KPMG

Tax alert

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Corporatisation by Medical Professionals and Tax Implications

In September 2024, the Inland Revenue Authority of Singapore (IRAS) issued an e-Tax Guide to provide clarity on the concept of tax avoidance and its consequences. The e-Tax Guide contains case studies that illustrate common business arrangements in the medical industry that may give rise to tax avoidance concerns. The case studies are not exhaustive, and any other arrangements not included in the Guide should not be assumed to fall outside the scope of tax avoidance.

The e-Tax Guide also outlines the IRAS' approach to dealing with business arrangements that may give rise to tax avoidance concerns.

What is Tax Avoidance?

Tax avoidance involves an arrangement that is artificial, contrived or has little or no commercial substance. The main objective of these arrangements is to obtain a tax advantage that was not intended by the Parliament. Tax avoidance is to be distinguished from tax evasion which is illegal.

Section 33 of the Singapore Income Tax Act 1947 (ITA) contains a general anti-avoidance provision that provides the Comptroller of Income Tax (CIT) with the power to disregard or vary certain arrangements for tax purposes, and make such adjustments as he considers appropriate, including the computation or recomputation of gains or profits, or the imposition of liability to tax. These measures enable the CIT to counteract any tax advantage through tax avoidance arrangements, without disturbing the actual contractual arrangements.

How does IRAS determine that tax avoidance has taken place

Pursuant to section 33 of the ITA, IRAS adopts an approach based on the principles outlined by the Court of Appeal ("CA") in the case of *CIT v AQQ* [2014] SGCA 15 ("*AQQ* case"). In the *AQQ* case, the CA held at [110] that the "scheme and purpose approach" ought to be adopted with respect to the interpretation of section 33 of the ITA. The "scheme and purpose approach":

(i) considers whether an arrangement prima facie falls within any of the three threshold limbs of section 33(1) of the ITA, such that the taxpayer has derived a tax advantage. A tax advantage is considered to arise if the purpose of the arrangement was to:

   a. Alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;
   b. Relieve any person from any liability to pay tax or to make a return under the ITA; or
   c. Reduce or avoid any liability imposed or which would otherwise have been imposed on any person by the ITA.

(ii) Section 33(1) does not apply to an arrangement that falls within the ambit of section 33(7). To fall under this statutory exception, the arrangement must satisfy two key conditions:

a. It must have been carried out for bona fide commercial reasons - "bona fide commercial condition"; and
b. It must not have had as one of its main purposes the avoidance or reduction of tax - "main purpose condition".

If the taxpayer has derived a tax advantage from an arrangement, the taxpayer may nevertheless disapply the operation of section 33(1) by showing that he was acting with bona fide commercial reasons and that the avoidance or reduction of tax was not one of the main purposes of the arrangement.

The first limb under section 33(7) focuses on the taxpayer's subjective commercial motives for entering into an arrangement whereas the second limb addresses the subjective consequences that the taxpayer aims to achieve.

In this regard, the CIT will typically request for information pertaining to the company, including (i) the reason for the incorporation of the company, (ii) the business model of the company, (iii) the activities carried out by the company and its employees, (iv) the assets owned by the company and the risks faced or borne by the company, as well as (v) whether arm's length remuneration was received by the director/doctor for the services that he/she has provided to the company.

Where an arrangement gives rise to savings and meets the "bona fide commercial condition" as well as the "main purpose condition", the arrangement should not attract the application of the general anti-avoidance provisions in section 33 of the ITA.

(iii) If the taxpayer is unable to avail himself of the statutory exception under section 33(7) of ITA, the remaining defence available to the taxpayer is if the tax advantage obtained arose from the use of a specific provision in the ITA 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.

As an example, the "Start-up Tax Exemption Scheme" and "Partial Tax Exemption Scheme" were introduced from Year of Assessment (YA) 2008 to encourage entrepreneurship. If the taxpayer is able to demonstrate that the incorporation of a company was within the Parliament's contemplation and purpose (which include encouraging enterprise risk-taking, helping enterprises grow, and allowing enterprises to plough back their profits to seize business opportunities), the CIT should have no basis to disregard the existence of the company as a separate legal person for Singapore income tax purposes.

If the CIT is of the view that there was tax avoidance, section 33 of the ITA will be invoked to vary the arrangement, to negate any undue tax advantage obtained by the taxpayer through the arrangement in question.

Common arrangements in tax avoidance

Through tax audits, IRAS has encountered medical practices with business arrangements set up for tax avoidance. In the e-Tax Guide, IRAS has set out the frequently used arrangements in tax avoidance, and the outcomes which may occur arising from IRAS application of section 33 to counteract the tax advantage:

Common arrangements used in tax avoidance	Outcomes which may occur, depending on facts of each case:
1) the shifting of income derived mainly from one's personal efforts or skills to a company	✓ The company structure would be disregarded and all income initially attributed to the company would be taxed in individual's capacity
2) the artificial splitting of income through the incorporation of multiple companies	✓ Income attributable to the same operation would be consolidated to be taxed under one company, or in the individual's capacity
3) the artificial re-incorporation of the same business	✓ The re-incorporation would be deemed as artificial and disregarded; ✓ start-up exemption would not be available to the re-incorporated business
4) attribution of income between company and individual not aligned with economic reality	The income/profit between the company and individual/ key personnel must be on an arm's length basis. If the individual/ key personnel is not adequately remunerated, the IRAS will adjust the remuneration using the following methods :- ✓ Market salary benchmarking ✓ Cost plus method (attributing profits to the company based on its value-add).

If the CIT determines that an arrangement falls within section 33 of the ITA, the CIT will make a section 33 adjustment to counteract the tax advantage. Under section 33A of the ITA, where a section 33 adjustment made in YA 2023 or subsequent YA results in any tax or additional tax payable by that person for any YA, a surcharge would apply. The surcharge is computed based on 50% of the tax or additional tax arising from tax adjustment made under section 33 of the ITA, unless otherwise partially or wholly remitted by the CIT.

Key observations and takeaways

The publication of the e-Tax Guide comes on the heels of a series of income tax appeal cases involving medical practitioners, decided by the tax tribunal and courts in Singapore. These include the cases of *GBF v CIT* [2016] SGITBR 1, *GCL v CIT* [2020] SGITBR1 (as well as the subsequent appeal to the High Court, *Wee Teng Yau v CIT and another appeal* [2020] SGHC 236), *GFG and another v CIT* [2023] SGITBR 1, and the most recent case of *GIP v CIT* [2024] SGITBR 2.

The case of *GIP v CIT* ("*GIP* case") is the latest income tax appeal case decided by the Singapore tax tribunal and courts on the dispute of whether the arrangements entered into by the taxpayers constitute tax avoidance. It serves as a useful case study on the application of the principles set out in the e-Tax Guide.

In the *GIP* case, Singapore Income Tax Board of Review (the "Board") affirmed the CIT's decision that the medical practitioner (i.e. GIP)'s incorporation of a company to enter into a partnership to operate a clinic was tax motivated. The appeal by GIP was triggered by the CIT taking the position that the income of the company was earned through GIP's personal efforts (i.e. medical and consultation services rendered by GIP to the clinic), and hence the full income should be assessed to tax in the GIP's hands, such that the company incorporated by GIP is to be disregarded for income tax purposes.

Briefly, the taxpayer, GIP, is a registered medical practitioner. GIP was an employee of NRM, a leading medical service provider, serving as its deputy medical director for several years until sometime in 2011. On 18 July 2011, GIP and GBRN (a wholly-owned subsidiary company of NRM) entered into a partnership ("1st partnership") to carry on the business of operating the clinic. The 1st partnership was registered with the Accounting and Corporate Regulatory Authority (ACRA) on 26 July 2011 under the business name, "GBRNT", with each partner taking up a 50% interest in the partnership.

GIP explained that his intention from the outset was to enter into the partnership through a corporate vehicle in order to benefit from the protection of limited liability. About six months after the commencement of the business, GIP incorporated a company, FDP (the "Company"), on 18 February 2012, with himself as its sole shareholder and director. On 30 March 2012, the Company (i.e. FDP) entered into a partnership agreement with GBRN, and the Company substituted GIP as GBRN's partner to carry on the business.

Other relevant facts of the case include:

(1) The Company had one other staff member (i.e. the corporate secretary), and the Company intended to keep the number of staff to the minimal.

(2) GIP's monthly salary at $7,000 or $85,000 per annum was based on that of a medical officer with 5 to 10 years experience working 42 hours a week. In contrast, the company received (i) a fixed monthly sum ("FMS") of S$12,000 (or $144,000 per year), (ii) locum fees, (iii) a first cut of the profits computed based on a percentage of the profits in the financial year, and (iv) 50% of distributable profits (i.e. after the first cut had been deducted).

(3) The Company's payment to GIP for his services in the clinic remained low because of the uncertain financial position and outlook of the partnership.

(4) There had been "no change to the work arrangement at (the clinic) either before or after the change in partnership".

(5) The Company paid GIP with regular dividends which are tax exempt under the ITA.

The Board, in arriving at the decision that the CIT was justified to invoke the anti-avoidance provision under section 33 of the ITA, adopted the same approach taken in the landmark case of *AQQ*, and considered the following issues:

(1) Whether the purpose or effect of the arrangement fell within the ambit of Section 33(1) (i.e. to derive a tax advantage by altering the incidence of tax payable, reducing or tax liability)

The Board was of the view that the case falls under the scope of Section 33(1) based on the objectively ascertained purpose and effect of the arrangement, which was to reduce GIP's individual income tax liability:

- These acts included the substitution of GIP with the Company in the partnership agreement with GBRN, the payment of a low salary by the Company to GIP, and the payment of tax-exempt dividends by the Company to GIP.
- For the same role which GIP performed in the business and the partnership before and after the incorporation of the Company, GIP's annual salary was only 43.1% of the remuneration he would have received if he, instead of the Company, was the partner of the partnership.

(2) Whether GIP was entitled to avail himself of the statutory exception under Section 33(3)(b) (now renumbered as 33(7)) (i.e. arrangement carried out for bona fide commercial reasons, and had not one of its main purposes is the avoidance or reduction of tax)

The Board was of the view that GIP was not entitled to avail himself of the statutory exception:

- The Board was not persuaded that the protection of limited liability (i.e. through the incorporation of the Company by mitigating or shielding GIP from different types of potential liability) was a reason for the incorporation of the Company. The Board was of the view that the benefits of limited liability conferred by the incorporation of the Company (i.e. in light of the various risks articulated by GIP, including liabilities from medical claims, public liability claims, general contractual and commercial liabilities claims) were exaggerated.
- GIP did not put forth cogent evidence that the reduction or avoidance of tax was not a main purpose of the incorporation the Company. On the contrary, GIP acknowledged that tax structuring was used to alleviate financial burdens required to be committed to the business, and that he "wanted and needed the tax savings which came with the incorporation of the company", albeit that GIP attempted to characterise the tax benefits as a by-product, and not the main objective.

(3) Whether the tax advantage obtained arose from the use of a specific provision in the ITA that was within the intended scope and Parliament's contemplation and purpose

The Board came to the conclusion that the tax advantages obtained by the Company from the Start-Up Tax Exemption scheme and Partial Tax Exemption scheme, were not in line with Parliament's intentions:

- The Start-Up Tax Exemption and Partial Tax Exemption schemes were designed to support entrepreneurial ventures and business growth by reducing tax burdens for small businesses.
- The fact that GIP left his job at NRM and went into the partnership venture with GBRN, in itself is not sufficient evidence of his entrepreneurial efforts and pursuits for the purposes of the Start-Up Tax Exemption and Partial Tax Exemption schemes, which are aimed at encouraging the pursuit of business ideas and business growth.
- There was no evidence presented to demonstrate that steps were taken to grow or expand the medical business of the Company, or to plough back the profits to grow the business of the Company.

The IRAS has in recent years been conducting regular audits on different groups of taxpayers, and in particular, medical practitioners. The series of income tax appeal cases involving medical practitioners has helped shed light on the CIT's application of the anti-avoidance provision in Section 33 of the ITA. With the principles of these cases distilled and set out in the e-Tax Guide, there is now better clarity on how the CIT intends to administer the statutory rules in 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 matters/case to your business, as well as any transactions which your business may be contemplating.

Authors

See Wei Hwa
Partner
Property Tax & Dispute Resolution
T: +65 6213 3845
E: wsee@kpmg.com.sg

Contact us

Ajay K Sanganeria
Partner
Head of Tax
T: +65 6213 2292
E: asanganeria@kpmg.com.sg

BANKING & INSURANCE

Alan Lau
Partner
Head of Financial Services, Tax
T: +65 6213 2027
E: alanlau@kpmg.com.sg

Lum Kah Wai
Partner
T: +65 6213 2690
E: kahwailum@kpmg.com.sg

ENERGY & NATURAL RESOURCES AND TELECOMMUNICATIONS, MEDIA & TECHNOLOGY

Gordon Lawson
Partner
Head of Energy & Natural Resources, Tax
T: +65 6213 2864
E: glawson1@kpmg.com.sg

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

Mark Addy
Partner
T: +65 6508 5502
E: markaddy@kpmg.com.sg

INFRASTRUCTURE, GOVERNMENT & HEALTHCARE AND MANUFACTURING

Chiu Wu Hong
Partner
Head of IGH & Manufacturing, Tax
T: +65 6213 2569
E: wchiu@kpmg.com.sg

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

Chris Roberts
Partner
T: +65 6411 8923
E: christopherroberts@kpmg.com.sg

Leo Yang
Partner
T: +65 6213 3721
E: leoyang5@kpmg.com.sg

Yong Jiahao
Partner
T: +65 6213 3777
E: jiahaoyong@kpmg.com.sg

REAL ESTATE & ASSET MANAGEMENT

Teo Wee Hwee
Partner
Co-Head of Real Estate, Tax, and Head of Asset Management & Family Office
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Anulekha Samant
Partner
Co-Head of Real Estate & Asset Management, Tax
T: +65 6213 3595
E: asamant@kpmg.com.sg

Agnes Lo
Partner
T: +65 6213 2976
E: agneslo1@kpmg.com.sg

Pearlyn Chew
Partner
T: +65 6213 2282
E: pchew@kpmg.com.sg

Evangeline Hu
Partner
T: +65 6213 2597
E: evangelinehu@kpmg.com.sg

Contact us

TRANSFER PRICING

Felicia Chia
Partner
Head of Transfer Pricing, Tax
T: +65 6213 2525
E: fchia@kpmg.com.sg

Lee Jingyi
Partner
T: +65 6213 3785
E: jingyilee@kpmg.com.sg

Denis Philippov
Partner
T: +65 6213 2866
E: denisphilippov@kpmg.com.sg

Yong Sing Yuan
Partner
T: +65 6213 2050
E: singyuanyong@kpmg.com.sg

INDIRECT TAX

Elaine Koh
Partner
Head of Indirect Tax
T: +65 6213 2300
E: elainekoh@kpmg.com.sg

Sharon Cheong
Partner
T: +65 6213 2399
E: sharoncheong@kpmg.com.sg

CORPORATE TAX PLANNING & COMPLIANCE

Audrey Wong
Partner
Head of Corporate Tax Planning & Compliance, Tax
T: +65 6213 2010
E: audreywong@kpmg.com.sg

Lim Geok Fong
Principal Advisor
T: +65 8118 1129
E: geokfonglim@kpmg.com.sg

TAX GOVERNANCE

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

TAX TECHNOLOGY & TRANSFORMATION

Lee Bo Han
Partner
T: +65 6508 5801
E: bohanlee@kpmg.com.sg

TAX REIMAGINED

Catherine Light
Partner
T: +65 6213 2913
E: catherinelight@kpmg.com.sg

Abad Dahbache
Partner
T: +65 6213 2034
E: abadullahdahbache@kpmg.com.sg

GLOBAL COMPLIANCE MANAGEMENT SERVICES

Cristina Alvarez-Ossorio
Partner
T: +65 6213 2688
E: cristinaalvarez@kpmg.com.sg

PERSONAL TAX & GLOBAL MOBILITY SERVICES

Murray Sarelius
Partner
Head of Personal Tax & Global Mobility Services, Tax
T: +65 6213 2043
E: murraysarelius1@kpmg.com.sg

Barbara Kinle
Partner
T: +65 6213 2033
E: bkinle@kpmg.com.sg

Eugenia Tay
Partner
T: +65 6213 2039
E: eugeniatay@kpmg.com.sg

Garren Lam
Principal Advisor
T: +65 9728 1502
E: garrenlam@kpmg.com.sg

FAMILY OFFICE & PRIVATE CLIENTS

Teo Wee Hwee
Partner
Head of Asset Management & Family Office
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Pearlyn Chew
Partner
T: +65 6213 2282
E: pchew@kpmg.com.sg

MANAGED SERVICES

Larry Sim
Partner
Head of Managed Services, Tax
T: +65 6213 2261
E: larrysim@kpmg.com.sg

Contact us

PROPERTY TAX & DISPUTE RESOLUTION

See Wei Hwa
Partner
T: +65 6213 3845
E: wsee@kpmg.com.sg

Leung Yew Kwong
Principal Advisor
T: +65 6213 2877
E: yewkwongleung@kpmg.com.sg

R&D AND INCENTIVES ADVISORY

Lee Bo Han
Partner
T: +65 6508 5801
E: bohanlee@kpmg.com.sg

TAX – DEALS, M&A

Adam Rees
Partner
T: +65 6213 2961
E: adamrees@kpmg.com.sg

BASE EROSION AND PROFIT SHIFTING (BEPS)

Andy Baik
Partner
Co-Head of BEPS COE
T: +65 6213 3050
E: andybaik1@kpmg.com.sg

Harvey Koenig
Partner
Co-Head of BEPS COE
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

TRADE AND CUSTOMS

Shafiqah Binte Abdul Samat
Principal Advisor
T: +65 8518 7867
E: shafiqahabdulsamat@kpmg.com.sg

INDIA TAX SERVICES

Bipin Balakrishnan
Partner
T: +65 6213 2272
E: bipinbalakrishnan@kpmg.com.sg

US TAX SERVICES

Andy Baik
Partner
Head of US Tax Desk
T: +65 6213 3050
E: andybaik1@kpmg.com.sg

Nicole Li
Principal Advisor
T: +65 9824 4169
E: nicoleli4@kpmg.com.sg

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KPMG
12 Marina View, #15-01
Asia Square Tower 2
Singapore 018961
T: +65 6213 3388
F: +65 6225 0984
E: tax@kpmg.com.sg

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