

Corporatisation of Professional Practices - A Recent Update on Tax Issues

August 2020

Introduction

It is common practice among high-earning professionals such as Doctors and Dentists to incorporate a Singapore company (or companies) under which they will provide their services. While using a company carries with it a number of commercial benefits for the business, it can also often lead to a reduction of the overall tax liability for the professional.

We take a closer look at the legislation on this and a recent case decision to provide an insight into the current views of the Singapore tax authorities in this area.

Section 33 - Income Tax Act

In recent years, the Inland Revenue Authority of Singapore ("IRAS") has been concerned that many such arrangements do not arise out of genuine commercial reasons and are part of an attempt to avoid taxes. Where such a determination is made, the Comptroller of Income Tax ("CIT") can invoke Section 33 of the Income Tax Act ("Act") to ignore the structure/arrangement set up by the taxpayer and re-assess their tax liability i.e. so that the individual is liable to pay individual income tax instead of corporate tax.

Section 33(1) of the Act states that the CIT may disregard any arrangement that they determine to have directly or indirectly resulted in any of the following:

a) Altered the incidence of any tax payable;

b) Relieved any person from any liability to pay tax; or

c) Reduced or avoided any tax liability.

However, Section 33(3)(b) clarifies that the above would not apply if the arrangement was carried out for bona fide commercial reasons and tax avoidance was not one of its main purposes.

Section 33 allows the CIT to take an anti-tax avoidance stand and ensures that taxpayers do not take advantage of or use corporate tax schemes outside of their intended purpose e.g. to reduce and avoid tax. It sets a standard that such corporate arrangements must be based on genuine commercial reasons and not as a way to reduce the overall tax liability. The recent case of *GCL vs. CIT (2020)* discussed below, is an example of the enforcement of Section 33 in the context of professionals and provides taxpayers with more guidance on how this section of the Act is applied.

Background Facts

The appeal in the case of *GCL vs CIT (2020)* was recently brought to the Income Tax Board of Review ("Board") by a licensed Dentist ("taxpayer") against additional Notice of Assessments raised by the CIT in respect of individual income tax. The facts of the case can be summarised as follows:

► The taxpayer was employed by an orthodontic clinic ("YCO"). In May 2012, he incorporated a private limited company ("GCL") with



At BDO, we have the expertise and experience in providing a comprehensive personal tax advisory services. Please feel free to contact us and let us know how we can assist you.

FOR MORE INFORMATION



WU SOO MEE

Executive Director
Personal Tax Advisory
Direct: +65 6828 9125
Mobile: +65 8333 0807
soomee@bdo.com.sg

BDO TAX ADVISORY PTE LTD

600 North Bridge Road
#23-01 Parkview Square
Singapore 188778
Tel: +65 6828 9118
Fax: +65 6828 9111

www.bdo.com.sg



him being the sole shareholder and director and terminated his employment with YCO. GCL then entered into a service agreement with YCO, where the taxpayer provided services as an independent contractor and continued treating patients at YCO's premises. Under this new arrangement, YCO paid service fees to GCL, and GCL in turn paid director's fees and salaries to the taxpayer.

- ▶ With the new arrangement, the taxpayer was paid a much lower salary by GCL and GCL profits were taxed at the lower corporate tax rate of 17%. The overall tax liability for the taxpayer was therefore significantly reduced. Furthermore, GCL was able to claim the corporate tax exemption and rebates.
- ▶ The CIT viewed the new arrangement as being caught by Section 33 and re-assessed the taxpayer's income for the Years of Assessment ("YA") 2013 to 2016, raising additional individual income tax Assessments to bring the full amount of service fees to tax on the individual.

Board Decision

The Board used the framework set out by the Court of Appeal in the *Comptroller of Income Tax vs AQQ (2014)* case for the application of Section 33 to arrive at its decision. The framework is as follows:

- a) Whether an arrangement led to any one of the three outcomes set out in Section 33(1)(a) to (c) above, such

that the taxpayer has **derived a tax advantage**. This determination must be based on **objective facts** without considering the motive of the taxpayer, which is subjective. If yes:

- b) Whether the arrangement qualifies for the exception under Section 33(3) (b) by being one that was carried out for **bona fide commercial reasons** and which **does not have tax avoidance** as one of its main purposes. If no:
- c) Whether the taxpayer can prove that the tax advantage arose from the use of a specific provision in the Act that was within the intended scope and purpose drawn out by the Parliament.

The Board views the structure implemented by the taxpayer as comprising of **two arrangements**, which are each separately subjected to Section 33 of the Act:

- 1) **The setting up of GCL to receive the income from providing dental services at YCO (previously received directly by the taxpayer)**
 - The Board's view is that the establishment of GCL does not fall within the ambit of Section 33 as it did not objectively affect the taxpayer's liability.
 - The Board noted that the use of a company to carry out a dental practice is a common and widely used practice and is not inherently an act to avoid taxes. Though the overall tax liability is reduced in this arrangement due

to the lower corporate tax rate and available tax exemptions, it is considered an inevitable consequence of a tax policy and is not in itself an act of tax avoidance.

- 2) **The setting up of the level 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 dividend**

- Under the new arrangement, the taxpayer received an unreasonably low level of remuneration from GCL. As a result, the overall tax liability was reduced. This is because the profits remaining in GCL were taxed at the corporate tax rate of 17%, which is lower than the taxpayer's previous effective rate of tax at individual rates. The profits were later paid out to the taxpayer as tax-exempt dividends.
- The taxpayer challenged this by explaining that the level of remuneration was determined based on the amount he required for his personal upkeep and maintenance, including his day-to-day expenditures such as housing and car loan payments. Furthermore, it was part of his business plan to receive only the amount of salary he needed and save the remaining profits for business operations and future investments (e.g. purchase of medical units).

- However, the Board noted that despite the above, the taxpayer was fully aware that his new remuneration was significantly lower compared to when he was an employee of YCO, even though his role at YCO had remained the same. This difference in level of remuneration could not be justified as being on a commercial basis. The Board was therefore of the view that the corporate arrangement objectively led to a reduction of overall tax liability and an avoidance of tax, and thus falls within Section 33 of the Act.
- The next step is to determine whether the arrangement qualifies for the exception in Section 33(3)(b) i.e. that it was carried out for bona fide commercial reasons and did not have tax avoidance as one of its main purposes.
- The Board found that the arrangement does not qualify for the exception as there is no commercial basis for the taxpayer's new level of remuneration. This is because it is neither reasonable nor reflective of the market pay for the same skill and experience level. Furthermore, the Board noted that from YA 2013 to YA 2016, the remaining profits in GCL subject to corporate tax remained around \$300,000, which is the level at which the start-up tax exemption and partial tax exemption are maximised for companies. Hence, the arrangement is not carried out for bona fide commercial reasons and does have the avoidance or reduction of tax as one of its main purposes.
- As the Board's decision is that the arrangement does fall within Section 33 of the Act, albeit under only one of the two arrangements i.e. the setting up of the level of remuneration, the taxpayer was liable to tax at individual income tax rates on the full amount of service fees received.

BDO Singapore - Our View

With the existing regulations and guidance provided by the authorities, the line between tax planning and tax avoidance is a grey area and as such professionals have found it difficult to remain compliant. Fortunately, the Board's decision in **GCL vs. CIT (2020)** now provides taxpayers with clearer guidance on how Section 33 is applied in the context of professionals in similar circumstances.

With the increasing scrutiny by the IRAS on companies that are set up to abuse corporate tax concessions, it is now essential for high-earning professionals who have incorporated companies to review the current structure of their business and make adjustments accordingly. Professionals should review their level of remuneration to ensure that it reflects market level or that there is a commercial reason and that it is at arm's length. It is important to note that in addition to Section 33, professionals who have incorporated companies to provide

their services must also comply with Section 34D of the Act which requires that all arrangements between related parties be conducted at arm's length.

While the Board viewed the setting up of GCL as not falling within the ambit of Section 33, we are cautious to note that this was due to the arrangement being an ordinary business norm and common practice. Where multiple companies are set up under the same professional and the setup cannot be explained by bona fide commercial reasons, the IRAS may take a different view and question the use of such companies.

The IRAS takes a strong stand against businesses and individuals who abuse tax exemption schemes or are non-compliant of the tax regulations and will not hesitate to take action where tax evasion/fraud is discovered. Professionals should therefore take the time to review their business structure/arrangements and if there is such a concern, they should seek professional advice to assess their specific circumstances and take the necessary remedial actions.



This newsletter has been carefully prepared, but it has been written in general terms and should be seen as containing broad statements only. This newsletter should not be used or relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained in this newsletter without obtaining specific professional advice. Please contact BDO Tax Advisory Pte Ltd to discuss these matters in the context of your particular circumstances. BDO Tax Advisory Pte Ltd, its partners, employees and agents do not accept or assume any responsibility or duty of care in respect of any use of or reliance on this newsletter, and will deny any liability for any loss arising from any action taken or not taken or decision made by anyone in reliance on this newsletter or any part of it. Any use of this newsletter or reliance on it for any purpose or in any context is therefore at your own risk, without any right of recourse against BDO Tax Advisory Pte Ltd or any of its partners, employees or agents.

BDO Tax Advisory Pte Ltd (UEN: 200818719H), a private limited company registered in Singapore, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.

©2020 BDO Tax Advisory Pte Ltd. All rights reserved.

www.bdo.com.sg

CONNECT WITH US.

Like us, follow us, engage us through our social media channels:

