Comptroller of Income Tax v KE
[2006] SGHC 140

Case Number : DA 29/2005

Decision Date : 07 August 2006

Tribunal/Court : High Court

Coram : Kan Ting Chiu J

Counsel Name(s) : David Lim (Inland Revenue Authority) for the appellant; Ong Sim Ho, Ong Ken Loon and Low Wee Siong (Ong Sim Ho) for the respondent

Parties : Comptroller of Income Tax — KE

Revenue Law – Income taxation – Deduction – Income taxation of licensed housing developer based on Completed Contract Method – Completion of contract under Housing Development (Project Account) Rules – Whether developer can deduct 85% of costs incurred up to temporary occupation permit (TOP) stage against 85% of purchase price accrued and defer deduction of remaining 15% of costs to balance 15% of purchase price receivable in subsequent year of assessment – Housing Developers (Project Account) Rules (Cap 130, R 2, 1997 Rev Ed)

7 August 2006 *Judgment reserved.*

Kan Ting Chiu J:

Facts

1 KE, the respondent, is a licensed housing developer. It developed a condominium project for which Temporary Occupation Permits ("TOPs") for the units were issued in 1998, by which time all the units had been sold.

2 The development was undertaken under the Housing Developers (Control and Licensing) Act (Cap 130, 1985 Rev Ed) ("the Act"). The agreements of the respondent entered into with the purchasers of the units were in the form prescribed under the Housing Developers Rules (Cap 130, R 1, 1990 Rev Ed). Clause 5 of the agreements stipulated that 85% of the purchase price was to be paid by instalments to the respondent within 14 days from the issue of the TOPs, the remaining 15% being payable on legal completion when legal titles are delivered to the purchasers.

3 The TOPs were issued within the respondent's financial year ended 30 June 1998 and the Year of Assessment ("YA") 1999.

4 The management of the finances of the development are governed by the Act and the Housing Developers (Project Account) Rules (Cap 130, R 2, 1997 Rev Ed) ("the Project Account Rules"). The Act requires housing developers to set up a project account for each development. Proceeds from the sale of the development have to be paid into the project account, and withdrawals from the project account can only be made for the purposes approved by the Project Account Rules. Rule 7 however provides that after the grant of the TOP, the developer may withdraw any surplus money in the project account after making several mandatory deductions.

5 The combined effect of this rule and cl 5 of the agreement is that the respondent has control of the moneys in the project account when the TOP is issued and 85% of the purchase price is payable.

6 When the TOPs were issued, the respondent had incurred $135.9m in construction and allowable expenses (hereinafter referred to as "the incurred costs").

7 The respondent which had elected to be taxed by the Completed Contract Method (also known as the Completion Method) sought to deduct 85% of the incurred costs from the 85% of the sale proceeds in computing its tax liability for YA 1999, with the balance 15% of the costs to be deducted from the remaining 15% of the sale proceeds in a subsequent year of assessment.

8 The Comptroller of Income Tax ("CIT") did not allow that, and took the position that the full amount of incurred costs was to be deducted in YA 1999 from the sale proceeds accrued in that year.

9 The respondent appealed to the Income Tax Board of Review ("the Board") against the CIT's decision. When the Board ruled in favour of the respondent, the CIT appealed against the Board's decision, and the appeal came before me.

The Completed Contract Method

10 This method allows a taxpayer such as the respondent who receives payment on contracts by instalments to compute his tax liability only at the completion of the contract.

11 The rationale for this method was explained by Lord Templeman in the Privy Council's decision in *TH Limited v Comptroller of Income Tax* (1950–1985) MSTC 457 ("*TH v CIT*") at 459; *Thomas Hill Ltd* [properly, Thomson Hill Ltd] *v Comptroller of Income Tax* [1984–1985] SLR 2 at 5, [9]:

> The principle which inspires the completed contract method is that a project does not yield a profit or an income until the project has been completed and proceeds of sale are or can be realised. Until completion, that is until profit or income can be realised, revenue is not recognised or attributed to enhance work in progress and on the other hand costs and expenses are not brought into account. There is thus no need to value work in progress from year to year in order to arrive at the profit for that year. Profit only arises when the contract or development is completed.

12 A housing development is not considered to be completed before legal titles to the properties are delivered to the purchasers. For licensed housing developers, however, the completion of a development is brought forward under the Statement of Accounting Standard 16 (Revised) ("SAS 16") issued by the Council of the Institute of Certified Public Accountants of Singapore in July 1996, para 5 of which states:

> **Recognition of profit under the completion method**
>
> 5 Profit shall be recognised when property is sold and a *temporary occupation licence has been issued* by the authorities and provided:
>
> a) The parties are bound by the terms of a contract;
>
> b) The collectibility of the sales price is reasonably assured; and
>
> c) The property is ready for delivery.
>
> Unless all conditions exist, recognition of all or part of the profit should be withheld. Where a

portion of the sales price is not due from the buyer under the terms of the purchase and sales agreement, the profit attributable to that portion may be deferred.

[emphasis added]

13 Although it has no statutory effect both parties accepted that SAS 16 is to be applied.

14 It was also common ground between the respondent and the CIT that the respondent's income from the development was to be recognised at the TOP stage, when 85% of the purchase price was payable to the respondent by the purchasers.

The Board's decision

15 The Board ruled in favour of the respondent, though not on the ground relied on by the respondent.

16 The Board identified that the question is to be determined by reference to two provisions of the Income Tax Act (Cap 134, 2004 Rev Ed), namely s 10(1)(*a*) which is the charging provision and s 14(1), the income-recognition provision:

> **10.**—(1) Income tax shall, subject to the provisions of this Act, be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in or derived from Singapore or received in Singapore from outside Singapore in respect of —
>
> (*a*) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised;
>
> …
>
> **14.**—(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 …

17 The Board relied heavily on Lord Templeman's judgment in *TH v CIT* in coming to its decision. It was unfortunate, in the circumstances, that when the Board purported to state the facts of that case by setting out the headnote of the case as reported in (1950–1985) MSTC 457 in its grounds of decision, some words were left out, which rendered the meaning incomplete (see *KE v Comptroller of Income Tax* [2005] SGITBR 4 at [41]).

18 The full headnote, with the words omitted by the Board reinstated and italicised, reads:

> TH Limited carried on business as housing developers. The company elected and the Comptroller accepted that the profit and loss accounts of the company should be prepared by the "completed contract method".
>
> Over a period of three years the property tax payable in respect of every development site held by the company was not charged against the company's profit in each year of payment as part of the general administration expenses of the company but was included in the costs and expenses of the development for the purposes of arriving at the net profit of that development *included in the income of the company in the year of completion of the development*. But for the

property tax paid, the net profit disclosed in the year of completion would have been higher by the amount of tax paid between the acquisition of the site and the completion of the project.

In the subsequent year's accounts, the taxpayer altered its practice with regard to property tax. The tax paid during that year in respect of each development site was treated as a general administration expense of the company and was brought into the profit and loss account for the year thus reducing the net profit liable to income tax. The Comptroller had insisted that the taxpayer comply with the completed contract method adopted by the company. The taxpayer appealed to the Board of Review, the High Court and the Court of Appeal of Singapore without success.

The taxpayer argued that if the property tax for each development had been treated as part of the development costs, the accounts of a company pending completion of the development would have been distorted. It also asserted that in the completed contract method some costs which were directly attributable to a particular contract and nothing else were not to be taken into account in the final computation of profit but were to be treated as though they were general expenses of the company simply because they did not enhance the value of the site which was in the course of development.

19 The taxpayer's appeal was dismissed by the Privy Council, and the grounds were summarised in the same headnote:

1. There could have been no distortion of the profit and loss accounts of the company prepared pursuant to the completed contract method save for the inevitable distortion caused by the method itself. But the method had been accepted by the Comptroller of Taxes and by the taxpayer and its advisers and had been approved by the Institute of Charted Accountants of England and Wales and the International Accounting Standards Committee.

2. The principles of commercial accounting applicable to the completed contract method require the uniform treatment of costs and expenses attributable to a particular project, whether those costs and expenses can be said to enhance the value of the subject matter of the project or not.

20 In the present case, the Board, in arriving at its decision, stated at [46] to [48] of its grounds of decision ([17] *supra*):

46. In the Board's view, the dispute that has arisen in this case (whereby 85% of the Sales Proceeds are deemed to have been derived in the Year of Assessment 1999 and that 100% of the Costs are to be deducted therefrom, leaving 15% of the Sales Proceeds taxable in the Year of Assessment 2000 with no corresponding proportion deduction of the Costs) is due to the adherence of the Completed Contract Method until TOP was granted for the Development and the abandonment of such method immediately thereafter.

47. As Lord Templeman had stated in *TH* at page 462, "in the present case the company is not being asked to abandon the completed contract method but to apply it uniformly and consistently".

48. To apply the Completed Contract Method (which has long been accepted by the Respondent and endorsed by this Board in *MPD*) uniformly and consistently would lead to the following two alternatives:

> (a) 85% of the Sales Proceeds to be deemed derived in the Year of Assessment 1999 (with a corresponding deduction of 85% of the Costs) and 15% of the Sales Proceeds to be deemed derived in the Year of Assessment 2000 (with a corresponding deduction of 15% of the Costs) ("Alternative 1"); or
>
> (b) 100% of the Sales Proceeds to be deemed derived in the Year of Assessment 1999, with a corresponding deduction of 100% of the Costs ("Alternative 2").

and at [55]:

> [T]he Board is of the opinion that only 85% of the Sales Proceeds are to be deemed to have accrued to the Appellant in the Year of Assessment 1999. Accordingly, applying [*Minister of National Revenue v Anaconda American Brass Ltd* [1956] AC 85], the accounting method consistent with tax laws and the Completed Contract Method would be Alternative 1. The Board accordingly holds that 85% of the Sales Proceeds are to be deemed accrued in the Year of Assessment 1999 (with a corresponding deduction of 85% of the Costs) and 15% of the Sales Proceeds are to be deemed accrued in the Year of Assessment 2000 (with a corresponding deduction of 15% of the Costs).

21 In [48] of the grounds of decision, the Board stated without explanation that the uniform and consistent application of the Completed Contract Method would lead to the two alternative positions set out, adding at [49] that the respondent's expert witness "also confirmed that the … two alternatives were the only two alternatives permitted under the Completed Contract Method."

22 The affidavit of evidence-in-chief of the respondent's expert witness, Mr Kaka Singh, did not contain any such confirmation, and he had only set out two scenarios in [16] of his affidavit set out in [36] hereof as illustrations, without asserting or implying that those were the only possible scenarios.

23 There must be at least a third alternative, that the full incurred costs (*ie,* the $135.9m) be deducted from the full income received or receivable, (*ie*, 85% of the total sale proceeds). This alternative has the benefit of being consistent with the words of s 14(1) of the Income Tax Act, that in ascertaining income "for any period" all outgoings and expenses incurred "during that period" shall be deducted. The provision calls for no apportionment or deferral of incurred costs.

24 With respect to the Board, [48] of its grounds of decision revealed a misunderstanding of Lord Templeman's judgment. When Lord Templeman referred to uniformity and consistency, he was referring to uniformity and consistency in the treatment of expenses attributable to a project, whether the expenses enhanced the value of the project or not, and that was said in response to the taxpayer's attempt to treat property tax separately from the other costs of development. His Lordship was not referring to any principle that would allow the apportionment of the costs of development to the 85% payment reckoning of the completion of the contract because the case pre-dated the Project Account Rules. At that time, a development project would be taken to be completed when title was delivered.

25 When Lord Templeman ruled at 460 that:

> … the completed contract method of computing income is accepted by the Comptroller of Taxes and by the company and its advisers and was approved by the Statement of Standard Accounting Practice No. 9 issued by the Institute of Chartered Accountants of England and Wales and by the International Accounting Exposure Draft No. 12 issued by the International Accounting

> Standards Committee. Pursuant to that approved method no income of the company arises from a development *until that development is completed*. Outgoings and expenses directly attributable to that development are not deductible from the income of the company as they arise but are only taken into account in arriving at the profit derived from the development and that profit constitutes part of the income of the company in the year of completion and not in any previous year. [emphasis added]

he was taking the project completion to be the date of legal completion.

26 There was no question in *TH v CIT* of maintaining uniformity and consistency in costs and profits between the 85% and the 100% payment stages. *TH v CIT*, on a proper reading, is not authority or basis for restricting the deduction of incurred costs to 85% for YA 1999.

The alternative basis

27 The respondent went beyond supporting the Board's ground for arriving at its decision. It went on under O 55D r 7(5) of the Rules of Court (Cap 322, R 5 2006 Rev Ed), to argue that the Board's decision should be affirmed on an alternative basis.

28 The respondent submitted on the application of s 10(1) and s 14 of the Income Tax Act:

> In view of the particular drafting employed for section 10(1)(a), it is obvious that it is necessary to first determine the "gains or profits" chargeable to tax under section 10(1)(a) before we turn to section 14(1). Adopting this interpretation, there would be certain costs, in particular, … cost of sales, which have to be taken into account at this stage and which are not subject to section 14(1).[note: 1]

29 There is nothing exceptional about the first sentence. Section 10(1) is the charging provision which sets out the sources of income which are subject to taxation. Section 14(1) is the income-recognition provision that specifies the manner in which income is to be quantified for the purpose of taxation.

30 Logic and practicality suggest that s 10(1) be applied first, before moving on to apply s 14. There is no purpose in quantifying income from a source which may not be taxable.

31 The second sentence, that costs of sales has to be taken into account under s 10(1)(*a*) and not under s 14 is controversial and hard to follow. Section 10(1) is concerned with the types of income, and s 14(1), the quantum of income. Costs of sales or construction costs affect the quantum, and not the type of income.

32 The respondent went on to assert that:

> The "gains or profits" chargeable to tax under section 10(1)(a) are to be determined according to the applicable principles of commercial accounting, in particular, the Completed Contracts Method.[note: 2]

33 If this is taken to mean that in this case "gains or profits" under s 10(1)(*a*) have to be quantified according to the Completed Contract Method, that is correct, as taxable income under s 10(1)(*a*) has to be quantified under s 14(1). However, the thrust of the statement was the respondent's contention on the manner in which the Completed Contract Method is to be applied.

34 In para 33 of its submissions before the Board, the respondent contended that:

> The correct approach requires that the "gains or profits" chargeable to tax under section 10(1)(a) first be determined by taking into account the related cost of sales against the revenue recognised. Applying this approach to the instant case and matching the related cost of sales against the revenue recognised pursuant to the applicable business and accountancy principles, 85% of the costs of sales has to be recognised in the Year of Assessment 1999, in which 85% of the proceeds from the sale of the units in the Development were recognised, and 15% of the costs of sales has to be recognised in the Year of Assessment 2000, in which 15% of the proceeds from the sale of the units in the Development were recognised.

35 Mr Kaka Singh, a senior accountant, stated in his affidavit of evidence-in-chief that:

> 8. In other jurisdictions, revenues and expenses may be accounted for on a cash received and cash paid basis. When this method is used, revenues are reported as earned in the period in which cash is received, and cost and expenses are reported in periods in which cash is paid. Taxable income matching is therefore calculated as the difference between cash receipts from revenues and cash payments for expenses. But in Singapore this cash method is not permitted under the accounting standards or the tax rules for companies. Rather, companies are required to prepare their financial statements on the accrual basis of accounting, i.e. to recognise transactions and events when they occur and not as cash or its equivalent is received or paid. As explained above, revenues can be earned in a period other than when cash is received, and expenses can be incurred in a period other than when cash is paid.

and that led the Singapore tax practice to adopt a matching rule:

> 9. … The accountant solves this problem by applying the matching rule. Under the matching rule, revenues must be assigned to the accounting period in which the goods were sold or the services performed, and expenses must be assigned to the accounting period in which they were used to produce revenue. Though direct cause-and-effect relationships can seldom be demonstrated for certain, many costs, in particular, costs of sales, can be related to particular revenue. The accountant will recognise such expenses and related revenue in the same accounting period …
>
> Thus, costs of sales is generally recognised in the same period in which the related revenue from sales is recognised. We cannot have a sale without a costs of sales. This is the most basic principle in accounting.

36 He went on to say that the same general principles apply in the preparation of the financial statements of housing developers, with income recognition to be carried out in compliance with SAS 16, and:

> 13. Applying the [Completed Contract Method], on the issue of the TOP, 100% of the revenue and the costs should be recorded because:
>
> > (a) at this stage the property buyer has sufficient stake in the property to honour payment of the sale price, that is, there is no uncertainty of the realisability of revenue; and
> >
> > (b) at this stage the property developer is in a very good position to estimate the cost to complete, that is there is no uncertainty of the cost incurred or to be incurred.

14. However, under the Housing Developers Rules, only 85% [of the sale proceeds] can be invoiced on the issue of the TOP. This gave rise to the practice of recording 85% of the revenue at this point. It should however be recognised that the payments by the buyer based on the Schedule to the Housing Developers Rules is a funding arrangement between the developer and the buyer and it is to assist the developer in funding its cash flow requirements and is not an acceptable accounting practice to measure the performance of the development or stage of completion of the development project.

15. In the recognition of costs, under the matching rule … costs of sales should be recognised in the same period in which the related revenue from sales is recognised. It is a fundamental accounting principle that we cannot have a sale without a costs of sales.

16. In determining the relative costs of sales to be recognised, it should be borne in mind that the scheduled or instalment payments by the buyers were in the nature of a funding arrangement between the buyers and the developer and that, to the extent there is an excess of total proceeds over cost, *each instalment is deemed to bear the same proportion of profit. That is to say*, *the percentage of the costs of sales recognised in each period should be directly proportional to the percentage of sales proceeds recognised in that period.* Therefore, if 100% of the sales proceeds are recognised in the Year of Assessment ("YA") 1999, 100% of the costs of sales should be recognised in YA 1999. Likewise, if 85% of the sales proceeds are recognised in YA 1999 and the remaining 15% in YA 2000, 85% and 15% of the costs of sales should be recognised in YA 1999 and YA 2000 respectively.

[emphasis added]

and

18.(d) The result of the Comptroller's method of computation is that it charges to tax an understated profit in YA 1999 and an overstated profit in YA 2000. The anomaly is very apparent when one looks at the result in YA 2000. As costs of sales had been fully deducted against 85% of revenue in YA 1999, no costs of sales were available for deduction against the 15% of revenue recognised in YA 2000. The consequence, therefore, is that the Appellant was charged to tax on the gross 15% of revenue in YA 2000, without any deduction for costs of sale. The charging to tax of gross receipts from sales of trading stock without any deduction for costs of sales is manifestly wrong insofar as it does not follow generally accepted accounting principles in the determination of gains or profits from trade chargeable to tax. The anomaly in YA 2000 arises as a direct result of the Comptroller recognising 100% of the costs of sales in YA 1999 against 85% of revenue, without giving due regard to the nature of costs of sales, which have to be "matched" with the related revenue from sales.

37 He did not make clear in para 13 of his affidavit what the "100% of the revenue" referred to. If that meant a 100% of the proceeds received, *ie*, 85% of the full sale price, that is correct. However if that meant a 100% of the sale price, that is incorrect.

38 The first sentence of para 14 implied that except for the intervention of the Housing Developers Rules, 100% of the purchase price is payable when the TOP is issued. This is not correct. In law, an agreement for the sale and purchase of real property is not completed before legal title to the property is delivered to the purchaser, and a developer or any vendor cannot expect to receive the full purchase price before passing title to the purchaser. The Project Account Rules freed the project account at the 85% stage and enabled the contract completion for the purpose of income recognition and taxation to be moved forward from the legal completion stage to the TOP stage.

39 With reference to para 16, even if it is accepted that when the purchase price is paid in instalments that is in the nature of a funding arrangement, there is no basis to assert that "each instalment is deemed to bear the same proportion of [the] profit" of the project.

40 When the Completed Contract Method is applied, the profit is recognised at the time of completion. The principle underlying the method, as explained by Lord Templeman and set out in [11] hereof, is to make it unnecessary to work out profits from year to year, and by the same reasoning, from instalment to instalment, and to quantify the profits only at the time of legal completion when title is delivered.

41 When the Completed Contract Method and SAS 16 are applied together, then at the time the sale proceeds of 85% of the purchase price are recognised, the whole costs of sales of $135.9m incurred at that time should be deducted. Once the project is taken to be completed at the 85% payment or TOP stage, all the existing income and costs should be taken into account, because there cannot be a second completion under the Completed Contract Method. If the accounting practice is different, it does not aid the respondent's case because, as the Board noted in [50] of its decision:

> The general principle is of course well established that where accountancy practice is inconsistent with tax laws, the latter must prevail (*Odeon Associated Theatres v Jones* [[1973] Ch 288;] 48 TC 257 and *Heather v P-E Consulting Group Ltd* [[1973] Ch 189;] 48 TC 320). In [*Pinetree Resort Pte Ltd v Comptroller of Income Tax* [2000] 4 SLR 1], Yong CJ further held as follows at pages 11 and 12 [;[33]] after referring to *Odeon* and *Heather*:
>
> > The editors of Whiteman on Income Tax (3rd Ed) point out that in general, if accounts are prepared in a normal commercial manner and in accordance with current accountancy practice, the profit shown by those accounts will be taken as the taxable profit, subject to any specific statutory provisions and *to the overriding power of the court to disregard accountancy practice where that practice appears to be based on a mistaken view of the law.* This spells out the fact that regardless of how persuasive accounting evidence is, the prerogative still lies with the court to decide whether a particular item should be regarded as income that has accrued for the purposes of liability to tax.
>
> [emphasis in original]

42 With regard to para 18(d) of Mr Kaka Singh's affidavit, the anomaly referred to is a direct outcome of the respondent's decision to have its tax liability determined according to the Completed Contract Method and SAS 16. If one looks at the situation from the stand point of the Completed Contract Method and SAS 16, there is no anomaly at all.

43 In a situation where the sale proceeds received or receivable in YA 1999 represents 100% of the purchase price, all the costs accrued up to the same period should be deducted. Likewise if the sale proceeds recognised in YA 1999 amount to 85% of the purchase price, all the costs accrued up to YA 1999, should be deducted. The underlying principle is the same, *ie*, all costs incurred up to the year of assessment are deducted from all the sale proceeds received or receivable up to that year of assessment. There is no reason or justification for deferring 15% of the accrued costs to a subsequent year of assessment, and then to treat the deferred costs and any further costs incurred in the subsequent year of assessment as one. Such a division and deferral is inconsistent with s 14(1) of the Income Tax Act, as I have explained in [23] hereof.

44 The respondent's arguments relied on the principles of commercial accounting and the notion of proportionality referred to by Mr Kaka Singh in para 16 of his affidavit. This adherence to

proportionality and the Board's ruling on uniformity and consistency share the same basis, *ie*, that any deduction for costs of sales for one year of assessment should be limited in proportion to the proportion of the sale proceeds received or receivable in that year of assessment. The difference between the approach taken by the respondent and that of the Board is that the Board did not find it necessary to start with a discussion whether construction costs should come under s 10(1)(*a*) or s 14(1) of the Income Tax Act.

45 For the same reasons I do not accept the Board's conclusion based on its ruling on uniformity and consistency, I reject the respondent's submission on proportionality.

Conclusion

46 The appeal is allowed, with costs to the CIT to be taxed.

[note: 1]Appellant's submissions dated 13 August 2004 tendered to the Board at para 15b. The Respondent's case dated 2 April 2006 tendered in the appeal before me specially refers to these submissions.

[note: 2]Respondent's case dated 2 April 2006 at para 38(ii).