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Tax Alert

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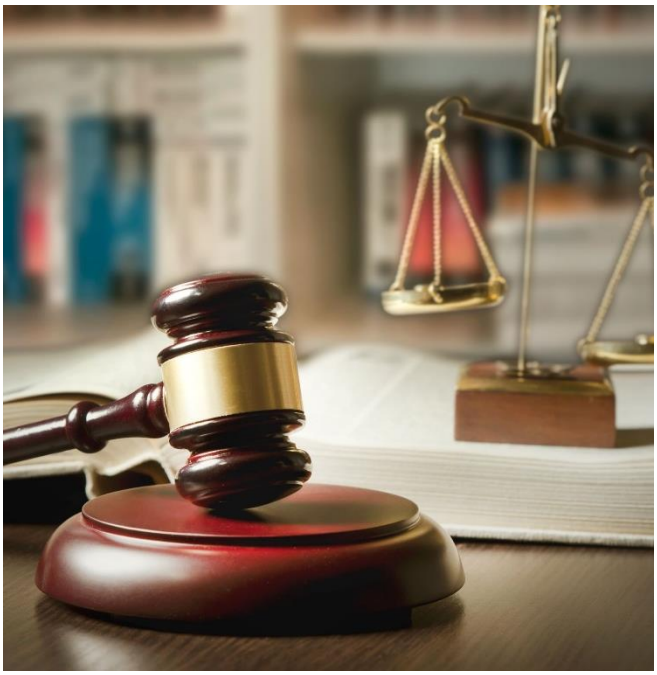
GBF v The Comptroller of Income Tax (2016) SGITBR 1

In this case before the Income Tax Board of Review (Board), the Comptroller of Income Tax (CIT) invoked the general anti-avoidance provision under Section 33 of the Singapore Income Tax Act (SITA) to disregard an arrangement by the Appellant to receive his physician compensation. The Board decided in favour of the CIT.

In this issue of Tax Alert, we review the decision of the Board and the implications that the decision would have on the application of Section 33.



Facts of the case

- The Appellant is a medical practitioner specialising in plastic and cosmetic surgery.
- In November 1996, the Appellant incorporated G (of which the shareholders were the Appellant and his wife) to conduct plastic and cosmetic surgery business.
- The Appellant has been employed by G since its incorporation and he is the sole medical practitioner at the clinic.
- In early 2008, pursuant to a Share Purchase Agreement (SPA) dated 6 March 2008, the Appellant and his wife sold their shares in G to B. The principal business activities of G remained unchanged. The Appellant and his wife continued as directors of G and the Appellant continued to be employed by G as the sole medical practitioner at the clinic.
- Under the SPA, it was provided that the Appellant's physician compensation will come from a Physician Compensation Pool and will be funded at 40% of Gross Operating Income.
- On 17 July 2008, about 4½ months after the SPA was signed, C, a corporate partnership, was formed with 2 corporate entities as partners (namely D and E). The Appellant is the sole director and shareholder of D, and the Appellant's wife is the sole director and shareholder of E.
- The Appellant's case was that for the period from 6 March 2008 to 17 July 2008, the Appellant was employed by G to provide medical services at the clinic. However after 17 July 2008 and upon the formation of the corporate partnership, it was the corporate partnership which provided the medical services to G. The Appellant was paid by G for his role in managing the clinic. Consequently the corporate partners, D and E, have rightfully received the Physician Compensation. The tax savings emanating from the corporate partners (D and E) receiving the income (instead of the Appellant who is an individual) arose from the "start-up" exemption under section 43(6A) of the Income Tax Act that was available to D and E.

Issues before the Board

The issues before the Board were as follows:

1. Whether the requirements in Section 33(1) of the SITA were met on the facts of this matter.
2. Whether the Appellant could rely on the exception in Section 33(3)(b) of the SITA.

Appellant's Contention

- For business convenience and benefits, the Appellant preferred the partnership structure as he intended to grow his practice by inviting other practitioners to come onboard as partners.
- The arrangement of the corporate partnership was for protection against practice and business risks.
- The Appellant maintained that he had no intention to avoid tax but that it was merely incidental to the decision to adopt the arrangement that he could apply Section 43(6A) of the SITA for a start-up tax exemption for both corporate entities (i.e. D and E).

CIT's Contention

- The CIT argued that B would have paid the physician compensation to the Appellant personally if not for the arrangement.
- The arrangement did not change the way the Appellant operated his practice and the true effect of the arrangement satisfied the requirement of all 3 limbs of Section 33(1) of the SITA.
- It was unusual for the Appellant not to be paid for the medical services rendered to G where the Appellant remained employed by G after the sale of the shares in G.
- The CIT challenged the Appellant's contention that the corporate partnership structure provides for business convenience and benefits, as in the CIT's view, the corporate partnership with 2 corporate entities as partners was a complex structure and could not be readily seen as the usual thing to do.
- There was no valid explanation behind the incorporation and role of E. Given the substantial tax savings derived by the Appellant (from the diversion of the income to D and E of which he and his wife are the respective shareholders), it was reasonable to infer that obtaining tax advantage was one of the main purposes of the arrangement.

The Board's Decision

The Board was of the following view:

- Section 33(1) of the SITA

– The Board was of the view that the arrangement was set up solely for D and E to receive the physician compensation. There was no partnership agreement in existence. There was no written evidence of any discussion or efforts to bring in any other practitioners. There was nothing in writing to show that at the material time when the corporate partnership was formed, the reasons for having the structure were considered by the Appellant. Further, the corporate partnership was formed 4½ months after the SPA was signed, instead of in tandem with the SPA as one would have expected if indeed the business benefits of the corporate partnership were considered in respect of the arrangement.

– The Board stated that the Appellant's explanation of his intention was solely based on oral evidence which could not be discerned from documentary evidence, nor his conduct in putting his business plan into action. In addition, the arrangement evidently gave rise to substantial tax savings. Based on the evidence and submissions presented, the Board was of the view that the requirements under all three limbs of Section 33(1) of the SITA have clearly been satisfied.

- Section 33(3)(b) of the SITA

– There was no written evidence to support the Appellant's contention that the corporate partnership was decided upon due to it being the most convenient structure available and the various benefits it offered. The business convenience and benefits offered were also not enjoyed as no other practitioner was ever invited to come onboard.

- There was a time lag of 4½ months between the signing of the SPA and the formation of the corporate partnership which is inconsistent with the Appellant's contention that the corporate partnership was part of the Appellant's investment in B.

- There was no change in the business operation of G after the signing of the SPA. The Appellant remained as a director of G and continued to be the sole practitioner at the clinic. After the corporate partnership was formed, the Appellant contended that he was paid for his role at G in managing the clinic through the corporate partnership. However, there was no documentary evidence to substantiate this.

- The Appellant also contended that the corporate partnership was for protection against practice and business risks. However, the argument of protection against practice risk is not justifiable as there is no interaction between the corporate partnership and the patients of the clinic. In addition, the practice risk was already managed by having in place the corporate entity, G. In respect of the business risk, there was no other business carried out by the corporate partnership except to receive the Appellant's physician compensation. After unravelling the SPA, the corporate partnership and the 2 corporate entities became dormant. The Board concluded that there was in reality, no business risk that was managed by the corporate partnership and its 2 corporate partners.

- As no services were provided by E to the corporate partnership or to G, the role of E and the Appellant's wife's contribution are unclear.

- The corporate partnership and its 2 corporate partners had no functional role in the practice of G. The Appellant had taken on the costs of maintaining the structure even when there are no other practitioners onboard and no actual practice or business risks to manage.

The Board concluded that one of the main subjective purposes of the arrangement was to avoid tax. The Appellant would therefore not be able to avail himself of the statutory exception under Section 33(3)(b) of the SITA.

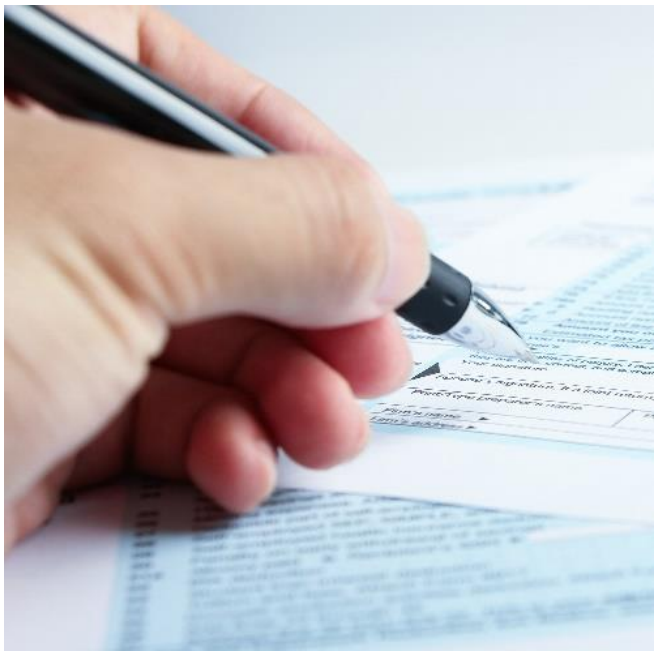
Our Comments

- The steps undertaken by the Appellant in this case are rather unusual. It is not uncommon for a medical practitioner to be employed by a corporate entity of which the practitioner and/or his relatives are shareholders. CIT does not seem to have taken issue with such arrangements, as long as the salary paid to the medical practitioner by the corporate entity is reasonable. In GBF, the Appellant however went one step further. He further arranged for two corporate entities to receive what is essentially the medical practitioner's income, in order to avail himself of the start-up exemption under section 43(6A). It is this extra step that triggered substantial tax savings for the Appellant that CIT found objectionable.

- The Section 33 anti-avoidance provision has existed in the Singapore Income Tax Act for a long time (in place in its current form since 1988). However, GBF v CIT is only the second income tax case on the application of the anti-avoidance provisions that was brought before the Board. The first case, AQQ v CIT, was heard by the Board in 2011 and was eventually ruled by the Court of Appeal in favour of the CIT in 2014.

  Following the conclusion of AQQ v CIT and based on the principles enunciated by the Court of Appeal in the case, the CIT has issued an e-Tax Guide entitled "Income Tax: The General Anti-avoidance Provision and its Application (First Edition)" on 11 July 2016 (Guide) setting out the CIT's approach to the interpretation and application of the general anti-avoidance provision in Section 33 of the SITA and provides some examples of arrangements, which in the CIT's view, have the purpose or effect of tax avoidance. The Guide also clarifies what Section 33 does not target, which is tax consequences of bona fide commercial transactions.

- The issuance of the Guide reinforces Singapore's support for the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) initiative. It is clear that there is an increased focus by the CIT to uncover arrangements that are artificial, contrived or have little or no commercial substance and are designed to obtain tax advantages. In light of the current environment, contemporaneous evidence/ documentation as highlighted in the decisions of both GBF v CIT and AQQ v CIT should be maintained by taxpayers to substantiate the commercial rationale and intent behind any arrangements undertaken, to avoid Section 33 of the SITA being invoked by the CIT.



- In the case of AQQ v CIT, the Court of Appeal held that Section 33 of the SITA should be applied as follows:
  1. Consider whether any of the three threshold limbs of Section 33(1) of the SITA were satisfied such that the taxpayer has derived a tax advantage.
  2. If yes to question 1, consider whether the taxpayer could rely on the statutory exception under Section 33(3)(b) of the SITA.
  3. If no to question 2, ascertain whether the taxpayer could rely on other specific provisions of the SITA (use of which is within the intended scope and Parliament's contemplation and purposes in enacting these provisions) to preclude the application of Section 33. On this third question, the Court of Appeal adopted the New Zealand 'scheme and purpose' approach as taken by the majority in the Supreme Court of New Zealand case of Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue [2009] 2 NZLR 289.

In deciding on GBF v CIT, the Board appeared to have adopted the procedure as enunciated in AQQ v CIT when applying the Section 33 provisions, although the third question above was not discussed. This could be due to the fact that currently there is no specific provision under the SITA that the Appellant could rely on to preclude the application of Section 33.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above case to your business.

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