ACC v CIT
[2009] SGHC 211

Case Number : OS 510/2009

Decision Date : 23 September 2009

Tribunal/Court : High Court

Coram : Andrew Ang J

Counsel Name(s) : Leung Yew Kwong and Tan Shao Tong (WongPartnership LLP) for the applicant; Jimmy Oei and Usha Chandradas (Inland Revenue Authority of Singapore) for the respondent

Parties : ACC — CIT

Revenue Law

23 September 2009

Andrew Ang J:

Introduction

1 This case concerns an application by a Singapore incorporated parent company ("the Applicant") for leave under O 53 r 1 of the Rules of Court (Cap 322, R 5, 2006 Rev Ed) to quash the decision of the Comptroller of Income Tax ("the Comptroller") that withholding tax is applicable to payments made by the Applicant to its overseas subsidiaries.

Background

The facts

2 The Applicant and its subsidiaries are in the business of leasing certain machinery. Most of the subsidiaries are offshore special purpose companies ("SPCs") incorporated in the Cayman Islands. Each SPC is used to own only one machine. Each SPC also enters into a separate loan agreement with one or more offshore banks to finance the purchase of its machine. The "one-company-one-machine" structure is typically used for the purpose of ring fencing risks and is usually a requirement of the banks providing financing.

3 The leases entered into by the SPCs with lessees can either come with a floating rate rent or a fixed rate rent. When the lease is at a floating rate rent, the rental chargeable by the SPC would fluctuate together with the floating interest rate charged by the offshore banks on the loan granted to finance the purchase of the machine. Therefore, the SPC will not have an exposure arising from the fluctuation in interest rates since both the rental and the interest payment will be naturally hedged.

4 However for leases at a fixed rate rent, the SPC would be exposed to interest rate fluctuations if the financing were at a floating rate since the rent is fixed while the interest payment fluctuates with the prevailing interest rate. In order to minimise the interest rate risk exposure on such fixed rate rents, the SPC would hedge the interest rate exposure on its floating interest rate loan. This is done through an interest rate swap agreement whereby:

(a) the SPC would stream to the counterparty fixed rate periodic payments computed as a fixed percentage of a notional amount; and

(b) in exchange the counterparty would pay to the SPC on the same dates floating rate percentages of the same notional amount.

5 Ordinarily, each SPC would enter into interest swap arrangements directly with banks as counterparties. However, for reasons elaborated upon below, the Applicant and its subsidiaries came to an arrangement whereby the former would enter into interest rate swap agreements with Singapore banks or Singapore branches of foreign banks ("onshore banks") on behalf of the latter in order to hedge the latter's exposure to floating interest rates ("the Onshore Swaps Setup"). That arrangement had two main advantages.

6 First, the Onshore Swaps Setup significantly reduced the administrative burden of each SPC in relation to the creation of swap agreements. Before a company enters into a swap transaction with a bank, it has to enter into an International Swaps and Derivative Association ("ISDA") agreement with that party. I will be elaborating on the nature of ISDA agreements below at [33]. For the present, it suffices to say that typically a company will put in place ISDA agreements with several banks so that it will have a choice of banks to work with. The Onshore Swaps Setup eliminated the need for each SPC to separately enter into ISDA agreements with different banks.

7 Second, the Onshore Swaps Setup allowed the Applicant to dispense with the numerous guarantees that it would otherwise have had to provide to secure the obligations of the SPCs, given that the SPCs, which typically own only one machine each, have much weaker balance sheets compared to the Applicant. The Onshore Swaps Setup did away with the problem of assuring the onshore banks of the SPCs' creditworthiness.

8 So that the benefit of the Onshore Swaps Setup would flow through to the respective SPCs, the Applicant would enter into swap agreements with each relevant SPC mirroring those which the Applicant entered into on such SPC's behalf ("Offshore Swaps Agreements"). Thus, where a swap agreement entered into with the onshore bank indicated the onshore bank as the floating rate payer and the Applicant as the fixed rate payer, the Offshore Swaps Agreement with the SPC would indicate the Applicant as the floating rate payer and the SPC as the fixed rate payer. The manner in which the Applicant and the SPCs entered into the Offshore Swaps Agreements reflected their intention that the former was entering into swap agreements for the benefit of the latter.

9 As the interest rate swap agreements with the onshore banks were intended for the Applicant's subsidiaries, the net payments or receipts were seen to be amounts due from or to the SPCs. Consequently, they were recorded in the Applicant's balance sheet as "Amount owing to/by subsidiary". Such corresponding payments or receipts were also recorded in the books of the SPCs. No tax deduction was claimed on the payment made by the Applicant to its subsidiary in relation the Onshore Swaps Setup. Neither were receipts from the banks arising from these interest rate swaps brought to tax. Whether any excess of receipts over payments was taxable was not in issue.

10 The Applicant wrote to the Comptroller on 23 October 2008 for confirmation that withholding tax was not applicable to the payments made by it to the SPCs. On 6 February 2009, the Comptroller replied to say that withholding tax was applicable. The Comptroller took the position that the payments made by the Applicant to its subsidiaries pursuant to the Offshore Swaps Agreement fell within the ambit of s 12(6) of the Income Tax Act (Cap 134, 2008 Rev Ed) ("ITA") and that the withholding tax requirements under s 45 of the same statute applied. As the Applicant had not complied with the relevant withholding tax requirements with respect to the payments in question, the Applicant was required to account to the respondent for the amount of tax which should have been withheld.

11 In consequence of the Comptroller's decision, the Applicant came before me seeking leave to apply to quash the determination by the Comptroller.

The Applicant's case

12 The Applicant made three main submissions. First, it argued that by virtue of the fact that the power exercised is statutorily derived, the matter is amenable to judicial review. Second, the Applicant asserted that it has sufficient interest in seeking judicial review by reason of the possible consequences that the Applicant faces if it fails to withhold and account for tax to the satisfaction of the Comptroller. The Applicant pointed out that the letter of 6 February 2009 was directed at the Applicants to withhold tax and to account for the tax that should have been withheld. In addition, the Applicant stressed that it is liable to pay any penalty that will be imposed arising from its failure to comply with the withholding of tax in respect of payments made to the SPCs.

13 Third, the Applicant submitted that it had met the threshold requirement of showing that the material before the court disclosed a *prima facie* case of reasonable suspicion in favour of granting the public law remedies sought by the Applicant. It said so on the basis that swap payments made to the SPCs are not "interest, commission, fees, or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee or service relating to any loan or indebtedness" within the meaning of s 12(6)(*a*) of the ITA. Further, on the basis that the Applicant was agent for the respective SPCs, the Applicant argued that the moneys transferred to the SPCs rightly belonged to the latter. It therefore followed that the payments by the Applicant to the SPCs were not "borne" by the Applicant, as provided for in s 12(6)(*a*)(i), but merely remitted. For the same reason, it followed that the sums, which were transferred to their rightful owners, were not "deductible against any income" of the Applicant as provided in s 12(6)(*a*)(ii).

The respondent's case

14 In response, the Comptroller submitted that its powers had been properly exercised and that the materials did not establish that the Comptroller committed any error of procedure or took action outside his area of competence in his dealings with the Applicant. Second, it argued that the Applicant did not have *locus standi* to seek judicial review because it was not the tax liability of the Applicant that was in issue but its subsidiaries'. The Applicant, according to the Comptroller, was only a collecting agent acting on behalf of the SPCs.

15 Third, the Comptroller made the case that a perusal of the materials would show that there is no arguable case for judicial review upon the grounds of illegality, *Wednesbury* unreasonableness, or procedural impropriety. Fourth, it urged that leave should not be granted because the application would open the floodgates to frivolous litigation regarding tax liabilities.

Decision of the court

16 After deliberation, I decided in favour of the Applicant. I now set out the reasons for my decision.

The legal principles in relation to the application for leave

17 As helpfully summarised in *Singapore Civil Procedure 2007* (Sweet & Maxwell Asia, 2007) at para 53/8/22, pp 785–786, the requirements that need to be fulfilled before the court will grant leave to apply for a quashing order include the following:

(1) The matter complained of is susceptible to judicial review.

(2) The applicant has sufficient interest in the matter.

(3) The material before the court discloses an arguable case or *prima facie* case of reasonable suspicion in favour of granting the public law remedies sought by the applicant.

18 It is trite reasoning that the requirements are meant to ensure that the application for a quashing order is not groundless, hopeless, misguided, trivial or a waste of time.

Whether the matter complained of is susceptible to judicial review

Nature of power exercised

19 In *Public Service Commissioner v Lai Swee Lin Linda* [2001] 1 SLR 644 at [41], the Court of Appeal held that one of the tests for determining whether a particular decision made by a body or an authority is amenable to judicial review is the source of the power that is being exercised in making that decision. It adopted the statement of Lloyd LJ, in *R v Panel on Take-overs and Mergers, ex p Datafin plc* [1987] QB 815 at 847; [1987] 1 All ER 564 at 538, who having first noted that the source of power is not the sole test, continued:

> Of course the source of the power will often, perhaps usually, be decisive. If the source of power is a statute, or subordinate legislation under a statute, then clearly the body in question will be subject to judicial review. If, at the other end of the scale, the source of power is contractual, as in the case of private arbitration, then clearly the arbitrator is not subject to judicial review: see *R v National Joint Council for the Craft of Dental Technicians (Dispute Committee), ex p Neate* [1953] 1 QB 704.

20 By the "source of power" test, the Comptroller's decision (that the Applicant's payments to the SPCs fall within the ambit of s 12(6) of the ITA) is clearly susceptible to judicial review. This is because the source of the Comptroller's power to assess and collect tax stems from s 4(3) of the ITA, which provides:

> *The Comptroller shall be responsible for the assessment and collection of tax* and shall pay all amounts collected in respect thereof into the Consolidated Fund. [emphasis added]

Nature of the matter that is the subject of the quashing order sought.

21 It is well established that in judicial review, the court is concerned not with the merits of a decision but the process by which the decision has been made (see *Leong Kum Fatt v Attorney General* [1984–5] SLR 367; *Lines International Holding (S) Pte Ltd v Singapore Tourist Promotion Board* [1997] 2 SLR 584; and *PSC v Linda Lai*) ([19] *supra*). This is because judicial review is not an appeal from a decision and the court cannot substitute its discretion for that of the public body nor can it quash a decision on the basis that the court would not have arrived at that decision or that some other decision would have been a better one.

22 However, the interpretation of statutes falls within the purview of the court. Thus, for example, in *JD Ltd v Comptroller of Income Tax* [2006] 1 SLR 484, the Court of Appeal was competent to

consider the ambit of the word "source" in s 14(1) of the ITA, as well as to make pronouncements on whether dividend income arising from a variety of share investment counters collectively formed a single source of income under s 10(1)(*d*) of the ITA. Similarly, in the present case, the Applicant is not asking for a review of the merits of the Comptroller's decision but is questioning whether, on a proper construction of s 12(6)(*a*) of the ITA, the Comptroller is procedurally *ultra vires* the statute. There can be no doubt that this question, which lies at the heart of the present matter, is susceptible to judicial review.

Whether the Applicant has sufficient interest in the matter

23 The question of sufficiency of interest cannot, and should not, be taken *in vacuo*. It must be considered within the legal and factual context of the case (see dicta of Lord Wilberforce in *Inland Revenue Commissioners v National Federation of Self-Employed and Small Businesses Ltd* [1982] AC 617 at 630 ("*IRC v National Federation of Self-Employed*")).

24 As briefly mentioned above at [14], counsel for the Comptroller would have me hold that as between the SPC (on whom no assessment has been made) and the Applicant (who is required by the Comptroller to withhold tax on pain of a debt being recoverable from it if it fails to do so), the SPC has the greater interest in the matter and the Applicant has no *locus standi* to seek judicial review. He urged me to accept this view on the basis that the income collected by way of withholding tax under s 45 of the ITA belonged to the SPC *de facto* and not to the Applicant. In the written submissions, it was argued that the Applicant is only a collecting Agent, and that the Comptroller does not require the Applicant to discharge the tax liabilities of its subsidiaries using its own funds.

25 The position advanced by counsel for the Comptroller erroneously assumes that only the party against whom tax is sought to be imposed (*ie*, the SPC) has a sufficient interest in judicial review of tax assessment decisions. In *R v Paddington Valuation Officer, ex parte Preachy Property Corporation* [1966] 1 QB 380, for example, it was held that a ratepayer, challenging the validity of valuation lists in which his name had been included, would be regarded as having standing to do so, even though the ratepayer had suffered no damage. *A fortiori*, in the present case where the Applicant is directed by the Comptroller to withhold tax on pain of such amount being recoverable against him as a debt if he should fail to do so, the Applicant surely can have *locus standi*.

26 What is all the more egregious is the position taken on behalf of the Comptroller that not only does the Applicant allegedly lack *locus standi* but the SPC too would not be able to object because no notice of assessment had been served on the SPC. In other words, the contention is that in this instance, executive power may be exercised without the possibility of review by any judicial body. The Applicant would not have *locus standi* because it allegedly lacks sufficient interest in the transaction and the SPC, against whom no assessment of tax has been made, would also not be able to bring the matter before the Income Tax Board of Review. Such a contention, in my view, is untenable. In any case, I hold that the Applicant does have *locus standi*.

Whether an arguable or prima facie case of reasonable suspicion exists.

27 Before leave can be granted to the Applicant, the material before the court must also disclose an arguable or *prima facie* case of reasonable suspicion in favour of granting the public law remedies sought. In *Chan Hiang Leng Colin v Ministry for Information and the Arts* [1996] 1 SLR 609 at 616, the Court of Appeal held that:

> What is required is not a prima facie case, but a prima facie case of reasonable suspicion. If the latter can be shown, then it cannot be said that the application must necessarily fail, for there would then appear to be an 'arguable case'.

The same test, albeit expressed in slightly different words, was applied in *PSC v Linda Lai* ([19] supra) at [22], where the Court of Appeal held:

> Leave would be granted, if there appears to be a point which might, on further consideration, turn out to be an arguable case in favour of granting to the applicant the relief claimed.

28 Clearly, the threshold requirement is not very high, although bare allegations will not suffice (see *Ung Yoke Hooi v Attorney General* [2008] SGHC 139 at [22]). The threshold is not high because the requirement that application for leave be taken out is merely meant to filter out "groundless or hopeless cases at an early stage" to "prevent a wasteful use of judicial time" and to "protect public bodies from harassment (whether intentional or otherwise)" (*PSC v Linda Lai* at [23]).

29 In coming to my conclusion, I was mindful that in cases concerning an application for leave to seek judicial review, the court ought not to go into the matter in any depth. It should rather make a "quick perusal of the material then available" before it (*IRC v National Federation of Self-Employed* at 106). In *PSC v Linda Lai* at [20]–[22], the Court of Appeal approved of the trial judge's refusal to embark upon any "detailed and microscopic analysis" of the material. In *Chai Chwan v Singapore Medical Council* [2009] SGHC 115 at [30], therefore, Belinda Ang Saw Ean J opined:

> 30 An application for leave to apply for judicial review being an *ex parte* application is usually considered on the papers by the judge who determines the *ex parte* application on 'a quick perusal of the material' and concludes that the material discloses 'what might on further consideration turn out to be an arguable case in favour of granting to the applicant the relief claimed'. In other words, on the face of the documents, the applicant must show some shred of an arguable case for judicial review upon the grounds of illegality, *Wednesbury* unreasonableness or procedural impropriety if he is to be granted leave.

30 In the present case, on a quick perusal of the material and arguments placed before me, I have been unable to say that the Applicant *prima facie* has no arguable case. The material does disclose what might on further consideration turn out to be an arguable case.

31 The crux of the substantive application to be filed turns on the construction of the deemed source provision in s 12(6)(*a*) of the ITA. The issue is whether the payments made by the Applicant to the SPCs, *ie*, payments under the Offshore Swaps Agreements, fall within the ambit of that section. Section 12(6)(*a*) of the ITA reads:

> (6) There shall be deemed to be derived from Singapore—
>
> (a) any interest, commission, fee or *any other payment* in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service *relating to any loan or indebtedness* which is —

(i) *borne*, directly or indirectly, by a person resident in Singapore or a permanent establishment in Singapore except in respect of any business carried on outside Singapore though a permanent establishment outside Singapore or any immovable property situated outside Singapore; or

(ii) *deductible* against any income accruing in or derived from Singapore. …

[emphasis added]

32 A preliminary issue aired before me was whether swap payments fell within the definition of "interest, commission, fee or any other payment". It was never contended before me, and in my view rightly so, that swap payments could fall within the definition of "commission or fee". I will therefore, only consider in turn whether it is arguable that swap payments could be "interest" or "any other payment" in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness.

33 As mentioned above at [6], before a company enters into a swap transaction with a bank, it has to enter into an ISDA agreement with that party. A description of what this entails can be found in Graham Roberts's *Law Relating to International Banking* (Woodhead, 1998), at pp 154–155:

> The ISDA agreement is a single Master Agreement, which the parties enter into ideally when they agree [*sic*] their first swap. This master agreement is intended to regulate the legal relationship between the parties; it is a detailed document governing most of the aspects of the relationship. Attached to the Master Agreement is a Schedule, in which the parties can add, amend or vary the details of the Master Agreement. The detailed economic features of each transaction separately are then recorded in a separate document, the confirmation.

In other words, the ISDA agreement serves as a master agreement by the terms of which individual swap transactions will be governed. I ought to note at this time that in the present case, nothing turns on this point. I have set out the above excerpt merely to provide a fuller picture of the transactions between the Applicant and the SPCs before embarking on the question whether swap payments are caught by the wording of s 12(6)(*a*) of the ITA.

34 In my view, there is an arguable case that swap payments do not fall within the definition of "interest". As defined in the *Singapore Master Tax Guide Manual* vol 2 (CCH Asia Ltd, 2007) at para 2168:

> An interest rate swap involves two unrelated parties who already have raised or will raise borrowings from different lenders, one carrying a fixed rate of interest and the other a floating rate. Under the swap transaction the parties undertake to meet each other's interest payments and this is effected by means of payments of interest differentials. The transaction is normally arranged through an intermediary bank and it is not unusual that the parties involved do not have any knowledge of each other's identity.

35 In relation to the excerpt above at [34], it is important to note that neither party to a swap transaction makes any loan to the other so as to give rise to an obligation on the part of the other to pay interest. Rather, the quantum of the periodic payments each has to make to the other can only be arrived at in the same way that interest is computed, *ie*, as the product of a principal amount, an applicable rate(s) and a time period expressed in the formula:

Periodic Payment = Notional Amount x Applicable Rate x Period of Time

In the case of swap transactions, since there is in reality no loan, the principal amount is the notional amount adopted by the parties.

36 In theory, the effect of the swap arrangement is that the SPC will receive from its counterparty a stream of floating rate swap payments with which it will make its floating rate interest payments to the offshore bank. In practice, the fixed rate and floating rate swap amounts payable by the SPC and the counterparty to each other are set off against each other so that on each payment date, only the difference is paid (see Jeff Madura, *International Financial Management*, (Thomas/South-Western, 8th Ed, 2006) at pp 549–550; and *Law Relating to International Banking* ([33] above) at p 146). Nevertheless, the SPC's exposure to interest rate fluctuations will have been hedged.

37 From the above, it can be seen that an interest rate swap agreement does not give rise to a payment of "interest" from one party to another as there is no underlying loan or indebtedness between the parties. Therefore, swap payments are not interest paid in connection with any loan or indebtedness, but rather a swapping of anticipated cash flows. Neither do such interest payments appear to be in connection any arrangement, management, guarantee, or service relating to any loan or indebtedness.

38 Turning then to the question of whether the swap payments could fall within the expression "any other payment", a plain reading of s 12(6)(*a*) of the ITA similarly reveals that for swap payments to qualify as "any other payment", they have to be made in connection with either "any loan or indebtedness", or "with any arrangement, management, guarantee or service relating to any loan or indebtedness". As already mentioned above, the swap payment does not arise from a loan or indebtedness but is a contractual swapping of cash flows. The payments are not made in connection with any loan or indebtedness but for the purpose of hedging risks. Neither do such payments appear to be connected to any "arrangement, management, guarantee or service relating to any loan or indebtedness". The swap payments therefore do not appear to be "interest" or "other payments" falling within the ambit of s 12(6)(*a*). Although in arriving at this preliminary conclusion, I have subjected s 12(6)(*a*) to some analysis, this is not to be taken as a substitute for a determination at the full hearing of the application for a quashing order.

39 Having already found that there is *prima facie* a reasonable suspicion in favour of granting the public law remedies sought by the Applicant on the basis of the Comptroller's decision being *ultra vires* the ITA, particularly s 12(6)(*a*), there is no need for me to go further, at this point in time, to consider the merits of the Applicant's argument that the swap payments made to the SPCs were not "borne" by the Applicant nor "deductible" against the Applicant's income for tax purposes. A consideration of the merits of those arguments would be better reserved for airing in the later substantive hearing.

Floodgates argument

40 One final point that needs to be disposed of is the argument made on behalf of the Comptroller that to allow this application would be to open the floodgates to frivolous litigation by those whose tax obligations under the ITA are clear. He contended that public bodies will be harassed by irresponsible and frivolous applications by vexatious litigants or unworthy cases as applicants would seek the assistance of the courts in the interpretation of the provisions in the ITA and in the structuring of their tax planning activities via the process of judicial review.

41 I do not think that the case at hand will lead to such results. The very purpose of requiring an

applicant to seek leave before applying for a quashing order is to sieve out frivolous vexatious or unworthy cases (see [18] and [28] above). If a case is frivolous, vexatious or unworthy, it will be precisely the task of the judge hearing the application for leave to stop the applicant from proceeding further by refusing to grant leave. If the application is meritorious, then surely the court cannot deny the applicant the leave he justly deserves just because other less meritorious applications may follow.

42 In regard to the specific issue of swap payments, there is even less likelihood of encouraging a spate of unmeritorious applications. This is because the case at hand involves the relatively rare situation where a swap transaction has been carried out between a foreign entity and a non-bank local entity. Almost all other offshore swap transactions are covered by either a Ministerial remission under s 92(2) of the ITA, or a statutory exemption under s 13(4) of the same statute (see IRAS, Practice Note on Tax Treatment of Interest Rate and Currency Swap Payments to Non-Residents, 1998/IT/7 (published on 31 October 1998)). The Ministerial remission applies to all interest rate and currency swap payments made by a bank in Singapore to its branches or another bank outside Singapore. The statutory exemption applies to interest rate or currency swap payments made on or after 1 April 1989 by an Asian Currency Unit of a bank in Singapore where:

(a) the payment is in currencies other than Singapore dollars;

(b) the payment is made to a person not resident in Singapore, other than a permanent establishment in Singapore; and

(c) the parties are not related to one another, or have obtained the approval of the Comptroller to be exempt from tax despite being related to one another.

The case at hand, which falls into neither of the above categories, is exceptional. Any apprehensions that the floodgates of judicial review will open are illusory than real.

Conclusion

43 For the above reasons, I granted the Applicant leave to seek a quashing order. The costs of this application are reserved to the judge hearing the substantive application.