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# Personal Service Companies and the Tax Avoidance Surcharge in Singapore

## Vincent Ooi[*]

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☞ keywords to be inserted by the indexer

### Abstract

*Incorporation of personal service companies provide tax and non-tax advantages. With the introduction of a tax avoidance surcharge in Singapore, incorporation for non-tax advantages risks additional "tax costs" if challenged by the revenue authorities, introducing uncertainty and litigation costs. Instead of relying on a GAAR, targeted measures should restrict tax advantages to the first company incorporated by each individual taxpayer.*

## A. Introduction

In recent years, medical professionals in Singapore who practise through companies have had their corporate structures carefully scrutinised for potential tax avoidance. The efforts of the Inland Revenue Authority of Singapore (IRAS) to address this issue have been well-publicised[1] and the IRAS itself has issued a circular stating its position on the matter.[2] Several cases have been litigated before the courts,[3] with a considerable number of cases yet to be determined. This issue is a familiar one in several jurisdictions.[4] In Singapore, for example, the average blended personal income tax rate typically exceeds the average blended corporate tax rate, even after considering tax rebates and deductibles.[5] This has naturally made it attractive for taxpayers (particularly professionals) to incorporate and practise through Singapore resident companies.

This article examines recent developments in Singapore case law on the anti-avoidance response to professionals incorporating companies,[6] alongside the recent amendments to the Singapore's Income Tax Act 1947 (SITA) which now imposes a 50% tax surcharge in cases where tax avoidance is found.[7] The imposition of a hefty surcharge may potentially discourage taxpayers from incorporating and benefiting from the resultant non-tax advantages. Even if a taxpayer is convinced that it has no tax avoidance motive when incorporating and practising through a company, there is a clear risk of being challenged by the IRAS, with the effect that the 50% tax surcharge may become an additional burden of incorporation. The test for tax avoidance is complex and intensely fact-specific. The uncertainty and costs of the dispute resolution process may discourage taxpayers from incorporation in all but the most obvious cases.

This issue can be resolved by enacting specific legislation to restrict the tax advantages of incorporation available to taxpayers, removing the need to rely on the General Anti-Avoidance Rule (GAAR) and the risk of the tax avoidance surcharge. It is a reasonable policy position to take to restrict tax advantages to the first company incorporated by each individual taxpayer, regardless of the motive of the taxpayer in incorporating further companies. A mechanism can then be put in place to allow taxpayers to apply to the IRAS to grant the tax advantages of incorporation on a case-by-case basis, depending on whether they are able to demonstrate that the additional companies conduct business that is sufficiently distinguishable from the first company. This proposal would be in line with the intent of Parliament to use the corporate tax structure to foster local entrepreneurship.[8] The details of this proposal are laid out in this article.

## B. Tax advantages of incorporation in Singapore[9]

There are three main categories[10] of tax advantages of incorporation in Singapore: (1) tax exemptions; (2) tax rebates; and (3) the tax rate differential between the Personal Income Tax (PIT) and Corporate Income Tax (CIT) rates. There are two main forms of tax exemptions in Singapore: the (1) Partial Tax Exemption (PTE)

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[1] The Straits Times, Iras recovers $10 million from high-earning tax avoiders; returns of 145 doctors, dentists under scrutiny (15 October 2018); and Timely for Iras to shut tax loophole (23 October 2018).
[2] IRAS, Circular: Incorporation of Companies by Medical Professionals and Relevant Tax Implications (November 2019) ("IRAS Circular").
[3] *GBF v CIT* [2016] SGITBR 1; and *GCL v CIT* [2020] SGITBR 1 (on appeal, *Wee Teng Yau v CIT* [2021] 3 S.L.R. 1290.
[4] Generally (see Lee Burns and Rick Krever, Individual Income Tax, in Victor Thuronyi (ed.), *Tax Law Design and Drafting: Vol 2* (IMF) (1998), pp.526–529), the UK (see Judith Freedman, "Small Businesses and the Corporate Form: Burden or Privilege?" (1994) 57 *Modern Law Review* 555), Australia (Ken Henry, "Australia's Future Tax System: Report to the Treasurer", *The Henry Review* (Treasury, 2009), pp.185–204), and New Zealand (see Adrian Sawyer, "Surgeons' Practices and Tax Avoidance: A Mutually Exclusive Relationship" (2009) 15 *New Zealand Journal of Taxation Law and Policy* 97).
[5] Discussed in the following section.
[6] These companies are colloquially referred to as "personal service companies" in the UK. The term is used in this article to make the point that it is often the individual taxpayer who incorporates these companies through which personal services are provided.
[7] SITA s.33A(2).
[8] *Hansard*, Singapore Parliamentary Debates, Official Report (27 February 2004) col.498 (Mr Lee Hsien Loong, Deputy Prime Minister and Minister for Finance).
[9] For a brief summary, see Vincent Ooi, "The Anti-Avoidance Response to Professionals Incorporating Companies in Singapore", *Asia-Pacific Tax Bulletin* (8 June 2020), 2–3.
[10] Compulsory superannuation contributions in Singapore are directly linked to the benefits received and function as a form of forced savings. There is thus less of an incentive for taxpayers to attempt to avoid paying such contributions.

Scheme; and (2) Start-Up Tax Exemption (SUTE) Scheme. At the present moment, under the PTE, 75% of the first SG$ 10,000 of a company's chargeable income, and 50% of up to the next SG$ 190,000 will be exempted from CIT.[11] For the first three years of a new company's existence, under the SUTE, 75% of the first SG$ 100,000 of a company's chargeable income, and 50% of up to the next SG$ 100,000 will be exempted from CIT.[12] There used to be corporate income tax rebates from Years of Assessment (YAs) 2013 to 2020, but none is available to companies at the moment. As for the differential between the PIT and CIT rates, the current maximum differential is 5% of the relevant chargeable income. The CIT rate in Singapore is a flat 17%. There are several progressive bands of PIT rates, starting at 0% and reaching a maximum of 22% for income in excess of SG$ 320,000.[13]

Given these features of the Singapore tax system, it is unsurprising that some taxpayers have taken steps to minimise their tax liabilities by adopting one or more of the following three main approaches. Adopting one of these approaches does not necessarily mean that the taxpayer is engaging in tax avoidance. Firstly, a taxpayer might incorporate a company and practise professionally out of it. This would typically involve getting patients to contract directly with the company. The taxpayer would enter into an employment agreement with the company at a low monthly salary. The pre-tax profits of the company would then be taxed at the CIT rate and the post-tax profits distributed as tax-free dividends[14] to the taxpayer, who would thus have avoided paying the higher PIT rates on such income, which would have been the case if the income had been directly received from the patients.

Secondly, a taxpayer might incorporate a company in order to benefit from the PTE or SUTE, where various amounts of chargeable income are exempted from CIT. However, instead of benefitting from these exemptions for one company, a taxpayer then goes on to incorporate several companies. In the process, the taxpayer could direct different patients to contract with the various companies, thus enjoying the benefits of the PTE or SUTE schemes on multiple occasions. Thirdly, a taxpayer might repeatedly incorporate new companies every three years, with the new companies performing exactly the same functions as the previous companies. The more favourable SUTE scheme would then become perpetually applicable as the three-year lifespan of the scheme would be refreshed with each new incorporation.

Even using one of these approaches alone might well result in substantial tax savings for a taxpayer. For example, assuming an annual income of SG$ 1,000,000, the tax rate differential alone might result in savings of SG$ 24,150.[15] Each additional company benefiting from the PTE scheme might result in savings of SG$ 17,425, while each additional company benefiting from the SUTE scheme might result in savings of SG$ 21,250. Incorporating a new company to take advantage of the SUTE rather than PTE scheme might result in savings of SG$ 3,825. It can be seen that when used together, the tax savings from these approaches rapidly add up to a very significant sum. It is thus unsurprising that the IRAS was compelled to intervene to address this potential loophole.

## C. Non-tax advantages of incorporation

In addition to the tax advantages of incorporation, there are also many non-tax advantages that might benefit a taxpayer. Most of these non-tax advantages are well-appreciated by lawyers across many jurisdictions and, broadly speaking, the position in Singapore does not differ that much from the rest of the Commonwealth. The incorporation of a company has the following effects: (1) the company is a body corporate with the powers of an incorporated company;[16] (2) it may sue and be sued in its own name; (3) it has perpetual succession;[17] (4) it may own land;[18] and (5) the liability of the members may be limited.[19]

As a matter of good corporate compliance, the professional wishing to practise through a company should enter into an employment contract with the company, and all corporate secretarial records properly documented and filed. All contracts with clients should be signed with the company rather than the professional. However, it is rare in practice to find a business where all the documentation is properly completed and filed.

### *1. Risk management*

If a professional runs a business as a sole proprietor, there is a possibility that different types of risks may be incurred by the business. As a sole proprietor, the law does not differentiate between personal assets and those of the business. Consequently, one could be legally compelled to sell off personal assets to satisfy a judgment debt. Structuring a business as a company limits the liability of all shareholders. The business becomes a

[11] SITA s.43(6B).
[12] SITA s.43(6D).
[13] From Year of Assessment ("YA") 2024, the PIT rates will be revised such that, inter alia, income in excess of SG$ 1 million will be taxed at a rate of 24%. This means that the maximum tax rate differential would be 7%.
[14] Singapore has a single-tier corporate tax system, where CIT is paid at the company level and dividend distributions from Singapore-resident companies are exempt from tax in the hands of the recipients.
[15] SG$ 194,150 if taxed at the PIT rates and SG$ 170,000 if taxed at the CIT rates.
[16] Companies Act 1967 (2020 Rev Ed) ("SCA") s.19(5).
[17] *Re Noel Tedman Holdings Pty Ltd* [1967] Qd R 561.
[18] SCA s.19(5) only mentions land, but there is no doubt that a company may own any other sort of property also.
[19] SCA s.19(5).

separate legal entity solely responsible for its own debts and liabilities.[20] The liabilities of the business are isolated from its individual shareholders and therefore do not expose the personal assets of any shareholder. A creditor can only go after the assets of a shareholder to the extent that it represents any unpaid share capital invested into the company.[21]

The separate legal personality of the company may be disregarded in exceptional circumstances in a procedure known as veil-piercing, though the courts are generally slow to do this.[22] The courts in Singapore have indicated that there are two general justifications for doing so: where the evidence shows that the company is not in fact a separate entity; and where the corporate form has been abused to further an improper purpose.[23]

A medical professional may be motivated to incorporate in order to limit personal liability. For instance, if the incorporated medical practice owes money to a vendor, the shareholder-doctor's personal assets cannot be claimed by creditors. This is because members are not responsible for the company's obligations and thus cannot be sued; instead, the company must be sued.[24] A doctor who initially starts a practice as a sole proprietorship may decide to develop supporting functions for the medical practice as the business expands. For example, the medical practice may decide to own substantial assets, such as properties or clinics where they may operate from, equipment, or surgical tools. Incorporating a business would allow for ringfencing of these assets and liabilities such that any business failure; contractual risks involving a particular clinic; or breach of contractual obligations involving employees, customers, or suppliers would fall on the company instead of the sole proprietor or general partner in an unincorporated entity. These contractual obligations are the sole responsibility of the company and assets held by the shareholder-doctor or other incorporated entities are ringfenced from claims by creditors.[25]

## 2. Tortious liability

While the previous paragraphs focused on contractual risks, limiting liability in tort would be another reason to incorporate. The general operation of a business can give rise to the risk of a professional being subject to tortious liability in several different ways. If the business has premises which host clients, occupiers' liability risk must be managed. Most businesses have employees, giving rise to the risk of vicarious liability for the actions of the employees. Professional negligence liability is a special category of risk that must be managed differently. Incorporation offers no protection for a professional such as a doctor, charged with malpractice liability, that is to say a failure to exercise an accepted standard of care in medical professional skills or knowledge, resulting in injury, damage or loss.[26] This kind of risk cannot be managed simply through incorporation, as the doctor will always remain personally liable for professional negligence whether or not the practice is done through a company. Doctors are therefore required to take up medical malpractice insurance to protect them from lawsuits resulting from professional negligence.[27]

However, where a group of doctors practise together in a single medical practice, incorporation can help manage the risk of the other doctors where one doctor is professionally negligent. Without incorporating a company, the default rule under a general partnership is for all partners to be jointly and severally liable for the activities of all partners pertaining to the partnership.[28] In such a case, incorporation will not save the doctor who is professionally negligent, but may protect the other doctors in the practice.

## 3. Easier access to capital

Incorporation may also facilitate the raising of capital for expansion purposes. This can be in the form of equity financing, through the issue of shares;[29] or debt financing, through the taking of loans or issuance of bonds. A company can also give a charge over its assets as security for loans,[30] with the possibility that the company directors themselves do not need to enter into risky personal guarantees. Portions of a company, divided into shares can be bought or sold without having any impact on the underlying structure or function of the company. Dividing a company into shares makes it easier for founders to share ownership of the business with each other and with new business partners.[31] For instance, doctors may want to receive funding from investors in order to open new clinics or invest in new technology and equipment. In that case, the investor can take up a stake in the business.

A professional wishing to retire and exit the business would find it much easier to sell the shares of the company rather than engage in an asset sale, which would be a lot more complicated and cumbersome as assets would have to be sold off in a piecemeal manner. There are also additional exit options on incorporation, such as

[20] See *Salomon v A Salomon & Co Ltd* [1897] A.C. 22 at 31, per Lord Halsbury LC. See also *Manuchar Steel Hong Kong Ltd v Star Pacific Line Pte Ltd* [2014] 4 S.L.R. 832.
[21] Insolvency, Restructuring and Dissolution Act 2018 (2020 Rev Ed) s.121(1)(d).
[22] Tan Cheng-Han, et al., "Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives" (2019) 16 Berkeley Bus. LJ 140, 151–152.
[23] *Tjong Very Sumito v Chan Sing En* [2012] 3 S.L.R. 953 at [67]; see also *Simgood Pte Ltd v MLC Shipbuilding Sdn Bhd* [2016] 1 S.L.R. 1129 at [195]–[204].
[24] *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd* [1916] 2 A.C. 307 at 338, per Lord Parker.
[25] Henry Hansmann, and Reinier Kraakman, "The Essential Role of Organisational Law" (2000) 110 Yale LJ 387.
[26] See *Noor Azlin bte Adbul Rahman v Changi General Hospital Pte Ltd* [2019] 3 S.L.R. 1063, on appeal, [2019] 1 S.L.R. 834.
[27] Medical Registration Act 1997 (2020 Rev Ed), s 36(7)(c).
[28] Singapore Partnership Act 1890 (2020 Rev Ed) ("SPA"), ss.5 and 9; see also *Lim Hsi-Wei Marc v Orix Capital Ltd* [2010] 3 S.L.R. 1189 at [32]–[49].
[29] *National Westminster Bank Ltd v Inland Revenue Commissioners* [1995] 1 A.C. 119 at 123; [1994] 3 W.L.R. 159; [1994] 3 All E.R. 1.
[30] SCA s.131(3); see also *National Westminster Bank Plc v Spectrum Plus Ltd* [2005] 2 A.C. 680; [2005] 3 W.L.R. 58; [2005] 4 All E.R. 209.
[31] In contrast to a general partnership where under s.20 of the SPA, partnership property will have its legal title devolve according to its nature and tenure, with partners who leave the firm or who are deceased, being able to claim an interest in the partnership property under s.42.

taking the company public on the stock exchange. Such options are not open to business structured as sole proprietorships or partnerships.

## D. The legal position on tax avoidance in Singapore

Singapore has a statutory GAAR which provides that "where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly" to give the taxpayer a tax advantage,[32] the Comptroller must "disregard or vary the arrangement and make any adjustment … to counteract the tax advantage obtained or obtainable … under that arrangement".[33] Guidance on how to interpret these statutory provisions was handed down by the Singapore Court of Appeal in the leading case of *CIT v AQQ*.[34] There are three steps in the analytical framework.[35]

(1) The first step of the framework involves the application of the predication principle laid out in *Lauri Joseph Newton v CTA*,[36] which was affirmed in *CIT v AQQ*.[37] The principle states that in order to bring an arrangement within the anti-avoidance section, it must be possible to predicate, by objectively looking at the overt acts by which it was implemented, that the arrangement was implemented in that particular way to avoid tax.[38] If the arrangement is "capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section".[39]

(2) The second step of the framework involves the determination of the taxpayer's subjective motives for the arrangement.[40] Section 33(7) provides that the GAAR does not apply to an arrangement entered into for bona fide commercial reasons and which did not have the avoidance or reduction of tax as one of its main purposes.[41] Both limbs of the test must be satisfied for the exception to apply. The court also noted that even if transactions are similarly structured, they may be "taxed differently depending on whether the taxpayer had set out to create a result whereby his tax liability was avoided or reduced".[42]

(3) The final step of the framework provides that if an arrangement is caught by the GAAR after applying the first two steps, the GAAR would nevertheless not apply if the tax advantage was one which Parliament intended the taxpayer to benefit from.

The principles laid out in *CIT v AQQ* were subsequently applied in *Wee Teng Yau v CIT*,[43] which is currently the only case involving personal service companies in Singapore to reach the Singapore High Court.[44]*CIT v AQQ* had a very different fact pattern, totally unrelated to personal service companies, making *Wee Teng Yau v CIT* a crucial case in this area. The court in *Wee Teng Yau v CIT* appears to have interpreted the first step of the *CIT v AQQ* framework by applying the predication principle as follows. It held that "doctors who set up private limited companies with a compendium of purposes such as delegating the management of the business and limiting the liability of the doctors are not the sort of arrangements contemplated in s.33".[45] However, it found that in the case before it, the main, if not only, purpose of the incorporation of the personal service company was to enable the taxpayer to avoid tax.[46] Ooi has argued that there are two ways of interpreting this finding of the High Court. Either the taxpayer did not appear to have a "compendium of purposes" for incorporation (or at least, did not appear to have pleaded this),[47] or that it may be predicated that it was the level of remuneration paid to the taxpayer by his newly incorporated company that was implemented to achieve a tax advantage.[48]

The latter interpretation appears to be more likely, since the predication principle is to be assessed objectively and it is hard to deny that, objectively speaking, the incorporation of the personal service company in that case did indeed provide the taxpayer with a host of non-tax advantages. It thus appears that incorporation would not constitute tax avoidance in itself, but if it was coupled with the paying of an artificially low salary to the professional, then it might well constitute

[32] SITA s.33(1).
[33] SITA s.33(2).
[34] *CIT v AQQ* [2014] 2 S.L.R. 847. This remains the only case on tax avoidance to have come before Singapore's apex court.
[35] *CIT v AQQ* [2014] 2 S.L.R. 847 at [110].
[36] *Lauri Joseph Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] A.C. 450 at 465–466; [1958] 3 W.L.R. 195; [1958] 2 All E.R. 759.
[37] *CIT v AQQ* [2014] 2 S.L.R. 847at [45]–[46].
[38] *CIT v AQQ* [2014] 2 S.L.R. 847at [45]–[46].
[39] *CIT v AQQ* [2014] 2 S.L.R. 847at [45]–[46].
[40] *CIT v AQQ* [2014] 2 S.L.R. 847at [74].
[41] *CIT v AQQ* [2014] 2 S.L.R. 847at [74].
[42] *CIT v AQQ* [2014] 2 S.L.R. 847at [74].
[43] For a brief summary, see Vincent Ooi, "Tax Avoidance by Professionals: Where are we with Wee Teng Yau?" (2021) *Singapore Journal of Legal Studies* (Mar) 220–230.
[44] No cases have yet reached the Court of Appeal at this time. There have been other decisions by the Income Tax Board of Review (the equivalent of the First-Tier Tribunal (Tax) in the UK), but such decisions are persuasive rather than binding.
[45] *Wee Teng Yau v CIT* [2021] 3 S.L.R. 1290 at [19].
[46] *Wee Teng Yau v CIT* [2021] 3 S.L.R. 1290 at [19].
[47] *Wee Teng Yau v CIT* [2021] 3 S.L.R. 1290 at [10]
[48] Ooi, "Tax Avoidance by Professionals: Where are we with Wee Teng Yau?" (2021) *Singapore Journal of Legal Studies* (Mar) 220–230, 228.

tax avoidance. In terms of the tax advantages discussed above, this suggests that it might not be tax avoidance to benefit from the PTE (or SUTE, where appropriate), but that care must be taken with the tax rate differential. Maximising the tax advantage of the tax rate differential by paying oneself an artificially low salary and distributing the company profits as tax free dividends might well constitute tax avoidance.

However, *Wee Teng Yau v CIT* still leaves open a very important question. On the facts of the case, the taxpayer had only incorporated one company. Given that one might quite reasonably argue that more companies might be incorporated, each for a "compendium of purposes", at what point does this cross the line into unacceptable tax avoidance? After all, many of the non-tax advantages discussed above could accrue to a taxpayer who sets up multiple companies.

Putting all of this together, we see that there are significant tax and non-tax advantages to professionals incorporating personal service companies in Singapore. Yet due to the way that the GAAR is formulated in Singapore, there is a real risk that the IRAS or a court may focus on the tax advantages and decide that a taxpayer is engaging in tax avoidance, notwithstanding a genuine belief on the part of the taxpayer that it is merely seeking the non-tax advantages of incorporation. It is particularly difficult for a taxpayer to satisfy the second limb of the statutory exception in s.33(7), namely that the arrangement must not have had the avoidance or reduction of tax as one of its main purposes. The taxpayer is essentially asked to prove a negative, which appears to be extremely difficult to do. The fact that the section refers to "one of its main purposes" makes it clear that multiple purposes are possible and even showing that the taxpayer was highly motivated by non-tax advantages may not be sufficient to prove that it did not have tax advantages as one of the main purposes. This creates considerable uncertainty for taxpayers as to whether the GAAR will be invoked on their arrangements. In addition, the intensely fact-specific nature of the test means that even if the taxpayer succeeds in resisting the application of the GAAR, it is likely that considerable time and resources would have been spent in litigation to achieve that outcome.

## E. The difficulty caused by the tax avoidance surcharge

Even if the GAAR were to be invoked in respect of a particular corporate structure, the uncertain prospect of successfully resisting the application of the GAAR and the certain prospect of a long-drawn-out litigation battle may deter taxpayers from contesting this at all. After all, under s.33(2), the Comptroller's powers are limited to negating the tax advantage conferred by the arrangement. This would mean that a taxpayer would not receive any of the tax advantages of incorporation and effectively be in the same position it would have been in had the incorporation never taken place. However, the taxpayer would be free to benefit from the non-tax advantages of incorporation in any case without any additional tax costs.

This position changed when s.33A of the SITA was enacted, affecting assessments made from YA 2023 onwards. Section 33A prescribes that where the Comptroller negates any tax advantage under s.33, "a surcharge equal to 50% of the amount of tax or the additional amount of tax is imposed on the" taxpayer.[49] Such a surcharge (together with the amount of the tax advantage) must be paid within one month of the issuance of the Notice of Assessment by the Comptroller, regardless of whether any appeal against the assessment has been filed.[50] However, the Comptroller retains the discretion to remit any surcharge or interest payable (or part thereof).[51]

This amendment puts taxpayers in a very difficult position. Consider a taxpayer with four clinics intending to ring-fence the risks in each location. The taxpayer might well be aware of the potential tax advantages of incorporating a company for each clinic but considers that as an ancillary benefit to the important objective of ringfencing the risks. Before YA 2023, the taxpayer could incorporate four companies for the non-tax advantages and simply not challenge the invocation of the GAAR on this arrangement. The taxpayer would lose the tax advantages of the arrangement[52] but would be able to retain the non-tax advantages of incorporation in any case without any additional tax costs.

From YA 2023, however, a taxpayer who adopts such an arrangement will have to bear the real risk of not only losing the tax advantages of incorporation but also paying a 50% surcharge on this amount if the Comptroller decides to invoke the GAAR. This translates into a tax cost which has to be borne by the taxpayer simply to benefit from the non-tax advantages of incorporation. It should be recalled that under s.33(2), the Comptroller must disregard or vary an arrangement where he is satisfied that the purpose or effect of the arrangement is to give the taxpayer a tax advantage. There is no discretion offered to the Comptroller on this point. In the experience of the authors, it is unlikely for the IRAS to accept that a taxpayer incorporated four companies without any intention of tax avoidance. Questions may also be raised as to the fairness of a policy which allows a taxpayer to claim the same set of tax advantages four times despite the business operations of the four companies essentially being the same.

A taxpayer who wishes to ringfence the four clinics without the risk of incurring the surcharge is left in a dilemma. It might approach the IRAS seeking an advance

[49] SITA s.33A(1)-(2).
[50] SITA s.33A(4). The Comptroller has the discretion to extend the time within which payment is to be made (s.33A(5)).
[51] SITA s.33A(7).
[52] Which under the law, it would actually be entitled to but might make a commercial decision to give it up so as not to endure the litigation process.

ruling[53] declaring that the arrangement would not constitute tax avoidance. However, due to the tax advantages of incorporation, the ruling is unlikely to be given in the taxpayer's favour. The taxpayer might instead seek to negotiate with the IRAS, offering to give up the tax advantages of incorporation in exchange for the surcharge being waived. However, such a proposal would strongly suggest that the taxpayer had no tax avoidance motive, meaning that the incorporation arrangement would not fall under the GAAR in the first place. Consequently, the taxpayer should not only be exempt from the surcharge but should also receive the tax advantages of incorporation. The taxpayer is thus left in a situation where, unless the IRAS is willing to rule that the incorporation of the four companies is not tax avoidance, then it must bear the risk of the surcharge being imposed if it wishes to proceed with the arrangement. This is an unfortunate situation which should be statutorily remedied expeditiously.

## F. Proposal for tax advantages to be restricted to the first company of each taxpayer

The general position taken by the IRAS essentially appears to be that it is unfair for taxpayers to benefit from the tax advantages of incorporation more than once unless each company is engaged in a fundamentally different kind of business.[54] This does appear to be in line with the policy position articulated by Parliament of using these tax advantages to promote entrepreneurship.[55] However, the GAAR and surcharge are rather blunt tools to achieve this policy outcome and more targeted measures might be preferred. It is suggested that at its core, the problem is that the members of a group of companies are individually assessed to tax despite the fact that they essentially function as a single business. Thus, to remedy this problem, a mechanism for grouping companies which essentially function together as a single business can be used to reflect the economic reality of the arrangement.

There are currently two mechanisms in Singapore Tax Law that can serve as a model for this new mechanism. The first comes from Goods and Services Tax Law, where the Comptroller is given the power to make a direction that persons named in the direction shall be treated as a single taxable person carrying on the activities of a business described in that direction.[56] The Comptroller must be satisfied that, inter alia, the activities of the people named in the direction each form only part of the activities which should properly be regarded as those of the business described in the direction, with the other activities carried on concurrently or previously (or both) by one or more other persons.[57] It is noted that there is another key condition currently included in this provision, which is the Comptroller must be satisfied that the main reason or one of the main reasons for the person concerned carrying on the activities is the avoidance of a liability to be GST registered.[58] If this provision is to be adapted for use in the context of professional service companies, then this key condition should be removed, leaving the test as one of whether the activities of the people named in the direction should properly be regarded as those of the business described in the direction. This would provide for a statutory basis for the group of companies to function as distinct entities for non-tax purposes, while enabling them to file and be assessed to tax as one entity.

The second mechanism that might be adapted can be found in the group relief provisions in the SITA. In order to qualify for group relief, one of the conditions is that the companies in question must be members of the same group. This is satisfied where at least 75% of the total number of issued ordinary shares in one company are beneficially held, directly or indirectly, by the other, or where at least 75% of the total number of issued ordinary shares in each of the two companies are beneficially held, directly or indirectly, by a third Singapore company.[59] For professional services companies, the legislation might provide that companies will be considered to be group companies if at least 51% of the issued ordinary shares of each company is beneficially held, directly or indirectly, by a common owner (with the holdings of the owner's close associates such as spouses also counted). Where companies are held to be group companies, then only the company that was incorporated the earliest should be able to benefit from the SUTE, PTE or any corporate tax rebates. Taxpayers should be able to apply to the Comptroller for a waiver of this restriction, providing good reasons why the companies' activities are so different that they should not be considered to be part of the same group. While it might be possible for shareholding in the group of companies to be manipulated to fall below the prescribed percentage threshold, it is submitted that this would generally be difficult to justify on the basis of bona fide commercial reasons and the GAAR could be invoked in these more limited cases.

## G. Conclusion

The current ease at which tax may be avoided through the simple use of incorporation in Singapore certainly warrants a response from the relevant authorities. It cannot be the case that taxpayers are allowed to blatantly create artificial structures in order to obtain tax benefits. However, the current approach of invoking the GAAR does bring with it several difficulties from the

[53] SITA, Seventh Schedule, para.1(1).
[54] IRAS Circular.
[55] *Hansard*, Singapore Parliamentary Debates, Official Report (27 February 2004) col.498 (Mr Lee Hsien Loong, Deputy Prime Minister and Minister for Finance) (n 8).
[56] Singapore Goods and Services Tax Act 1993 (2020 Rev Ed) (SGSTA) Sch.1 para.2.
[57] SGSTA Sch.1 para.2(2)(b).
[58] SGSTA Sch.1 para.2(2)(d).
[59] SITA s.37B(3)-(5). There are other safeguards like requiring that the beneficial holding of shares is also coupled with a beneficial entitlement to the distribution of profits and distribution of residual assets on a winding up.

perspectives of both revenue collection and commercial decision making. Revenue collection is made more difficult because the use of the GAAR means that the negation of the tax advantages of incorporation are contingent upon the subjective intention of the taxpayer to avoid tax. This may not necessarily be easy to prove, potentially leading to long, drawn-out litigation. Commercial decision making is also made more difficult since there is considerable uncertainty on whether the taxpayer will be able to prove that it did not intend to avoid tax. The addition of the tax avoidance surcharge greatly exacerbates the problem since a taxpayer will not only have to give up the tax advantages of incorporation but also pay a surcharge if it should fail to successfully contest the application of the GAAR.

The current framework also makes it difficult for a taxpayer to benefit from the non-tax advantages of incorporation, since these go hand-in-hand with the tax advantages, meaning that there is a real risk that the IRAS will invoke the GAAR on the arrangement. The tax avoidance surcharge results in a taxpayer effectively having to pay a tax cost to obtain the non-tax advantages of incorporation and there does not seem to be any convenient way of ensuring that the surcharge will not need to be paid. Even if a taxpayer is willing to forgo the tax advantages of incorporation in exchange for the certainty of the surcharge not being imposed, there is currently no clear statutory basis for the IRAS to allow this.

The solution is to decouple the tax advantages from the non-tax advantages, allowing taxpayers to benefit from the latter without unfairly excessively benefiting from the former. Two mechanisms have been proposed, either of which would result in a policy effect of denying taxpayers the tax advantages of incorporation for more than one company unless each company is engaged in a fundamentally different kind of business.