www.pwc.com/sg/tax

Tax Bulletin

ATG v Comptroller of Income Tax

October 2011

pwc

ATG v Comptroller of Income Tax [2011] SGITBR 2

The Inland Revenue Authority of Singapore (IRAS) has been known to take the view that a company that places its plant and machinery with a sub-contractor (related or not) for the manufacturing of its products is not entitled to capital allowances on capital expenditure incurred for that machinery. It is presumably for this reason that the Economic Development Board of Singapore introduced the Integrated Industrial Capital Allowance (IICA) scheme in 2003. This scheme allows a Singapore company to claim capital allowances on plant and machinery owned by it, albeit that it is used by its overseas wholly-owned subsidiary for the manufacturing of the Singapore company's goods. It is unclear how strong the take-up rate of this scheme has been over the years. Its usefulness is somewhat limited in that the scheme does not apply to a company outsourcing manufacturing to either a third-party sub-contractor or a related company in Singapore.

Even with the IICA scheme in place, the lingering question of whether capital allowances were not already available under the existing law never quite went away. It was our view that they were. With *ATG v Comptroller of Income Tax*, we have (for now) an answer. This is that capital allowances are available to a person placing his own plant and machinery with a sub-contractor for the manufacture of his products.

Facts

ATG, a Singapore resident company, manufactured high precision components and devices as well as certain equipment for manufacturing those products. It sub-contracted the manufacturing of the products to sub-contractors, both inside and outside Singapore. Under this model, the sub-contractors would procure certain components of the products from third-party vendors or ATG; process or assemble them; manufacture the finished products or the components; and sell the finished products or components to ATG.

The agreed pricing between ATG and the sub-contractors ensured that the sub-contractors did not profit from the buying and ownership of the raw materials bought from suppliers designated by ATG. Further, ATG placed certain plant and machinery (comprising equipment, moulds and dies) for manufacturing the products and other components at the sub-contractors' premises. ATG was responsible for the plant and machinery, bearing all maintenance and repair costs, and effectively retained ownership of it.

The question for the Board of Review was whether ATG was entitled to capital allowances under sections 19(2)[1] and 19A(1)[2] of the Income Tax Act (the "Act") on its plant and machinery placed with sub-contractors for the manufacturing process.

---

[1] "Where at the end of the basis period for any year of assessment, a person has in use machinery or plant for the purpose of his trade, profession or business, there shall be made to him, on due claim, in respect of that year of assessment, an allowance for depreciation by wear and tear of those assets…."

[2] "Notwithstanding section 19, where a person carrying on a trade, profession or business incurs capital expenditure on the provision of machinery or plant for the purpose of that trade, profession or business, there shall be made to him, on due claim for any year of assessment and in lieu of the allowances provided by section 19, an annual allowance of 33 1/3% in respect of the capital expenditure incurred." This section accelerates the claim.

The arguments presented

Both parties accepted that the test was whether there existed the requisite degree of connection between ATG's business and the expenses incurred in buying the plant and machinery.

The Comptroller argued that capital allowances should not be available to ATG on the following grounds:

- the associated risks of the manufacturing process ultimately stayed with the sub-contractors;
- title to the manufactured goods as well as the risks and rewards remained with the sub-contractors until sold to ATG; and
- Parliament would not have legislated the IICA scheme within the Economic Expansion Incentives (Relief from Income Tax) Act (EEIA) if capital allowances would have been available in such a case.

By contending the first two points above, the Comptroller was presumably trying to show that the connection between ATG's trade and the expenditure incurred on the plant and machinery was insufficient to justify the claiming of capital allowances by ATG – the plant and machinery was for the benefit of the sub-contractors' trade rather than that of ATG. ATG (rightly) countered that the test was whether the plant and machinery was used for the purpose of its trade, not which person had title to or bore the risk of the goods made.

What the Board of Review said

After going through the arguments presented by both sides as well as case law precedent (though none was directly on point), the Board of Review summarised the following principles:

- the purpose of sections 19 and 19A is to give allowances for capital expenditure incurred in providing plant and machinery for the purposes of a taxpayer's trade or business;
- "for the purpose of trade" means for the purpose of enabling a person to carry on and earn profits in the trade; and
- there must be a nexus between the expenditure incurred and the taxpayer's trade or business. This is a question of fact and in deciding, it is important to consider whether the expenditure was "really incidental to the trade" or was incurred "for the purpose of earning the profits". Just because the expenditure also benefits a third party will not affect a finding of the purpose of earning of profits.

Based on the facts, the Board of Review was satisfied that there is sufficient connection between ATG's trade and the capital expenditure incurred in providing the plant and machinery placed with its sub-contractors. The equipment placed with the sub-contractors was used exclusively for the manufacturing of ATG's products and components. ATG continued to own and maintain the equipment; it bore repair and maintenance costs as well as depreciation costs. ATG supplied training and know-how for the operation of the equipment, which contained ATG's proprietary design. Access to the equipment was controlled and steps were taken to prevent counterfeiting. In addition, the machinery was not of a type that could be commercially priced for sale to the sub-contractors. (The first two points seem relevant while the last three points about training, restricted access and not being available for sale appear to be less relevant and on our reading, they should have no bearing in deciding whether the capital expenditure was incurred for the purpose of earning the profits.)

Although the sub-contractors also benefited from the use of the equipment, there was nothing in sections 19 or 19A to suggest that ATG cannot claim capital allowances on such equipment – they were used to earn profits for ATG. That the sub-contractors assumed the risks in its manufacturing business or owned the products before the passing of title had no bearing on the Board of Review's finding.

In relation to the IICA scheme, the Board thought that the underlying transaction in the relevant provisions in the EEIA was the carrying out of an approved project through an overseas subsidiary. They did not overlap entirely with sections 19 and 19A of the Act and therefore should not restrict the application of those two sections.

How does it affect you?

One common question posed is whether it makes any difference if the plant and machinery is placed at the premises of an overseas sub-contractor. Leaving the potential issue of permanent establishment aside, *ATG* suggests that location is not an issue. It was said at the start of the decision that sub-contractors of ATG were found both inside and outside Singapore with no further reference made to that point. Indeed, an officer from the IRAS's Tax Policy and Rulings Branch, Tax Policy and International Tax Division, was asked to explain to the Board of Review the IRAS's guidelines in distinguishing between toll manufacturers and contract manufacturers. The officer "accepted that in some situations, the location of the equipment for which capital allowance is claimed is not a factor."[3]

It is not known if the Comptroller has appealed the decision. Assuming no appeal has been lodged, certainly any taxpayer that has a similar arrangement to the fact pattern described above and who has been consistently denied capital allowances should consider re-opening their case. That said, one should bear in mind that the IRAS may well attempt to restrict the application of this decision to the specific fact pattern.

In our view, one lingering question in such a case is whether the Singapore principal is in fact leasing the equipment to the manufacturer with the rental being embedded in the price of the goods manufactured. Had it been a standalone charge, the rental is likely to have been liable to withholding tax in the other jurisdiction. If, however, it is embedded within the pricing and effectively netted off, the foreign tax authorities are likely to lose out on withholding tax on the gross rental payable. On the other hand, this means lower costs for the Singapore principal.

---

[3] Paragraph 64 of the decision.

Get in touch

Contact us

If you would like to discuss any of the issues considered in this bulletin, please speak to your usual PwC contact or contact our team:

Corporate Tax		
Alan Ross	alan.ross@sg.pwc.com	+65 6236 7578
Sunil Agarwal	sunil.agarwal@sg.pwc.com	+65 6236 3798
Paul Cornelius	paul.cornelius@sg.pwc.com	+65 6236 3718
Abhijit Ghosh	abhijit.ghosh@sg.pwc.com	+65 6236 3888
Jenny Goh	jenny.goh@sg.pwc.com	+65 6236 3638
Ho Mui Peng	mui.peng.ho@sg.pwc.com	+65 6236 3838
Anuj Kagalwala	anuj.kagalwala@sg.pwc.com	+65 6236 3822
Paul Lau	paul.st.lau@sg.pwc.com	+65 6236 3733
Lennon Lee	lennon.kl.lee@sg.pwc.com	+65 6236 3728
Elaine Ng	elaine.ng@sg.pwc.com	+65 6236 3627
David Sandison	david.sandison@sg.pwc.com	+65 6236 3675
Peter Tan	peter.tan@sg.pwc.com	+65 6236 3668
Tan Tay Lek	tay.lek.tan@sg.pwc.com	+65 6236 3768
Teo Wee Hwee	wee.hwee.teo@sg.pwc.com	+65 6236 7618
Yip Yoke Har	yoke.har.yip@sg.pwc.com	+65 6236 3938
Corporate Tax Compliance Services		
Nicole Fung	nicole.fung@sg.pwc.com	+65 6236 3618
Indirect Tax (Goods and Services Tax)		
Koh Soo How	soo.how.koh@sg.pwc.com	+65 6236 3600
Transfer Pricing		
Nicole Fung	nicole.fung@sg.pwc.com	+65 6236 3618
Paul Lau	paul.st.lau@sg.pwc.com	+65 6236 3733
Kevin McCracken	kevin.j.mccracken@sg.pwc.com	+65 6236 7308
Mergers & Acquisitions		
Chris Woo	chris.woo@sg.pwc.com	+65 6236 3688

About PricewaterhouseCoopers Services LLP
PwC is one of the largest providers of professional tax services in Singapore. Our tax professionals and directors help individuals, businesses, both public and private organisations, with tax strategy, planning and compliance. From financial services, treasury, fund management, mergers and acquisitions, intellectual property, international tax planning (inbound and outbound) and Goods and Services Tax (GST) to transfer pricing, our tax professionals will provide you with the ideal tax solution. Visit our website at www.pwc.com/sg/tax

www.pwc.com/sg/tax

© 2011 PricewaterhouseCoopers Services LLP. All rights reserved. In this document, “PwC” refers to PricewaterhouseCoopers Services LLP, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

These notes are designed to keep clients up to date with tax developments and do not constitute professional advice. They are of a general nature only and are not intended to be comprehensive. Readers are therefore advised that before acting on any matter arising from these notes, they should discuss their particular situation with the Firm. No liability can be accepted for any action taken as result of reading the notes without prior consultation with regard to all relevant factors.