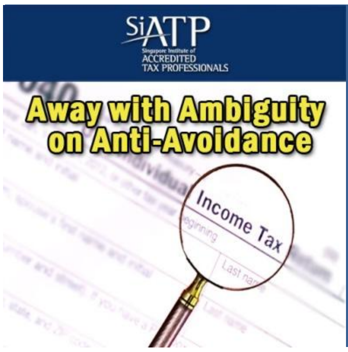

TED: Away With Ambiguity On Anti-Avoidance

Understand the Practical Insights

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When does tax planning become tax avoidance? Although it is a seemingly easy question, there is no easy answer.

Section 33 of ITA

Singapore's general anti-avoidance rules (GAAR) are found in Section 33 of the Income Tax Act (ITA).

While Section 33(1) is very widely drafted and may potentially cover any tax benefits arising from an "arrangement", Section 33(3)(b) limits the scope of Singapore's GAAR and specifically excludes "any arrangement carried out for *bona fide* commercial reasons and had not as one of its main purposes the avoidance or reduction of tax".

The term "one of the main purposes" suggests that it is possible for an arrangement to have multiple main or even secondary purposes. It also suggests that as long as the avoidance or reduction of tax is a secondary purpose (or incidental to the arrangement), such arrangement should not be caught by Singapore's GAAR on the basis that it is carried out for bona fide commercial reasons.

This was explained by Liu Hern Kuan, Head of Tax, Rajah and Tann Singapore, at a recent Tax Excellence Decoded session by the Singapore Institute of Accredited Tax Professionals (SIATP).

Section 33 allows the Comptroller of Income Tax (CIT) to impose tax to counteract the tax advantage obtained or obtainable from an arrangement, but does not confer CIT the power to impose a penalty on the taxpayer.

Until the Court of Appeal of Singapore (CA)'s landmark decision in AQQ v CIT [2014] SGCA 15 (the "AQQ case"), there had been no guidance on the interpretation of Section 33, and interpretation of Singapore's GAAR had been at best ambiguous.

The AQQ Case: The Facts

AQQ was incorporated in Singapore as part of a corporate restructuring exercise in a Malaysian-listed group (B Group). To finance the acquisition of several subsidiary companies in Singapore, AQQ issued interest-bearing Fixed Rate Notes to N Bank.

In due course following the restructuring, AQQ received franked dividends (which carried tax credits available for set-off against AQQ's chargeable income) from its subsidiary companies under the previous full imputation system.[1]

[1] Prior to 1 Jan 2003, Singapore operated a full imputation system for all companies where corporate income was only subject to tax once at the shareholders' level at their respective marginal income tax rates.

AQQ also incurred interest expense on the Fixed Rate Notes to N Bank. Essentially, AQQ sought to deduct interest expense from the dividend income, and at the same time, claim tax credits from the franked dividends.

The transactions from the restructuring resulted in AQQ obtaining $225 million from N Bank; the entire sum was returned to N Bank on the same day following a circuitous route. There was in essence no genuine loan, and the restructuring exercise was planned based on N Bank's concept paper, which indicated that the entire saving relates to tax credit refund.

The AQQ Case: The Considerations

In the AQQ case, the CIT invoked Section 33 on the basis that the reorganisation of B Group had the purpose of tax avoidance, was artificial and contrived, and carried out to extract Section 44 tax credits.

In deciding whether AQQ had avoided tax, the CA suggested that the analysis on whether there was tax avoidance should take the following steps:

(1) Consider whether Section 33(1)(a), (b) or (c) applies;

(2) If Section 33(1) applies, whether the statutory exception in Section 33(3)(b), viz. the arrangement was carried out for *bona fide* commercial reasons and had not as one of its main purposes the avoidance of tax, applied to the arrangement;

(3) If exemption in Section 33(3)(b) does not apply, whether the use of the specific provision in the ITA from which the tax advantage is derived is consistent with Parliament's contemplation and purpose behind the specific provision, both as a matter of legal form and economic reality within the context of the entire arrangement.

Whether Section 33(1) Applies

The CIT argued that the reorganisation of B Group is a composite scheme comprising both the corporate restructuring and financing arrangement. The CA accepted that the CIT was entitled to treat the arrangement as a composite scheme, and agreed with the CIT that the scheme falls within the definition of "arrangement" under Section 33(2) of the ITA.

Applying the predication principle[2], the CA found that Section 33(1) would apply as AQQ had avoided tax liability (which otherwise would have been imposed if not for the interest deduction generated) through the arrangement.

Mr Liu Hern Kuan, Head of Tax, Rajah & Tann Singapore LLP, threw light on the topic of anti-avoidance.

Whether the Statutory Exception in Section 33(3)b Applies to the Arrangement

Based on Section 33(3)(b), Singapore's GAAR do not apply to any arrangement carried out for *bona fide* commercial reasons and where the avoidance or reduction of tax is not as one of its main purposes.

In the AQQ case, while there may have been *bona fide* commercial reasons for entering into the composite scheme, such commercial reasons offered by AQQ related only to the corporate restructuring and not the financing arrangement.

[2] The predication principle requires a consideration of whether one can objectively ascertain from the observable acts by which an arrangement is implemented and deduce that the arrangement was implemented in a way so as to obtain the tax benefit stated in any of the limbs in section 33(1).

Moreover, the oral evidence given by the Chief Financial Officer of B Group indicated that one of the main purposes of the arrangement was to extract tax credits. It was thus concluded by the CA that the financing arrangement did not fall within the statutory exception in Section 33(3)(b).

WHETHER THE TAX ADVANTAGE OBTAINED AROSE FROM THE USE OF A SPECIFIC PROVISION IN THE ITA IS CONSISTENT WITH PARLIAMENT'S PURPOSE BEHIND THE SPECIFIC PROVISION

As AQQ was unable to avail itself of the statutory exemption under Section 33(3)(b), the CA applied the "scheme and purpose approach" as adopted by the majority in the New Zealand case of *Ben Nevis* [106] cf [104b] to determine whether the tax advantage obtained arose from the use of a specific provision in the ITA consistent with Parliament's purpose in enacting such provision. Essentially, the "scheme and purpose approach" suggests that a purposive interpretation of the provisions should be adopted.

Other relevant factors to be considered when determining whether a tax avoidance arrangement exists include:

(i) Manner in which the arrangement was carried out
(ii) Role of all relevant parties and any relationship they may have with the taxpayer
(iii) Economic and commercial effect of documents and transactions
(iv) Duration of the arrangement
(v) Nature and extent of the financial consequences that the arrangement has for the taxpayer

In AQQ's case, it was found that the payment of interest did not incur any real economic costs within the B Group as a whole. Applying the scheme and purpose approach, the CA did not think it was within Parliament's purpose that deductions for interest expenses should be made to reduce the quantum of assessable dividend income (when there were no real economic costs incurred). As such, it was found that the tax advantage obtained did not arise from the use of a specific provision in the ITA consistent with Parliament's purpose.

IRAS' e-Tax Guide

More recently, the Inland Revenue Authority of Singapore (IRAS) issued an e-Tax Guide[3] to clarify its approach to the construction of the general anti-avoidance provisions in Section 33.

In the guide, IRAS drew extensively on the principles mentioned by the CA in the AQQ case, and provided examples of arrangements which it would regard as having the purpose or effect of tax avoidance within the meaning of Section 33(1) of the ITA. These examples are classified into four broad categories:

(i) Circular flow or round-tripping of funds;
(ii) Set-up of more than one entity for the sole purpose of obtaining tax advantage;
(iii) Changes in the form of business entity for the sole purpose of obtaining tax advantage, and
(iv) Attribution of income that is not aligned with economic reality.

A fully-booked session on anti-avoidance was facilitated by Rajah & Tann Partner and Head of Tax Liu Hern Kuan.

[3] e-Tax Guide on "Income Tax: The General Anti-avoidance Provision and its Application" dated 11 July 2016.

The examples show that an arrangement would generally be regarded by IRAS to have the effect of tax avoidance if it can be objectively ascertained and deduced that the arrangement was implemented to obtain tax benefits as stated in Section 33(1), and that tax avoidance was one of the main purposes in the stipulated arrangement or that the arrangement was not carried out for *bona fide* commercial reasons.

While the examples do not clarify how Section 33 is to be applied per se, they are useful in helping taxpayers understand the types of arrangements that are generally frowned upon by IRAS. However, based on the AQQ case, it would appear that in determining whether an arrangement is considered to be tax avoidance, the intent and purpose behind the arrangement must be considered.

To justify that their transactions are not tax avoidance, businesses must be able to demonstrate that these transactions are carried out for *bona fide* commercial reasons, and that the avoidance or reduction of tax (if any) is not one of the main purposes of the transactions. Often, contemporaneous documentation is the answer when queried by the tax authorities.

For example, if a company is able to produce the minutes of a Board Meeting (which articulates the commercial reasoning behind the Board's decision to undertake a transaction at a given time), it would greatly assist the company in satisfying the CIT that it has not engaged in tax avoidance arrangements. Other contemporaneous documentation may include letters, emails and other correspondences at the time the arrangement was set up or carried out.

In this era of heightened international attention and public interest on tax avoidance, it is perhaps wise for businesses to tread carefully and avoid engaging in (or be perceived to engage in) tax avoidance schemes. Keep things simple. Stay genuine.

Facilitator

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