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TAX TREATMENT OF THE GAINS AND LOSSES FROM THE SEPARATE TRADE OF A PIONEER ENTERPRISE



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- updating of paragraphs 2 and 5 by inserting footnotes 1 and 2, respectively.
- updating of last sentence to paragraph 5 following the change mentioned in footnote 2
- updating of paragraphs 7 and 10 following the change mentioned in footnote 2.

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TAX TREATMENT OF THE GAINS AND LOSSES FROM THE SEPARATE TRADE OF A PIONEER ENTERPRISE

INTRODUCTION

1. Under Section 5(2) of the Economic Expansion Incentives (Relief from Income Tax) Act (Cap 86), the Minister for Trade and Industry may approve any qualifying company to be a pioneer enterprise. Upon approval, the company will enjoy a tax relief period ranging from five to ten years.
2. During the tax relief period, income derived by the company from the trade for which it has been approved as a pioneer enterprise (i.e. the pioneer trade) will be exempt from tax. However, the company is not allowed to carry on any other trade or business without the Minister's permission¹.
3. Where the carrying on of a separate trade is allowed by the Minister¹ the company is required to maintain separate accounts for that trade. In addition, special rules apply to the computation of its income from the pioneer trade (i.e. the pioneer income). These rules are briefly explained in paragraphs 4 and 5 below.
4. Section 8(3) provides that where the carrying on of a separate trade results in a loss in any accounting period, the pioneer income for that period shall be reduced by the loss. This requirement may, however, be waived if the Comptroller is satisfied that the loss was not incurred for the purpose of obtaining a tax advantage.
5. Section 8(4) provides that where the separate trade results in an adjusted profit in any accounting period which is less than 5% of the gross revenue, the adjusted profit shall be deemed to be 5% of the gross revenue. The pioneer income shall also be abated accordingly. A lower profit margin may, however, be approved by the Minister². Following the delegation of authority to the Comptroller, applications for a lower profit margin which were previously processed by the Economic Development Board, should be submitted to Comptroller for consideration.

¹ This requirement to seek approval from Minister if the pioneer enterprise wishes to carry on any trade or business other than the trade or business relating to the pioneer product has been removed following the amendment to the Economic Expansion Incentives (Relief from Income Tax) Amendment [EEIA] Act 2004 (SN 11 of 2004 dated 30 Apr 2004).

² Following the amendment of the EEIA Act 2004 (SN 11 of 2004 dated 30 Apr 2004), the Comptroller of Income Tax has been empowered to determine the amount of statutory income derived by a pioneer enterprise from the carrying on of a separate trade.

6. Section 8(3) and 8(4) are not applicable to a pioneer enterprise whose separate trade is considered by the Comptroller to be subordinate and incidental to the carrying on of the pioneer trade.
7. The purpose of this Practice Note is to spell out:
 - (a) some of the circumstances under which the Comptroller may consider that a loss under Section 8(3) was not incurred for the purpose of obtaining a tax advantage;
 - (b) some of the factors that may be considered by the Comptroller when processing applications for a lower profit margin under Section 8(4).

Section 8(3)

8. The Comptroller may consider that a loss under Section 8(3) was not incurred for the purpose of obtaining a tax advantage under certain circumstances. Some of these circumstances are:
 - (a) where the loss incurred was due to depressed sale prices arising from recession, poor market conditions, exceptionally strong competition and substandard products;
 - (b) where the extent of the loss is reasonable, and :
 - (i) direct expenses have been properly charged to both the pioneer and separate traders;
 - (ii) appropriate and reasonable bases are use in apportioning indirect expenses between the pioneer and separate trades;
 - (c) where the separate trade was already in a loss position before the commencement of the pioneer trade.
9. The Comptroller's decision will depend on the specific circumstances of each case for each accounting period. The onus of proof that the loss was not incurred for the purpose of obtaining a tax advantage rests solely with the pioneer enterprise.

Section 8(4)

10. Comptroller takes into consideration a number of factors when processing applications for a profit margin of less than 5% of gross revenue from a separate trade to be exempted from the provisions of Section 8(4). Based on the merits of

each case, Comptroller may either approve or reject the application. Some of the factors looked at by the Comptroller include:

- (a) importance of the separate trade to the pioneer enterprise;
 - (b) size of turnover of the separate trade;
 - (c) whether the separate trade is a new or established activity;
 - (d) profit margins of the separate trade in the past;
 - (e) whether profit margins of the separate trade follow market trends for that industry.
11. A pioneer enterprise carrying on a separate trade must satisfy the Comptroller that expenses have been properly charged to the pioneer and separate trade activities. When examining the accounts for each accounting period, the Comptroller may therefore require the pioneer enterprise's auditor or tax agent to certify that expenses have been properly charged or allocated between the two trade activities.
12. Where a pioneer enterprise claims that the loss from a separate trade was not incurred for the purpose of obtaining a tax advantage, the Comptroller may further require the auditor or tax agent to confirm that the loss was incurred under circumstances stated in paragraph 8 above.