TED: Insights on Singapore Tax Cases

Understanding the Application of Tax Laws

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The interpretation and application of the Income Tax Act (ITA) in relation to business transactions are often contentious due to the uniqueness and complexity of different business scenarios. Invariably, the differences in interpretation between taxpayers and the Comptroller of Income Tax (CIT) will lead to tax disputes.

Case laws are formed when tax disputes are decided by the Income Tax Board of Review (ITBR) and the Courts. They set precedents for future disputes, and provide useful clarification on the interpretation of tax laws as well as how they should be applied in specific business situations.

Accredited Tax Practitioner (Income Tax & GST) Allen Tan, Principal, and Ng Chun Ying, Senior Associate, Baker & McKenzie.Wong & Leow, discussed recent Singapore tax cases and shared their insights at a recent *Tax Excellence Decoded* (TED) event organised by the Singapore Institute of Accredited Tax Professionals.

1) Discovery of Exchange of Information Documents – AXY v CIT [2016]

In *AXY*, the National Tax Service of the Republic of Korea (NTS) issued an exchange of information (EOI) request to the CIT for information on banking activities of certain Korean taxpayers in Singapore. Pursuant to the request, the CIT proceeded to issue notices to various banks in Singapore for the requested information. The taxpayers subsequently applied for leave to commence judicial review of the CIT's decision to issue the notices. In the context of this application, the taxpayers applied for discovery against CIT to compel the CIT to disclose certain documents.

In considering the application for discovery, the Court was guided by the principle laid down in *ABU v CIT* [2015] that the Courts are not required to substantively review an EOI request. The application for discovery was allowed in part, and the Court ordered the disclosure of the NTS' EOI request, the CIT's correspondence with NTS and the notices issued by CIT to the banks, on the basis that they were relevant and necessary to the fair disposal of the case.

KEY OBSERVATIONS

In general, like other administrative acts by a public authority, the CIT's exercise of its administrative powers under the EOI regime is susceptible to judicial review by the Courts. This process safeguards taxpayers' interests under an EOI framework that has significantly expanded in recent times.

In *AXY*, the taxpayers came to know about NTS' EOI request. However, the CIT is generally not required to notify the relevant taxpayer that an EOI request has been made. As such, in most cases, the taxpayer may not even know that he/she has been made the subject of an EOI request and therefore, the taxpayer's ability to commence a claim for judicial review is circumscribed.

It should be noted that *AXY* was decided based on the law before the introduction of section 105HA(3) of the ITA in 2014. The said provision restricts the discovery of EOI requests and related documents in judicial review proceedings. This presents an additional hurdle for taxpayers to mount any legal challenge against EOI requests.

Accredited Tax Practitioner (Income Tax & GST) Allen Tan, Principal, and Ng Chun Ying, Senior Associate, Baker & McKenzie.Wong & Leow, shared insights on key tax issues enunciated in recent tax cases.

2) Deductibility of Borrowing Expenses – GBG v CIT [2016]

The taxpayer was a Singapore-incorporated company in the business of ship and rig repair, building and conversion. It incurred facility fees which were paid to banks for the commitment of funds under various facility agreements and sought to deduct such facility fees.

The facilities could be drawn down for the following purposes:

i) Capital expenditure and general working capital requirements;
ii) General corporate funding, and
iii) Standby funding to finance any shortfall for a yard expansion project.

The taxpayer did not draw down on any of the facilities during their respective availability periods, which ranged from 12 to 35 months.

The issue was whether the facility fees paid by the taxpayer in respect of the facilities, which were not drawn down, were tax deductible.

As no monies were borrowed by the taxpayer on the facilities, the parties agreed that section 14(1)(a) of the ITA would not be applicable. Instead, the taxpayer's position was that the facility fees were incurred wholly and exclusively in the production of the income within the general section 14(1) deduction formula, and were not prohibited from deduction by section 15(1)(c) of the ITA, not being capital in nature.

The ITBR held that there was no necessity for a drawdown of facilities for the facility fees to be considered as borrowing costs, and hence the precedent case of *CIT v IA* [2006] concerning the deductibility of facility fees on a loan that was drawn down was relevant.

Applying the principles established in *IA*, the ITBR held that the facilities were not specifically taken for revenue purposes based on the stated purposes of the facilities. Hence, the facility fees were capital in nature and not tax deductible. In ascertaining the purpose of the facilities, documentation (such as facility letters and directors' resolutions) is key.

Key Observations

The decision in *GBG* follows a series of decisions on the deductibility of borrowing costs in *IA, T Ltd v CIT* [2006], and *BFC v CIT* [2014], which held that the classification of borrowing costs as capital or revenue depends on the nature of the underlying loan, which is in turn determined by the purposes for which the loan was taken. *GBG* extends the sufficient linkage test in *IA* to include sums incurred in connection with a facility even where there was no actual drawdown.

GBG illustrates the importance of having objective contemporaneous documentation, particularly the facility documents, as evidence of the purpose of the loans. In practice, however, taxpayers may find it not commercially viable to restrict the purposes of the loans in the facility documents, even if the loans were eventually drawn down for revenue purposes only.

GBG also illustrates the difficulties and potential complexities for borrowing costs to qualify for deduction under Singapore tax laws. Section 14(1)(a) of the ITA allows the deduction of prescribed borrowing costs in lieu of interest from year of assessment 2008 onwards, but there are still hurdles for taxpayers to rely on this provision.

3) Anti-Avoidance – GBF v CIT [2016]

The taxpayer, a medical practitioner, incorporated a company (G) with his wife to carry on the business of plastic and cosmetic surgery in 1996. Both the taxpayer and his wife were directors and shareholders of G. The taxpayer was the sole medical practitioner at G.

Accredited Tax Practitioner (Income Tax & GST) Allen Tan, Principal, and Ng Chun Ying, Senior Associate, Baker & McKenzie.Wong & Leow, also discussed the intricacies in tax laws to better manage tax risks.

In March 2008, the taxpayer and his wife sold their shares in G to another company (B) pursuant to a share purchase agreement (SPA), and under which B was to pay "physician compensation" of $815,763 for the taxpayer's services for the period of 1 January 2008 to 30 June 2009. In July 2008, the taxpayer set up two new corporate entities – D and E – where each was wholly owned by the taxpayer and his wife respectively. A corporate partnership (C) was also formed, with D and E as its partners.

Thereafter, the taxpayer and his wife continued as directors of G, and the taxpayer remained as the sole medical practitioner employed by G.

However, under the new arrangement, the "physician compensation" for the taxpayer's services was paid by B to the corporate partnership, C. D and E also each benefitted from the startup tax exemption scheme under section 43(6A) of the ITA.

The ITBR found that following the arrangement, there was no change in the *modus operandi* of G's practice. The new entities, C, D and E, had no functional role in G's business. There was also no evidence to substantiate the taxpayer's assertions that the arrangement was set up for the purposes of managing practice and business risks, and for business convenience and benefits to grow the practice.

For these reasons, the ITBR concluded that the arrangement was formed solely to receive the physician compensation and manage it in the most tax-efficient manner. The objective purpose and effect of the arrangement was that the taxpayer derived substantial tax savings. The ITBR also held that the taxpayer could not rely on the section 33(3)(b) exception as one of the main subjective purposes of the arrangement was to avoid tax.

KEY OBSERVATIONS

As Singapore's general anti-avoidance rules do not target tax consequences of *bona fide* commercial transactions, it is critical that any arrangements carried out should make business sense, such that any tax savings arising from an arrangement should merely be an effect (and not one of the *main* affects) of the arrangement.

It is also vital for companies to ensure there is sufficient contemporaneous documentation to support any transactions. Such documents would reflect the taxpayer's state of mind at the point when the decision was made and would be key in substantiating the intention behind the carrying out of an arrangement.

Keeping abreast with the latest tax decisions may help businesses identify potential tax risks. Keep an open mind when reading a tax case – appreciate the issues, analyse the risks, and act on the problems.

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