

SINGAPORE INCOME TAX ACT*: THE ENIGMA OF SECTION 33

Tax morality is not one of the more common virtues of mankind. A few of us are morally impeccable in our dealings with our fellow individuals. The larger proportion of the populace is generally honest with an occasional lapse or two. But the vast majority of mankind feel no scruples about their less than honest dealings with the Tax Department. The latter entity is often visualised as an enormous worm, hungrily chewing away at the man in the street. The utility of the worm is grudgingly acknowledged. So man invents a game called dodging: where he is able to manoeuvre himself into a niche which results in least damage to himself, his satisfaction is enhanced. Sometimes, the man puts up a barrage to prevent the worm from reaching him. To storm this barrage, the worm wields the weapon in section 33 of the Singapore Income Tax Act. In more than twenty years of its life, the worm has but used this weapon once. The trial run made in 1965 was less than successful but the experience gained from the first encounter goes far to explain the enigma of section 33.

*Section 33: "Comptroller may disregard certain transactions and dispositions"*¹

Section 33 is deceptively short in its enunciation.

33. (1) Where the Comptroller is of the opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the persons concerned shall be assessable accordingly.
- (2) In this section "disposition" includes any trust, grant, covenant, agreement or arrangement.

A number of questions come to mind upon reading the section. What is an artificial or fictitious transaction? When is a disposition not given effect to? Is 'fictitious' to be distinguished from 'artificial'? What consequences follow from the comptroller's disregard of such transactions; can he avoid the transactions and reconstruct the arrangement such that income may be deemed to be in the hands of the taxpayer? Or is his power of a more limited nature, giving him the right to annihilate but no more? Must the comptroller give his reasons for holding the transaction artificial or fictitious or not in fact given effect to? Must the taxpayer prove that the transactions are in fact genuine etc.?

* Singapore Statutes, Rev. Ed. 1970, Cap. 141.

1. Marginal note thereof.

Procedure Under s. 33

A number of preliminaries have been set out and clarified in the first case heard in Singapore.² Where the Comptroller is of the opinion that certain transactions involving a taxpayer come within section 33, he may make an assessment on the income of the taxpayer accordingly. Upon notice of such assessment the taxpayer may either accept the Comptroller's assessment or dispute the claim on an appeal to the Board of Review. The onus then falls upon him to show that such assessment cannot be sustained and that his transactions are not within the categories listed, that is, they are neither "artificial or fictitious" nor "not in fact given effect to". If the taxpayer is able to establish a *prima facie* case when he closes his submissions, the onus shifts to the Comptroller to show that the transactions do in fact come within the section. Where the taxpayer is not able to establish a *prima facie* case at the close of his case, the Comptroller's assessment must be sustained. But where a *prima facie* case has been made out, the Comptroller must bring forth evidence either to rebut the taxpayer's case or create a situation where there is a conflict in the evidence. In the case of a successful rebuttal by the Comptroller, the assessment will be sustained. Where there is no rebuttal but the Comptroller has adduced conflicting evidence, the Court may call upon the taxpayer to come forward and explain his transactions: if he does not do so, an inference may be drawn by the Court that his absence is explainable upon the presumption that if he had given evidence it would have been against him. A similar presumption may not be drawn where the Comptroller fails to establish that conflicting evidence is present in the case.

Substantive Law

The substantive part of section 33 is less certain. The above mentioned Singapore decision and an earlier Malaysian decision³ under section 29 of the then Income Tax Ordinance 1947 may throw some light on this area. The Australians have a section in their Income Tax Act which is similar but not *in pari materia* with the local legislation.⁴ There is no English equivalent although the common law does take care of sham transactions and their tax statutes deal with specific tax avoidance schemes common in England.⁵

The common law of England treats all sham transactions as void. However, a man may order his affairs so as to attract a minimum tax upon his income, and such management cannot be attacked by the Commissioners of Inland Revenue, however unappreciative they may be. It must be stressed that the management of affairs will only

2. *C.E.C. v. Comptroller of Income Tax* [1971] 2 M.L.J. 43.

3. *Comptroller of Income Tax v. A.B. Estates Ltd.* [1967] 1 M.L.J. 89.

4. See the Australian Income Tax and Social Services Contribution Assessment Act, 1936-1962, s. 260.

5. See *Duke of Westminster v. I.R.C.* [1935] A.C. 1. See also Income and Corporation Taxes Act 1970, ss. 460, 461, 488.

encompass tax avoidance techniques as tax evasion is a crime — tax evasion is explained to be a fraud upon the authorities through under declaring of income or a deliberate failure to make a return.⁶

It was acknowledged in both the Malaysian and Singapore decisions that sham transactions are void.⁷ What is less clear is the extent to which section 33 has enlarged the common law position. Such an enlargement may be found in one interpretation of the expression “artificial or fictitious”. If the words are synonymous, then “artificial” like “fictitious” means sham. However, if the two words are not synonymous but are read disjunctively i.e. each to be attributed a separate meaning, then section 33 may be read to cover more ground than the common law. If fictitious transactions are synonymous with sham transactions, then “artificial transactions” must mean something other than sham transactions. The Malayan case of *Comptroller of Income Tax v. A.B. Estates Ltd.*⁸ provided one possible interpretation which could be given to the word “artificial”. McIntyre J. held in that case that it meant ‘unnatural’. A transaction which is artificial in the field of business is one which is not motivated by economic considerations, because such a transaction would be unnatural.⁹

If further elucidation was hoped for in the Singapore decision, such hopes were quashed as the presiding Judge, Winslow J., stated:

I do not propose to embark here on a discussion of the distinction between ‘artificial’ and ‘fictitious’ transaction as used in section 33. Suffice it to say that the board itself found that the transactions were not artificial but fictitious and I do not wish to be drawn into the controversy which seems to be raging as to whether the decision of the Federal Court of Malaysia in *Comptroller of Income Tax v. A.B. Estates*⁸ was correctly decided, so far as this particular appeal is concerned.

Despite his Lordship’s desire not to be drawn into the controversy, the fact that his Lordship accepted the Board’s decision that the transaction was not artificial but fictitious, must mean that there is a distinction between the two adjectives. By adopting the Board’s decision, his Lordship has tacitly approved the distinction drawn by the Board, such distinction having been arrived at by the Board after considering the Malaysian case.¹⁰ It may therefore be inferred that the current state

6. See Royal Commission on the Taxation of Profits and Income (England), Final Report, 1955 Cmd. 9474, Para. 1016.

7. *Comptroller of Income Tax v. A.B. Estates Ltd.* [1967] 1 M.L.J. 89, at p. 93. *C.E.C. v. Comptroller of Income Tax* [1971] 2 M.L.J. 43, at p. 64.

8. [1967] 1 M.L.J. 89.

9. *Ibid.* at p. 93. It may be noted that section 460 of the English Income and Corporation Taxes Act 1970, dealing with the cancellation of tax advantages from certain transactions in securities, require the taxpayer to show that the transactions “... were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments...” to bring themselves out of the grip of the section. The criteria adopted here may be another possible interpretation for the term ‘artificial’ albeit a very harsh one on the taxpayer.

10. Subsequent to the decision of *C.E.C. v. Comptroller of Income Tax*, the Board of Review, in an unreported decision (Appeal No. 4 of 1970), reiterated its acceptance of the distinction drawn by McIntyre J. between “artificial” and “fictitious” transactions, and decided the case relying upon the Judge’s dicta on what would constitute an artificial transaction.

of the law draws a distinction between 'artificial' and 'fictitious' transactions: that 'artificial' means 'unnatural' and 'fictitious' means 'sham'.¹¹

Disposition Not In Fact Given Effect To

This part of the section did not receive any comment in the Malaysian case; but Winslow J. in the Singapore case did consider it in his dicta. His Lordship stated that he had read section 260 of the Australian Act as discussed in *Gunn's Income Tax Law and Practice of Australia*, 8th ed., Vol. IV, and all the cases noted therein, and had discerned the following points of law.¹²

One clear principle seems to emerge from nearly all these cases and that is to the effect that the taxpayer must in the first instance have been the actual owner of or person with a vested right in property on which tax has been sought to be avoided, either by a disposition to which effect was not given (see our section 33) or where the whole arrangement was so designed as to enable the taxpayer to retain the income of the property allegedly disposed or otherwise transacted to another....

Did taxpayer derive income from property alienated ?

To that extent those dispositions were not given effect to and can be said to have reduced tax within our section 33 and therefore could be avoided by the tax authority.

The above observations are startling because his Lordship having found certain features which were common to the Australian cases, drew the conclusion that the same features should govern the interpretation of Singapore's section 33. These features are,

- (1) the need for a previous vesting of property in the taxpayer prior to the disposition
- (2) an accrual of income to the taxpayer after the alienation.

With due respect to his Lordship, it is submitted that the principles found by his Lordship to be present in the Australian cases are not completely evident. In the case of *Newton v. Federal Commissioners of Taxation*,¹³ a case greatly emphasised by his Lordship, there seemed to be absent this feature of prior vesting of property in the taxpayers. The taxpayers were shareholders in three private companies which had made huge profits and whose businesses were rapidly expanding. The companies were faced with the choice of paying additional tax for failure

11. It is of interest to note that the Hearsman report 1947 (A Report to their Excellencies the Governors of the Malayan Union and Singapore, with Recommendations, including a Draft Bill and Proposals for Administration and Staffing) in its "note on clauses of the Draft Bill" (at p. 18) talked of "artificial or colourable" transactions. It is not quite clear if the note meant to use "colourable" synonymously with "fictitious" or whether the authors of the bill considered the law with regard to 'fictitious' transactions a reiteration of the common law governing sham transactions, and felt it necessary to explain 'artificial' transactions with the alternative adjective "colourable".

12. [1971] 2 M.L.J. 43, at p. 64.

13. [1958] A.C. 450.

to make a sufficient distribution, or of making a sufficient distribution and thereby increasing the tax liability of the shareholders. A scheme was then devised whereby the companies created three classes of shares, A ordinary, B ordinary and B preference shares. The company then gave an option to Pactolus, a company dealing in shares, to purchase the A ordinary shares to which a special dividend was to be attached. Further, a holder of A ordinary shares was given the option to purchase the B preference shares issued at par. Thus Pactolus purchased both the A ordinary shares and the B preference shares, and received the special dividends paid to A ordinary shareholders. The B preference shares were then sold by Pactolus back to the original shareholders (now holding B ordinary shares only) in the same proportions as their holdings in the companies. These shareholders, before the transactions, were not the actual owners nor did they have vested rights in the property dealt with, i.e., the portion of income distributed as dividends to Pactolus. Income of a company does not belong to the shareholders until such time as such income be declared payable to the shareholders in the form of dividends. Yet upon avoidance of these transactions by the Commissioner of taxation, the shareholders in this case were held liable to tax upon such amounts as were found to be in their possession.

Even if his Lordship be right in holding his view on the state of the Australian law, it is here contended that the Singapore Court should not follow this interpretation with regard to section 33. A person may dispose of property which would in the normal course of events have vested in him but, because of the intervention of previous arrangements, does not so vest. One example would be the case of an author who incorporates a company to which he sells all exclusive rights in his books presently in existence or which he may write in the future. The lump sum payment made to him for the sale may be regarded as a part of capital receipt and thus not subject to tax. Through the corporate entity interposed between the taxpayer-author and the income received from the publication of his books, the taxpayer may manipulate the timing of dividends to be declared to shareholders, thereby minimising taxes. Similar situations which have arisen in Australia have in fact been held to be invalid as against the Commissioner of Tax.¹⁴

Is Section 33 An Annihilating Provision ?

The Australian Courts have held that their section 260 is merely an annihilating provision with no powers in the Commissioner of Tax to reconstruct the facts. This has been approved by the Privy Council in the case of *Newton v. Federal Commissioners of Tax*¹⁵ in a much quoted statement:

This question then arises: What is the effect of section 260 on that arrangement? It is quite clear that nothing is avoided as between the parties but only as against the commissioner. As against him the arrangement is "absolutely void" so far as it has the purpose or effect of avoiding tax. This is not a very precise use of the words "absolutely void". Ordi-

14. See *Millard v. Federal Commissioner of Tax* (1962) 108 C.L.R. 336.

15. [1958] A.C. 450 at p. 467.

narily, if a transaction is absolutely void, it is void as against all the world. In this case what is meant is that the commissioner is entitled completely to disregard the arrangement—and the ensuing transactions—so far as they have the purpose or effect of avoiding tax. In the words of the courts of Australia, it is an “annihilating provision—the commissioner can use the section so as to ignore the transactions which are caught by it. But the ignoring of the transactions—or the annihilation of them—does not itself create a liability to tax. In order to make the taxpayers liable, the commissioners must show that moneys have come into the hands of the taxpayers which the commissioner is entitled to treat as income derived by them.

The accuracy of this interpretation has been recognised by tax commentators on the Australian section.¹⁶

In the Singapore case, Winslow J. also applied this principle to the Singapore section and came to the conclusion that “(t)he disregarding of transactions does not itself create a liability to tax.”¹⁷ For liability to accrue, the Comptroller must show that income has come into the hands of the taxpayer which is derived from the transactions as profits. All that the Comptroller is empowered to do under section 33 is to set aside the transactions.

This view is to be contrasted with the position taken by the Malaysian case where McIntyre J. held that, though no income was in the hands of the taxpayer after disregarding the transactions, the comptroller could nevertheless impute income to be present. The argument was that the income would have been present but for the transactions avoided by the Comptroller. In other words, *de facto* presence of income in the taxpayer is not a necessary prerequisite for the additional tax liability which may be imposed on him by the Comptroller.¹⁸

It is this writer's view that the position adopted by Australia and Singapore is correct. The language of section 33 which allows it being regarded as an annihilating provision does not justify the position taken by the Malaysian Court. The Comptroller may “disregard any such transaction or disposition and the persons concerned shall be assessable accordingly”. It may be suggested that the word “accordingly” refers to the position of the taxpayer had he not entered into the transactions or dispositions. But a more cogent argument would be to interpret “accordingly” to mean “according to the provisions of the Act.” Reference must then be made to section 10 of the Act which is the charging section of the statute. Tax may only be payable upon “income of any person accruing in or derived from Singapore or received in Singapore from outside Singapore...” if such income falls within any of the listed heads. To deem income would be outside the ambit of section 10(1).

It may also be argued from the point of fiscal policy that to allow the deeming of income would be unsatisfactory. The justification upon which tax is levied is to permit the government to take its share of

16. See *Gunn's Income Tax Law and Practice of Australia*, 8th ed., Vol. IV; Hayek, *Ryans Manual of Income Tax Law in Australia*, 2nd ed., at p. 247.

17. [1971] 2 M.L.J. 43, 65.

18. See Berriman, “When is an artificial transaction real?” (1967) 8 Me Judice 14.

such profits as fall due to the taxpayer. If the taxpayer does not have any income it is completely inequitable and contrary to the arguments for taxation to allow the Comptroller to tax him upon illusory income. It would be in the nature of a penalty to the taxpayer for having arranged his affairs contrary to the pleasure of the Comptroller.

Conclusion

There is no doubt that section 33 is a formidable weapon which may be used by the Comptroller to tear down any artificial or fictitious barrages set up to avoid taxes. To recapitulate:

- (1) Transactions which are 'artificial' (meaning 'unnatural') or 'fictitious' (meaning 'sham') or dispositions which are not given effect to, may be disregarded by the Comptroller.
- (2) The Comptroller's powers are however limited to annihilation of the transactions: he may not reconstruct the facts nor deem income to be present in the taxpayer if such does not exist at time of annihilation.

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