

8/84

O N A P P E A L

FROM THE COURT OF APPEAL OF THE REPUBLIC OF SINGAPORE

B E T W E E N :

THOMSON HILL LIMITED

Appellant

- and -

THE COMPTROLLER OF INCOME TAX

Respondent

CASE FOR THE RESPONDENT

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1. This is a case about the computation of profits of a housing development company. The features of the case include -

Record

(i) an accounting system, known as the "completed contract" system, which, so far as the Comptroller is aware, has not previously been considered in any Commonwealth court;

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(ii) the treatment under the completed contract system of a particular form of expense of the development company, namely Singapore property tax, a tax which has some affinities to rates in the United Kingdom;

(iii) a purported change in accounting methods between one accounting year and the next; and

(iv) the important principle that, where an appeal is limited to a point of law, the findings of the tribunal of first instance on matters of expert evidence are likely to be paramount.

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2. In Singapore income tax is charged for years of assessment, which correspond to the calendar year, but the charge for any particular year of assessment is measured by reference to the profits of what is commonly called the "basis year" preceding the year of assessment. The year of assessment of the Appellant company concerned in this case is 1975, and the liability is measured

Income Tax Act (Chapter 141) s. 10(1)

Ibid. s.35(1)

Record

on the profits in the basis year, namely the calendar year 1974. A number of points are common ground:

Income Tax Act (Chapter 141) s.10
(1) (a)

(a) the Appellant's activity of housing development constituted a trade, so that the Appellant was liable to pay income tax by reference to the profits of the trade.

(b) The completed contract system, which the Appellant adopted as the basis of its own accounts was acceptable for income tax purposes. 10

Ibid. s.14
(1)

(c) Property tax was an expense wholly and exclusively incurred in the production of the trading profits, and was therefore in principle a deductible expense.

The disputed issue concerns the time at which, pursuant to the completed contract system adopted by the Appellant, property tax fell to be deducted. The alternatives are these:

(i) property tax referable to land comprised in a particular development project was, like other items of expense specifically referable to that development, deductible in the year when the development was completed. This was the basis on which the Appellant prepared its accounts for years before 1974. 20

(ii) All property tax, like general overhead expenses of the Appellant, was deductible in the year in which it was incurred. This is the basis to which the Appellant purported to change when it drew up its accounts for the calendar year 1974. 30

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3. More specifically, the Appellant's accounts for 1974 as submitted to the Comptroller include a deduction for property tax of \$253,980. This tax related to land the development of which was not completed in the year, and the deduction of it in the accounts for 1974 was a departure from what the Appellant had done in the three previous sets of accounts prepared since its formation in April 1970.

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The Comptroller disallowed the deduction. The Appellant appealed to the Board of Review, the first instance appeal tribunal, which dismissed the appeal. Subsequent appeals to the High Court (Chua J.) and the Court of Appeal (Wee Chong Jin C.J., T. Kulasekaram, J., and A.P. Rajah J.) were also dismissed. The appeal now comes before the Board by leave granted by the Court of Appeal. It is clear from s.82 of the Income Tax Act that the findings of fact of the Board of Review are conclusive and that the appeal is limited to questions of law. 40 50

Vol. I
pp.64-75
pp.82-88

4. The Completed Contract System

Record

10 The completed contract system has not been
considered in any reported case known to the
Comptroller. It is not so familiar that the
courts should take judicial notice of it. There-
fore the only material relating to the system which
is proper for the Board to consider is the material
in this case itself, and in particular in the
evidence adduced before and the findings of the
Board of Review. The vital extracts are set out
below, but it may be helpful to introduce them
with the general observation that the essence of
the system is not to bring in receipts from or
expenses referable to a development project while
the project is still in progress, but instead to
hold back the accounting for such receipts and
expenses until the project is completed. The
following are, in the Comptroller's submission,
20 the critical extracts from the evidence before or
findings of the Board of Review.

(A) Evidence of the Appellant's Expert Witness

The Appellant called evidence from an expert
witness, Mr. Coomber. The notes of his evidence
include the following general observations
concerning the completed contracts basis.

Vol.I
pp.14-16

30 "It is the most conservative method of
computing contracts covering more than
one year. Revenue is recognised when
contract is completed or substantially
completed.

Vol.I
p.14
lines 29-35

Costs and progress payments are
received but profit is not reported till
contract is substantially completed."

Mr. Coomber then gave this evidence in relation
to the point precisely in dispute:

"From perusal of P & L accounts it would
appear that property tax has been expensed
under profit and loss account.

Vol.I
p.14 lines
36-42
p.15
lines 1-5

40 Such a treatment of property tax is not
inconsistent with commercial accounting
practice. It is not inconsistent with
completed contracts accounting basis.

Property tax should never be
capitalised as it does nothing to enhance
value of property concerned and is paid
solely in the period it becomes payable and
certainly produces no benefit lasting beyond
such period."

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(B) The Comptroller's Expert Witness

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pp.16-22

The Comptroller adduced expert evidence from Mr. Yip Thin Peng. The following are extracts from the notes of his evidence.

Vol.I
p.16
lines 25-36

"In the course of my work I have had experience in dealing with files of property developers.

Two methods are normally used to reflect profits:

1) by completed contracts method, costs of development are accumulated in respect of each project. When completed, profits are brought into P/L account and assessed for tax. Expenses should be deferred for matching revenue with expenses." 10

Vol.I
p.17
lines 2-11

"The company has adopted the completed contracts method. Property tax has been treated as part of costs of development by most property development companies in Singapore to be able to arrive at true profits of that project." 20

Practice of capitalising property tax is in accordance with normal accounting practice.

Appellant's method for 1970-73 is considered proper."

The Comptroller at this stage makes three brief observations relating to Mr. Yip's evidence. First, the reference to "capitalising property tax" does not mean that property tax is treated as an expense of a capital nature. It merely means that, where the completed contract system is used, property tax is one of the expenses deducted, not when it is incurred, but when the project is completed. Secondly the Appellant's method for 1970-73 referred to by Mr. Yip was the previous method under which property tax referable to uncompleted development projects was not deducted in the current year. Thirdly the Comptroller respectfully asks your Lordships to note the statement of principle: 30

Vol.I
p.16
lines 35-36

"Expenses should be deferred for matching revenue with expenses." 40

(C) Documentary Evidence

Two accountancy documents were before the Board of Review.

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(i) SSAP9 - Statement of Standard Accounting Practice No. 9, issued by the Institute of Chartered Accountants in England and Wales. This does not relate to the completed contract system of accounting, and in the Comptroller's submission is of marginal relevance at most.

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pp.24-43

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(ii) International Accounting Standard Exposure Draft 12. This does refer to the completed contract method. On behalf of the Comptroller reference will be made to the full terms of the Exposure Draft at the hearing before your Lordships. At this point it is merely submitted in general terms that the Exposure Draft supports the decision of the Board of Review and of the courts in Singapore. The general description of the system is in these terms:

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"Under the "completed contract method", revenue is recognised only when the contract is completed or substantially completed. Costs and progress payments received are accumulated during the course of the contract, but profit is not reported until the contract activity is substantially completed."

Vol. I
p.48 lines
41-46 and
p.49 line 1

(D) The Decision of the Board of Review

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In their written grounds of decision the Board of Review made the following material findings.

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"3. In its accounts pertaining to its various development projects the company has adopted the "completed contract" cost accounting system, whereby profit is recognised only when the contract or project is completed. Under this system, expenditure incurred in a development together with receipts from booking fees and progress payments are accumulated during the course of the project and profit is not reported under the project is substantially completed."

Vol. I
p. 2
lines 5-24

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"4. Each project is treated separately and individual cost records are kept for each project. Development expenses are then capitalised in the balance sheet and are accumulated and carried forward from year to year until the project is completed. Upon completion all the expenses attributable to a particular project are deducted from proceeds of sale, with net profits assessed to tax."

Record

Vol. I
p. 5 lines
19-29

"19. Considering the evidence before us and the submissions of Counsel, we are of the view that the accumulation of property tax payments by the company pending the completion of the projects in respect of which they are paid, is not inconsistent with ordinary principles of commercial accounting where the "completed contract cost" method of accounting is adopted. We do not accept Mr. Coomber's opinion that such a treatment would only be proper in respect of the accounts of single-development companies." 10

5. Property Tax

Chapter 144

In the Comptroller's submission it is not necessary for your Lordships to examine the detailed features of property tax. A few salient features should, however, be mentioned. The tax is charged by the Property Tax Act. It is not a tax charged on income or profits. Rather it is charged on the value of land. By s. 6(1) of the Act it is payable "upon the annual value of all houses, buildings, lands and tenements whatsoever included in the Valuation List." By s. 6(2) it is payable by the owner of the property. (This is a difference from the rating system in the United Kingdom, where liability falls on the occupier.) By s. 6(3) "the tax shall be a first charge on the property concerned." In the last analysis the Comptroller (who is responsible for the administration of property tax as well as income tax) has power to sell the property in order to recover unpaid property tax. A point which is of some relevance in the present case is that the amount of property tax referable to the individual property is always known with precision. 20 30

6. The Comptroller's Submissions

(a) The Comptroller first submits to your Lordships that the appropriate treatment of property tax under the completed contract system was a matter for the Board of Review, and their finding on the point is conclusive unless they make some error of law. No such error can be shown. 40

(b) The Board of Review were fully entitled to prefer the evidence of Mr. Yip to that of Mr. Coomber. His evidence was based on extensive knowledge of practice adopted in Singapore. His evidence was wholly logical and consistent with the underlying principle of the completed contract system. That principal is that both receipts and expenses referable to land comprised in a particular project should not be brought into the accounts until the project is completed. Property tax is an expense specifically referable to land comprised 50

in a project, and the Comptroller submits that there is no rational basis for distinguishing it from other such items of expenditure. At the very least the Board of Review were entitled to accept Mr. Yip's evidence to that effect.

10 (c) The explanation given by Mr. Coomber for his opinion that property tax should not, under the completed contract system, be deducted when the project is completed, was that "it does nothing to enhance the value of the property concerned". However, he gave no reasons to support the distinction between expenditure which does and expenditure which does not enhance the value of a property, in each case being expenditure specifically referable to property comprised in a development project. The distinction is certainly not supported by the Exposure Draft, which, indeed, refutes it. According to the Exposure Draft one kind of cost which would be dealt with under the completed contract system is insurance, which is certainly not an expense which enhances the value of the property.

Vol. I
p. 50,
line 7

30 (e) The Comptroller further submits that, even if (which the Comptroller would deny) a taxpayer adopting the completed contract system can in some cases deduct property tax as a current expense like the general overheads, the Appellant cannot do so in this case. That is because it treated property tax as an expense to be deferred for its first three accounting periods, and cannot change in that respect for its fourth. This is sometimes referred to as the principle of consistency. On fuller analysis the consistency principle is really two separate principles, one of consistency from year to year and another of internal consistency within the year.

40 (f) As regards consistency from year to year the principle is that, where a trader adopts a particular method of treating an item in his accounts, he should follow it consistently from one year to the next unless there is some strong and sufficient reason to change. If consistent principles are not followed from year to year, then the separate accounts of all the individual years will not in aggregate reflect the overall profit of the trading activity. The principle was authoritatively laid down by the House of Lords in Duple Motor Bodies Ltd. v. Ostime /1961/ 1 WLR 739 and reaffirmed in BSC Footwear Ltd. v. Ridgway /1972/ A.C. 544 (though in the latter case it was held by a majority of three to two that there were good reasons on the particular facts for departing from the practice constantly followed in the past). In the Duple case /1961/ 1 WLR 755 Lord Reid said:

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"One thing clearly emerges as approved by the accountancy profession - whatever method is followed, it must be applied consistently.. and if a method has been applied consistently in the past, it seems to follow that it should not be changed unless there is good reason for the change sufficient to outweigh any difficulties in the transitional year."

The Duple case concerned an attempt by the Inland Revenue to insist on a change from the consistently followed practice, but the principle is enunciated by Lord Reid in entirely general terms, and applies equally to a case where it is the taxpayer, not the Inland Revenue, which is seeking to depart from the previous consistent practice. In the present case the Appellant is attempting to depart from what it had consistently done in the past. The Comptroller submits that no sufficient reason for the departure has been established by the Appellant and that the Comptroller was fully justified in declining to accept the change of basis.

(g) As regards consistency within the year there is a most important point which arises on the facts of the present case. The Appellant's accounts for the year 1974 are internally inconsistent as regards the treatment of property tax. In that year the Appellant -

(i) completed the development of a project known as Golden Hill, and

(ii) owned other areas of land in relation to which it did not complete the development projects.

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p.60

In accordance with the completed contracts system the profit and loss account for 1974 included the profit (of \$7,629,893.26.) on the Golden Hill project. In the computation of that profit one of the items deducted was property tax referable to Golden Hill and incurred in previous years. But the same accounts also seek to deduct as an expense property tax attributable to other projects and incurred in the current year. In the Comptroller's submission there is a manifest inconsistency which renders the profit and loss account wholly unacceptable. In relation to one project (Golden Hill) property tax is deducted in the year of completion, not the year of the tax liability; in relation to other projects property tax is deducted in the year of the tax liability, not the year of completion. Accounts prepared in that way cannot show a true and fair view of the profit for the year. Even if, consistently with the completed contract system, either of those two methods of

treating property tax was acceptable, only one of them can be used in any one accounting period. The principle is closely analogous to the proposition, laid down by the Judicial Committee, in Bombay Commissioner of Income Tax v. Ahmedabad New Cotton Mills Co. Ltd., (1929) 46 TLR 68 that if the stock in trade of a trader is valued at the end of an accounting period on a particular basis, then it must also be valued on the same basis at the beginning of the period. Otherwise the accounts do not reflect the true profit. In the present case the Comptroller submits that, even if the Appellant's accounts were not subject to other objections, they would be unacceptable for this reason.

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7. The Comptroller therefore humbly submits that the appeal should be dismissed with costs for the following among other

R E A S O N S

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(1) BECAUSE the essence of the completed contract system adopted by the Appellant is that expenses specifically referable to land comprised in a development project are not deducted until the project is completed, whereas the property tax of \$253,980 debited in the Appellant's accounts for the calendar year 1974 was an expense specifically referable to land comprised in development projects which had not been completed.

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(2) BECAUSE Mr. Yip's statement of principle that "expenses should be deferred for matching revenue with expenses" is logical, cogent and convincing and applies to property tax fully as much as to other expenses.

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(3) BECAUSE Mr. Coomber's statement that the deduction of property tax under the completed contract system should not be deferred because "it does nothing to enhance the value of the property concerned" is unsupported by any reason or authority, is unconvincing and is inconsistent with the Exposure Draft which Mr. Coomber himself produced.

(4) BECAUSE in any event the Board of Review were fully entitled to prefer the expert evidence of Mr. Yip to that of Mr. Coomber, and fell into no error of law in doing so.

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(5) BECAUSE the Appellant, having treated property tax in one way in its accounts for previous periods, could not change and treat it in a different and inconsistent way in its accounts

for 1974 unless there was a good reason for the change, and no good reason has been shown.

- (6) BECAUSE the profit and loss account of the Appellant for 1974 was on any view inconsistent within itself and failed to show a true and fair view of the profit for the year, in that it contained a double deduction for property tax - one deduction being made on one basis in relation to the project completed in the year, and another deduction being made on a different and contradictory basis in relation to projects not completed in the year. 10
- (7) BECAUSE the decisions of the Board of Review, the High Court and the Court of Appeal were right.

ANDREW PARK Q.C.

IN THE PRIVY COUNCIL

O N A P P E A L

FROM THE COURT OF APPEAL OF THE
REPUBLIC OF SINGAPORE

B E T W E E N :

THOMSON HILL LIMITED Appellant

- and -

THE COMPTROLLER OF
INCOME TAX Respondent

CASE FOR THE RESPONDENT

Jaques & Lewis,
2 South Square,
Gray's Inn,
London W.C.1.

Solicitors for the Respondent