

IRAS e-Tax Guide

Income Tax: The General Anti-avoidance Provision and its Application (First Edition)



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The General Anti-avoidance Provision and its Application

1 Aim

- 1.1 This e-Tax Guide is issued with two objectives:
- (i) First, it sets out the Comptroller of Income Tax's ("CIT") approach to the construction of the general anti-avoidance provision in section 33 of the Income Tax Act ("ITA"); and
 - (ii) Second, it provides some examples on arrangements, which in CIT's view, have the purpose or effect of tax avoidance within the meaning of section 33(1) of the ITA. By providing the examples, this e-Tax Guide aims to deter taxpayers from entering into such arrangements. Such arrangements will be subject to the wide powers of the CIT under section 33(1).
- 1.2 This e-Tax Guide only addresses tax avoidance arrangements within the meaning of section 33 of the ITA. It does not cover arrangements that:
- (i) form the subject of specific anti-avoidance provisions in the ITA; and/or
 - (ii) involve the evasion of tax.
- 1.3 The guidelines and accompanying examples in this e-Tax Guide are not meant to be exhaustive. CIT may update this e-Tax Guide with new guidelines and new examples of arrangements, where necessary.
- 1.4 For the avoidance of doubt, arrangements that are not described within this e-Tax Guide should not be taken as falling outside the ambit of section 33(1) of the ITA, and acceptable to CIT.

2 At a glance

- 2.1 With respect to the construction of section 33 of the ITA, CIT adopts an approach based on the principles enunciated by the Court of Appeal ("CA") in the case of *CIT v AQQ* [2014] SGCA 15¹ ("AQQ case").² The CA held at [110] that the

¹ A Malaysian listed group incorporated the taxpayer company AQQ to carry out a restructuring and financing arrangement in 2003. AQQ acquired 100% shares in four Singapore companies (which have significant amount of section 44 credits in their accounts) from related companies. AQQ then financed the purchase of these shares via round-tripping financing arrangements through two banks located in different countries). The Court of Appeal upheld the decisions of the Income Tax Board of Review and the High Court, and ruled that section 33 was applicable. The Court of Appeal held that the restructuring and financing arrangements were not commercial transactions under which any tax avoidance or reduction was merely incidental. The Court of Appeal ruled that one of the main purposes of the restructuring and financing arrangement was to obtain a tax benefit by creating interest deductions to reduce the tax payable on the dividend income. Please refer to the judgement for full facts of the case.

² References and discussion of the judgement are included in this Guide for the convenience of the reader. The reader is urged to read the full judgement for the full context of the case.

“scheme and purpose approach” ought to be adopted with respect to the interpretation of section 33. The scheme and purpose approach is as follows:

- (i) consider whether an arrangement *prima facie* falls within any of the three threshold limbs of section 33(1) such that the taxpayer has derived a tax advantage; and if so,
- (ii) consider whether the taxpayer may avail himself of the statutory exception under section 33(3)(b); and if not,
- (iii) ascertain whether the taxpayer has satisfied the court that the tax advantage obtained arose from the use of a specific provision in the Act 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.

2.2 The examples of arrangements (as well as their key features) that CIT would regard as having the purpose or effect of tax avoidance within the meaning of section 33(1) of the ITA may be classified into the following broad groups:

- (i) Circular flow or round-tripping of funds;
- (ii) Setting-up of more than one entity for the sole purpose of obtaining tax advantage;
- (iii) Change in business form for the sole purpose of obtaining tax advantage; and
- (iv) Attribution of income that is not aligned with economic reality.

3 Glossary

3.1 Tax avoidance arrangement

A tax avoidance arrangement normally involves an arrangement that is artificial, contrived or has little or no commercial substance and is designed to obtain a tax advantage that is not intended by Parliament.

3.2 Tax evasion

Tax evasion is a criminal offence which involves the reduction of one's tax liability or obtainment of tax credits or refunds through illegal means such as the claim for fictitious or non-existent expense and the failure to declare taxable income.

3.3 Tax planning

Tax planning is a process of structuring a transaction or series of transactions to minimise one's liability to tax, and usually fulfills both the legal requirements and intent of the income tax law.

4 Background

- 4.1 There is a spectrum of tax planning activities. At one end is tax mitigation, which is often considered legitimate tax planning within both the language and spirit of the law. At the other end of the spectrum is tax avoidance that fulfills the legal requirements of the law but not necessarily the intent of the law³.
- 4.2 In Singapore, the general anti-avoidance provision is found in section 33 of the ITA, which was enacted to curb the proliferation of blatant tax avoidance arrangements in Singapore. Section 33 empowers the CIT to disregard and make relevant adjustments to arrangements which are carried out with tax avoidance as one of their main purposes and not for bona fide commercial reasons.
- 4.3 Bona fide commercial transactions which are carried out not in pursuance of any tax avoidance arrangement will not come within the scope of section 33. Companies and individuals granted tax exemptions and concessions under specific tax provisions would not be affected by section 33, provided that no artificiality or contrivance exists to exploit the exemptions or concessions intended by the Parliament.

5 Approach to the construction of section 33

- 5.1 The statutory construction of the current section 33 was considered in the AQQ case. The CA in that case at [42] and [43] stated that for section 33 to apply, there must be an arrangement. An arrangement as defined under section 33(2) of the ITA means “any scheme, trust, grant, covenant, agreement, disposition, transaction and includes all steps by which it is carried into effect”. A tax avoidance arrangement may constitute a combination of steps that may be individually unobjectionable.
- 5.2 Further, it was held in the AQQ case at [110] that the construction of section 33 involves the following three steps:
 - (i) Whether an arrangement *prima facie* falls within any of the three threshold limbs of section 33(1) such that the taxpayer has derived a tax advantage; and if so,

³ In the case of *Commissioners of Inland Revenue v Willoughby* [1997] STC 995, Lord Nolan stated the hallmarks of tax avoidance and tax mitigation:

“The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.”

- (ii) Whether the taxpayer may avail himself of the statutory exception under section 33(3)(b); and if not,
- (iii) Whether the taxpayer has satisfied the court that the tax advantage obtained arose from the use of a specific provision in the Act 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.

Step 1: Whether an arrangement falls within any of the three threshold limbs in section 33(1)

5.3 Section 33(1) empowers the CIT to make necessary adjustments to any arrangement if he is satisfied that the purpose or effect of such arrangement is directly or indirectly:

- (i) To alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;
- (ii) To relieve any person from any liability to pay tax or to make a return under this Act; or
- (iii) To reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act.

5.4 In determining whether any of the three threshold limbs in section 33(1) is satisfied, the CA adopted the "predication principle" established in the Privy Council decision of *Lauri Joseph Newton v Commissioner of Taxation of the Commonwealth of Australia* ("Newton Case") [1958] AC 450⁴. In the Newton case, Lord Denning explained (at 465-466):

"In order to bring the arrangement within the section, you must be able to predicate – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are 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...".

5.5 The predication principle requires a consideration of whether one can objectively ascertain from the observable acts by which an arrangement is implemented and deduce that the arrangement was implemented in that way so as to obtain the tax benefit stated in any of the limbs in section 33(1)(a) to (c).

⁴ At [45] of the AQQ case.

Step 2: Whether the taxpayer may avail himself of the statutory exception under section 33(3)(b)

- 5.6 Section 33(3)(b) contains two cumulative limbs. To fall under this exception, the arrangement:
- (i) Must have been carried out for bona fide commercial reasons; and
 - (ii) Must not have had as one of its main purposes the avoidance or reduction of tax.
- 5.7 The application of section 33(1) is limited by section 33(3)(b) if the arrangement is carried out for bona fide commercial reasons and had not as one of its main purposes the avoidance or reduction of tax.
- 5.8 The first limb of section 33(3)(b) is concerned with the taxpayer's subjective commercial motives for entering into the arrangement and the second limb is concerned with the subjective consequences that the taxpayer wishes to obtain.

Step 3: Whether the tax advantage obtained arose from the use of a specific provision in the Act

- 5.9 If the taxpayer is unable to avail himself of the statutory exception under section 33(3)(b), it is necessary to ascertain whether the taxpayer could rely on other specific provisions of the ITA to preclude the operation of section 33.
- 5.10 In ascertaining whether the use of a specific provision in the Act was within the intended scope and Parliament's contemplation, the CA endorsed the "scheme and purpose approach" adopted by the majority of the Supreme Court of New Zealand in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289⁵. In *Ben Nevis*, at [103], it was held that a general anti-avoidance provision should not be read as "overriding" any specific provision of the Act or vice versa. Instead, a purposive interpretation of the provisions should be adopted. In this regard, a provision should be understood within the context of the Act and in accordance with section 9A(1) of the Interpretation Act, as promoting the overall purpose and object underlying the Act.
- 5.11 The High Court in *AQQ v CIT* [2012] SGHC 249, at [154], set out a number of relevant factors to determine whether a tax avoidance arrangement exists, the significance of which will depend on the particular facts of each case. These factors are:
- (i) The manner in which the arrangement was carried out;
 - (ii) The role of all relevant parties and any relationship they may have with the taxpayer;
 - (iii) The economic and commercial effect of documents and transactions;
 - (iv) The duration of the arrangement; and
 - (v) The nature and extent of the financial consequences that the arrangement

⁵ At [106] of the AQQ case.

has for the taxpayer.

- 5.12 The High Court said that a classic indicator of a use that is outside parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way.⁶

6 Examples of tax avoidance arrangements

- 6.1 To provide clarity and guidance on the types of arrangements which in CIT's view would have the purpose or effect of tax avoidance within the meaning of section 33(1) of ITA, the examples in this section have been categorised into broad categories which contain a hallmark of tax avoidance. They are:

- (i) Circular flow or round-tripping of funds;
- (ii) Set-up of more than one entity for the sole purpose of obtaining tax advantage;
- (iii) Changes in the form of business entity for the sole purpose of obtaining tax advantage; and
- (iv) Attribution of income that is not aligned with economic reality.

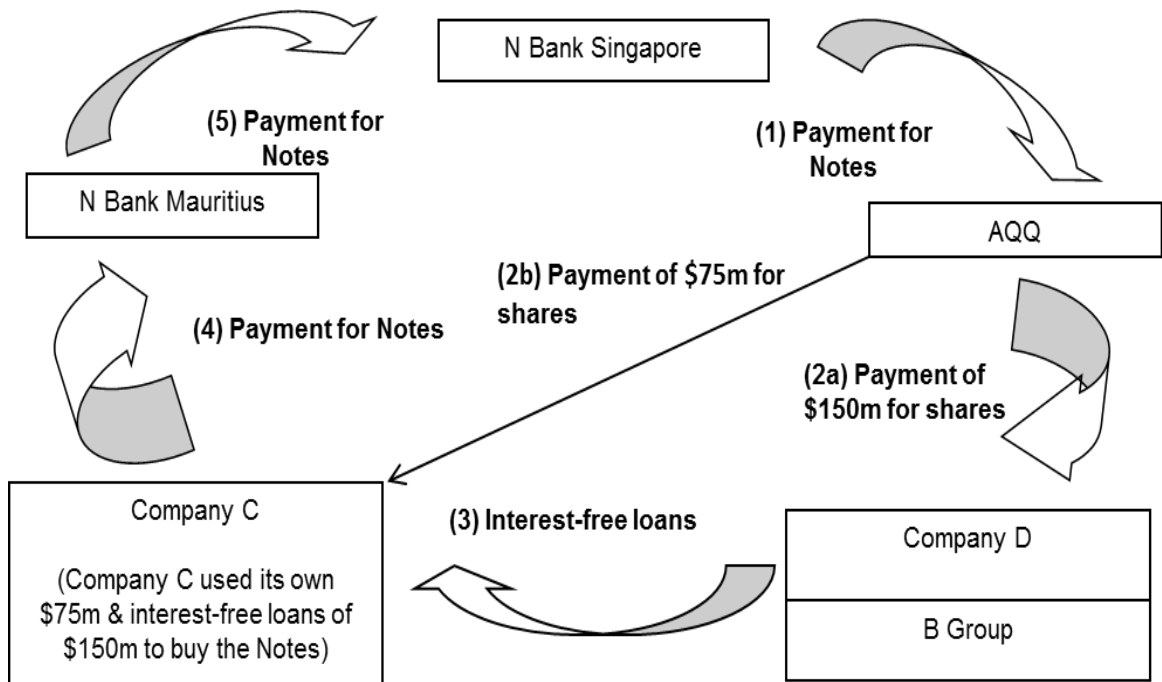
Circular flow or round-tripping of funds

- 6.2 In a circular flow of funds, there is usually no change in the financial position of the taxpayer as a result of the round-tripping of funds. A key characteristic of the round-tripping of funds is that a payment which accords a tax deduction to one party is flowed directly or indirectly from that party to another related party as a non-taxable receipt.

⁶ The above discussion of the approach adopted by the CA and the factors considered by the High Court is meant to be a factual recount of the judgements, for the purpose of facilitating the reader's understanding of the relevance of the AQQ case in interpreting section 33 of the ITA. It is not intended to be an exhaustive analysis, and the reader should refer to the full judgements for the full context.

Example 1

6.3 The flow of funds and interest in AQQ case are diagrammatically represented below:



	Interest
AQQ paid N Bank Singapore	8.850%
N Bank Singapore retained	0.005%
N Bank Singapore paid the balance as “conditional payment” to N Bank Mauritius	8.845%
N Bank Mauritius retained	0.005%
N Bank Mauritius paid the balance as “conditional payment” to Company C	8.840%

6.4 In the AQQ case, as part of B Group’s restructuring, AQQ (a wholly-owned Singapore incorporated subsidiary of B Group) financed the purchase of shares in subsidiaries through round-tripping financing arrangements via two banks located in Singapore and Mauritius. The loan provided by N Bank Singapore flowed in a circular manner on the very same day from N Bank Singapore to AQQ, then to related sellers, followed by a Malaysian group company, N Bank Mauritius and finally back to N Bank Singapore.

6.5 Almost the entire interest paid by AQQ was returned to the Malaysian group company which bought back the loan from N Bank Mauritius. Thus, the group did not incur any real economic interest costs. The main purpose of the loan was to

create interest deductions to reduce the tax payable on the dividend income.

- 6.6 The CA in the AQQ case at [89] concluded that “The round tripping of AQQ’s full purchase price of the Subsidiaries in a single day and the artificial interposition of the two external entities crosses the line between tax efficiency and tax avoidance in the absence of any cogent explanation for why it was necessary for AQQ to choose this all too complicated method of transferring funds from one subsidiary of the B Group to another through the conduit of two entities of N Bank located in two different countries.”.

Setting up of more than one entity for the sole purpose of obtaining tax advantage

- 6.7 CIT regards the setting up of more than one entity, which would not have been carried out if not for the purpose of reducing or avoiding tax, as tax avoidance. This is usually designed to maximise a tax benefit that is granted based on certain thresholds such as the Tax Exemption Scheme for New Start-up Companies⁷ (“SUTE”) or partial tax exemption (“PTE”) scheme.
- 6.8 In determining whether the setting up of more than one entity constitutes tax avoidance, CIT would consider the following factors (not meant to be exhaustive):
- (i) extent of change in business operations, processes and people functions, e.g. novation or re-drawing of contracts, employment contracts, setting up of bank accounts;
 - (ii) extent of change in business locations; and
 - (iii) extent of change in the decision-making process.

Example 2

- 6.9 Before restructuring, Mr. W. is the sole shareholder and director of Company A. With a chargeable income of \$900,000, the tax payable by Company A is \$119,000 after taking into account the exempt amount under SUTE.

Tax payable by Company A - before restructuring

Chargeable income of Company A	\$900,000
<u>Less:</u> Exempt amount under SUTE	
- 100% on first \$100,000	
- 50% on next \$200,000	\$200,000
Tax payable @ 17%	\$119,000

⁷ The SUTE scheme was introduced to encourage entrepreneurship and help our local enterprises grow. Under this scheme, a newly incorporated company that meets the qualifying conditions can claim full tax exemption on the first \$100,000 normal chargeable income and a further 50% exemption on the next \$200,000 of the normal chargeable income for each of the first 3 consecutive years. It is not intended to facilitate the restructuring of existing businesses through the incorporation of new companies without genuine commercial reasons and solely to obtain tax benefits.

6.10 After a business restructuring, the income of Company A is split up among three companies, namely Companies B, C and D. The three companies which are beneficially owned by the same shareholder, Mr. W, qualify for SUTE. The income derived by each qualifying company is equal to the amount of income qualifying for SUTE. Notwithstanding the business restructuring, B, C and D have neither distinct business plans nor operations. The three qualifying companies operate largely as one business with the same pool of sales staff, assets and business premises. The chargeable income for each company is \$300,000 and each company claims SUTE of \$200,000. The total tax payable by the three companies is \$51,000. As a result of the restructuring, there is a reduction in the tax payable of \$68,000.

Tax payable by Companies B, C and D - after restructuring

Aggregated chargeable income of Companies B, C and D (\$300,000 x 3)	\$900,000
<u>Less:</u> Aggregated exempt amount under SUTE (\$200,000 x 3)	\$600,000
Aggregated tax payable @ 17%	\$ 51,000
Reduction in tax payable	\$ 68,000

Change in business form for sole purpose of obtaining tax benefit

- 6.11 The use of a specific business form is a choice exercised by taxpayers based on commercial and business considerations. However, where there is a change in the form of business entity with no valid business reasons, this may suggest that the use of a different form of business entity is intended to exploit a specific tax benefit that is conferred only to that form of business entity.
- 6.12 CIT would consider a number of factors to ascertain if the use of a certain business form amount to tax avoidance falling within the ambit of section 33 of the ITA. Such factors (not exhaustive) include:
- (i) The reason(s) for the change in the form of business entity;
 - (ii) Whether the activities carried out by the new business entity conform to the reason(s) given;
 - (iii) Whether new employees are engaged to support the activities of the new entity;
 - (iv) How the income is attributed before and after the conversion.

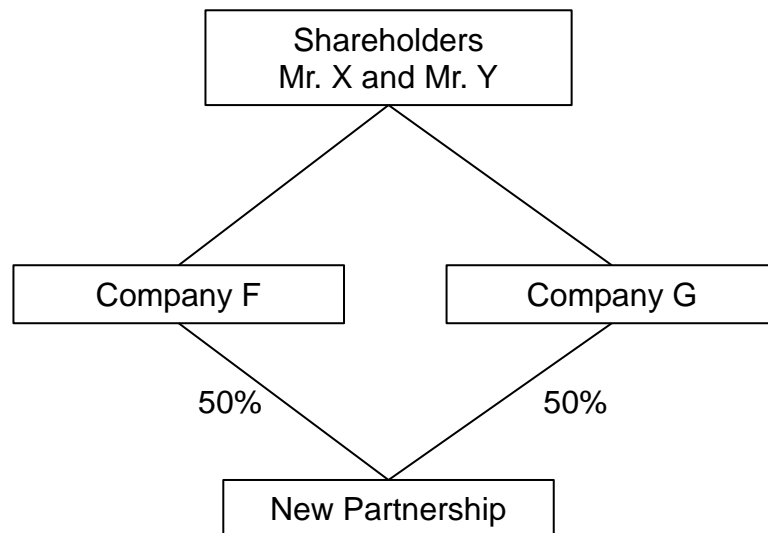
Example 3

6.13 Before restructuring, Mr. X & Mr. Y are the shareholders of Company E. With a chargeable income of \$600,000, the company’s tax payable is \$76,075 after taking into account the exempt amount under PTE.

Tax payable by Company E - before restructuring

Chargeable income	\$600,000
<u>Less:</u> Exempt amount under PTE	
- 75% on first \$10,000	
- 50% on next \$290,000	\$152,500
Tax payable @ 17%	\$ 76,075

- 6.14 Company E carries out a restructuring exercise by transferring all its businesses to a partnership and conducting all its businesses through the partnership with no commercial reasons apart from exploiting the tax benefit under the SUTE scheme. The partners of the partnership are two newly incorporated companies, Companies F and G. Both Mr. X and Mr. Y are shareholders of the two companies.



- 6.15 Both companies F and G meet the conditions to qualify for SUTE. The income of the partnership is taxable in the hands of the corporate partners, Companies F and G. The total tax payable by the corporate partners is \$34,000. As a result of the restructuring, there is a reduction in the tax payable of \$42,075. Furthermore, the corporate partners are able to onward distribute their profits as one-tier tax exempt dividends to the shareholders Mr. X and Mr. Y respectively.

Tax payable by Companies F and G - after restructuring

Aggregated chargeable income (\$300,000 x 2)	\$600,000
<u>Less:</u>	
Aggregated exempt amount under SUTE (\$200,000 x 2)	\$400,000
Aggregated tax payable @ 17%	\$ 34,000
Reduction in tax payable	\$ 42,075

- 6.16 While the arrangement in **Example 3** may legally meet the qualifying conditions for SUTE, CIT would generally regard it as a tax avoidance arrangement within the ambit of section 33(1) of the ITA as it artificially converts a company to a

partnership and exploits the tax benefit under the SUTE scheme by forming newly incorporated companies as partners of the partnership. The main purpose of the restructuring exercise is to reduce income tax.

Example 4

- 6.17 A profitable sole proprietorship converts into a company without any commercial reason and the conversion is solely to avoid being taxed at the higher marginal personal income tax rate as compared to the corporate income tax rate. As mentioned in paragraph 6.12, CIT would consider several factors in determining the applicability of section 33.
- 6.18 Where the conversion is supported by genuine commercial reasons to CIT's satisfaction, CIT would generally not regard such a conversion as constituting tax avoidance under section 33 of the ITA where the tax benefit obtained through the corporatisation is merely incidental. As the sole-proprietor may now be the managing director of the company, the amount of remuneration paid to him should commensurate with his services rendered.

Attribution of income that is not aligned with economic reality

- 6.19 The assignment of income from one person to another person may be regarded as invalid from the tax perspective where the assignment is not supported by any economic basis – e.g. if the party receiving the assignment of income has not done anything to merit a receipt of the income. The factors that CIT would consider to determine if the attribution of income is aligned with economic reality include the type of work done by each party, the amount of work done, and the extent of each party's responsibility in making key decisions in the running of the business.

Example 5

- 6.20 An individual, Mr. Z, who is a sole-proprietor, receives an income of \$100,000 from his client for his services rendered. With a chargeable income of \$300,000, the tax payable by him is \$38,750.

Tax payable by Mr. Z - before assignment of income

Chargeable income of Mr. Z	\$300,000
Tax on the first \$200,000	\$20,750
Tax on the next \$100,000 @ 18%	\$18,000
Tax payable	\$38,750

- 6.21 Mr. Z, who is contractually entitled to receive the income of \$100,000 from his client for services rendered by him, assigned his right to receive that income to a shell company, Company H. Mr. Z is the director and sole shareholder in Company H which meets the conditions to qualify for SUTE. The chargeable income of Mr. Z and Company H is \$200,000 and \$100,000 respectively. The

total tax payable by Mr. Z and Company H is \$20,750. As a result of the assignment of income, there is a reduction in the tax payable of \$18,000.

Tax payable by Mr. Z - after assignment of income

Chargeable income of Mr. Z	\$200,000
Tax payable	\$20,750

Tax payable by Company H – after assignment of income

Chargeable income of Company H	\$100,000
<u>Less:</u> Exempt amount under SUTE	\$100,000
Tax payable @ 17%	\$0

- 6.22 It is not necessary for Mr. Z to set up a company to conduct its business. Besides, the assignment is not in consideration for any service rendered or goods supplied by Company H to Mr. Z. In fact, the assignment is simply meant to reduce the tax liability on that income which is assigned. In this case, the assignment of the income and the setting up of a shell company would likely be regarded as for tax avoidance purposes and the income would be treated as received by and taxable in the hands of Mr. Z.

7 What section 33 is not targeted at

- 7.1 Section 33 is aimed at tax avoidance schemes designed to avoid tax and is not intended to interfere with the tax consequences of genuine commercial transactions. For example, (i) the placement of monies in a local bank or with a bank outside Singapore, (ii) the provision of housing accommodation to employees directly instead of giving a taxable housing allowance or (iii) the non-remittance of foreign income, is not intended to be the subject of the CIT's exercise of his section 33(1) powers.

8 CIT's powers under section 33

- 8.1 The CA in the AQQ case was of the view that section 33(1) expressly provides CIT with wide powers, including the power to impose a liability to tax to counteract any tax advantage arising from the impugned arrangement.
- 8.2 The CA in [126] outlines the postulates that CIT may refer to when seeking to exercise his powers under section 33(1) as follows:
- (i) the tax liability that arises from the inclusion of an income sought to be excluded or the disallowance of a deduction sought to be made;
 - (ii) the hypothetical tax liability on the economic and commercial basis of what would likely have happened if the taxpayer had not entered into the arrangement constituting tax avoidance; and

(iii) the tax liability if the arrangement simply had not taken place.

8.3 CIT will act within the scope of section 33(1) and will exercise his powers (conferred under the section) in a fair and reasonable manner.

9 Contact Information

9.1 If you have any enquiries or need clarification on this e-Tax guide, please email:

- (a) via [myTax Mail](#) (Corporate); or
- (b) se@iras.gov.sg (Individual)