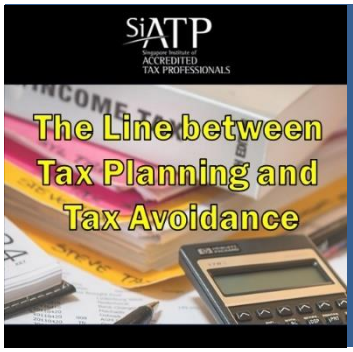

The Line Between Tax Planning And Tax Avoidance

Knowing The Distinction And Implications

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In recent years, many countries are taking a fresh look at their domestic anti-avoidance provisions amid increasing public interest on tax avoidance and growing fiscal needs. As tax authorities step up enforcement actions, more disputes on whether an arrangement falls within the ambit of tax planning or tax avoidance are expected.

While most people are aware that planning for taxes is permissible under the law but avoidance of taxes is not, it is often difficult to draw a clear line between the two, as the varying fact pattern of each case may lead to a different conclusion.

Singapore's general anti-avoidance provisions are easy to read, but they are not always easy to apply in practice, particularly in complex arrangements where the risks hinge on the facts, circumstances and evidence available. Does an arrangement that results in a more favourable tax outcome than a prior arrangement automatically get into the crosshairs of the tax authorities and are deemed to be tax avoidance? This was one of the issues that was tackled head on by James Choo, Partner, International Tax and Transaction Services, Ernst & Young Solutions LLP, at a webinar organised by the Singapore Chartered Tax Professionals, as he deep dived into Singapore's general anti-avoidance provisions and their application in the recent case of *GCL v Comptroller of Income Tax (CIT) [2020]*.

Singapore's General Anti-Avoidance Provisions

Singapore's general anti-avoidance provisions are found in Section 33 of the Income Tax Act (ITA). Essentially, Section 33 empowers CIT to disregard and make adjustments to arrangements which are carried out with tax avoidance as one of their main purposes and not for bona fide commercial reasons.

PROPOSED AMENDMENTS TO SINGAPORE'S GENERAL ANTI-AVOIDANCE PROVISIONS

The recent Income Tax (Amendment) Bill 2020 reaffirms Singapore's position against tax avoidance. It proposed the repeal and re-enactment of the general anti-avoidance provisions, and in addition, the introduction of a surcharge to be imposed on adjustments made under the general anti-avoidance provisions[1].

[1] The Income Tax (Amendment) Act 2020 has since been gazetted on 7 December 2020. New Sections 33 and 33A are now in force.

One key change that the new Section 33 would make is the elimination of CIT's discretion in dealing with tax avoidance cases. While CIT may choose to disregard or vary an arrangement and make such adjustments as he considers appropriate under the existing legislation, he would be required to disregard or vary the arrangement and make adjustments that he considers appropriate following the proposed change.

SURCHARGE ON ADJUSTMENTS UNDER SECTION 33

The new Section 33A would impose a surcharge on tax avoidance arrangements. The surcharge would apply to adjustments made to tax assessments from Year of Assessment (YA) 2023, and would amount to 50% of the income tax or additional income tax to be imposed by CIT as a result of the adjustments made to counteract the advantage obtained or obtainable from the arrangement.

GCL v CIT [2020]

GCL v CIT [2020] (GCL) is the latest tax avoidance case dealing with the general anti-avoidance provisions in Section 33 of the ITA. In GCL, the taxpayer, a dentist, was employed in an orthodontic clinic (YCO) and derived employment income which was taxed on an individual basis (the "former arrangement").

In 2012, the taxpayer ceased his employment relationship with YCO, and incorporated a company, GCL, where he was the sole shareholder and director. GCL then entered into a service agreement with YCO to provide dental services to YCO as an independent contractor. The services were provided by the taxpayer at YCO's premises. YCO paid service fees to GCL which would then pay director's fees, dividends and salaries to the taxpayer.

CIT'S ARGUMENTS

CIT submitted that GCL was incorporated to receive income from providing dental services at YCO (which was previously received directly by the taxpayer), and that GCL paid an artificially low level of remuneration to the taxpayer, so that most of the remaining profits of GCL could be paid to the taxpayer as tax-exempt dividends. CIT asserted that in doing so, it can be objectively ascertained that the arrangement falls within either Section 33(1)(a) or (c) of the ITA.

THE TAXPAYER'S ARGUMENTS

The taxpayer submitted that the new arrangement did not fall within the ambit of Section 33(1) and that GCL was incorporated as a business vehicle to operate his own dental practice. He explained that the remuneration paid to him by GCL was determined based on what was adequate for his day-to-day expenditure, and claimed that the remaining profits were intended to be retained in GCL to fund its operations, particularly for the purchase of a medical unit.

THE INCOME TAX BOARD OF REVIEW'S DECISION

In arriving at its decision on whether the arrangement falls within any of the limbs under Section 33(1)(a) to (c) of the ITA, the Income Tax Board of Review (ITBR) applied the three-step framework set out in the landmark case of *AQQ v CIT* [2012]:

- *Step 1*: *Whether an arrangement prima facie falls within any of the three threshold limbs of Section 33(1)(a) to (c) such that the taxpayer has derived a tax advantage ("objective test" where determination should be made on objective facts and the motive of the taxpayer is irrelevant)*

The ITBR considered the arrangement purported by CIT in two parts – firstly, the incorporation of GCL to receive income for providing dental services, and secondly, the setting of remuneration paid to the taxpayer by GCL, such that there remained profits in GCL to be taxed and thereafter paid to the taxpayer as tax-exempt dividends.

INCORPORATION OF GCL

The ITBR held that the incorporation of GCL to operate a dental business and to receive an income did not fall within Section 33(1) as they were unable to predicate that these steps and their effect were implemented for tax avoidance. The ITBR highlighted that the use of a company to carry out a dental practice is a common and widely used setup, and is not inherently an act to avoid tax.

Remuneration paid by GCL

On CIT's assertion that the remuneration paid by GCL to the taxpayer was "artificially" low, the ITBR noted that the new arrangement objectively led to a reduction of overall tax for the taxpayer.

While the taxpayer had explained that the level of remuneration had been based on what was necessary for his personal upkeep and maintenance, there was a significant difference in the level of remuneration paid to him by GCL compared to the remuneration he had received as an employee of YCO under the former arrangement, even though his personal role had largely remained the same under both arrangements. Accordingly, the ITBR found the arrangement and its effect led to an avoidance of tax, and is not capable of explanation by reference to ordinary business or commercial basis.

- *Step 2*: *Whether the taxpayer may avail himself of the statutory exception under Section 33(3)(b) ("subjective test" which determines the subjective motive of the taxpayer by drawing inference from the factual evidence)*

The ITBR opined that the appropriate level of remuneration that GCL should have paid the taxpayer under the new arrangement is a question of fact, taking into consideration market pay at comparable skill and experience level. The determination of the taxpayer's remuneration based on personal upkeep and maintenance requirements was neither commercial nor reflective of reasonable remuneration, as evidenced by the significant difference with the income the taxpayer had received as YCO's employee under the former arrangement.

Further, the ITBR noted that for YAs 2013 to 2016, the remaining profits in GCL after paying the remuneration to the taxpayer was consistently and "rather uncannily" around $300,000, which was the level where GCL would maximise exemptions provided under the ITA, namely the start-up tax exemption (SUTE) and partial tax exemption (PTE) respectively.

Accordingly, the ITBR held that the exception under Section 33(3)(b) would not apply.

- *Step 3*: *Whether the taxpayer has satisfied the court that the tax advantage obtained arose from the use of a specific provision in the Act that was within the intended scope and Parliament's contemplation and purpose, both as a matter of legal form and economic reality within the context of the entire arrangement*

The ITBR noted that the Parliament's intent for SUTE and PTE is to encourage the conduct of an enterprise through a corporate structure. An arrangement that sought to utilise SUTE and PTE for the avoidance of tax does not fall within such intent.

Based on the above, the ITBR found that the taxpayer has not proven that the assessments by CIT are excessive and accordingly, dismissed the taxpayer's appeal[2].

[2] The taxpayer has since appealed to the High Court against the ITBR's decision. In Wee Teng Yau v CIT and another appeal [2020], the High Court affirmed the ITBR's decision and dismissed the taxpayer's appeal.

Other Pointers From GCL

NOT EVERY TRANSACTION RESULTING IN TAX BENEFITS AMOUNTS TO TAX AVOIDANCE

The ITBR concluded that an arrangement would not fall within the ambit of Section 33(1) merely because its tax outcome was more favourable than a prior arrangement, without considering the reasonableness of the overt acts undertaken. This reaffirms the distinction between tax planning and tax avoidance, and that not every transaction resulting in tax benefits will amount to tax avoidance. If a transaction can be supported by business and commercial reasons, then the transaction may constitute legitimate planning.

CONTEMPORANEOUS DOCUMENTATION OF COMMERCIAL REASONS

To defend against a Section 33 challenge from the tax authorities, taxpayers must satisfy the Courts through an enquiry into the subjective motive for entering into the arrangement and the consequences sought, and the economic realities involved. Contemporaneous documentation (such as minutes of meetings and board's resolutions) is therefore crucial to provide the necessary evidence to substantiate the taxpayer's assertion that an arrangement is supported by legitimate commercial reasons.

Taxpayers need to recognise the changing trend on tax avoidance and be mindful of the thin line between tax planning and tax avoidance. It would be timely to review existing arrangements in view of the proposed amendments to Singapore's general anti-avoidance provisions.

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