NOTES OF CASES

INCOME TAX

THE ISOLATED TRADING TRANSACTION

Director-General of Inland Revenue v. *C.K.K.* [1974] 2 M.L.J. 104.
Director-General of Inland Revenue v. *L.C.W.* [1975] 1 M.L.J. 250.
Director-General of Inland Revenue v. *N.P.K.* [1975] 1 M.L.J. 256.

In the first case, the taxpayer was a licensed auctioneer and appraiser in Kuala Lumpur and owned three pieces of rubber land. In 1955, he became a shareholder and director of Kumfort Ltd., a company incorporated in that year for the main purposes of property development and housing construction. In 1960, one Ting Chok, a major shareholder and an active director, informed the Board of Directors that several acres of agricultural land under old rubber trees with prospects for housing development were up for sale. The taxpayer together with the company, several directors and some outsiders bought the land for $157,088.90. However, the Collector of Land Revenue refused them permission to convert the agricultural land to building land, with the result that it was sold some four years later in almost the same condition in which it was purchased to another company for $1,344,270. Kumfort Ltd. paid income tax on its share of the profits, and it was sought to assess the taxpayer on his share under s. 10(1) of the Income Tax Ordinance, 1947. The High Court (Gill F.J., as he then was) and the Federal Court (Suffian L.P., Lee Hun Hoe C.J. (Borneo) and Ong Hock Sim F.J.) upheld the decision of the Special Commissioners that the taxpayer was not carrying on a trade or business of dealing in land, and consequently his share of the profits did not come within s. 10(1) of the Ordinance. The Federal Court pointed out that this was an isolated transaction by the taxpayer, and did not therefore constitute a trade or business carried on by him within the meaning of s. 10(1) (a).

The taxpayer in the second case was a businessman dealing in timber and rubber, as well as an importer and exporter. He owned rubber estates and a number of buildings in Sandakan and Kota Kinabalu (Sabah), including five blocks of flats which he had rented out. In 1953 he bought a piece of land for $20,000, and surrendered it in 1958 to the Government in exchange for another piece of land. At the time of purchase, his intention was to construct flats on the land for renting, and not for sale. Indeed, the land had always been shown in the taxpayer's accounts as part of his fixed assets. By 1966, twenty-four flats had been built, and before the end of the taxpayer's financial year on 30th June 1967, nineteen flats had been sold and the remaining five let out. The accounts for that financial year revealed that the land had been transferred to the taxpayer's trading account at its market value in 1963 of $480,000 (the date when the taxpayer

submitted plans for the construction of the flats) and not at its original purchase price of $20,000. The Special Commissioners found that the profit from the construction and sale of the nineteen flats constituted income in respect of gains or profits from a business and was assessable to tax under s. 4(a) of the Income Tax Act, 1967. A majority further decided that the value of the land as an item of stock-in-trade should be $20,000, and not $480,000. The Federal Court (Suffian L.P., Lee Hun Hoe C.J. (Borneo) and Ong Hock Sim F.J.) upheld the Commissioners on the former point, but reversed their decision on the latter one.

Judgment in the third case was given against the taxpayer, a timber merchant and timber hauling contractor, also from Sabah. A company called Timber Producers of Sabah Ltd., of which the taxpayer was the managing director and secretary, was granted a special licence to extract timber for a period of ten years under a Sabah Ordinance. As it did not wish to involve itself in heavy capital outlay, the company invited tenders for the extraction and sale of the timber, and the taxpayer submitted a tender in the name of a firm of which he was the sole proprietor. The tender was eventually awarded to the taxpayer and one Voo Khen, as they were the highest tenderers. Neither had any previous business connections. One of the unsuccessful tenderers, Tio Chee Hing, persuaded the successful parties to assign their rights under the tender to him for an agreed sum of $275,000, and an additional sum of $25,000 if the export of timber exceeded two million cubic feet. The taxpayer was assessed to tax on his share of these payments, on the ground that it was income chargeable under either s. 9(1)(a) or s. 9(1)(f) of the Sabah Income Tax Ordinance, 1956 (gains or profits from a trade or business, or a profit arising from property). The Special Commissioners decided that the sums constituted a gain or profit from a business, but were not profits within the meaning of s. 9(1)(f). The appeal before the Federal Court (Suffian L.P., Lee Hun Hoe C.J. (Borneo) and Ong Hock Sim F.J.) proceeded solely on the basis of the existence of a business as the source of the profits, and the court upheld the Commissioners' decision on this point.

Commentary. It will be observed that all of the above cases are Malaysian cases, decided by the same members of the Federal Court. It is thought that the reasoning of the court on the substantive issues of the first and third cases as regards the badges of trade may be relevant to Singapore law, though of course not binding on the courts here, inasmuch as the former involved the interpretation of s. 10(1)(a) of the Income Tax Ordinance, 1947 and the latter s. 9(1)(a) of the Sabah Income Tax Ordinance, 1956 — both identical with s. 10(1)(a) of the Income Tax Act (Cap. 141, Singapore Statutes, Rev. Ed. 1970). The second case was argued in relation to s. 4(a) of the Malaysian Income Tax Act, 1967, so that on the issue of the weight to be attached to an "isolated transaction", it will not be applicable in Singapore. However, dicta on this point may be noted, as well as the discussion of the question of valuation of the land as stock-in-trade.

Ever since the leading case in Singapore of *D.E.F.* v. *Comptroller of Income Tax* [1961] M.L.J. 55, the law here has been that, *pace* Windham J. in the Kenyan case of *H. Co. Ltd.* v. *Commissioner of Income Tax* 1 E.A.T.C. 65, carrying on a business within the meaning of s. 10(1)(a) of the Income Tax Ordinance, 1947 imports (at least

in the case of an individual) a series or repetition of acts the sum of which constitutes the business. Since, therefore, the fundamental idea is that there must be the continuous exercise of an activity before there can be a liability to tax under s. 10(1) (a), an isolated trade or business transaction does not give rise to such liability. This view of the law was followed in later cases, e.g. *E.* v. *Comptroller-General of Inland Revenue* [1970] 2 M.L.J. 117, *L.* v. *Comptroller-General of Inland Revenue* [1973] 2 M.L.J. 14. However, it is necessary to note the qualification placed on this concept by Ambrose J. in *D.E.F.* v. *C.I.T.,* to the effect that if it is proved that a person intended to carry on a business and that he carried out one business transaction with that intention, then he carried on a business. Thus, in the case of a company, it may be clear from its memorandum that the company intends from the outset to carry on a particular business, so that even if the company goes into liquidation after only one transaction, it may still be held to have engaged in a trade or business within the meaning of s. 10(1)(a). This consideration probably prompted Buttrose J. in *D.E.F.* v. *C.I.T.* to remark that the test in the case of an individual was not the same as that in the case of a trading company, and accounts for the decision of the Singapore Board of Review in *E. Finance Co.* v. *C.I.T.* [1970] 2 M.L.J. xxviii, and of Ong Hock Sim FJ. in *1. Investment Ltd.* v. *Comptroller of Inland Revenue* [1973] 2 M.L.J. 10.

While ultimately the question of trading is one of fact, in which all the surrounding circumstances must be taken into account, the feature of an "isolated transaction" is certainly important, if not crucial, in Singapore, and its incidence has given rise to a majority of the reported Singapore and Malaysian cases on trading. However, the exact ambit of an "isolated transaction" does not appear to have been judicially determined. It is thought that the phrase is susceptible to the following interpretations (from the most narrow to the most liberal):

1) one act of purchase, followed by one act of sale, regardless of the time interval;

2) several acts of purchase, followed by one act of sale, regardless of the time interval;

3) one act of purchase, followed by several acts of sale, regardless of the time interval;

4) several acts of purchase, followed by several acts of sale involving the same subject-matter, the entire transaction taking place over a short interval of time.

The inclusion of 4) possibly stretches too far the ordinary meaning of an "isolated transaction". It is preferred on the basis that the series of acts is but an isolated incident in the life of the individual, not to be thereafter repeated. Thus, one may buy and sell shares continually for a brief period, and then abandon the activity altogether: for the individual, it represents an abnormal occurrence in his everyday life. However, this interpretation is not likely to commend itself to the court, and certainly not to the Comptroller. A perusal of the cases will reveal that the courts do not have regard so much to the part played by the activities in question within the general pattern of the taxpayer's lifestyle as to the frequency of the activities themselves in deciding whether the transaction may be labelled a single adventure or an isolated transaction: see, e.g. *Pickford* v. *Quirke* 13 T.C. 251.

Moreover, s. 10(1) (a) imposes the charge on profits from a trade or business, "for whatever period of time such trade [or] business. . . may have been carried on...".

The third interpretation may also be questionable. In the case of an "isolated transaction", the emphasis should possibly be on that transaction which *realises* the profit. While the purchase of an asset puts the individual in a position to make a profit, it is only on selling it that the profit can be made: there is no profit before the act of realisation. If then there are several acts of realisation, it is arguable that this cannot be an instance of an "isolated transaction", notwithstanding the single act of purchase. This analysis may be supported by a comparison of the English cases of *Martin* v. *Lowry* 11 T.C. 297, *The Cape Brandy Syndicate* v. *I.R.C.* 12 T.C. 358 and *Rutledge* v. *I.R.C.* 14 T.C. 490. Now it has been pointed out time and again that the English cases must be treated with caution, since the English statutory definition of "trade" widens the ordinary definition of that word to include the isolated transaction as "an adventure or concern in the nature of trade" (see, e.g. Lee Hun Hoe C.J. in *D.G.I.R.* v. *C.K.K., supra,* at p. 108). However, it is instructive to observe that, in *Martin* v. *Lowry,* where the transaction involved one act of purchase and several acts of sale (there were more than 1,000 buyers), the Special Commissioners, who were upheld by the House of Lords, expressly found that "in exercising these activities Mr. Martin was for the time being *carrying on a trade* the profits of which are chargeable to income tax and excess profits duty":* there was no need for either the Commissioners or the House of Lords to have recourse to the extended definition of trade. Again, in *The Cape Brandy Syndicate* v. *I.R.C.,* where a syndicate purchased 3,100 casks of brandy, mixed it and sold it in turn to various purchasers, the court paid attention to the number of sales effected in weighing the importance to be attached to the submission that this was an isolated transaction. Scrutton L.J. in the Court of Appeal stated *(supra,* at p. 376):

> The first question argued below was, was that a transaction or business as distinct from one transaction. Inasmuch as there were over 100 sales of this composite article extending over 18 months, it appears to me that there was abundant evidence on which the Commissioners could find that it was a trade or business.

On the other hand, the case of *Rutledge* v. *I.R.C.* involved one purchase and one sale only (all the toilet paper was sold to one buyer), and both the Commissioners as well as the court approached it on the basis that it must have been at most an "adventure in the nature of trade", The Lord President declared *(supra,* at p. 496): "... the question here is not whether the Appellant's isolated speculation in toilet paper was a trade, but whether it was an 'adventure... in the nature of trade'." In addition, it will be remembered that the taxpayer in *D.G.I.R.* v. *L.C.W.* made one act of purchase of the land in question, but, having built a number of flats on it, he sold nineteen flats to various buyers over a two-year period. Lee Hun Hoe C.J. remarked *obiter* that this could not be considered an isolated transaction (*supra,* at p. 252):

> This is not a case of merely selling one single flat but it involves the sale of 19 flats over a period of time from 1965 to 1967. That the question of isolated transaction does not arise in this case has clearly been accepted by the parties.

* Emphasis added.

It is generally admitted that the first interpretation is valid. Thus, *D.E.F.* v. *C.I.T., E.* v. *C.G.I.R., L.* v. *C.G.I.R., E. Finance Co.* v. *C.I.T.* and *I. Investment Ltd.* v. *C.I.R.* all involved one act of purchase and one act of sale. There is no direct authority extending the scope of an "isolated transaction" to cover several acts of purchase and one act of sale (the second interpretation). It is, however, submitted that the second interpretation is equally valid, on the ground that it is the act which realises the profit that should be the relevant consideration. In *D.G.I.R.* v. *C.K.K.,* there were apparently several acts of purchase (the syndicate of which the taxpayer was a member bought twenty-three lots of land from three different owners) although there was only one act of sale, and the case was argued throughout on the basis that "the transaction of purchase and eventual sale was a single isolated transaction": see Lee Hun Hoe C.J., *supra,* at p. 108. Moreover, *Leeming* v. *Jones* 15 T.C. 333 entailed two acts of purchase and one act of sale: the House of Lords dealt with this case on the footing that it involved an "isolated transaction".

Notwithstanding what has been discussed above, the reader will come upon the following observations of Lee Hun Hoe C.J. in *D.G.I.R.* v. *C.K.K. (supra,* at p. 107):

> The mere fact that this is an isolated transaction does not automatically take the profit arising therefrom out of the category of chargeable property. Such cases as *Martin* v. *Lowry; California Copper Syndicate (Limited and Reduced)* v. *Harris; Benyon* v. *Ogg; Cape Brandy Syndicate* v. *Commissioner of Inland Revenue; Commissioner of Inland Revenue* v. *Fraser* and many other cases are in effect cases of one enterprise. It does not matter whether it is one purchase and sale or one purchase and many sales. Because that does not preclude the court from holding that the subject matter of the transaction to be a trade or an adventure in the nature of a trade.

With respect, his Lordship's assertions are too widely worded and inapposite in the context in which they appear. While they may be an accurate statement of the English position, they do not take into account the wording of the Ordinance under discussion, as interpreted by case law, and since his Lordship's immediately preceding remarks dealt with liability to tax in the light of the ordinary concept of "trade" as opposed to the extended definition of that word, the impression created is that the remarks quoted above are intended to reflect the general position under the Ordinance, notwithstanding the citation of wholly English cases. In view of his Lordship's subsequent comments in the case correcting this misleading impression, we may confine these observations to the situation in which the ordinary meaning of "trade" has been extended to include "an adventure in the nature of trade".

The qualification placed on the test of "isolated transaction" by Ambrose J. in *D.E.F.* v. *C.I.T.* (mentioned earlier in this commentary) was invoked by the Director-General in *D.G.I.R.* v. *C.K.K.,* where it was contended that "right from the very beginning the object of the respondent [taxpayer] in purchasing the property was to sell it at a profit either before or after development" *(supra,* at p. 105), so that "a trade itself existed right from the time the land was acquired" *(supra,* at p. 108). In the High Court, Gill F.J. (as he then was) did not deal with this point, stating that "all those grounds. . . were rejected by the Special Commissioners", and the Federal Court simply mentioned the argument without pursuing it. Admittedly, the point

turns on a finding of fact, which is generally within the jurisdiction of the Special Commissioners (or in Singapore, the Board of Review), and the courts have usually been most reluctant to overrule this tribunal's findings of fact, save on the grounds laid down in *Edwards* v. *Bairstow & Harrison* 36 T.C. 207. On the other hand, the statements in the judgments do not make it clear whether the Commissioners rejected the *existence* of the fact or whether they rejected the Director-General's *submissions* as to the importance to be attached to the fact (whose existence may have been accepted). It is thought that if the latter interpretation is right, the court ought to have argued the point — a substantive one after all — at some length. Its determination would have had a material bearing on the ultimate decision, as was fully appreciated by Abdul Hamid J. in the recent Malaysian case of *U.N. Finance Bhd.* v. *D.G.I.R.* [1975] 1 M.L.J. 109, at p. 114.

The Director-General was more successful in *D.G.I.R.* v. *N.P.K.* The taxpayer there sought to rely on a novel definition of "isolated transaction." His contention was that he had never before carried on "timber business" jointly with Voo Khen, so that although the joint venture in no way affected the nature of his existing business (the transaction involved was still the sale of timber) it was an isolated transaction. Needless to say, this contention received short shrift at the hands of Ong Hock Sim F.J. and Lee Hun Hoe C.J. The former said (*supra,* at p. 258):

> In my opinion there is nothing in section 9(1)(a) which enjoins that "business" of the taxpayer for purposes of assessment of liability to tax is that business carried on "all by himself" or "limited to trading in his personal capacity" or that any joint venture with another in his line of trade or business was equally not liable to tax unless he had worked together or had business connections with that other before undertaking the joint venture.

The latter observed *(supra,* at p. 259):

> Section 9 of the Sabah Income Tax Ordinance, 1956 relates to the nature of the activity and not to the constitution of the business, e.g. whether the taxpayer was conducting such activity alone or in conjunction with others.

Even if this had been an instance of an "isolated transaction", it seems clear from the judgments of the members of the Federal Court that they would have considered that it was "part of a business carried on by [the taxpayer]" within the test laid down in the "most comprehensive and lucid judgment" of Gill F.J. (as he then was) in *E.* v. *C.G.I.R.*

The Federal Court did not decide whether the sums involved were assessable under s. 9(1)(f) as profits arising from property (s. 10(1)(f) of Cap. 141 is the equivalent Singapore provision), as the appeal was argued only in relation to s. 9(1)(a). The Commissioners had ruled that there was no liability under s. 9(1)(f). The exact scope of the head of charge under s. 10(1)(f) of the Singapore Income Tax Act has not been the subject of judicial decision. The corresponding head of charge in the U.K. Taxes Act is Schedule A, formerly Schedule D, Case VIII, and it is interesting to note that Megarry J. in *Lowe* v. *J.W. Ashmore Ltd.* [1971] Ch. 545 held that a company which sold turf *in situ* from their fields to two other companies (the latter entering into the land, executing the actual turf-cutting operations and removing the cut turf) was assessable to tax in respect of the receipts from these

sales, since they constituted income from a trade (Schedule D. Case I), and since, alternatively, they were annual profits or gains arising from the company's ownership of an estate or interest in or right over land (Schedule D, Case VIII — now Schedule A). Whether the same reasoning would have appealed to the Federal Court, or, indeed, whether it will find favour with the Singapore court is uncertain. Income assessed under s. 10(1)(f) of Cap. 141 is not "earned income" within the meaning of s. 2, so that an individual would not be entitled to earned income relief under s. 39(1) (b). Nor would loss relief under s. 37(2) (a) be granted in the case of a s. 10(1) (f) assessment.

The issue of valuation of the land in *D.G.I.R.* v. *L.C.W.* had an important bearing on the computation of the taxable profit of the taxpayer's trade; for if the cost price of the land in relation to the business was $20,000, and not $480,000, the taxable profit would be increased by $460,000. Although Suffian L.P. confessed that he had some initial doubts on the matter, the Federal Court unanimously held that the correct value to be placed on the land as stock-in-trade should be its value at the time it was appropriated to the business in 1963, viz. $480,000. It is submitted that this decision was correct in principle. Lee Hun Hoe C.J. delivered the leading judgment, and based his opinion on the interpretation of s. 35(3) and Sch. 9, para. 17 of the Income Tax Act, 1967, which he found to be eminently in accordance with accepted commercial accounting principles. The court obviously agreed that the taxpayer had initially acquired the land as an investment in 1953, and only some years afterwards did he form an intention of trading in it. His Lordship ruled (*supra,* at p. 255):

> When respondent converted his capital assets into stock-in-trade and started dealing in them the taxable profit on the sales must be determined by deducting from the sale proceeds the market value of the assets at the date of conversion into stock-in-trade since that is the cost to his business and not the original cost to him.

The same result is reached if recourse is had to the principle in *Sharkey* v. *Wernher* 36 T.C. 275, as extended by *Petrotim Securities Ltd.* v. *Ayres* 41 T.C. 389 and *Ridge Securities* v. *I.R.C.* 44 T.C. 373. The first case dealt with a self-supplier who transferred stock-in-trade from her trade to a non-trading venture, and the principle of valuation laid down there was extended in the second case to a trader disposing of his stock-in-trade to an outsider. In both these cases, the issue was; what was the figure to be credited to the *transferor's* trading account? The answer, viz. market value at the date of the disposal, was then applied in relation to a *transferee's* trading account in the third case, the court following a dictum of Lord Denning M.R. in the second case *(supra,* at p. 407). The principle could thus be equally applicable to the trading account in *D.G.I.R.* v. *L.C.W.* to which the land was transferred.

Closely allied with this issue is the question of "supervening trade". It has already been noted that the Federal Court accepted that the taxpayer did not intend to trade in land at the time he first acquired it in 1953 (see, e.g. Lee Hun Hoe C.J., *supra,* at p. 253). However, the court felt that he eventually changed his mind, and the only reasonable inference that could be drawn from his subsequent conduct in relation to the property was that he had begun to carry on a concern in the nature of trade (as was found by the Special Commissioners). The possibility of the existence of a "supervening trade"

had already been determined in *Sharpless* v. *Rees* 23 T.C. 361, and affirmed by Croom-Johnson J. *obiter* in *Cooksey & Bibby* v. *Rednall* 30 T.C. 514, at p. 519. The latest English case on this point was *Taylor* v. *Good* [1974] 1 W.L.R. 556, where the Court of Appeal reversed Megarry J.'s decision at first instance [1973] 2 All E.R. 785. It is therefore regrettable that the Federal Court was referred to the overruled decision alone without having been apprised of the subsequent judgment of the Court of Appeal. In this case, the taxpayer, who had no history of dealing in land, acquired a mansion with the intention of using it as a family residence. He later rejected the idea, applied for and was granted planning permission to demolish the mansion and erect ninety houses. He did not execute this plan, but sold the land at a profit to a firm of property developers. Megarry J. held that although the land had been purchased with no thought of trading, supervening trading took place subsequently when the taxpayer applied for and obtained planning permission. The Court of Appeal held that this could not be so, as the taxpayer had no pre-existing trade of dealing in land of which the transaction in question might be made a part. It is thought that the following observations of Russell L.J. (supra, at p. 560) are equally relevant in Singapore, and tie in well with those of Gill FJ. (as he then was) in *E.* v. *C.G.I.R. (supra,* at p. 130):

> If of course you find a trade in the purchase and sale of land, it may not be difficult to find that properties originally owned (for example) by inheritance, or bought for investment only, have been brought into the stock-in-trade of that trade . . But where, as here, there is no question at all of absorption into a trade of dealing in land of lands previously acquired with no thought of dealing, in my judgment there is no ground at all for holding that activities such as those in the present case, designed only to enhance the value of the land in the market, are to be taken as pointing to, still less as establishing, an adventure in the nature of trade.

Nor, *a fortiori,* can they be taken as pointing to, or as establishing a trade. In *D.G.I.R.* v. *L.C.W.,* however, it may be noted that the taxpayer, who appears to have been a most versatile businessman, being an importer, exporter, timber and rubber dealer, as well as the owner of five blocks of flats let out on rent, in contrast to the modest Cheltenham grocer in *Taylor* v. *Good,* did much more than simply apply for and obtain planning permission (although the commencement of construction work may be solely referable to his initial investment plans): he accepted deposits for the sale of the flats, permitted minor alterations to some of the flats at the request of the purchasers and obtained a $400,000 loan from a bank to finance the completion of the apartment block. Moreover, although the property had been originally entered into his accounts as part of his fixed assets in 1973, it was transferred to a trading account in 1967. The issue of "supervening trading" was also discussed at some length (*obiter*) by Abdul Hamid J. in *U.N. Finance Bhd.* v. *D.G.I.R.* (*supra*). His Lordship there based his remarks largely on, and approved the reasoning of the Court of Appeal in *Taylor* v. *Good.*

Having accepted the Commissioners' finding that there was a concern in the nature of trade, the Federal Court ruled that the land should be valued as stock-in-trade at its value "at the time of appropriation in 1963". The principle stated is correct, but it is rather puzzling that the year 1963 was chosen as the time when the appropriation was made. It is thought that, on the facts, 1965 was the year of

appropriation. The reason given for choosing 1963 was that it was in this year that the Sandakan Town Board approved plans for the construction of the flats in question. However, the taxpayer's original plan required him to construct the flats in any event, since he intended to rent them out. It was only in 1965 that he admittedly changed his intention of using the land and flats as an investment and decided to sell some of the flats because of the Indonesian confrontation and his own financial difficulties. Lee Hun Hoe CJ. stated (at p. 252): "I think the crucial period is the moment he intended to sell the flats in 1965 to the time he sold the last flat as at June 30, 1967." His Lordship further remarked (at p. 253): "[In 1965] he also changed his intention to retain the flats for renting as an investment. He decided to sell the flats . .". The value of the land in relation to the business should, therefore, have been its market value at 1965, and not 1963.

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