TOEING THE LINE BETWEEN TAX PLANNING AND TAX AVOIDANCE IN SINGAPORE

The difference between tax avoidance and tax evasion is the thickness of a prison wall.

Denis Healey, former UK Chancellor of the Exchequer

With enhanced penalties on tax avoidance arrangements, professionals and businesses will have to think twice when planning their taxes.

On 20 July 2020, the Ministry of Finance proposed amendments to expand the current general anti-avoidance provision in the Income Tax Act (Cap. 134) to deter tax avoidance arrangements. Similar changes will also be proposed in respect of the anti-avoidance provisions under the Stamp Duties Act (Cap. 312) and the Goods and Services Tax Act (Cap. 117A).

Under the amended section 33 of the Income Tax Act, the Comptroller is required to disregard or vary a tax avoidance arrangement and make any adjustment where appropriate. The draft Bill also proposes that the scope of the provision be expanded to include any tax advantage obtained or obtainable by a company incorporated in Singapore to include any qualifying deduction of that company that has been transferred to another company under group relief.

A surcharge equal to 50% of the amount of tax imposed in respect of the tax avoidance arrangements will also be imposed with effect from Year of Assessment 2023. This is in addition to the current powers of the Singapore authorities to reverse the tax avoidance transactions and claw back the rightful tax amounts.
Businesses should therefore be more prudent when structuring their businesses and planning their taxes. It is useful to be reminded of the following principles when planning your business and tax affairs:

**Corporatisation of and by itself is NOT a tax avoidance arrangement**

Alarm bells were raised as the Inland Revenue of Singapore (IRAS) announced the launch of investigations into the tax returns of 145 medical professionals in private practice, as well as 32 medical groups in 2015. *Straits Times* reported that as of October 2018, more than $3.6 million in taxes have been clawed back from 20 doctors and dentists.

In such cases, many professionals were found to have set up corporate entities to receive income from their provision of services (which was previously received directly by the professionals).

While income derived by a company may be subject to a tax at a lower rate compared to the highest individual tax rate, this is not itself per se an act of tax avoidance. This was explicitly recognised by the Income Tax Board of Review in the case of *GCL v Comptroller of Income Tax*.

What matters is whether there are genuine commercial reasons for incorporation, which would require an analysis into the economic realities of the business arrangement.

**Arrangement must be for bona fide commercial reasons AND not for the sole purpose of avoiding tax**

In the event that an arrangement is found to have produced a tax advantage, it is necessary for the taxpayer to establish that:

- there are adequate bona fide commercial reasons behind the business arrangement; and

- any tax benefits must be an incidental outcome and not one of the main purposes of the arrangement.

Common bona fide commercial reasons cited by taxpayers generally include the facilitation of future business expansion; the ease of obtaining financing from financial institutions; ring fencing liability and risk management; business succession etc. However, this has to be reflected in the economic realities of the business arrangement.
Some common examples of tax avoidance arrangements cited by IRAS include:

- the shifting of income derived mainly from one’s personal efforts or skills to a company;

- the artificial splitting of income through incorporation of multiple companies;

- the artificial re-incorporation of the same business to take advantage of the start-up tax exemption; and

- the attribution of income between company and individual which is not aligned with economic reality.

For instance, a business that relies substantially on the provision of personal services by an individual will not be able to justify the commercial purpose for its corporatisation if:

- the company performs a limited function (e.g. to receive revenue from services rendered by a professional);

- the company does not have any employees who participate in the day-to-day operations of the company;

- the company does not own substantial assets that are necessary for the operations; and

- the company bears little to no risk on its own (apart from that borne by the individual providing the services).

Take another instance where a business decides to incorporate subsidiaries or related entities to expand its operations. Such an arrangement would be in breach of the anti-avoidance provision where the purported expansion is essentially the splitting up of a single business operation. Characteristics of such an arrangement include:

- multiple companies performing the same or similar functions;

- multiple companies sharing the same pool of assets and manpower; and

- multiple companies operate out of the same office premises.
Arrangement must involve arm’s length transactions

For related party arrangements, which is most commonly found in family-owned businesses, greater scrutiny is needed for transactions between related parties to ensure that transactions are conducted at arm’s length and do not fall afoul of the anti-avoidance provisions.

To take advantage of the lower corporate tax rate, it is common for business owners to pay themselves a nominal salary and thereafter declare a substantial tax-exempt dividend to themselves.

However, such arrangements may possibly be viewed as a tax avoidance arrangement, especially where the attribution of profits earned by the company does not reflect the economic reality i.e. where an individual’s contributions far outweigh the company’s share of the profit based on its value-add to the business.

In such circumstances, IRAS can also invoke its powers under section 34D of the Income Tax Act to make the necessary adjustments so as to reflect the economic reality. Do note that when IRAS makes a transfer pricing adjustment, a surcharge of 5% on the amount of transfer pricing will be imposed, regardless of whether there is any additional tax payable resulting from the said adjustment.

Appropriate structuring of business operations in Singapore

Notwithstanding the above, businesses should not be deterred from taking advantages of the multitude of tax incentives schemes provided by the Singapore government, such as those afforded to fund and fund managers under section 13CA, section 13R or section 13X of the Income Tax Act; as well as the Special Situation Fund for Startups (SSFS) and Finance & Treasury Centre (FTC) Incentive provided by the Economic Development Board.

At Infinity Legal LLC, we can advise you on the structuring of your business operations so as to take advantage of the tax incentive schemes afforded to businesses in Singapore and help you to navigate the general anti-avoidance regulations in Singapore. We also provide legal representation in the event of enforcement action and court proceedings relating to tax matters.

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