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# When is Income under Long-term Contracts Derived?

## **Abstract**

This article examines when income under long-term contracts is derived in Australia and Singapore. Grollo is revisited in the context of Australian Income Tax Ruling IT2450, and the Australian test of 'recoverability' for derivation is reviewed. Next, the Income Tax Board of Review's reasoning in MPD, the only Singapore case that directly dealt with the timing of income recognition, is examined. Some common law cases on long-term contracts are also surveyed to distil the principles underlying derivation. The concept of derivation is similar in both countries, with MPD adopting the notion that the money must have 'come home' to the taxpayer for income to be derived or earned. Income under a long-term contract is derived when a right to receive the payments has arisen to the taxpayer, the taxpayer has provided the services contracted for, and he is not required to fulfil any further obligation.

## **Keywords**

taxpayers, income tax, long-term contracts

## **Cover Page Footnote**

I would like to thank Professor Stephen Barkoczy and an anonymous referee for their helpful comments to an earlier draft of this article. Any remaining error is mine.

## WHEN IS INCOME UNDER LONG-TERM CONTRACTS DERIVED?\*

*Tan How Teck*<sup>1</sup>

This article examines when income under long-term contracts is derived in Australia and Singapore. *Grollo* is revisited in the context of Australian Income Tax Ruling IT2450, and the Australian test of 'recoverability' for derivation is reviewed. Next, the Income Tax Board of Review's reasoning in *MPD*, the only Singapore case that directly dealt with the timing of income recognition, is examined. Some common law cases on long-term contracts are also surveyed to distil the principles underlying derivation. The concept of derivation is similar in both countries, with *MPD* adopting the notion that the money must have 'come home' to the taxpayer for income to be derived or earned. Income under a long-term contract is derived when a right to receive the payments has arisen to the taxpayer, the taxpayer has provided the services contracted for, and he is not required to fulfil any further obligation.

### Introduction

The issue of when income under long-term contracts is derived for tax purposes is a vexed one. This article explores the concept of 'derivation' as it is applied to income under long-term contracts in Australia and Singapore. For our purposes, these contracts include construction contracts and contracts for services, the performance of which straddles two or more tax years. In Australia, the 'recoverability' test of derivation of income under the earnings basis has been applied, or its scope clarified, in several cases. Some of these cases addressed the taxability of money received or receivable for work-in-progress in professional firms.

*MPD*,<sup>2</sup> the only Singapore case that is directly pertinent to the issue, is examined. A few of the common law cases cited in that decision are also surveyed for the underlying tax principles. For income to be derived under

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\* I would like to thank Professor Stephen Barkoczy and an anonymous referee for their helpful comments to an earlier draft of this article. Any remaining error is mine.

1 Assistant Professor, Division of Business Law, Nanyang Technological University, Singapore.

2 *MPD Pte Ltd v CIT* (Appeal No 11 of 1996) (1998) MSTC 5,249.

long-term contracts, not only must a right to receive the payments have arisen to the taxpayer, but he must also have provided the services contracted for and there must be no further obligations for him to fulfil. The different outcomes of some of the cases may be explained partly by material differences of fact and partly by the extent that the question of timing of derivation was framed as one of law.

### The Australian view of ‘derivation’

The relevant Australian tax provision referred to ‘the gross income **derived** directly or indirectly from all sources whether in or out of Australia’,<sup>3</sup> Derivation need not involve an actual receipt of cash. Thus, Issacs J opined in *Harding* that ‘derived’ was the equivalent of arising or accruing,<sup>4</sup> and in *Thorogood* that ‘derived’ was not necessarily actually received, although that would ordinarily be the mode of derivation.<sup>5</sup> Income is derived under accruals-basis accounting when it is earned.<sup>6</sup> On long-term construction contracts, the Commissioner’s Income Tax Ruling 2450 and *Grollo* offer insight.<sup>7</sup>

#### Income Tax Ruling IT2450

The Australian Commissioner said in IT2450 that he would accept either the basic approach or the estimated profits basis of recognising income from long-term construction contracts. The condition is that whichever was chosen must be used consistently for all the years during which the particular contract ran and for all similar contracts the taxpayer entered into.

Under the basic approach, all progress and final payments (as well as upfront payments) received in a year (including amounts billed or entitled to be billed in that year) were to be included in assessable income, and losses and outgoings were deductible to the extent allowed by the income tax law. Taxpayers may not defer recognising contract income by, for example, delaying billing until after the income year in which an entitlement to bill has arisen.

3 *Income Tax Assessment Act 1936*, s 25(1). The provision has been replaced by s 6-5 of the *Income Tax Assessment Act 1997*.

4 *Harding v FCT* 23 CLR 119, 133, cited with approval by Dixon J in *C of T (SA) v The Executor Trustee and Agency Co of South Australia Ltd* (1938) 5 ATD 98 (*Carden’s case*) 130.

5 *FCT v Thorogood* (1925) 40 CLR 454, 458.

6 Menzies J in *J Rowe & Son Pty Ltd v FCT* (1971) 124 CLR 421, 448.

7 On the derivation of income through contracts where there is ‘amount uncertainty’, see Woellner R, Barkoczy S, Murphy S and Evans C, *Australian Taxation Law* (Sydney: CCH Australia, 2002), 887-889. The authors identified three common types of such contracts, namely fixed-price contracts with uncertain dollar amounts, conditional or revocable contracts, and ‘variable consideration’ contracts.

WHEN IS INCOME UNDER LONG-TERM CONTRACTS DERIVED?

Taxpayers who use the basic approach should exclude amounts retained under retention clauses from assessable income until they receive or are entitled to receive them.

Under the estimated profits basis, a taxpayer may spread the ultimate profit or loss on a long-term construction contract over the years taken to complete the contract, if the basis is reasonable and is in accordance with accepted accountancy practices. The ultimate profit or loss is, in effect, notional taxable income expected to arise under a particular contract. The amount could be adjusted from year to year to reflect changes caused by increases in material and labour costs, industrial problems, and delays, among other things. Because this basis focuses on the end result of the contract, the question of when tax liability attaches to upfront payments, advance progress payments and retention money does not arise.

The Commissioner rejected the completed contracts basis under which profits and losses are brought to account only on completion of a contract.

The three approaches have been described as the 'receipts and outgoings', 'percentage of completion' and 'emerging profits' approaches, respectively. In *Grollo*, the court had to decide between the first and last of these.

### **Grollo Nominees**

The taxpayers were members of the Grollo group of companies, which were mainly involved in constructing buildings in Melbourne. The issue germane to our discussion was whether Grollo's share of profit from long-term construction contracts should be calculated using the basic approach, which the Grollo group invariably adopted in their accounts and which the Australian Commissioner submitted should apply,<sup>8</sup> or the completed contract basis, which the taxpayers were contending for.

The taxpayers submitted that, where income was to be derived from construction work that had to be carried out over some years, the difference between receipts and disbursements in any year might differ greatly from the true profit (or loss) that would be derived from the whole of the work. Moreover, the builder could not reliably estimate the costs to complete the construction until the project was about 90% complete, and that happened after the disputed years of income. The taxpayers therefore contended that the completed contracts basis should apply instead.<sup>9</sup>

The Full Federal Court rejected the taxpayers' submission for several reasons. On the evidence, the basic approach was an acceptable method of accounting;

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8 *Grollo Nominees Pty Ltd v FCT* 97 ATC 4585.

9 Above n 8, 4612-4613.

and since the taxpayers had always had accounting advice, there was no reason to reject the basic approach they adopted. The Court also pointed out that the overall approach of the *Income Tax Assessment Act* was to ascertain assessable income and allowable deductions, and thus the resultant taxable income, annually. If a company engaged in carrying out a long-term building contract received an excess of what would apparently be assessable income for any year of income over the amount of allowable deductions, the Act requires the excess to be treated as taxable income. There might be reasons why certain receipts ought not to be treated as income in a particular year; for example, the receipts may represent advance payments or retention sums or they may be earmarked for further expenditure or application in subsequent years. The Court however stressed that, *subject to those matters*, the Act requires an annual account to be made so that taxable income may be assessed for each year.<sup>10</sup>

### The 'work-in-progress' cases

Certain contracts that entail work-in-progress may last more than one year, or may contemplate one party making progress payments to the other at pre-determined phases. Australia has several work-in-progress cases involving professional practices. Thus, *Henderson*<sup>11</sup> said that derivation required the fees under the earnings basis to have matured into recoverable debts. In that case, the Full High Court ruled that it would be inappropriate to include as assessable income the estimated value of work-in-progress where payment for services could not be demanded, even though the services had been performed. Although *Henderson* involved a large accounting partnership, the 'recoverability' test was applied to a cash-basis solicitor who practised in Victoria. The solicitor was held not to have derived or earned his fees until one month had passed from the date he delivered a signed bill to his clients; until that date, he could not recover his costs under the (Victorian) *Supreme Court Act 1958*.<sup>12</sup> The test was also applied to a company that had supplied its customers with some unbilled gas as at the relevant year-ends. The Commissioner argued that the company had done all that it was required to supply the gas and had therefore derived the income. But the court ruled that until the gas meters were read and accounts rendered, the company's claims against the customers had not matured into recoverable debts.<sup>13</sup>

These decisions seemed to imply that the 'recoverability' test required not only that a bill had been rendered, but also that the amount must be legally enforceable. But in *Barratt*, the Full Federal Court said that *Henderson* did not rule that an amount could be derived only when it was presently

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10 Above n 8, 4615.

11 *Henderson v FCT* (1970) 119 CLR 612.

12 *FCT v Firstenberg* 76 ATC 4141.

13 *FCT v Australian Gas Light Co* 83 ATC 4800.

## WHEN IS INCOME UNDER LONG-TERM CONTRACTS DERIVED?

recoverable.<sup>14</sup> Under an alternative interpretation of the test, a fee would be 'recoverable' once it had been earned even if no bill had been rendered. For once a bill is rendered, the accumulated 'value' would cease to be work-in-progress for accounting purposes, even if the whole of the relevant work was incomplete.<sup>15</sup>

In *Stapleton*,<sup>16</sup> a partner received money for his share of work-in-progress of the partnership he was retiring from, under a memorandum that set out his responsibilities and entitlements as a partner. He was held to have derived those receipts as income. In *Grant*,<sup>17</sup> Jenkinson J followed Sheppard J's reasoning in *Stapleton* and concluded that work-in-progress in professional firms constituted an affair of revenue that represented what would in time become income when the work in question was complete. These cases suggest that, if a contract for service provided that periodical payments for ongoing work were to be made regardless of whether the work was complete, the clients were bound to pay for the work-in-progress. In other words, the 'billable' portion represented a recoverable fee, even if no account had been rendered for it.

### Singapore's view of derivation

In Singapore, income tax is payable upon the **income** of any person accruing in or **derived** from Singapore or received in Singapore from outside Singapore. Such income includes gains or profits from any trade, business, profession or vocation, for whatever period of time it may have been carried on or exercised.<sup>18</sup> UK judicial authority suggests that the word 'profits' takes a natural and proper sense - a sense that no commercial man would misunderstand.<sup>19</sup>

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14 *Barratt v FCT* 92 ATC 4275. The taxpayers were partners in a pathology practice. Under the *Medical Practitioners Act 1938 (NSW)*, patients had a right to contest the taxpayers' bills and to have the bills independently reviewed if they applied within six months from the date they were served with the bills. That Act also provided that the taxpayers could not begin recovery action until after six months from the date the bills were served. The Court found that this six month condition was only an impediment to enforcing the debt, which already existed.

15 Woellner R, Vella, Burns L, Barkoczy S and Krever R, *1999 Australian Taxation Law* (CCH 9th ed, 1999) 922-923.

16 *Stapleton v FCT* 89 ATC 4818.

17 *FCT v Grant* 91 ATC 4608. In this case, a new accounting partnership was formed out of two former partnerships. The taxpayers, who were retiring partners, received a payment from the continuing partners in respect of their share of unbilled work in progress. See generally Barkoczy S and Neilson T, 'Tax Treatment of Work in Progress: A Call for Legislative Change' (1996) 7 *Law Institute Journal* 53.

18 *Income Tax Act* (Cap 134)(1999 ed), s 10(1)(a).

19 Per Lord Halsbury LC in *Gresham Life Assurance Society v Styles* 3 TC 185, 188.

The relevant Singapore Accounting Standard prescribes two methods of accounting for long-term construction contracts. Under the percentage of completion method (PCM), revenue is recognised as the contract activity progresses, ie, costs incurred in reaching a particular stage of completion are matched with progress payments received at that point, the result being attributed to that proportion of the work completed. PCM may be adopted only if the outcome of a contract can be reliably estimated; otherwise, the completed contracts method (CCM) has to be used. Under CCM, costs and progress payments are accumulated during the performance of the contract, and profit is recognised when the contract is completed or substantially completed, ie, where remaining costs and potential risks are insignificant in amount. Despite the Privy Council's reservation in *TH Ltd* about the inherent distortions that CCM brings to the accounts,<sup>20</sup> the Comptroller in practice accepts PCM or CCM for purposes of preparing the accounts.

### MPD

In *MPD*, the Income Tax Board of Review held that certain progress payments that a housing developer had received in respect of uncompleted property were not realised as income yet and were therefore not taxable. The decision was not appealed.

In that case, the taxpayer company was incorporated to develop a private residential condominium estate and to sell the units. It concluded standard-form sale and purchase agreements with buyers of units. The year of assessment in dispute was 1995. Under Singapore's preceding-year basis of

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20 *TH Ltd v CIT* (1950-1985) MSTC 457 (Privy Council Appeal No 49 of 1982). In that case, the taxpayer was a developer. It had adopted CCM in its accounts since its business commenced in 1970, but debited property tax to the profit and loss account for the year 1974 and claimed it as a revenue expense for the first time. The taxpayer explained that CCM required only expenses that enhanced the property value to be capitalised as development costs. Further, a slump in the property market in 1974 meant that the taxpayer would be over-valuing its stock if it continued to capitalise property tax. Lord Templeman considered (at 460) that there was a 'fundamental contradiction' between CCM and the taxpayer's new treatment of charging property tax. For a critique of this case up to Singapore's Court of Appeal stage, see Tily S, 'The Resolution of Tax Disputes over the Taxpayer's Choice of Accounting Method' (1982) 24 *Malayan Law Review* 48. Contrast *TH Ltd* with the Hong Kong case of *Secan v CIR* [1999] 1 HKLRD 802 and [2000] 1 HKLRD 532, in which the taxpayers were also engaged in the development of property for resale. *Secan* capitalised interest as part of the cost of its development for 1988, 1989 and 1990. In 1991, on completion and sale of flats in part of the development, *Secan* sought to deduct the balance of the interest and related finance charges incurred in the previous three years for the uncompleted flats. The Commissioner denied this claim. The Court of Final Appeal affirmed the decision of the Court of First Instance, which allowed the claim.

## WHEN IS INCOME UNDER LONG-TERM CONTRACTS DERIVED?

assessment, the taxpayer's basis period was its financial year ended 30 June 1994. As at that date, neither possession nor title to the units had passed to the buyers. The Comptroller's practice had been to tax housing developers at the stage when the temporary occupation permit ('TOP'; formerly, temporary occupation licence) was issued. At that stage, the buyers of condominium units collect their keys (take possession), and their lawyers retain 5% of the purchase price as stakeholders, pending the issue of the certificate of statutory completion (formerly, certificate of fitness). In *MPD*, the Comptroller departed from practice and assessed the taxpayer on profits based on the PCM that it had adopted.

The taxpayer submitted that the progress payments it had received up to 30 June 1994 were not yet realised as income for tax purposes, and that whether income has been realised was a question of law - accounting principles do not bind the court. In compliance with the *Housing Developers (Control and Licensing) Act*<sup>21</sup> and subsidiary legislation,<sup>22</sup> the taxpayer had put the receipts in a project account with a bank. The money could be withdrawn and used only for specified purposes and under limited circumstances. The taxpayer also pointed out that the receipts were subject to contingencies. At the year-end, the development was only about 21% complete and the taxpayer was contractually required to complete it before rendering title to the buyers. If the pre-completion progress payments were taxed, the taxpayer would have no statutory remedy or set-off for tax assessed if it was subsequently liable for any breach of its obligations or if, for example, an unforeseen rise in costs of the remaining construction resulted in an actual loss. To tax the receipts would be to anticipate profits, and this violated the cardinal principle that only realised profits were taxable.

The taxpayer gave evidence that, based on the 'deferred tax' item in the accounts, it had envisaged paying tax for the reported profit in future; its tax liability had not crystallised at 30 June 1994 because the actual profits could not be ascertained then.

The Comptroller submitted that the taxpayer had derived income in the amount of progress payments received or receivable. Under the standard-form contract, on signing the prescribed sale and purchase agreement, the taxpayer was immediately entitled to its receipt of 20% of the purchase price. The taxpayer had chosen PCM and the auditors' opinion was that the accounts gave a true and fair view of the taxpayer's financial position. The taxpayer's total sales and costs could therefore be reasonably estimated. Under the agreement, the taxpayer was fully entitled to each progress payment it received. The taxpayer could sue for unpaid instalments and in fact appropriated such profits by declaring dividends from the profits. The statutory restrictions only

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21 Cap 130 (1985 ed), s 22.

22 *Housing Developers (Project Account) Rules* (1997 ed) Rule 5.

regulated the manner in which the receipts could be used; they did not cause the receipts to lose their income nature. In support, the Comptroller cited *Coyle*<sup>23</sup> and *Horizon Homes*,<sup>24</sup> both New Zealand High Court cases. Further, the Comptroller's accounting witness testified that under PCM, as the amount of revenue recognised was determined based on the stage of completion at the end of each accounting period, the taxpayer's 'deferred tax' item was a current liability at the time of assessment.

### *Coyle and Horizon Homes*

The relevant tax legislation in New Zealand included the expression 'all profits or gains **derived** from any business'.<sup>25</sup>

*Coyle* supports the view that, in a long-term construction contract, a receipt is derived when it is due and payable, ie, when the taxpayer could sue for its recovery, in respect of work already done and certified for. The performance of the work does not, however, give rise to a derivation, if payment for it is not contractually due. In *Coyle*, a plumbing and roofing contractor entered into a joint venture, which prepared its accounts using CCM. The Revenue reassessed the taxpayer using PCM. Holland J rejected the taxpayer's argument that the progress payments received were advances and had not fully come home. His Honour said, however, that the money that the Ministry of Works was entitled to retain should be included as the taxpayer's assessable income only when it became payable to the taxpayer.<sup>26</sup> It appears that the progress payments were received free of the encumbrances or restrictions such as those in *MPD*.

*Horizon Homes* similarly took derivation to presuppose entitlement - a taxpayer has not derived income to which he is not yet contractually entitled, but when a progress payment is due, it need not be received in cash. The taxpayer was one of three companies engaged in constructing domestic houses. It adopted CCM in 198, but the Revenue estimated and included as income derived in 1987 an average gross profit component in progress payments received that year. The High Court held that the taxpayer's method was appropriate, as it complied with the accounting standard that governed profits on construction contracts. Uncertainties regarding prior cost estimates, actual costs and the percentage variation in final outcome for 1987 meant that the taxpayers' individual contract costs could not be reliably estimated before completion. On the contrary, the Revenue's treatment did not give a more accurate reflection of income.

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23 *HW Coyle Ltd v CIR* (1980) 4 TRNZ 1.

24 *Horizon Homes Ltd v CIR* (1994) 16 NZTC 11,064.

25 *The Land and Income Tax Act 1954*, s 88(1)(a).

26 Above n 23, 12.

### The Board's decision

The Board distinguished *Coyle* and *Horizon Homes* on the ground that they involved contractors, whereas the taxpayer was a developer who had to operate a project account under strict conditions. It appears that only the fact that various constraints applied to the taxpayer's use of the receipts was crucial. This is because the Board had referred to *Arthur Murray*<sup>27</sup> and quoted *Carden*:<sup>28</sup>

[The word 'gains'] refers to amounts which have not only been received but have 'come home' to the taxpayer, and that must surely involve, if the word 'income' is to convey the notion it expresses in the practical affairs of business life, not only that the amounts received are unaffected by legal restrictions, as by reason of a trust or charge in favour of the payer – not only that they have been received beneficially – but that the situation has been reached in which they may properly be counted as gains completely made, so that there is neither legal nor business unsoundness in regarding them without qualification as income derived.

Citing *Eckel*<sup>29</sup> and *Montana Lands*,<sup>30</sup> the Board considered that the taxpayer could be taxed on the profits in question only when it has done all that was required to do to earn the income. Until the taxpayer has fulfilled his obligations, the money could not be said to have 'come home' to him. The taxpayer faced contingencies, such as having to refund part of the purchase price in certain circumstances. The purchase price might fall, construction costs might go up, and there were external risks beyond the taxpayer's control. Even after the TOP was issued, the regulations required the taxpayer to set

27 Above n 2, 5255. *Arthur Murray (NSW) Pty Ltd v FCT* 114 CLR 314.

28 The Australian High Court in *Arthur Murray* (at 319) had referred to this passage and approved of it.

29 *Eckel v Board of Inland Revenue* [1989] STC 305. In *Eckel*, the taxpayer objected to assessments raised on him for 1973 and 1974, which included the profit that his wife had derived from the sale of land to a company. The Privy Council held that the contract for sale of the land envisaged that both parties had to perform certain obligations over a period of time. Although the wife had commenced trading in 1970 when the contract was concluded, it was only in 1973 and 1974 that she fulfilled all the conditions necessary to earn the profit, in particular, by satisfying the company of her title to the land and by executing the conveyances that entitled her to receive the sums due. The assessments were therefore upheld.

30 *CIR v Montana Lands Ltd* [1968] HKTC 334. See also Hong Kong Inland Revenue Department, Departmental Interpretation & Practice Notes No. 1, Part B: Ascertainment of Profit and the Valuation of Work-in-Progress in Building and Engineering Contracts, Property Development and Property Investment Cases, July 1976. *Montana Lands* may be contrasted with *Perrott v DFCT (NSW)* (1925) 40 CLR 450, a case that involved sales of land on credit terms. In *Perrott*, the Australian High Court rejected the taxpayer's submission that the instalments of purchase price of land could not disclose income until he had recovered the cost of the land sold.

aside a certain sum in the project account to complete the building project and the sales, together with a further 20% for contention and inflation.<sup>31</sup> As the taxpayer had no control over the money at 30 June 1994, he had not derived any income.

Thus, to the Comptroller, the restricted uses the taxpayer could make of the receipts merely related to the application or disposition of income already derived. But the Board's view was that the restrictions meant that, from a legal and a practical standpoint, the receipts could not be regarded as income derived, even if they were inherently revenue. Although *Carden* involved a cash-basis doctor while *Arthur Murray* was about the taxability of prepaid fees for ballroom dancing classes, the Board cited them as authority that income is derived in Singapore when it has come home to the taxpayer or earned by him.

### ***Montana Lands***

Of particular interest is *Montana Lands*. There, the taxpayer carried on the business of real estate and property development. It constructed and sold flats. The flats in question were sold on an instalment basis and the instalments were payable over a number of years. The contracts provided that when the full purchase price has been paid, the vendor would undertake to execute an assignment of the premises to the purchaser. If the building had been completed, the purchaser would be allowed to occupy the flat, but as a licensee only. Upon any default in payment of instalments, he would be required to vacate the flat without prejudice to other rights of the vendor under the contracts, which included forfeiting all deposits and instalments paid. The Revenue treated the transactions as credit sales and assessed the taxpayer for year of assessment 1965/1966 by including the outstanding instalments (excluding an element that represented interest) as revenue currently earned. The Supreme Court (Original Jurisdiction) in Hong Kong held that the contract was executory. The payments had not accrued due in the year under dispute and the transactions remained to be completed - a buyer contracts for a title to the flat, not its mere possession or occupation. The profits were therefore not already earned but were in course of realisation, over a period. *Mills-Owens J* said that the contract was analogous to an entire contract; consequently, the profit was realised, and therefore taxable, only on completion. Granting the purchaser possession did not convert an anticipated or expected profit into an actual profit.<sup>32</sup>

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31 Above n 22, Rule 7.

32 Above n 30, 366-367.

### The Board's 'big picture' approach

Taking a big picture, the Board concluded that developers' profits are taxable at the TOP stage. At that time, all income and expenses could be known, and expenses still outstanding would not be of a substantive nature. This means that 95% of the sale proceeds would be recognised as revenue in the year, and costs incurred up to that year allocated to the units sold. The retention money will be derived as income when it becomes payable to the developer upon the issue of the certificate of statutory completion. The reason for the delay in recognising as income the retention money, representing 5% of total purchase price, is not that there is no physical receipt but that entitlement to it has not accrued. This is reminiscent of Holland J's approach in *Coyle*.

However, by not scrutinising the terms of the standard sale and purchase agreement, the Board approached the issue of 'derivation' as one of mixed law and fact. In that respect, it departed from *Montana Lands*. So far, however, no developer in Singapore has appealed against an assessment on the ground that legal completion should apply.

### *Weeks*

Although not referred to in *MPD*, a UK case, *Weeks*,<sup>33</sup> deserves mention.

*Weeks* suggests that, under the earnings basis of accounting, where the provider of services under a long-term contract views it as a whole in assessing its profitability, progress payments under the contract are not earned as income merely because entitlement to them arises.

The issue in *Weeks* was whether progress payments received for uncompleted architectural services were taxable in the year of receipt. The accounts of a partnership of architects that were drawn up for the relevant years had followed SSAP 9 on 'Stocks and Work-in-progress' and valued work done on the contracts according to a formula that comprised, at most, 40% of the estimated profit.

The taxpayer's accounting witness testified that, under the earnings basis, progress payments were irrelevant to ascertaining profit. A profit was 'earned' under a contract only when the contract was complete, or had reached a sufficiently advanced stage for it to be predictable with reasonable certainty that a profit would be realised. Progress payments were not in themselves 'fees earned'. Even though the architect had to be paid for work done at each stage,

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33 *Symons v Weeks* [1983] STC 195. See Freedman J, 'Profit and Prophets – Law and Accountancy Practice on the Timing of Receipts – Recognition Under the Earnings Basis (Schedule D, Cases I & II), continued' (1987) 3 *British Tax Review* 104, 109.

he knew he had to complete the remaining stages if his reputation were not to suffer. In practice, therefore, he regarded each stage as part of a whole job and the payments as part of one fee. The contract was, in this business sense, 'entire'. The Revenue's accounting witness thought, however, that a fairer result would be to recognise the progress payments as revenue when they became receivable and to provide for contingencies. Warner J held for the taxpayer.

The *MPD* decision is in line with the principle in *Weeks* – a profit could be derived ('earned') only when the contract had *at least* reached that stage where it was possible to predict a profit with reasonable certainty.

## Conclusion

The tax authorities in Singapore have not published any ruling similar to IT2450 in Australia. The basic approach does not apply in Singapore, which accepts only the PCM and CCM bases of accounting for long-term construction contracts. In *Grollo*, the Australian court made it clear not only that taxable income had to be ascertained annually, but also that this did not pre-determine the issue of whether receipts in any year were derived as income. It is implicit in *MPD's* decision that income for Singapore tax purposes is similarly determined annually, for each year of assessment. Where, as in *MPD*, the receipts are subject to contingencies (such as earmarking) and the taxpayer does not have control over them, they are to be excluded from taxable income in the year of receipt. In this respect, the principles in *Grollo* and *MPD* do not conflict.

As a result of *MPD*, the TOP basis of recognition of income applies to all housing developers in Singapore, regardless of whether they use PCM or CCM and whether any buyer defaulted on the payments. Income is derived when it has come home to the taxpayer, ie, when the taxpayer has fulfilled all the conditions under the contract necessary for him to earn the income. The right to receive the payments, ie entitlement or receivability, is necessary but not sufficient for derivation. Conversely, derivation may occur without an actual receipt. The Board's notion of derivation would seem to apply to progress payments under any long-term contract generally, and it is a question of law and fact whether they have been derived as income at each stage under the contract. Unlike in *Montana Lands*, the Board did not frame the question of derivation as one wholly of law, hence the different outcomes - legal completion versus TOP. In effect, the Board's 'big picture' approach regarded the standard agreement prescribed under the *Housing Developers' Regulations* as an entire contract in the sense used in *Weeks*. Like *Grollo* and *Weeks*, *MPD* suggests that income may be derived, even if the amount could not be accurately determined. The 'recoverability' test of derivation that emanated from the Australian work-

WHEN IS INCOME UNDER LONG-TERM CONTRACTS DERIVED?

in-progress cases is not inconsistent with the notion of derivation in *MPD*. The presence of contingencies explains why the progress payments (although recoverable sums) in *MPD* were not regarded as derived. The same reason distinguished *MPD* from *Coyle*.