

# **IRAS CIRCULAR**

## **CARRY-FORWARD OF LOSSES AND CAPITAL ALLOWANCE**



**INLAND REVENUE  
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OF SINGAPORE**

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Paragraph 2: To make consequential change in view of the amendments to the Companies' Act in respect of a company's capital structure

Addition of Paragraph 8: Incorporation of Section B of the e-Tax Guide on "Simplification of Income Tax Rules and Procedures for Companies" (Ref: 2003/IT/11) [repealed]

Sections quoted in the circular have been renumbered with reference to the Income Tax Act (Revised Edition 2008)

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## **INTRODUCTION**

1. Sections 37(16) and 23(5) were introduced to provide a waiver from the strict rules for carry-forward of losses and capital allowances provided under sections 37(12) and 23(4). The provisions of sections 37(16) and 23(5) applied from year of assessment 1988.
2. Prior to the introduction of sections 37(16) and 23(5), losses and capital allowances which could not be fully deducted against income for any year of assessment (i.e. the unabsorbed losses and capital allowances) were not available for deduction against the income of a subsequent year of assessment if more than 50% of the total number of issued shares of the company was held in the subsequent year of assessment by persons different from those in the year the losses arose or the capital allowances were granted. This is referred to commonly as a substantial change in shareholders. No exception to this rule was provided in the law once such a change in shareholders occurred. This strict rule, which is provided under sections 37(12) and 23(4) was introduced in the early 1970's as an anti-tax avoidance measure.
3. A substantial change in shareholders can take place for reasons other than to obtain a tax advantage. In recognition of this, sections 37(16) and 23(5) were enacted. Under these sections, the Minister for Finance may, if he is satisfied that a substantial change in shareholders has occurred not for the purpose of deriving any tax benefit or obtaining any tax advantage authorise a waiver from the provisions of sections 37(12) and 23(4). The losses and capital allowances which are granted the waiver can, however, only be deducted against the gains or profits derived from the same trade or business as that from which the losses or allowances arose.
4. With the enactment of sections 37(16) and 23(5), at least two major questions arise. They are:
  - (a) the circumstances under which a waiver is granted and how to apply for the waiver; and
  - (b) whether unabsorbed losses and capital allowances are eligible for the waiver in cases where a substantial change in shareholders occurred prior to the year of assessment 1988.

This Practice Note is intended to provide answers to the above two questions.

## **ADMINISTRATIVE PRACTICE**

5. The Minister for Finance has delegated the powers of granting the waiver under sections 37(16) and 23(5) to the Comptroller of Income Tax. Hence, companies may apply in writing to the Comptroller for the waiver to be granted. To be granted the waiver, the Comptroller has to be satisfied that the substantial change was not for the purpose of deriving any tax benefit or obtaining any tax advantage.

6. Generally, a substantial change of shareholders brought about by the following situations will be regarded as not being for the purpose of deriving tax benefit:
  - (a) nationalisation of a private/public company;
  - (b) privatisation of a government-owned enterprise;
  - (c) normal trading of the shares of the applicant or those of its holding company on a recognized stock exchange; and
  - (d) change carried out for genuine commercial reasons and was not tax motivated, e.g. as part of a company rescue package.
  
7. Although sections 37(16) and 23(5) took effect from the year of assessment 1988, unabsorbed losses and capital allowances which have not been disregarded prior to the year of assessment 1988 are eligible for deduction against the income for the year of assessment 1988 and thereafter if waiver is granted. This means that even though there has been a substantial change in shareholders before the year of assessment 1988, so long as the unabsorbed losses or capital allowances have not been considered for deduction against the income of any year of assessment before the year of assessment 1988 i.e. they have not been disallowed, they are eligible for deduction if waiver is granted. An example will serve to make this clear.

#### Example

##### Facts:

- (a) Company XYZ incurred losses for each of the years 1984, 1985 and 1986 in the amounts of \$100,000, \$400,000 and \$300,000 respectively. It derived income of \$900,000 for the year of assessment 1988.
- (b) A substantial change in shareholders occurred in the year 1986.

##### Treatment:

Based on the existing practice of applying the provisions of section 37(12), the losses for the years 1984 to 1986 would not have been disregarded as none of the years of assessment before the year of assessment 1988 had income assessable to tax. Consequently, if waiver is granted for the substantial change in shareholders in 1986, the losses from 1984 onwards are eligible for deduction against the income for the year of assessment 1988. Otherwise only the losses of 1986 are deductible.

### **APPLICATION PROCEDURE**

8. With effect from 7 Aug 2003, companies can submit their application for waiver of shareholding test even if the company is not yet in the position to utilise the losses and capital allowances. This is done in recognition that there could be considerable time lag between the time the substantial change of shareholders occurs and when the unutilised losses or capital allowances are claimed. Timely application would make it easier for companies to retrieve relevant records to support their application for waiver of shareholding test.

9. Application should be made to the Corporate Tax Division, Inland Revenue Authority of Singapore with the following particulars:
- a) Date of substantial change in shareholders or takeover
  - b) Details of the commercial reasons leading to the change or takeover
  - c) Advantages derived by the takeover company
  - d) Details of the net worth of the assets of the applicant
  - e) The price at which takeover company paid for the shares of the applicant and the basis on which such price was determined and arrived at
  - f) Future plans of the applicant after the takeover and whether such plans were implemented; if not, give reasons
  - g) Whether any activities of the takeover company or any other company under common control have been or will be transferred to the company; if so, furnish details
  - h) Whether future expansion of the associated companies under common control have been or will be diverted to the company; if so, furnish details
  - i) A chart showing the group structure before and after the relevant event

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