

# IRAS releases new e-Tax Guide on appropriation of trading stock and conversion of non-trade/capital assets

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The Inland Revenue Authority of Singapore (IRAS) recently released a new e-Tax Guide titled “Tax Treatment on Appropriation of Trading Stock for Non-Trade or Capital Purposes and Conversion of Non-Trade or Capital Assets to Trading Stock”.

The e-Tax Guide provides details on the income tax treatment when trading stock held by businesses is appropriated for non-trade or capital purposes and when non-trade or capital assets are converted to trading stock.

Its release follows the insertion of section 10J of the

Singapore Income Tax Act 1947 (ITA) which applies to an appropriation of trading stock for non-trade or capital purposes and section 32A of the ITA which applies to a conversion of non-trade or capital asset to trading stock. These sections, which came into effect on 16 November 2021, were inserted via the Income Tax (Amendment) Act 2021 as a result of the Ministry of Finance’s periodic review of the income tax system.

This tax alert summarises the tax treatments listed in the new e-Tax Guide and provides our insights on them.

## Tax treatments and administrative requirements

The following table reflects the tax treatments and administrative requirements at a glance:

	(1) When trading stock is appropriated for non-trade or capital purposes		(2) When non-trade or capital asset is converted to trading stock
	(a) Holds or uses trading stock as capital asset	(b) Donates the trading stock	
<b>Income tax treatment</b>			
▶ <b>Open market value (OMV) as at date of appropriation/conversion</b>	Treated as income for the year of assessment (YA) relating to the basis period in which the trading stock was appropriated	For donation that qualifies for enhanced tax deduction under section 37(3) <sup>1</sup> : <ul style="list-style-type: none"> <li>• Cost of acquiring, making or constructing the trading stock (not OMV) treated as income</li> <li>• Enhanced deduction continues to be enjoyed for qualifying donations based on OMV</li> </ul> For donation of perishable trading stock: <ul style="list-style-type: none"> <li>• OMV accepted as nil</li> </ul>	Treated as the cost of the trading stock in computing the profit or loss arising from a subsequent sale or disposal of such trading stock
▶ <b>Other deductible amounts</b>	Expenses incurred in appropriation, including those incurred to acquire, manufacture, construct or otherwise bring the trading stock into existence up to date of appropriation, should be tax deductible	For donation that qualifies for enhanced tax deduction under section 37(3) <sup>1</sup> , cost of acquiring, making or constructing the trading stock should be tax deductible	Any additional cost incurred on trading stock up to the date of sale should be available for tax deduction at the time when the trading stock is subsequently disposed of

	(1) When trading stock is appropriated for non-trade or capital purposes	(a) Holds or uses trading stock as capital asset	(b) Donates the trading stock	(2) When non-trade or capital asset is converted to trading stock
<b>Income tax treatment</b>				
▶ <b>Net gain or loss on appropriation/conversion</b>	Taxable/deductible		No gain or loss arising on appropriation	Non-taxable/non-deductible, as any such gain/loss is capital in nature
▶ <b>Capital allowance (CA) [applicable where asset is a qualifying plant or machinery]</b>	CA allowed based on OMV as at date of appropriation		Not applicable	If CA has previously been claimed prior to conversion, compute balancing adjustment <sup>2</sup> based on difference between tax written down value and OMV as at date of conversion
▶ <b>Net gain or loss on subsequent disposal</b>	<ul style="list-style-type: none"> <li>• Non-taxable/non-deductible</li> <li>• Compute balancing adjustment<sup>2</sup> if CA has been claimed</li> </ul>		Not applicable	<ul style="list-style-type: none"> <li>• Taxable/deductible</li> <li>• Computed based on actual sale price less OMV of asset on date of conversion less cost of any additional work done</li> </ul>
<b>Compliance matters relating to the appropriation/conversion</b>				
▶ <b>In the income tax return for YA relating to basis period in which appropriation/conversion took place</b>	<ul style="list-style-type: none"> <li>• Bring to tax the gain/claim the loss, arising from the appropriation</li> <li>• Make relevant tax adjustments in respect of the appropriation</li> </ul>		<ul style="list-style-type: none"> <li>• Make relevant tax adjustments in respect of the appropriation/donation</li> </ul>	<ul style="list-style-type: none"> <li>• Include computation of balancing adjustment<sup>2</sup> (if applicable)</li> <li>• Make relevant tax adjustments in respect of the conversion</li> </ul>
▶ <b>Other administrative requirements</b>	<ul style="list-style-type: none"> <li>• Give notice of appropriation/conversion<sup>3</sup> at point of filing tax return relating to basis period in which the appropriation or conversion took place</li> <li>• Maintain contemporaneous documents to support the appropriation/conversion, including date on which the appropriation/conversion took place and how OMV is determined [to be submitted to Comptroller of Income Tax (CIT) upon request]</li> </ul>			

<sup>1</sup> Section 37(3) of the SITA provides for 250% enhanced tax deduction for qualifying donations of artefacts, sculptures or works of art, shares and immovable property, made to an approved museum or institution of a public character as appropriate.

<sup>2</sup> Any balancing charge, if applicable, is capped at the amount of capital allowances previously granted in respect of the non-trade/capital asset.

<sup>3</sup> Individuals are exempt from this requirement, as provided in the Income Tax (Exemptions from Notification under Sections 10J(5) and 32A(4)) Rules 2022. The prescribed reporting form (AC Reporting Form) is available in the IRAS website.

### Timing of tax adjustment

Depending on whether the CIT agrees with the date of appropriation reported in the income tax return, the timing of tax adjustment (to bring to tax income arising from the appropriation) may differ.

Where the CIT based on available facts determines that the date of an appropriation is within the basis period of a YA that is earlier or later than the YA for which a person reports the appropriation, the tax adjustment is to be made in the YA in which the CIT discovers sufficient facts to reasonably conclude the applicable appropriation date. For failure to report or inform the CIT of an appropriation

which took place on a particular date, the tax adjustment will be made in the YA in which the CIT discovers sufficient facts to reasonably conclude that there has been an appropriation.

### Our comments

The provisions of section 10J, which applies to the permanent appropriation of trading stock on or after 16 November 2021, have prospective operation. That said, prior to the introduction of section 10J, the CIT may have in certain instances taxed the notional gains arising from the appropriation of trading stock, by relying on the UK case *Sharkey v Wernher* (1955) 36 TC 275.

In our view, the *Sharkey v Wernher* case has no application in Singapore, where the principle that a person cannot trade with himself (referred to as the principle of mutuality) has been accepted by the Singapore courts in the case of *BLP v Comptroller of Income Tax* [2014] SGHC 127.

Given the Singapore Courts' position that a taxpayer cannot trade with himself, or make a profit from himself, this suggests that the principle in *Sharkey v Wernher* should not be applicable in Singapore.

Furthermore, it is to be noted that the general fundamental position of income tax in Singapore is that tax is only chargeable on realised gains. It follows that a notional gain (such as that arising from the appropriation of trading stock for non-trade or capital purposes) should not be subject to tax unless Parliament has explicitly provided for the taxing of such a notional gain in the legislation.

Prior to the introduction of section 10J, there were no specific statutory provisions which deemed the notional gain arising from the appropriation of trading stock as taxable. While certain tax practitioners had previously pointed to section 32 (which pertains to the valuation of trading stock on discontinuance or transfer of trade or business) as a basis for the imposition of tax on the notional gain arising from an appropriation of trading stock, it is to be noted that section 32 merely provides the valuation formula for the purposes of computation of gains or profits. In other words, section 32 does not go so far as to deem the computation under that provision as "income chargeable with tax under the Income Tax Act".

Section 32, therefore, does not in our view provide for the application of the principle in *Sharkey v Wernher*. If it did, there would have been no necessity to introduce section 10J into the Income Tax Act. It is basic premise of statutory interpretation that Parliament does not legislate

in vain: *Li Weiming v Public Prosecutor* [2013] 2 SLR 1227 at [18].

Notably, the lack of a statutory basis for the imposition of income tax on the notional gain arising from the appropriation of trading stock was apparently acknowledged by the Minister for Finance Mr Lawrence Wong at the second reading of the Income Tax (Amendment) Bill 2021 on 5 October 2021.

He said the following in Parliament in relation to the introduction of section 10J (previously known as section 10P of the Income Tax Act):

*" This proposed amendment is necessary to protect our revenues. Without this amendment, there would be revenue loss from deductions claimed by the taxpayer when the asset was held as trading stock, whereas any gain on the subsequent disposal of the asset will be treated as capital in nature and not subject to tax in Singapore."*

In view that the CIT may previously have, in certain instances, taxed the notional gains arising from the appropriation of trading stock prior to the introduction of section 10J, section 61 of the Income Tax (Amendment) Act 2021 contains a provision which validates any such tax assessment which may have been made before section 10J came into force.

If not for the validation provision of section 61 of the Income Tax (Amendment) Act 2021, any previous imposition or collection of income tax by the CIT on the appropriation of trading stock, prior to the coming into force of section 10J, may be *ultra vires*.

### **How we can help**

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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