KPMG

Tax Alert

ISSUE 20 | **SEPTEMBER 2021**

As we transition to the new normal in anticipation of an end to the virulence of the COVID-19 pandemic, it is an opportune time to examine if property tax is ready for the future economy. We examine this issue against the backdrop of the recent Court of Appeal judgment in *Skyventure VWT Singapore Pte Ltd v Chief Assessor* [2021] 2 SLR 116.

Background

Property tax is a tax on immovable property. Machinery, which is affixed to land or buildings such that it constitutes part of the immovable property, is subject to property tax unless otherwise excluded from taxation.

In the recent *Skyventure* case, the Court of Appeal dismissed the taxpayer company's appeal to exclude the value of its wind tunnel machinery from taxation. The taxpayer company, which operates an indoor skydiving centre and uses the wind tunnel machinery to provide customers with a simulated skydiving experience, had sought to rely on the exclusion clause under section 2(2) of the Property Tax Act.

Under section 2(2), the enhancement in value of the immovable property is excluded from property tax if the machinery is used for the following qualifying purposes:

a) the making of any article or part thereof;

b) the **altering**, repairing, ornamenting or finishing **of any article**; or

c) the **adapting for sale of any article**.

On the facts of the *Skyventure* case, the Court of Appeal only needed to construe paragraphs (b) and (c) of section 2(2) as no "articles" were made by the wind tunnel machinery.

The appeal

In the appeal proceedings, the counsel for the taxpayer company argued for the wind tunnel machinery to be regarded as falling within the scope of the exclusion clause of section 2(2) on the basis that:

1) the wind tunnel is a machinery which alters and adapts the air within it by increasing velocity and pressure while reducing the temperature of the air; and

2) the aerodynamic or lifting effect of the airflow is "sold" to customers paying for a simulated skydiving experience in the flight chamber of the wind tunnel.

While the Court of Appeal recognised that the wind tunnel is a machinery which:

1) "constitutes part of a system which creates, modifies and controls airflow", and

2) "did alter airflow so as to induce its skydiving-friendly aerodynamic properties",

it was nevertheless of the view that the wind tunnel machinery fell outside the scope of the exclusion clause under section 2(2) of the Act.

The reasoning provided by the Court of Appeal is that the term "article" in section 2(2) refers to "matter which is intended to be sold or which is the subject matter of a sale of services to make, alter, repair, ornament, finish or adapt for sale the same" (hereafter "**sale requirement**").

On this basis, the Court of Appeal held that the exclusion clause under paragraph (c) of section 2(2),which caters to situations where the machinery is used for the adapting for sale of any article, would not be available to the wind tunnel machinery, as the Court of Appeal was of the view that "there was … no 'sale' of the 'adapted article' (i.e. the aerodynamic effect of the airflow) as such".

The Court of Appeal also held that the exclusion clause under paragraph (b) of section 2(2), which caters to situations where the machinery is used for the altering of any articles, would not be available. Although the Court of Appeal recognised that the wind tunnel machinery "did alter airflow so as to induce its skydiving-friendly aerodynamic properties", it was of the view that "the altered airflow was not an article which was intended to be sold per se".

In short, while the Court of Appeal recognised that the adapted airflow "did carry aerodynamic properties conducive to simulated skydiving", it was not convinced that the "sale requirement" was met. More specifically, the Court of Appeal was "not satisfied that there was any transfer of property (in respect of the skydiving-friendly aerodynamic properties of the air) to the customers of the appellant".

The earlier case of *First DCS*

In the decision of the Court of Appeal, reference was made to its earlier judgment in the property tax case of *Chief Assessor and another v First DCS Pte Ltd* [2008] 2 SLR(R) 724 (***First DCS***), where it was held that the "machinery that chilled water, which was then piped to customers' premises to provide a 'district cooling service', had adapted the water for sale".

A primary point of contention raised in the earlier case of *First DCS* was whether a "sale" had occurred, given the fact that ownership of the chilled water produced by the "cooling machinery" did not pass to the customers. While the Court of Appeal acknowledged that "the chilled water itself was not sold", it was nevertheless of the view that a "sale" had taken place in the *First DCS* case, in that "property in the cooling or chilling effect of the water had in fact passed completely from the taxpayer in that case to the customers, in return for monetary consideration passing from the latter to the former".

Applying the principles of *First DCS*

In view that the arguments put forth by the taxpayer company in support of the exclusion of the wind tunnel machinery from property taxation are similar to those raised in the *First DCS* case, the Court of Appeal re-examined its earlier decision in the *First DCS* case.

In reaffirming its earlier decision that the "cooling machinery" in *First DCS* qualified for exclusion under section 2(2), the Court of Appeal commented (and appeared to have placed weight on the fact) that "the chilling effect was delivered to the customers" whereupon "the water returned, **bereft** of the chilling effect, through pipelines to the taxpayer to be re-chilled".

Drawing from the principles laid down in *First DCS*, the Court of Appeal concluded that, in the case of the indoor skydiving centre, the aerodynamic effect of the airflow was not an article which was "intended to be sold", on account that:

1) The skydivers themselves were not the terminus for the aerodynamic effect of the airflow, unlike the customers of the taxpayer in the *First DCS* case.

2) The airflow carrying skydiving-friendly aerodynamic properties entered the flight chamber, and airflow carrying the **same** skydiving-friendly aerodynamic properties exited the flight chamber to be recirculated afresh.

While the Court of Appeal recognised that "[t]he skydivers had paid money to enjoy the adapted article", it took the view that there was no "sale" of the adapted article to the customers. In particular, the Court of Appeal was of the view that that there was "no transfer of property in the adapted article" and that such property in the adapted article "remained at all times with the taxpayer". In this regard, the Court of Appeal concluded that "the adapted air was merely the means by which the skydivers could enjoy the experience of skydiving".

Consequently, the Court of Appeal dismissed the appeals and held that the exclusions under section 2(2) of the Act would not be available to the wind tunnel machinery.

Our comments

Can the decisions in *First DCS* and *Skyventure* be reconciled?

The decision of the Court of Appeal to dismiss the taxpayer company's appeal in the *Skyventure* case ultimately comes down to its view that there was no sale of the aerodynamic or lifting effect of the air, adapted by the wind tunnel machinery, to the customers.

It may however be worthwhile to note that there are a number of similarities between the *Skyventure* case and the *First DCS* case, as summarised in the table below.

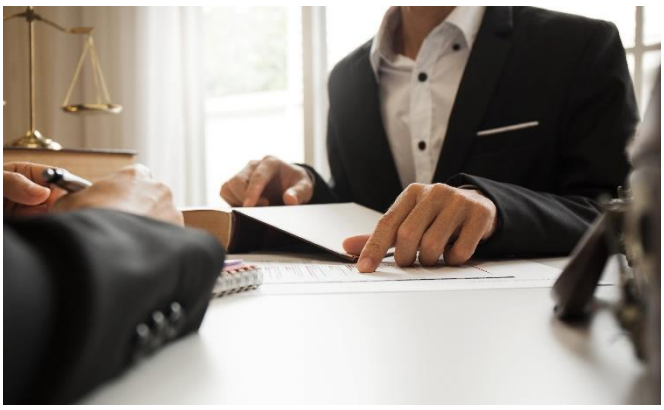
	***First DCS* case**	***Skyventure* case**
What the customers are paying for	District cooling services (i.e. air-conditioning services)	Simulated skydiving experience
Type of machinery involved in providing the services to the customers	Cooling machinery	Wind tunnel machinery
Function performed by the machinery	The cooling machinery **alters and adapts** the water travelling through the pipelines of the district cooling network by **reducing the temperature and increasing density**	The wind tunnel **alters and adapts** the air within it by **increasing velocity and pressure, while reducing the temperature of the air**, thereby making the adapted air suitable for skydiving
The "article" involved	Cooling effect of the chilled water	Aerodynamic effect of the adapted airflow

Nonetheless, the Court of Appeal distinguished the *First DCS* case from the *Skyventure* case, and was of the view that in the latter:

- there was no "sale" of the "adapted article" (i.e. the aerodynamic effect of the airflow); and
- the altered airflow was not an article which was intended to be sold per se.

Notably, the Court of Appeal reaffirmed its earlier decision in *First DCS* that the cooling machinery qualifies for exclusion from property tax under section 2(2) of the Act. In this regard, the Court of Appeal commented in the *Skyventure* case that "the reasoning as well as decision of this court in [*First DCS*] probably stand at the very border of what would pass legal muster under s 2(2)(c) of the Act".

Having read the decisions of the Court of Appeal in relation to both the *First DCS* case and the *Skyventure* case, we unfortunately are unable to agree with the reasonings provided by the Court of Appeal in distinguishing the two cases.



We compare the two cases in the table below.

Issue: Whether there was a "sale" or "transfer" of property	***First DCS* case**	***Skyventure* case**
Fact	The chilled water itself was **not sold** and ownership of the chilled water produced by the cooling machinery did not pass to the customers	The adapted air itself was **not sold** and ownership of the adapted air produced by the wind tunnel machinery did not pass to the customers
Decision of the Court of Appeal	A "sale" has taken place in that "property in the cooling or chilling effect of the water had passed completely from *First DCS* to its customers, in return for monetary consideration passing from the latter to the former"	There is **no sale or transfer** of property (i.e. the skydiving-friendly aerodynamic properties of the air) to the customers
Reason #1 provided by the Court of Appeal – "terminus"	The customers of *First DCS* were the **terminus** of the chilling effect of the adapted water. (The Court of Appeal however did not further elaborate on what it meant by the concept of "terminus")	The skydivers themselves were **not the terminus** for the aerodynamic effect of the airflow
Reason #2 provided by the Court of Appeal – "bereft"	The chilling effect was delivered to the customers whereupon the water returned, **bereft** of the chilling effect, through pipelines to the taxpayer to be re-chilled [**Note:** It is not scientifically correct to say that the "chilling effect" was delivered to customers. Heat travels from hot to cold objects, and not the other way round. It is the customers who "lost" heat to the surroundings, rather than the "chilling effect" of the adapted water being "delivered to the customers".]	The airflow carrying skydiving-friendly aerodynamic properties entered the flight chamber, and airflow carrying the **same** skydiving-friendly aerodynamic properties exited the flight chamber to be recirculated afresh. In other words, the property in the adapted article remained at all times with the appellant

In the *Skyventure* case, the customers are obviously not paying for the sale or purchase of tangible goods or products. Instead, the company is selling, and the customers are paying, for an experience — an indoor skydiving experience. Such fact pattern is similar to that in the *First DCS* case where the company is selling, and the customers are paying, for an experience — the cooling effect of the chilled water.

In our view, while the adapted air (with the relevant aerodynamic properties) in the *Skyventure* case was not sold to the customers per se, the aerodynamic effect of the adapted air was "sold" to them in that customers had paid for a simulated skydiving experience in the flight chamber and experienced the aerodynamic effect of the adapted airflow, just like the customers of *First DCS* who paid for and experienced the cooling effect of the chilled water. In this regard, it is not entirely clear to us why the Court of Appeal took the view that "the skydivers themselves were not the terminus for the aerodynamic effect of the airflow" in the *Skyventure* case.

It is also worthwhile noting that the simulated skydiving experience can only take place within the flight chamber of the wind tunnel machinery — the air outside the flight chamber simply does not have the same aerodynamic or lifting effect as the air within the flight chamber.

However, it appeared from the decision that the Court of Appeal may have placed emphasis on the point that "the wind tunnel produces a smooth and continuous flow of sped-up, high-pressured and cooled-down air in the flight chamber when it is operated", and may not have placed equal emphasis on the fact that the air outside the flight chamber did **not** have the same aerodynamic or lifting effect as the air within the flight chamber.

Adopting the same logic applied by the Court of Appeal in the explanation of the *First DCS* case, when the air exited the flight chamber into the diffuser area of the wind tunnel, it was **bereft** of the aerodynamic or lifting effect experienced by the customers within the flight chamber. It is for this reason that the wind tunnel machinery comes with four wind turbines which have a combined strength of 1,800 horsepower, necessary to increase the velocity of the air going back into the flight chamber, to provide customers with a simulated skydiving experience within the flight chamber.

For the above reasons, it is our view that the aerodynamic or lifting effect of the adapted air had been sold and passed to the customers when they enjoyed their simulated skydiving experience in the flight chamber of the wind tunnel machinery.

A thin line between statutory interpretation and the exercise of "legislative" powers

On a related note, it is interesting to read that the Court of Appeal, in explaining its interpretation of the "sale requirement" under section 2(2)(c), stated in its decision for the *Skyventure* case that "tax is a creature of statute and it is not for the courts to stretch the relevant statutory provisions (such as s 2(2)(c) of the Act) beyond what their language and context are able to reasonably bear".

Nevertheless, the Court of Appeal held that an eventual sale of the article would be required in order for the machinery in question to be excluded from property tax under all 3 limbs of section 2(2), when the words "for sale" are conspicuously absent in paragraphs (a) and (b) of section 2(2). This raises the perennial issue of determining when the process of statutory interpretation stops, and at which point the statutory provisions are stretched beyond what "their language and context are able to reasonably bear".

In the *Skyventure* case, the Court of Appeal, in explaining its interpretation of section 2(2), reasoned that a contrary interpretation "would imply, rather counterintuitively, that Parliament intended to deprive the State of property tax revenue in order to encourage such an economically unproductive and potentially wasteful activity."

With the greatest respect, such a statement does not sit well with the Government's push to develop and grow all sectors of the economy, particularly as our country pivots away from traditional manufacturing activities, and transitions towards the economy of the future.

All economic activities taking place in the country adds to the gross domestic product of Singapore, regardless whether the activity constitutes part of the traditional economy or the new economy. It is also worthwhile highlighting that all types of economic activities create employment opportunities, which is in turn a stimulant for further consumption and economic growth.

In any case, the property tax savings by the taxpayer (and the property tax revenue foregone by the Government) from the exclusion of such machinery for property tax purposes is merely a small fraction of the total cost of the machinery. It therefore follows that no rational taxpayer would spend money in installing machinery simply for the sake of deriving a property tax advantage in respect of activities or machinery, which are "unproductive" or "wasteful" from a business standpoint.

What constitutes a "sale" in the modern and future economy?

In our view, it may be overly narrow to define the term "sale" in the conventional sense — where property must pass from one person to another — in the context of a modern economy such as that of Singapore. It may not be necessary for the seller of an article to be bereft of the article for a "sale" to take place in the modern or future economy.

As a point of illustration, when a music streaming company such as Spotify "sells" its streaming services to customers, there is no transfer of property rights. The songs and other such property rights remain at all times with the company. Similarly, when a company such as Disney "sells" an experience to customers who have paid for an amusement ride or a stay in its hotels, a "sale" has taken place to the extent that the customers have acquired what they are paying for. In this case, this would be experiencing the amusement ride or hotel stay.

In the modern economy, the fact that there was no "transfer of property", and that the property "remained at all times" with the company, should not ipso facto mean that no "sale" has taken place.

Is it time for an amendment of section 2(2)?

The existing provisions in section 2(2) of the Property Tax Act were first enacted in the 19th century to encourage investments in machinery for manufacturing and processing industries. As the existing provisions of section 2(2) hark back to the early days of the Industrial Revolution, it is not surprising that the provisions are rather archaic and generally not in tune with the modern and future economy.

Following the latest development in the recent Court of Appeal decision, it would appear that many kinds of machinery, including those used for the new economy and in furtherance of Singapore's transition to the future economy, would face the risk of not falling within the scope of section 2(2). Many of these machineries that would not qualify for exclusion from property tax are, however, critical tools of trade in the future economy.

Examples of machineries which the taxman is known to be imposing property tax on include:

a) machinery for the provision of cold chain logistical facilities to store vaccines and other perishables, where the installation of such machinery can significantly reduce loss and wastage

b) machinery for the provision of contamination-free or sterile environment for the life sciences industry (including the medical technology, biotechnology, pharmaceuticals and medical devices industries), where vaccines and drugs may be manufactured

c) machinery comprising photovoltaic systems and inverters for the provision of solar power in specialised factories

d) machinery for the automatic storage and retrieval systems (ASRS) to store and retrieve goods, designed to meet the objectives of faster deliveries, higher efficiency and lower costs

e) machinery with state-of-the-art sorting technologies used by the logistics industry designed to meet the requirements of e-commerce

f) machinery such as robotics, Internet of Things (IoT)-enabled carts and automated guide vehicles used for the lifting and conveying of goods

We are of the opinion that Singapore may be seen to be lagging in updating its property tax legislation in this area, compared to the positions taken in other jurisdictions which have excluded machinery used for "trade processes" from tax assessment. While it is ultimately a matter of fiscal policy as to whether Singapore is to follow the position taken in jurisdictions such as England and Hong Kong, it would seem that there is good policy case for Singapore to liberalise and broaden the scope of the exclusion under section 2(2), or otherwise overhaul the existing property tax regime, if it intends to encourage investments in modern technologies needed by emerging sectors of the future economy.

How we can help

As your committed tax advisor, we welcome any opportunity to discuss the relevance of the above case to your business and any transactions which your business may be contemplating.

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