
> > … the issue we have to decide is whether the borrowing took place in such circumstances that the borrowed monies are to be regarded as an addition to the taxpayer company's capital resources or whether the borrowing formed part of the day to day activities in the earning of profits in the business.

In my opinion, that question only permitted one answer: the borrowing itself did not form part of *the day to day activities of the taxpayer in earning profits*.

[emphasis added]

4 6 We also note that Lord Templeman referred to the various *authorities*. In our view, it is unnecessary to delve into these decisions in any detail, simply because the focus ought to be (and indeed has been) on the facts and holdings in *Beauchamp*'s case itself. It will therefore suffice for the purposes of the present proceedings to mention in the briefest of fashions some of the more significant decisions.

47 In the House of Lords decision of *Farmer (Surveyor of Taxes) v Scottish North American Trust, Limited* [1912] AC 118, for example, although the House of Lords did refer to the temporary and fluctuating manner in which the moneys concerned were borrowed, the focus was really on the fact that the purpose of the loans was centred on revenue (as opposed to capital) purposes. Again, the purpose for which the loans concerned were taken was, in our view, the focus of the English High Court decision of *Ascot Gas Water Heaters, Ltd v Duff (HM Inspector of Taxes)* (1942) 24 TC 171. And, in the English Court of Appeal decision of *The European Investment Trust Company, Limited v Jackson (HM Inspector of Taxes)* (1932) 18 TC 1, Finlay J (at first instance, and whose decision was affirmed on appeal) did refer to the concept of temporary accommodation. However, the learned judge also referred (at 12) to the (contrasting) situation where there is an accretion to the capital structure of the company, inasmuch as the taxpayer obtains "sums which are used as capital *and nothing else*" [emphasis added]. In short, there is nothing in these (and other decisions cited in *Beauchamp*'s case) that detracts from the fundamental proposition that the purpose of the loan concerned is of paramount importance.

48 It is clear, therefore, that the facts in *Beauchamp*'s case are not only distinguishable from those which obtain in the present proceedings but also that a close analysis of that case demonstrates that it does *not* stand for the *inflexible and blanket* proposition advanced by the appellant in the present proceedings to the effect that the purpose of the loan is immaterial when ascertaining whether or not the loan concerned is a revenue or a capital transaction.

4 9 We turn now to the other main decision that figured prominently in the arguments of both counsel in the present proceedings: the *Wharf Properties* case ([16] *supra*). That decision – by the Judicial Committee of the Privy Council hearing an appeal from the Hong Kong Court of Appeal – decided that the *purpose* of the loan was important. Interestingly, the decision of the Privy Council was delivered by *Lord Hoffmann*, now a member of the House of Lords.

50 In the *Wharf Properties* case, the taxpayer was a Hong Kong property development company which entered into a contract to purchase an old tramway depot at Causeway Bay with a view to redeveloping it. The depot was in fact ultimately redeveloped into a commercial complex known as Times Square. In order to finance this project, the taxpayer borrowed the necessary funds from various banks and financial institutions. The various loans were for short periods, ranging from a week to a month, but were always renewed. The issue before the Privy Council was whether or not the taxpayer was entitled to deduct the interest payments made in relation to these loans.

51 The Privy Council held that the acquisition of the tramway depot and holding it pending its conversion by redevelopment into an income-earning capital asset was made for a capital purpose and that the payments of interest were therefore also made for a capital purpose. The key concept in the *Wharf Properties* case was that relating to *purpose*. Indeed, the reference to the concept of purpose is both repeated and (more importantly) central. Agreeing with Litton VP's view, which was

laid down at the (Hong Kong) Court of Appeal stage, the Privy Council stated (at 11,028) that:

> [T]here is no other way in which the nature of the interest payment can be discovered. The immediate consideration for each payment of interest is, of course, the use of money during the period in respect of which the interest has been paid, *but since money is no more than a medium of exchange which may be expended for either capital or revenue purposes, the question can be answered only by ascertaining the purpose for which the loan was required during the relevant period.* [emphasis added]

Reference may also be made in this regard to the Transvaal Provisional Division decision of *Commissioner for Inland Revenue v General Motors SA (Pty) Ltd* (1981) 43 SATC 249 at 254 (*per* McCreath J, with whom Irving Steyn and Le Grange JJ concurred).

52 Lord Hoffmann in the *Wharf Properties* case (at 11,028–11,029) did in fact also deal with *Beauchamp*'s case. He did not consider the case to be relevant because:

> It [*Beauchamp's* case] is directed to a different question namely whether the sum borrowed constitutes an addition to the company's capital or is a revenue *receipt*. In other words, it looks at the nature of the *loan* in the hands of the recipient rather than the question of whether a payment of interest is a capital or revenue expense. It is unusual for a loan of money to constitute a revenue receipt but this can be the case if borrowing money is "part of the ordinary day to day incidence of carrying on the business" (Lord *Templeman* in *Beauchamp* …) which may be the case in businesses of banking, financing or otherwise dealing in money … ***Ordinarily***, however, a loan to ***a trading company, whatever the purpose for which it is intended to be used, will be an addition to that company's capital***. Mr Gardiner [counsel for the taxpayer company] did submit that the ***shortness of the successive terms of*** the loans in this case was enough to make them revenue receipts, ***but their Lordships do not agree. The borrowing did not form part of the company's trading activities.*** While it or a replacement loan remained in place, it was an addition to Wharf's [*viz*, the taxpayer company's] capital.
>
> Thus, while the question of whether money is intended to be used for a capital or revenue purpose is ***inconclusive*** as to whether its ***receipt*** is a revenue receipt or an addition to the company's capital, the ***purpose of the loan during the period for which the interest payment was made is critical*** to whether it counts as a capital ***or*** revenue ***expense***. In the present case, during the whole of the two years in question, the loan was clearly being applied for the purpose of acquiring and creating a capital asset rather than holding it as an income-producing investment. It follows that the interest was being expended for a capital purpose.
>
> [emphasis added in bold italics]

53 With respect, the distinction just drawn between receipt and expenditure is somewhat artificial. As we have already argued, the stronger distinction lies in *the precise purpose* for which the loan was taken and that, *in itself*, furnishes the requisite criterion as well as justification for drawing the line between a transaction in the nature of capital on the one hand and one in the nature of revenue on the other. There is in fact a hint that such an approach ought to be adopted in the very judgment of Lord Hoffmann himself in the *Wharf Properties* case, where the learned law lord observed thus ([16] *supra* at 11,029):

> In cases like *Beauchamp v. FW Woolworth plc*, where the borrowings are for the *general* purposes of the company *and* are *spent* on *both* capital *and* revenue account, it will be *much more difficult to say* whether a given interest payment is an expenditure of a capital or revenue nature.

[emphasis added]

54 Unfortunately, however, Lord Hoffmann then immediately proceeded to observe further, as follows (see *ibid*):

> But this question did not arise in the *Beauchamp* case and there is no such difficulty in this one. Their Lordships think that in the present case a true and fair view of the taxpayer's transactions required the interest to be treated as an expense of the development.

55 With respect, it is unfortunate that the Privy Council, in the *Wharf Properties* case, did not distinguish *Beauchamp*'s case in a more satisfactory fashion. To the extent, however, that we are constrained to choose between both decisions without more, we would respectfully decline to follow *Beauchamp*'s case. However, as we have emphasised, we do not think that we need to go so far. In our view, an application of the "purpose test" to the facts of *Beauchamp*'s case would have yielded the *same result* as that arrived at by both Hoffmann J as well as the House of Lords. Further, the decision in the *Wharf Properties* case does in fact support our view (expressed below) that the "purpose test" is not only relevant but is also to be accorded primacy.

56 We note, further, that support for our view is to be found in the Eleventh Cumulative Supplement by Michael Sherry of one of the foremost treatises in the field, Peter G Whiteman *et al*, *Whiteman on Income Tax* (Sweet & Maxwell, 3rd Ed, 2001), as follows (at para 7-58):

> Whether or not a facility is, in a given case, "fluctuating and temporary," is surely a question of fact. However, Lord Templeman went further: "The authorities do not support the proposition that a borrowing of a definite sum for a fixed term of five years can be an income transaction." … While it may very well be the case that a five-year facility will be revenue in nature only in the rarest of circumstances and that the loans under consideration could not be so described by any reasonable body of Commissioners, *it is submitted that these last dicta go too far. Surely the question of whether or not a transaction is on income or capital account depends upon its circumstances and it must be possible that in the myriad of complex transactions that take place in the commercial world one will arise where as a matter of commercial reality a five-year term loan is on revenue account. To hold, as Lord Templeman has effectively done, that as a matter of law, such a loan is always on capital account is, it is submitted, to burden our jurisprudence with an unnecessary rule.* [emphasis added]

57 Finally, it must also be reiterated that the taxpayer in the present proceedings entered into the Syndicated Loan in order to acquire *trading stock*.

58 The principle that loans used to acquire trading stock are regarded as revenue in nature is derived from the Australian Federal Court decision of *Federal Commissioner of Taxation v Hunter Douglas Limited* (1983) 83 ATC 4,562. Lockhart J explained as follows (at 4,576):

> Borrowing money to carry on business must prima facie be treated as augmenting the capital employed in the business. Borrowings by finance companies to then lend to their customers, and borrowings by trading companies to finance the purchase of trading stock, are exceptions to this general rule. Such borrowings are an integral part of the ordinary conduct of the company's business and are thus revenue, not capital, items. … Moneys borrowed by a trading company for the purpose of financing the purchase of trading stock are borrowed with a view to disposal of the stock at a profit. They are in each case part of the company's circulating capital.

59 Mr Liu submitted that the trading stock exception is unique to the Australian tax regime,

which has a distinct statutory regime for trading stock. However, we note that the *Singapore Master Tax Guide Manual* (CCH Tax eds) (1989, 2001 release) also refers to expenditure on trading stock as being deductible and an English case is cited for this proposition. This particular work states (at p 2803, para 1010):

> (d) *Expenditure relating to fixed capital* — if the expenditure relates to circulating capital, ie stock in trade, it will rank for deduction. It will not if it relates to fixed capital, ie fixed assets. The distinction between fixed and circulating capital is that fixed capital is what the owner turns to profit by keeping it in his possession; circulating capital is capital which is turned over, and in the process of being turned over, yields profit or loss (*John Smith & Sons v Moore* 12 TC 266).

Our decision – the primacy of the "purpose test" and the concept of complementarity

60 Looking closely at the abovementioned decisions, both parties had, with respect, therefore missed the point in presenting a picture of irreconcilable difference between these two tests (*viz*, the "purpose test" and the "temporary and fluctuating test", respectively). The present proceedings raised, in our view, not the question as to which test was to be preferred but, rather, how the tests can be reconciled with each other and which was to have primacy, especially in a situation of direct conflict. We hasten to add that, on our analysis of the leading cases above (especially *Beauchamp*'s case), we find nothing in those cases that detracts from such an approach.

61 Admittedly, both these tests are not the same. However, they are not incompatible with each other. Indeed, in our view, they *complement* each other, although primacy must be given to the "purpose test". This would be, *a fortiori*, the case in situations of conflict between the "purpose test" and the "temporary and fluctuating test". As we shall see, the "temporary and fluctuating test" is, arguably, itself ambiguous. Let us elaborate.

62 It is our view that the "purpose test" is of the first importance inasmuch as given the significant difficulties in distinguishing revenue from capital transactions as stated at the outset of this judgment, this particular test provides an eminently appropriate starting-point for any inquiry of this nature. In other words, the *purpose* of the *taxpayer* in entering into the transaction (here, loan) concerned must surely be of vital importance. Put simply, did the taxpayer intend to enter into a transaction having the character of revenue *or* did it, instead, intend to enter into a transaction having the character of capital? As alluded to in [39] above, however, the purely subjective assertions by the taxpayers are not conclusive and the court will not be oblivious to the objective facts if they tell a different story.

63 Notwithstanding this, it remains the case that without taking into account the purpose of the taxpayer in entering into the transaction in question (a position argued for forcefully by Mr Liu), we would necessarily enter into the rarefied and abstract sphere which wholly disables us from ascertaining whether or not the transaction has the character of revenue or of capital.

64 The corollary of any approach that disregards the purpose of the loan is that, in the specific context of *loans*, *all* loans – and the accompanying expenses – would *almost never* be considered to be *revenue* transactions for the very simple reason that, *without* taking into account the purpose of the taxpayer in entering into the transaction concerned, *any and all funds from any loan* would *clearly amount to an addition or accretion to the capital structure of the taxpayer*. However, such an approach – advocated by Mr Liu – is both *excessively literal as well as too blunt and sweeping*. More importantly, it is inconsistent with *legal principle* which looks *not merely* at a *factual* approach but, rather, one which can be justified on a *normative* level as well.

65 However, might it not be argued that the "purpose test" is, in a sense, circular? We suggest that such an argument is misconceived inasmuch as the purpose of the transaction concerned (here, the Syndicated Loan) cannot be divorced from its context – in particular, its factual context. This is why the distinction between capital and revenue has often been described as being a factual inquiry. However, it will not do, in our view, to simply leave it at that. It is an abdication of judicial responsibility to merely state that "it all depends on the facts" when it is possible to furnish some further (if only rough) guidelines. As Choo Han Teck J put it in the Singapore High Court decision of *Ngee Ann Development Pte Ltd v Nova Leisure Pte Ltd* [2003] SGHC 168 at [6]–[7]:

> In construing a contractual document the only immutable principle is that the court should extract such meaning from the words that the parties had chosen to reflect their intention at the time of the contract. It is wrong to give to the words a meaning that counsel thinks the words ought to mean, or even what the court thinks they ought to mean. Semantic interpretation is very often a very difficult exercise. What the words say and what the parties mean by the words they say may not be the same thing. … One great fundamental in the application of the law is consistency because consistency is the alloy of predictability. In this regard, the courts ought to consistently adopt the approach that the meaning to be given to written words must first be that as appears from the text. The context becomes an aide in interpretation only if the words are vague or ambiguous, and only to the extent that a reasonable application of the context would easily bring out the meaning intended by both sides.
>
> *For the above reason the phrase "it all depends on the facts of the case" can so easily become the anthem of inconsistency. The phrase has such a magical ring to it. It seems that whenever this incantation is made the court is at liberty to do as it pleases – because 'there is no case like the present'. That is the temptation we must all resist.*
>
> [emphasis added]

66 Although the words italicised in the above quotation were espoused in a slightly different context, the *general principle* contained therein is germane to the point we have made in the preceding paragraph. In the circumstances, we proceed to attempt to furnish a couple of rough guidelines that are not only of assistance to the present court but which may also be of some assistance to courts in future cases relating to a similar type of transaction and/or set of facts. And we hope to demonstrate, in the process, that the "temporary and fluctuating test" does, on occasion at least, have a role to play in complementing the all-important "purpose test".

67 One guideline – in so far as the present (and specific) context of *loans* are concerned – is to ascertain whether or not there is *a sufficient relationship or linkage between the loan in question and the main transaction or project for which the loan has (ostensibly, at least) been taken*. If there is no, or an insufficient, linkage, then it must be assumed that the sole purpose of the loan is to augment or add to the capital structure of the taxpayer. If so, then the loan itself must be of a capital nature. A clear illustration of a situation where there is no linkage to the main transaction is where the taxpayer takes out the loan without stipulating what it is to be used for.

68 On the other hand, if there is a linkage, such linkage *must* nevertheless be *sufficient*. This is undoubtedly a question of fact and (we might add) commonsense. For the avoidance of doubt, however, we are of the view that a sufficient linkage would clearly be present if the evidence demonstrates that the loan was taken in order to finance the main transaction or project. Indeed, this would be the position in the standard situation.

69 If it is ascertained that there is a sufficient relationship or linkage in the manner set out in

the preceding two paragraphs, then the next question to ask is whether or not the main transaction or project *itself* is of a capital nature or of a revenue nature. This constitutes, in effect, the second (and closely related) guideline. If the project itself is of a *capital* nature, then it must follow (given the satisfaction of the requirement of linkage) that the *loan* linked to it *cannot possibly* be of a revenue nature. This is because the funds from the loan would, *ex hypothesi*, be *intended to* augment or add to the *capital structure* of the taxpayer, *given the (capital) nature of the project itself*. Put simply, these funds would be *sunk into* the taxpayer's capital structure when viewed from the *long-term perspective.* If, on the other hand, the loan is linked to a project which is of a *revenue* nature, the *converse* result would ensue inasmuch as the loan would be of a revenue nature as well.

70 We are of the view that, at this particular juncture, the "temporary and fluctuating test" could be usefully introduced or employed. We have, in mind, in particular, the use of this test in demonstrating the *absence* of a *link* between the loan and the main transaction. For example, in the present proceedings, the *broadbrush* approach which we alluded to above (at [22]) might, as we have mentioned, have been substituted with a more nuanced examination of the *precise elements and purposes* of the Syndicated Loan itself. Certain of these elements or parts might, for instance, have been proved (through, *inter alia*, an interpretation of the material terms of the loan concerned) to have been intended for some *other* purpose *unrelated to* the main transaction *and* which actually adds to the *capital* structure of the taxpayer itself (in which case *those* elements or parts would *not* be "temporary and fluctuating" and therefore would be of the character of *capital*). In contrast, where the elements or parts of the loan have been proved to have been intended for a purpose *related to* the main transaction, the *latter* of which is *revenue* in nature, then those elements or parts would (conversely) be of the character of *revenue*. It therefore follows that, where, as here, the appellant has *admitted* that the purpose of the Syndicated Loan itself was to acquire trading stock, it follows, *a fortiori*, that it (the loan) is *revenue* in nature. If so, the "temporary and fluctuating test" is, in effect, redundant because, by virtue of the appellant's admission, the linkage between the Syndicated Loan and the main transaction (centring, here, on the Condo Project) has, *ex hypothesi*, been established. If, however, there had been no such admission, the "temporary and fluctuating test" might well have been significant in enabling the parties such as the appellant in the present proceedings to demonstrate that *at least part* of the loan might *not* have *a linkage* to *the main transaction* in the first instance. In particular, if it could be proved that part of, or even the entire, loan was intended to be a long-term one, then either that part of, or the entire, loan (as the case may be) would be capital in nature.

71 Nevertheless, the "temporary and fluctuating test" is by no means conclusive and might even conflict with the "purpose test". As we have already mentioned, where there is a situation of conflict, the latter must prevail over the former. In our view, however, such situations of conflict will, in practical terms, be rare *if a linkage* between the loan and the main transaction is established. To elaborate, if the main transaction is found to be in the nature of capital, then, the linkage between that transaction and loan having been established, the nature of the loan will necessarily be in the nature of capital as well. The same reasoning would apply if the main transaction is found to be in the nature of revenue instead. In other words, the nature of the loan will necessarily be in the nature of revenue as well. At this juncture, it would appear to us that the issue as to whether or not the loan itself is "temporary and fluctuating" depends, in the final analysis, on whether *the main transaction* is "temporary and fluctuating". In other words, *the nature of the main transaction is all-important as the loan takes its character from it*. If, however, the main transaction is *unrelated* to the loan, then the loan itself must (as we have already pointed out above) *necessarily* be *capital* in nature since there would (to reiterate) be no other point to the loan except to add to the capital structure of the taxpayer. On the other hand, if there *is* a linkage between the main transaction and the loan, then in order to ascertain whether or not the *loan* is temporary and fluctuating, *the court must look at the nature of the main transaction*. In other words, it is, in our view, a *misnomer* to apply the

"temporary and fluctuating test" in the context only of the *loan* when such a test ought logically to be applied to *the main transaction instead* – for the main transaction *underlies* the loan. If it does not, then there is of course no connection between the two and (as already mentioned) this means that the loan must necessarily be capital in nature.

72 The view that we have adopted in the preceding paragraph is both logical and fair. The rationale underlying the "temporary and fluctuating test", as applied to the *loan*, suffers from a number of difficulties.

73 One cannot conclude that a loan is a capital loan simply because the size of the loan was larger than the company's capital. If the appellant's contention is correct, how much larger must the Syndicated Loan be in relation to the shareholder's contributed capital of the respondent before it can be considered to be a capital loan?

74 Similarly, we are not convinced by the appellant's argument that the Syndicated Loan was a capital loan because it was a term loan. The lack of temporariness or recurrence of a loan cannot be determinative factors as to whether it is revenue or capital in nature. As the judge rightly questioned at [82] of his judgment:

> Would that then mean that if [the respondent] had managed to structure the Syndicated Loan for a much shorter duration but on a renewal basis, that would make a difference? I do not think the result should rest on such a foundation.

75 Given the difficulties just enunciated, might it be less confusing to adopt a *broader version* of the "temporary and fluctuating test" by applying it *not* to the nature of *the loan* as such but, *rather*, to the nature of *the main transaction instead* – bearing in mind that the *linkage* (if any) between the loan and the main transaction must *also* be considered? Nevertheless, it is clear, in our view, that this was *not* what Mr Liu meant when he advocated the adoption of the "temporary and fluctuating test". His focus was very *specific*; it was centred on *the loan transaction only*. In the circumstances, therefore, the qualities of "temporary and fluctuating" applied *specifically* to the terms of *the loan* and the context surrounding it. On the contrary, the *broader* conception of the concept of the "temporary and fluctuating test" which we have suggested involves taking into account contexts and surrounding circumstances *other than* those of the loan itself. This would include, and very importantly at that, the context and circumstances surrounding the *main transaction* as well. In this way, the "temporary and fluctuating test" is *not* confined to the terms of the loan and its surrounding context and circumstances but takes on, rather, the *much broader distinction that inheres between capital on the one hand and revenue on the other – hence*, the focus on the *main transaction* rather than merely the loan transaction. *Put another way, the "temporary and fluctuating test"* in its *broader incarnation simply distinguishes between revenue (which is, by nature, temporary and fluctuating) and capital (which is, by nature, permanent).* We *also* note that, in the nature of things, the adoption of the *broader* "temporary and fluctuating test" *necessarily* involves ascertaining (simultaneously) the *purpose* behind the *main transaction* as well.

76 We have to acknowledge that there may be good reasons in principle and logic why Mr Liu adopted the approach he did. In a sense, to utilise the "temporary and fluctuating test" in such a *broad* fashion (with, *inter alia*, direct – and even conclusive – reference to the *main transaction*) is *not practically helpful*, at least for the most part. This is because if, as pointed out in the preceding paragraph, the *practical effect or impact* is to *reiterate the basic distinction between revenue and capital without more,* then it is (ironically) of *little, if any, practical use simply because we must (in the nature of things)* have regard to *the particular facts* at hand. In other words, *this* particular version of the "temporary and fluctuating test" would be *too broad to be practically useful*. One

would have, instead, to look closely at the *facts* concerned instead – which is necessary in any inquiry in any event.

77 If, *however*, we are to adopt a *narrower version* of the "temporary and fluctuating test" (as advocated by Mr Liu), then it would be accompanied by the *various problems set out briefly above* (at [73]–[74]). Looked at in this light, applying the "temporary and fluctuating test" to *the main transaction instead* might make for less confusion.

78 However, *regardless of* which version of the "temporary and fluctuating test" is applied, a consideration of the *main transaction* (in particular, its linkage – or absence of linkage – to the loan) is necessary. *This is the practical reality or substance of the process itself*. In adopting such an approach, we go further and extend the reasoning in the *Wharf Properties* case, although it is our view that this approach was at least implicitly adopted in that case inasmuch as the court must (whether consciously or otherwise) necessarily have had regard to the purpose of the *main transaction* in order to arrive at the nature of the loan and, hence, the nature of the interest associated with that particular loan.

79 To *summarise* the approach we have set out above:

(a) One should first ascertain the *purpose* of the taxpayer in entering into *the loan* – *ie*, whether it was for the purposes of revenue *or* for the purposes of capital. In order to ascertain such a purpose, a reasoned approach would include the relevant steps in (b) to (d) below.

(b) One ought to ascertain, *first*, whether a sufficient linkage or relationship exists between the loan and the main transaction or project for which the loan was taken.

(c) If, in (b) above, no, or an insufficient, linkage is established, the purpose of the loan must, *ex hypothesi*, be merely to add to the capital structure of the taxpayer and is therefore capital in nature. In this regard, it may in fact be proved that *only some of the elements* of the loan do *not* have a linkage to the main transaction, and *one main (if not conclusive) indicator* of this *absence of a linkage* is that those particular elements or parts of the loan are *not* temporary and fluctuating in nature but are, instead, of a permanent (and therefore *capital*) nature (at this stage, one is applying the *narrower version* of the "temporary and fluctuating test" suggested by Mr Liu). One should note that this narrower version of the "temporary and fluctuating test" is fraught with potential practical problems.

(d) On the other hand, if in (b) above, a sufficient linkage is established, one must then (and *secondly*) proceed to ascertain whether the *main transaction* is of a capital or of a revenue nature (at this stage, one is applying the *broader version* of the "temporary and fluctuating test"). If it is of a capital nature, then (given the linkage to the loan) the loan is also of a capital nature. If, on the other hand, the main transaction is of a revenue nature, then (once again, given the linkage to the loan) the loan is also of a revenue nature. In the nature of things, the process outlined here *necessarily* involves a consideration of the *purpose* of the *main transaction and* is also *factual* in nature.

80 Let us now *apply* the principles just summarised to the facts in the present proceedings.

81 First, what was the *purpose* of the taxpayer in entering into the Syndicated Loan? This is where the *concession* by the appellant becomes *critical* in the context of the *present proceedings*. The appellant, having *admitted* that the Syndicated Loan was incurred in the production of income as the Syndicated Loan was used to acquire trading stock (*ie*, the Land) for the purposes *of developing*

the Condo Project for sale (as opposed to capital investment by, say, retention for rental purposes) as well as to finance the development costs of the said Condo Project (again, for sale), it was clear that the *loan concerned* (*viz*, the Syndicated Loan) had the character of revenue, and not capital. In other words, there was no need to even go beyond step (a) in [79] above.

82 However, *even if* no concession or admission was forthcoming from the appellant, the same result would obtain. In particular, it is our view that there was a sufficient linkage or relationship between the Syndicated Loan and the main transaction (which was to develop the Condo Project). This much was clear from the very terms of the Syndicated Loan itself.

83 There having been established a sufficient linkage between the Syndicated Loan and the main transaction, the issue next arises as to whether or not the *main transaction* is of a capital or of a revenue nature (applying the *broader version* of the "temporary and fluctuating test"). As we have already noted, the main transaction related to the development of the Condo Project *for sale* (as opposed to retention for investment). Although the distinction between capital and revenue is (as we have also noted) not always a clear one, it is plain that, on the facts of the present proceedings, the main transaction was of a *revenue* nature. In the circumstances, therefore, *the Syndicated Loan*, being linked directly to the main transaction, would *also* be of a *revenue* nature.

84 A few more general observations that arise from the facts in the present proceedings might be in order.

85 It seems to us that the appellant, as we have alluded to above, might have adopted too sweeping an approach in assuming that the *entire* loan was intended to finance the development of the Condo project. Put another way, to the extent that a part of the Syndicated Loan did *not* involve the development of the Condo Project, it was – to *that* extent – part of capital, as opposed to revenue. This is indeed a point that the CIT might wish to consider in future situations of this nature. But this would, as we have already mentioned, entail a detailed examination of the terms and conditions of the loan itself. *However*, having admitted that the *entire* funds from the Syndicated Loan in the present proceedings were utilised for the purposes of developing the Condo Project, the appellant *cannot* now argue that a part (or parts) of this loan were capital (as opposed to revenue) in nature. This was why the appellant sought to argue that the "purpose test" was irrelevant. With respect, we find such an approach somewhat disingenuous because *the appellant itself* was, in *substance* at least, *applying the "purpose test" as well* but, *because of its admission*, *attempted to argue simultaneously that the purpose was irrelevant*. However, as we have already pointed out, acceptance of the appellant's approach would result in at least two undesirable consequences.

86 The first is that *conceptual and practical confusion* would be introduced as a result. As we have endeavoured to explain above, there is no inherent contradiction between the "purpose test" and the "temporary and fluctuation test" which are, on the contrary, best utilised in a *complementary* fashion. Indeed, the *very facts* in the present proceedings demonstrate that these tests ought to be utilised in a complementary fashion. Most significantly, we have arrived at the conclusion that the Syndicated Loan *was temporary and fluctuating* in nature and that, even on the appellant's suggested approach, the respondent taxpayer must succeed. Indeed, the *temporary and fluctuating* nature of *the Syndicated Loan supports* the finding (accepted by *both* parties) to the effect that the purpose behind the Syndicated Loan was of a *revenue* (and not a capital) nature. Indeed, the *symmetry of reasoning and findings* on the facts of the present proceedings themselves illustrate the *complementarity* of *both* tests, which is the central proposition of law we have already endorsed above.

87 The second undesirable consequence if the appellant is correct has already been mentioned

above but, because of its enormous significance if accepted, bears repeating. And it is that if the "purpose test" were irrelevant, then *every loan* would, *ex hypothesi*, be (in point of *fact*) an addition or accretion to capital. This is far too broad and sweeping, as well as blunt, an approach to adopt. Indeed, on the facts of cases such as those in the present proceedings, such an argument is even counter-intuitive.

88 However, as we have also pointed out above, if some refinement in approach is necessary, it must lie in the examination of the terms and conditions of the relevant loan agreement itself in order to ascertain whether *all or only a part* of that loan was intended to be of a revenue nature – and *vice versa*. This would, in turn, entail ascertaining whether or not all or only a part of the loan concerned is temporary and fluctuating in nature, regard necessarily being had to the relevant factual matrix itself.

89 It is clear, however, that, on the facts of the present proceedings, the *entire* Syndicated Loan was intended to be of a temporary and fluctuating nature, consistent with the purpose for which it was entered into, *viz*, to help finance a project that was *itself* of a revenue nature.

90 It is important, in our view, to emphasise that *the relevant time* for ascertaining whether or not a loan is in the nature of revenue or in the nature of capital is *at the time it was entered into*. We state this because, in a worst case scenario, and taking the facts of the present proceedings by way of illustration, it could *in fact* turn out that *few, or even none*, of the units in the Condo Project were sold. In that event, and in order to mitigate its losses, the respondent taxpayer might have resorted to *renting* out these units. Would this then constitute evidence that the Condo Project as well as loan were in the nature of capital instead of revenue? The simple answer to this is that hindsight is 20/20 vision. We are concerned here with points of principle. And, in principle, the relevant time of inquiry is the time at which the loan was entered into (see also *per* Lord Wilberforce in the House of Lords decision of *Simmons v Inland Revenue Commissioners* [1980] 1 WLR 1196 at 1199).

91 We do wish to emphasise, however, that the point made in the preceding paragraph is not one that is writ in stone. In other words, if it could be proved that there had been a clear change in purpose from a revenue one to a capital one (and *vice versa*), a different result might obtain. This is obviously a question of fact (see, for example, the English High Court decision of *West v Phillips (HM Inspector of Taxes)* (1958) 38 TC 203 and the Hong Kong Court of Appeal decision of *Commissioner of Inland Revenue v Richfield International Land and Investment Co Ltd* [1989] 1 HKLR 125) (affirmed by the Judicial Committee of the Privy Council in *Richfield International Land and Investment Co Ltd v Inland Revenue Commissioner* [1989] STC 820). Indeed, where a dual purpose is present, this might pose further difficulties for the court and where (presumably) the predominant or principal purpose would be fundamental (see, for example, the English Court of Appeal decision of *Kirkham v Williams (Inspector of Taxes)* [1991] 1 WLR 863). However, there was clearly *no* change in the purpose in so far as the facts of the present proceedings are concerned.

92 Having concluded that the Syndicated Loan is revenue in nature, we now proceed to consider whether the Relevant Expenses are deductible under the ITA.

Whether the relevant expenses are deductible under the ITA

93 A threshold requirement for an expense to be deductible is that it must have been incurred after the relevant business has commenced: see s 14(1) (reproduced above at [10]). This is merely a corollary of the fact that tax is payable only "for whatever period of time [a] trade, business, profession or vocation may have been carried on or exercised": see s 10(1)(*a*) of the ITA. Thus,

income tax is imposed – and expenditure deductible – only after business has commenced. Once this threshold is met, a two-tier test of deductibility kicks in. At the first tier, an expense is *prima facie* deductible if it comes within the general deduction formula under s 14(1) or if it is otherwise specifically authorised pursuant to, *inter alia*, ss 14(1)(*a*)–14(1)(*h*). At the second tier, these inclusionary provisions are subject to the exclusionary clauses contained in s 15(1), which enumerate expenses that are specifically disallowed as deductions. An expense is deducted only if it falls within the inclusionary provisions *and* outside the exclusionary provisions.

94 Before the Board, it was not disputed that the Borrowing Expenses and Prepayment Penalty were "wholly and exclusively incurred" in acquiring the income under s 14(1) of the ITA. This was the basis upon which the judge found that the Borrowing Expenses and Prepayment Penalty were deductible expenses.

95 The appellant argued, however, that the payment of the Prepayment Penalty was not "wholly and exclusively incurred in the production of income" as the condominium units could have been developed by the respondent without incurring the Prepayment Penalty. In relation to the Guarantee Expenses, the appellant also argued that the Guarantee Expenses could not be directly linked to the Syndicated Loan because of the extra step involved of withdrawing the moneys first from the Project Account before the repayment of the Syndicated Loan. The appellant also contended that while the Prepayment Penalty and Guarantee Expenses permitted the respondent to obtain substantial interest savings, this related to the respondent's financing structure and could hardly be said to have led to the production of income.

96 In support of their arguments, the appellant cited the Canadian Privy Council decision of *Montreal Coke and Manufacturing Company v Minister of National Revenue* [1944] AC 126 ("the *Montreal Coke* case"). In the court below, the judge did not consider this case in examining whether the Prepayment Penalty was a deductible expense but in relation to whether the Guarantee Expenses were deductible under the ITA. The judge observed (see GD at [112]):

> In *Montreal Coke*, the taxpayer had financed its business by money borrowed from the public on interest-bearing bonds. The principal and interest were payable at the bond-holders' option in US dollars. Owing to market conditions, the taxpayer decided to redeem the bonds and to issue new bonds at lower rates and less onerous conditions. The exercise incurred expenses which included a premature payment premium, an exchange premium as the existing bondholders elected to be paid in US dollars, commission to underwriters, interest on overlapping periods, and legal and printing expenses. The question was whether such expenses were deductible from income. The Privy Council decided they were not. Lord Macmillan said [at [1944] 1 All ER 743] at 746:
>
>> The question at issue turns entirely upon the terms of the Income War Tax Act, 1927. Part II of the Act, which is headed "Exemptions and Deductions," contains sect. 6 which has a sub-heading "Deductions from income not allowed." So far as relevant to the present purpose sect. 6 reads as follows:
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>>> 6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of (*a*) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income; (*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation depletion or obsolescence, except as otherwise provided in this Act.
>>
>> By sect. 9 of the Act the tax is charged upon income and by sect. 3 income is defined to mean annual net profit or gain.

> It is important to attend precisely to the language of sect. 6. If the expenditure sought to be deducted is not for the purpose of earning the income, and wholly, exclusively and necessarily for that purpose, then it is disallowed as a deduction. If the expenditure is a payment on account of capital it is also disallowed. The appellants say that the outlays in question were made wholly exclusively and necessarily for the purpose of earning income and were not payments on account of capital. The respondent maintains the contrary.
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> The justification for upholding the deductions claimed could not be more attractively presented than it is in the judgment of RINFRET, J. (now Chief Justice of Canada), with which TASCHEREAU, J., concurred. The judge says:
>
>> There are two ways of increasing the profits from a trade or commercial or other calling; either by increasing the earnings while the expenses remain the same or by decreasing the expenses while the earnings remain the same. Of course, if the expenses diminish at the same time as the gross earnings are increased the profits will be correspondingly larger and the proposition just mentioned is only made more evident … In order to pay a lower interest and to get rid of the exchange rates it was necessary to redeem the original bonds; and therefore the expenses required to achieve that result were wholly, exclusively and necessarily laid out or expended for the purpose of decreasing the fixed interest and exchange charges and accordingly "for the purpose of earning the income."
>
> Down to the last nine words quoted the statement of RINFRET, J., is unexceptionable, but their Lordships are unable to accompany him in leaping the last fence. If the statute permitted the deduction of expenditure incurred for the purpose of increasing income the appellants might well have prevailed. But such a criterion would have opened a very wide door. *It is obvious that there can be many forms of expenditure designed to increase income which would not be appropriate deductions in ascertaining annual net profit or gain.* The statutory criterion is a much narrower one. Expenditure to be deductible must be directly related to the earning of income. The earnings of a trader are the product of the trading operations which he conducts. These operations involve outgoings as well as receipts and the net profit or gain which the trader earns is the balance of his trade receipts over his trade outgoings. It is not the business of the appellants to engage in financial operations. The nature of their business is sufficiently indicated by their titles. It is to these businesses that they look for their earnings. Of course, like other business people, they must have capital to enable them to conduct their enterprises, but *their financial arrangements are quite distinct from the activities by which they earn their income.* No doubt the way in which they finance their businesses will or may reflect itself favourably or unfavourably in their annual accounts but *expenditure incurred in relation to the financing of their businesses is not* in their Lordship's opinion, *expenditure incurred in the earning of their income* within the statutory meaning. The statute in sect. 5(*b*) above quoted significantly employs the expression "capital used in the business to earn the income," differentiating between the provision of capital and the process of earning profits.

Section 5(b) of the relevant legislation there permits the deduction of "such reasonable rate of interest on borrowed capital used in the business to earn the income as the Minister in his discretion may allow".

[emphasis added]

97 We are, however, of the view that the *Montreal Coke* case can be distinguished as the court there had earlier found that the original expenses were capital in nature.

98 The requisite nexus between the "expenses incurred" and "the production of income" under s 14(1) of the ITA was elucidated by the Singapore Court of Appeal in *Pinetree Resort Pte Ltd v Comptroller of Income Tax* [2000] 4 SLR 1 ("*Pinetree*'s case"). Chief Justice Yong Pung How held (at [47]) that:

> Section 14(1) of the Income Tax Act provides that in ascertaining the income of a taxpayer for any period, there shall be deducted all outgoings and expenses wholly and exclusively incurred during that period by the taxpayer in the production of income as long as these are not expressly prohibited by other sections in the Income Tax Act. The important feature of when deductions may be made for the purposes of this case is the fact that s 14 requires a nexus between the incurrence of the expense and the production of income. In determining whether this nexus is present, the business has to be looked at as a whole set of operations directed toward producing income, in which case an expenditure which is not capital expenditure is usually considered as having been incurred in gaining or producing income; *W Nevill & Co v FCT* (1937) 56 CLR 290.

99 In the Australian High Court decision of *W Nevill and Company Limited v The Federal Commissioner of Taxation* (1937) 56 CLR 290 (which was also cited in *Pinetree*'s case, as noted in the preceding paragraph), Latham CJ stated (at 301):

> The mere reduction of expenditure, though it decreases the expenditure side of an account, does not increase the receipts side of the same account. In my opinion the answer to this contention is to be found in a recognition of the fact that it is necessary, for income tax purposes, to look at a business as a whole set of operations directed towards producing income. No expenditure, strictly and narrowly considered, 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 with that due regard to economy which is essential in any well-conducted business, then the expenditure (if not a capital expenditure) is an expenditure incurred in gaining or producing the assessable income. If it is not a capital expenditure it should be deducted in ascertaining the taxable income of the taxpayer.

Indeed, a holistic view that eschews artificiality and technicality ought to prevail (see also *per* Rich, Dixon and McTiernan JJ at 304, 307 and 309, respectively).

100 Applying the wider nexus test as laid down by the Court of Appeal in *Pinetree*'s case, the Prepayment Penalty and Guarantee Expenses permitted the respondent to obtain substantial interest savings thereby increasing the respondent's overall profitability. As such, these Expenses can be regarded as having been incurred "in the production of income" under s 14(1) of the ITA.

101 The case authorities relied on by the judge, *Federal Commissioner of Taxation v Marbray Nominees Pty Ltd* (1985) 85 ATC 4,750 ("*Marbray*'s case") and *Vodafone Cellular Ltd v Shaw* [1997] STC 734 ("*Vodafone*'s case") to find that the Prepayment Penalty is a deductible expense, are also highly persuasive as both dealt with prepayment penalties.

102 In *Marbray*'s case, the Australian court concluded that the prepayment penalty was revenue in nature and deductible as it found that the underlying loan was revenue in nature.

103 In *Vodafone*'s case, Millett LJ, who delivered the leading judgment of the English Court of Appeal, first examined whether or not the payments made were of a capital or revenue nature. He observed that by cancelling the agreement concerned, the taxpayer merely obtained a reduction in its annual expenditure. This was not a benefit of an enduring nature in the way that fixed capital

endured. It followed therefore that it was a revenue payment.

104 Similarly, the judge in the present proceedings was of the view that the interest savings the respondent enjoyed after securing a release from the Syndicated Loan was not the kind of enduring benefit in the sense in which the expression is used.

105 The issue as to whether the Guarantee Expenses created an advantage, which is of an enduring benefit to the respondent's business, is also determinative of whether the Guarantee Expenses is a capital or revenue expenditure and is therefore deductible. This test has its genesis in the House of Lords decision of *British Insulated and Helsby Cables, Limited v Atherton* [1926] AC 205 ("*Atherton*") at 213–214, where Viscount Cave LC observed thus:

> [W]hen an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade … there is a very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as attributable not to revenue but to capital.

106 Rowlatt J, in the English High Court decision of *Anglo Persian Oil Co, Ltd v Dale (HM Inspector of Taxes)* (1931) 16 TC 253 (whose decision was affirmed by the Court of Appeal), explained (at 262) the phrase "enduring benefit" as meaning:

> [A] benefit which endures, in the way that fixed capital endures; not a benefit that endures in the sense that for a good number of years it relieves you of a revenue payment. It means a thing which endures in the way that fixed capital endures. It is not always an actual asset, but it endures in the way that getting rid of a lease or getting rid of onerous capital assets or something of that sort as we have had in the cases, endures. I think that the Commissioners, with great respect, have been misled by the way in which they have taken "enduring" to mean merely something that extends over a number of years.

What this means is that a payment may be made and be deductible as revenue expenditure even though it provides a long term advantage to the trade. This can be so even though the payment does not relate to anything which can be described as a capital asset. Even where it does, a deduction may be possible. Thus in the House of Lords decision of *Commissioners of Inland Revenue v Carron Company* (1968) 45 TC 18, Lord Reid said (at 68):

> [M]oney spent on income account, for example on durable repairs, may often yield an enduring advantage. In a case of this kind what matters is the nature of the advantage for which the money was spent.

107 We accept the respondent's argument that the payment of the Guarantee Expenses did not bring into existence any asset or advantage for the enduring benefit of the respondent's trade and hence the Guarantee Expenses should be regarded as revenue and not capital in nature. What the early repayment of the Syndicated Loan resulted in was only "revenue benefit", *ie*, considerable economy, saving in working expenses and also improved efficiency for the respondent's business.

108 The judge was of the view that the bank guarantees amounted to a refinancing which enabled the release of funds to pay the Syndicated Loan. Indeed, it is well established by cases such as*Federal Commissioner of Taxation v JD Roberts; Federal Commissioner of Taxation v Smith* (1992) 92 ATC 4,380 and *Federal Commissioner of Taxation v Jones* (2002) ATC 4,135 that expenses incurred in connection with the refinancing of a revenue loan are also revenue in nature. Further, there appears to be no reason why the respondent's claims for a deduction of the Guarantee

Expenses should be denied when interest expenses incurred on loans taken up to refinance earlier loans or borrowings are possibly deductible under the IRAS Interpretation and Practice Note 19, "Administrative Concession for Interest Incurred by Taxpayers on Loans to Refinance Earlier Loans on Borrowings" *IRAS Compass* (17 April 1995, 3(2)) at 4, if the refinancing is effected for genuine commercial reasons. The judge seemed to be alluding to this point when he opined (GD at [111]):

> I do not see why the nature of the second facility should make a difference. The main components of the Guarantee Expenses were based on interest calculations as well.

109 Accordingly, for the reasons set out above, the Relevant Expenses incurred by the respondent are revenue expenses and deductible against the respondent's taxable income under s 14(1) of the ITA.

110 Given our decision, it is unnecessary to consider any issue with respect to s 15(1)(*c*) of the ITA as we have found that the Relevant Expenses are revenue in nature and, hence, would not fall afoul of this provision in any event.

Conclusion

111 In the circumstances, we dismiss the appeal with costs.