

# **IRAS CIRCULAR**

## **CHANGES IN THE TAX TREATMENT UNDER SECTION 11(2) OF THE SINGAPORE INCOME TAX ACT**



**INLAND REVENUE  
AUTHORITY  
OF SINGAPORE**

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## Introduction

1. Section 11(2) of the Singapore Income Tax Act (revised edition 2004) ["ITA"] has been amended<sup>1</sup> to effect a number of changes. Among the changes are those:

- (a) to recognize a company limited by guarantee that carries on a trade or professional association as a mutual concern (if the company satisfies certain prescribed conditions) to which the provisions of section 11(2) of the ITA shall apply; and
- (b) to change the basis of computing the 50% of receipts of any trade or professional association by way of entrance fees and subscriptions which are claimed or claimable as a deduction under section 14 of the ITA (hereinafter referred to as the "50% cap") to determine if that trade or professional association is carrying on a business..

2. This circular explains the changes to the tax treatment under section 11(2) in view of the above amendments.

## Background

3. The mutuality principle in common law is founded on the precept that a person cannot make profit by trading with himself. Thus, any surplus of a mutual concern derived through transactions with its members is not regarded as "gains or profits from trade or business" and thus not liable to tax.

4. While the ITA does not provide for the tax treatment of mutual concerns, section 11 of the Act codifies the conditions for a mutual body of persons to be regarded as carrying on a trade or business for tax purposes. The tax treatment in respect of a body of persons that carries on a club or similar institution is stipulated in section 11(1) whereas section 11(2) provides for the tax treatment in respect of a body of persons that carries on a trade or professional<sup>2</sup> association.

5. Specifically, section 11(2) states that where a body of persons, whether corporate or unincorporate, carries on a trade or professional association such that more than half its receipts by way of entrance fees and subscriptions are from persons who claim or would be entitled to claim a deduction under section 14 of the ITA in respect of such fees/subscriptions, such a trade or professional association would be deemed to be carrying on a business. This means that the whole of its income from transactions both with members (including entrance fees and subscriptions) and others shall be deemed to be receipts from a business and subject to tax.

6. A company is not regarded as a mutual concern because of its independent legal personality and its inherent aim to make profits. Hence, the tax treatment provided under section 11(2) is not applicable to a company even if it carries on a

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<sup>1</sup> The Income Tax (Amendment) Act 2007

<sup>2</sup> In practice, IRAS has been applying the provisions under section 11(2) of the ITA to professional associations even though they are not explicitly mentioned in section 11(2). The amendment to section 11(2) also expressly includes them.

trade or professional association. Section 2 of the ITA also specifically excludes a company from the definition of “body of persons”.

## **Changes in Tax Treatment under Section 11(2)**

### *To Recognize a Company Limited by Guarantee Carrying On a Trade or Professional Association as a Mutual Concern*

7. Increasingly, more trade associations are set up as companies limited by guarantee for various business considerations. Therefore, the government has decided to recognise such a company limited by guarantee that carries on a trade or professional association as a mutual concern if the company limited by guarantee meets the following prescribed conditions:

- (a) it must be set up not for purposes of profit or gain and if the company derives any surplus, it must be used to carry out its not-for-profit objectives;
- (b) it exists for the sole purpose of benefiting its members and is operated exclusively for the same purpose for which it was organized;
- (c) the contributors to the common fund, as a class, should be identical to the participators in the mutual surplus;
- (d) there must be arrangements which entitle the contributors to the common fund to control it; and
- (e) the constituent documents must prohibit the company limited by guarantee from making any distribution, whether in money, property or otherwise, to its members.

8. Changes have been made to section 11(2) to enable the Minister (or such person as he may appoint) to approve such companies (the process to apply for approval is explained in paragraph 14) and to subject such companies to the treatment specified in section 11(2) by expanding the definition of “body of persons” in the new section 11(3) to include companies limited by guarantee.

### *To Change the Basis of Computing the 50% Cap*

9. In addition, section 11(2) of the ITA is amended to revise the basis of computing the 50% of receipts of any trade or professional association by way of entrance fees and subscriptions which are claimed or claimable as a deduction under section 14 of the ITA i.e. the 50% cap to determine whether such a trade or professional association is deemed to be carrying on a business. The revised basis of computing the 50% cap is applicable to a body of persons including a company limited by guarantee [approved under the new section 11(3)] that carries on a trade or professional association.

10. Prior to the amendment, section 11(2) states that where more than 50% of the receipts of a trade or professional association by way of entrance fees and

subscriptions are from persons (including both Singapore and foreign members) who claim or would be entitled to claim a deduction under section 14 of the ITA, the trade or professional association shall be deemed to be carrying on a business and the whole of its income from transactions with Singapore members, foreign members and non-members shall be subject to tax. If not more than 50% of the receipts are from persons who claim or would be entitled to claim a deduction under section 14 of the ITA, only income from transactions with non-members shall be subject to tax. However, no distinction was made between Singapore and foreign members.

11. The new amendment however makes a distinction between Singapore and foreign members. For computing the 50% cap, only receipts from Singapore members<sup>3</sup> are taken into account. Following the amendment, where more than 50% of the receipts of a trade or professional association by way of entrance fees and subscriptions from *Singapore members* are from those who claim or are entitled to claim a deduction under section 14 of the ITA, the trade or professional association will be deemed to be carrying on a business but only the income from transactions with *Singapore members* and non-members will be subject to tax. The income from transactions with *foreign members* will not be subject to tax. Where not more than 50% of the receipts from *Singapore members* are from those who claim or are entitled to claim a deduction under section 14 of the ITA, only income from transactions with non-members will be subject to tax. The basis of computing the 50% cap and corresponding tax treatment of the income from transactions with members and non-members under section 11(2) of the ITA before and after the change are summarized in the following table:

	Before tax change	After tax change
<b>The 50% Cap</b>	Trade or professional association is deemed to be carrying on a business where more than 50% of receipts by way of entrance fees or subscriptions are from persons (including both Singapore and foreign members) who claim or are entitled to claim a deduction under section 14.	Trade or professional association is deemed to be carrying on a business where more than 50% of receipts by way of entrance fees or subscriptions from <i>Singapore members</i> are from those who claim or are entitled to claim a deduction under section 14.
<b>Tax Treatment of receipts where:</b>		
<b>- 50% Cap breached i.e. Trade or professional association is deemed to carry on a business</b>	The whole of income from transactions with Singapore members, foreign members and non-members is subject to tax	Income from transactions with Singapore members and non-members is subject to tax whereas income from transactions with foreign members is not subject to tax
<b>- 50% Cap not breached</b>	Only income from transactions with non-members is subject to tax	Only income from transactions with non-members is subject to tax

<sup>3</sup> “Singapore members” mean members comprising:

- (a) persons, other than companies, resident in Singapore;
- (b) companies incorporated in Singapore (excluding branches or offices located outside Singapore); and
- (c) branches or offices of companies incorporated outside Singapore that are located within Singapore.

12. The following illustrates how the 50% cap is computed:

Trade Limited is a trade association set up as a company limited by guarantee. In the Year of Assessment 2008, Trade Limited receives \$10,000 of subscription fees from its members, of which \$7,500 is from its Singapore members and \$2,500 is from its foreign members. Of the subscription fees received from its Singapore members, \$5,000 can be claimed as deduction under section 14 of the ITA by the members.

Receipts from Singapore members that is claimed or claimable as deduction under section 14  
Total receipts from Singapore members

$$\frac{5,000}{7,500} > 50\%$$

Trade Limited does not meet the 50% cap. Thus, it is deemed to be carrying on a business and the income from its Singapore members (i.e. \$7,500) will be liable to tax. The \$2,500 received from foreign members will not be taxed.

### **Implementation Date**

13. The amendments made to section 11(2) of the ITA will take effect from Year of Assessment 2008.

### **Application Procedures For Companies Limited by Guarantee**

14. To obtain approval as a mutual concern to which the treatment specified in section 11(2) is applicable, a company limited by guarantee that carries on a trade or professional association must make an application in writing to the Comptroller of Income Tax for such approval. The application is to be submitted to Corporate Tax Division – General Branch, IRAS. In the application, the company is required to provide the following information:

- (a) The company's name and tax reference number (e.g. ROC no.);
- (b) A written confirmation that the company meets all the prescribed conditions stated in paragraph 7(a) to 7(e) of this circular; and
- (c) Relevant documents (e.g. the company's Memorandum and Articles of Association) to substantiate that the company meets the qualifying conditions.

15. Once approval of an application is granted, it shall continue indefinitely unless revoked. IRAS reserve the right to revoke the approval if at any time the company limited by guarantee is found to have failed to satisfy any of the prescribed conditions.

**Enquiries**

16. For any enquiry or clarification on this circular, please call:

1800-3568622 (Corporate Income Tax); or  
6351-3882 (Taxation of Body of Persons)

Inland Revenue Authority of Singapore