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IRAS e-Tax Guide

Income Tax: The General Anti-Avoidance Provision and its Application (Second Edition)

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The General Anti-Avoidance Provision and its Application

1 Aim

1.1 This e-Tax Guide is issued with three objectives:

(i) First, it sets out the approach adopted by the Comptroller of Income Tax ("CIT") to the construction of the general anti-avoidance provision in section 33 of the Income Tax Act 1947 ("ITA");

(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); and

(iii) Third, it provides details on the imposition of surcharge under section 33A of the ITA and the circumstances under which remission of the surcharge may be considered.

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 <u>not meant to be</u> 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 15[1] ("AQQ case").[2] The CA held at [110] that the "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(7); 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 conduit entity to obtain treaty benefit for the purpose of avoiding withholding tax;

(iii) Assignment of debt to an offshore jurisdiction for the main purpose of obtaining tax advantage;

(iv) Setting up of more than one entity for the sole purpose of obtaining tax advantage;

(v) Change in business form for the sole purpose of obtaining tax advantage; and

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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.

(vi) 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 fulfils the legal requirements of the law but not necessarily the intent of the law[3].

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.

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[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."

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(5) 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,

(ii) Whether the taxpayer may avail himself of the statutory exception under section 33(7); 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 450[4]. 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).

Step 2: Whether the taxpayer may avail himself of the statutory exception under section 33(7)

5.6 Section 33(7) 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(7) 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(7) 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(7), it is necessary to ascertain whether the taxpayer could rely on other specific provisions of the ITA to preclude the operation of section 33.

[4] At [45] of the AQQ case.

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 289[5]. 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 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 of 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) Setting up of conduit entity to obtain treaty benefit for the purpose of avoiding withholding tax;
(iii) Assignment of debt to an offshore jurisdiction for the main purpose of obtaining tax advantage;
(iv) Setting up of more than one entity for the sole purpose of obtaining tax

[5] At [106] of the AQQ case.

[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.

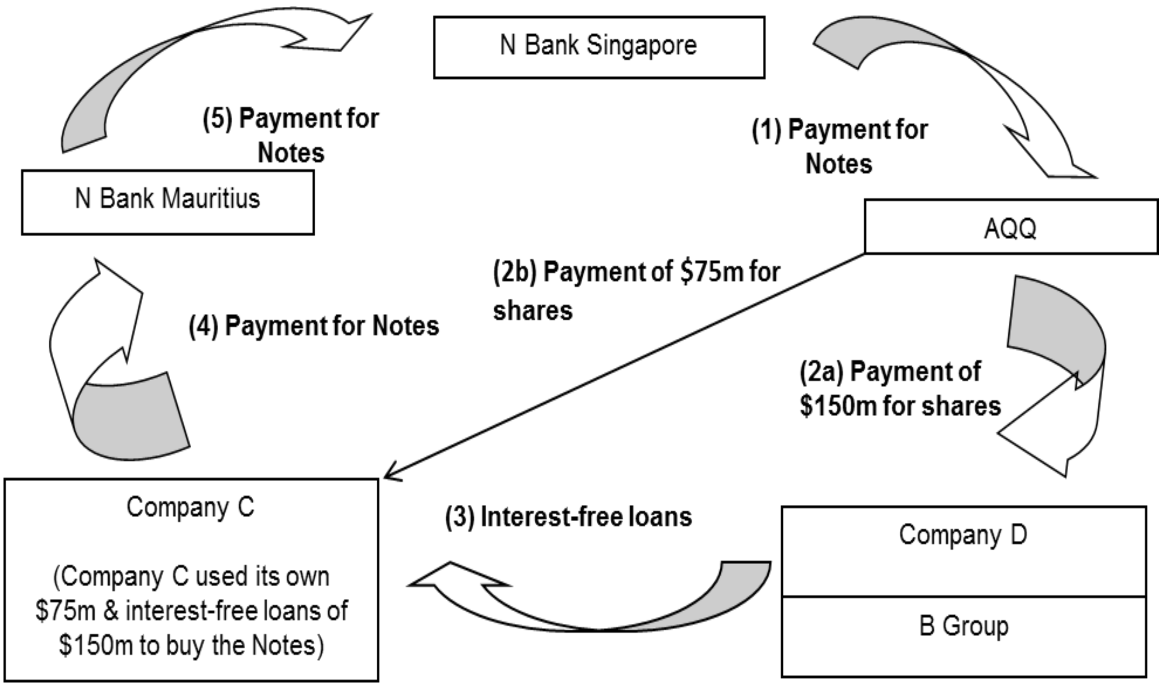
advantage;
(v) Changes in the form of business entity for the sole purpose of obtaining tax advantage; and
(vi) Attribution of income that is not aligned with economic reality.

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.

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.".

<u>Setting up of conduit entity to obtain treaty benefit for the purpose of avoiding withholding tax</u>

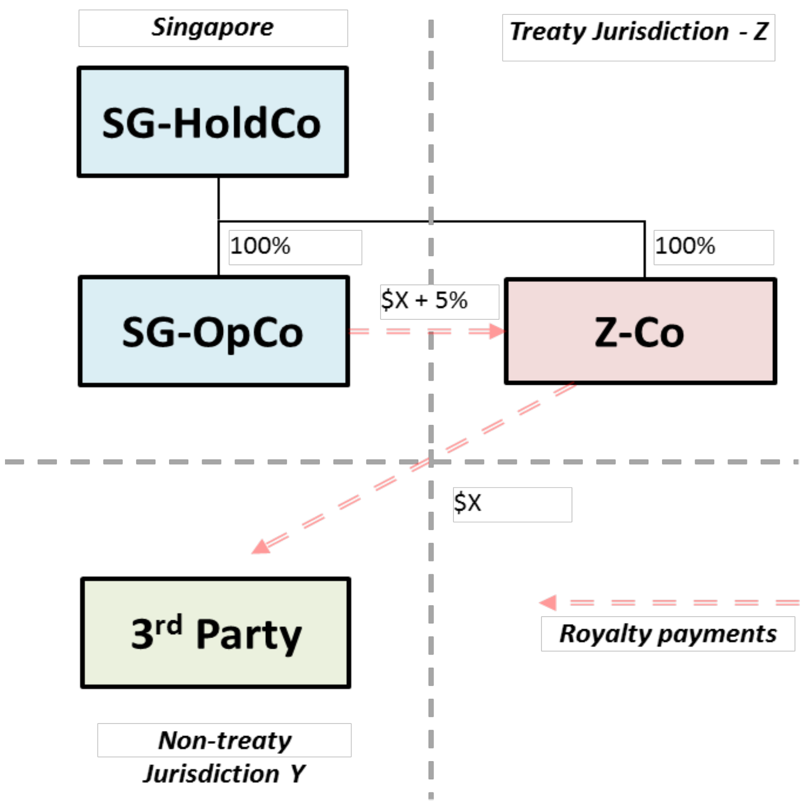
6.7 Only residents of a contracting state are entitled to benefits under an income tax treaty. Taxpayers who are residents of a jurisdiction with no tax treaty with Singapore ("non-treaty jurisdiction") may seek to obtain the benefits of a tax treaty between Singapore and a treaty jurisdiction by organizing a legal entity in the latter to serve as a conduit for income earned in Singapore. This practice is commonly referred to as treaty shopping.

6.8 CIT regards the setting up of a conduit entity to obtain tax treaty benefits that would otherwise not be available to the taxpayer (i.e. treaty shopping) as tax avoidance. In determining whether the setting up of an entity in a treaty jurisdiction constitutes treaty shopping, CIT would consider the following factors (not exhaustive):

(i) the commercial reason for setting up the entity in the treaty jurisdiction;
(ii) the functions performed, assets owned and risks assumed by the entity;
(iii) the work done by the employees and directors of the entity;
(iv) whether the entity had any contractual obligation to onward pay the income received from Singapore;
(v) the actual fund flow; and
(vi) the rights or control over the use of the income concerned by the entity.

<u>Example 2</u>

6.9 SG-OpCo intends to enter into a licensing arrangement for intellectual property ("IP") rights with a third party who is resident in a non-treaty jurisdiction (Y). Under the licensing arrangement, SG-OpCo has to bear the withholding tax of 10% on the royalty payments. To avoid the Singapore withholding tax, SG-HoldCo sets up a subsidiary (Z Co) in a treaty jurisdiction (Z). The SG-Z treaty provides for 0% withholding tax on the royalty paid by a Singapore resident to an entity resident in jurisdiction Z. Z Co then enters into a licensing arrangement for the IP rights with the third party in jurisdiction Y and sub-licenses the same IP rights to SG-OpCo with a mark-up of 5%. There is no withholding tax on outbound royalty payments in jurisdiction Z and Z Co enjoys a low domestic tax rate on the net royalty income. The group structure and the flow of royalty payments are represented diagrammatically below.



6.10 Z Co has no office premises or employees in jurisdiction Z. It has no other business activities besides being the intermediary between SG-OpCo and the third party in the back-to-back licensing arrangement. The contract negotiation with third party and invoicing of the royalty payments are performed by SG-HoldCo for which Z Co pays a management fee to SG-HoldCo.

6.11 CIT will generally regard the set-up in **Example 2** above as a tax avoidance arrangement within the ambit of section 33(1) of the ITA as the main purpose of the back-to-back licensing arrangement is to avoid the Singapore withholding tax and reduce SG-OpCo's income tax. Z Co is a conduit which seeks to obtain the treaty benefit (i.e. 0% withholding tax on royalty payments) between Singapore and jurisdiction Z which would otherwise not be available to SG-OpCo. The arrangement has also resulted in the shifting of profit from SG-OpCo to Z Co through the inflated deduction claim on royalty expenses with the 5% mark-up. Without the back-to-back licensing arrangement, SG-OpCo would be paying the royalty expenses (without the 5% mark-up) to the third party in jurisdiction Y. CIT will deny the claim for deduction on the mark-up of 5% of the royalty expense. As there is no tax treaty between jurisdiction Y and Singapore, the royalty payments would be subject to withholding tax.

Assigning debt securities to an offshore jurisdiction for the main purpose of obtaining tax advantage

6.12 CIT regards the assignment of debt securities (and the associated rights to interest income) to an offshore jurisdiction, which would not have been carried out if not for the purpose of reducing or avoiding tax, as a tax avoidance arrangement. This is usually designed in a corporate group structure to obtain a tax deduction on interest expense incurred on the assigned debt securities while reducing/avoiding tax on the interest payments by assigning such receipts to an offshore jurisdiction.

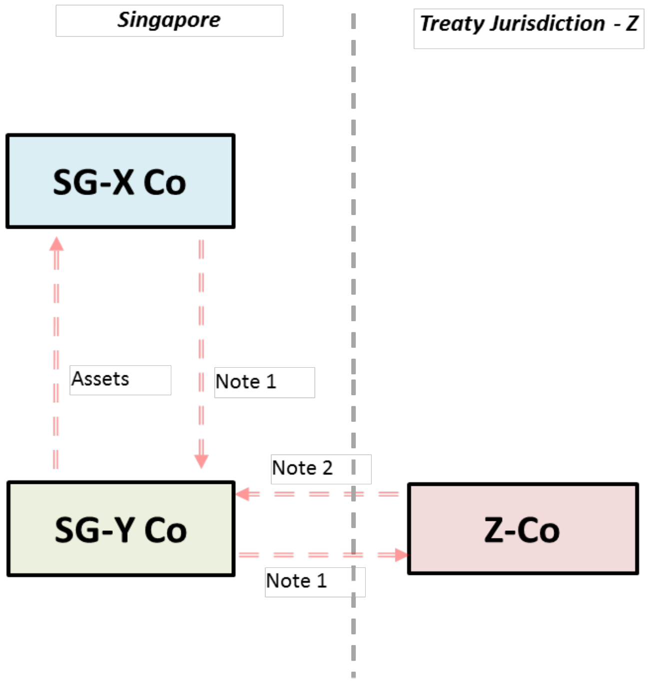
6.13 In determining whether the assignment of debt securities constitutes tax avoidance, CIT would consider the following factors (not exhaustive):

(i) the commercial reason for the assignment of debt securities;
(ii) the consideration received by the assignor and whether it is of equal worth to the market value of the assigned debt securities;
(iii) the functions performed, assets owned and risks assumed by the assignee;
(iv) the actual flow of funds;
(v) whether the assignee had any contractual obligation to onward pay the interest income received from Singapore; and
(vi) the rights or control over the use of the interest income by the assignee.

Example 3

6.14 SG-X Co, SG-Y Co and Z-Co are all related companies of a corporate group. Under a business restructuring arrangement, SG-X Co acquires business assets from SG-Y Co and in return SG-Y Co receives an interest-bearing note at 8% p.a. (i.e. Note 1) from SG-X Co. Under section 14(1)(a) of the ITA, SG-X Co can claim interest deductions on Note 1 as the transferred assets will be used in the production of its income. SG-Y Co subsequently assigns Note 1 to Z-Co in return for Note 2. While the principal amounts and interest rates of Note 1 and Note 2 are the same, their interest payment terms differ. In particular, interest on Note 1 is payable on a monthly basis while interest on Note 2 is not payable until notice is given by the noteholder (SG-Y Co).

The group structure and the transfer of assets and issuance of Note 1 and Note 2 are represented diagrammatically below.



6.15 Z-Co is the intermediate holding company of SG-Y Co. Z-Co has no employees as it makes use of the financial expertise of its own holding company in running its business. There is no remuneration paid to the holding company for services rendered. Z-Co has no other investment except for the investment in SG-Y Co. The corporate group gives the reason why Note 1 is assigned to Z-Co in exchange for Note 2 is to provide funding for Z-Co's future investments. However, in fact, Z-Co did not acquire any other investments.

6.16 Based on the above facts, CIT regards the assignment of Note 1 to Z-Co in return for Note 2 as a tax avoidance arrangement. The assignment has effectively altered the incidence of tax on interest income from Note 1 from SG-Y Co to Z Co. Under the tax treaty between Singapore and jurisdiction Z, withholding tax is not payable on the interest payments made to Z-Co. Jurisdiction Z imposes a very low tax rate on the interest income of Z-Co. SG-Y Co is not liable to tax on the interest income on Note 2 as no notice of payment has been given by SG-Y Co and therefore interest is not due and payable. Effectively, the assignment of Note 1 in return for Note 2 has allowed the corporate group to enjoy interest deduction via SG-X Co and avoid paying tax on the corresponding interest income in Singapore. CIT will subject the interest income to tax in SG-Y Co.

<u>Setting up of more than one entity for the sole purpose of obtaining tax advantage</u>

6.17 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 Companies[7] ("SUTE") or partial tax exemption ("PTE") scheme.

6.18 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 nature of business and locations;
(iii) extent of change in the decision-making process; and
(iv) whether the entities operate out of the same premises, share the same assets and have the same pool of staff who participate in the day-to-day operations.

<u>Example 4</u>

6.19 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 $131,750 after taking into account the exempt amount under SUTE.

<u>Tax payable by Company A - before restructuring</u>

Chargeable income of Company A	$900,000
<u>Less</u>: Exempt amount under SUTE - 75% on first $100,000 - 50% on next $100,000	$125,000
Tax payable @ 17%	$131,750

6.20 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

[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 a 75% tax exemption on the first $100,000 normal chargeable income and a further 50% exemption on the next $100,000 of the normal chargeable income for each of the first 3 consecutive years of assessment. The SUTE scheme 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.

restructuring, Companies 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 $125,000. The total tax payable by the three companies is $89,250. As a result of the restructuring, there is a reduction in the tax payable by $42,500.

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
Less: Aggregated exempt amount under SUTE ($125,000 x 3)	$375,000
Aggregated tax payable @ 17%	$ 89,250
Reduction in tax payable	$ 42,500

6.21 As the business operations of Companies B, C and D have largely remained the same as that of Company A prior to restructuring and there are no valid commercial reasons to form the three companies, the income received by the three companies (i.e. B, C and D) would be regarded as originated from the same set of operations. As such, CIT views the splitting of income into multiple companies (i.e. from A to B, C and D) as artificial and contrived. The purpose is to gain an undue tax advantage from additional exemption under the SUTE scheme which would not be obtainable without the arrangement.

Change in business form for sole purpose of obtaining tax benefit

6.22 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.

6.23 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.

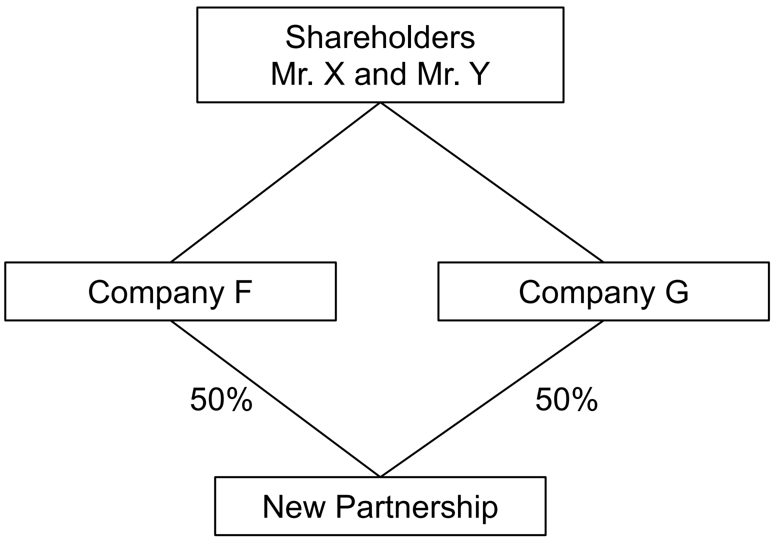
Example 5

6.24 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 $84,575 after taking into account the exempt amount under PTE.

Tax payable by Company E - before restructuring

Chargeable income	$600,000
Less: Exempt amount under PTE - 75% on first $10,000 - 50% on next $190,000	$102,500
Tax payable @ 17%	$84,575

6.25 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.



6.26 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 $59,500. As a result of the restructuring, there is a reduction in the tax payable of $25,075. 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
Less: Aggregated exempt amount under SUTE ($125,000 x 2)	$250,000
Aggregated tax payable @ 17%	$ 59,500
Reduction in tax payable	$ 25,075

6.27 While the arrangement in **Example 5,** legally, may 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. This is because 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 6

6.28 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 6.23, CIT would consider several factors in determining the applicability of section 33.

6.29 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

6.30 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 – for example, 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 7

6.31 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 $40,550.

Tax payable by Mr. Z - before assignment of income

Chargeable income of Mr. Z	$300,000
Tax on the first $280,000 Tax on the next $20,000 @ 20%	$36,550 $4,000
Tax payable	$40,550

6.32 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 $25,400. As a result of the assignment of income, there is a reduction in the tax payable of $15,150.

Tax payable by Mr. Z - after assignment of income

Chargeable income of Mr. Z	$200,000
Tax payable	$21,150

Tax payable by Company H – after assignment of income

Chargeable income of Company H	$100,000
Less: Exempt amount under SUTE - 75% on first $100,000	 $75,000
Tax payable @ 17%	$4,250

6.33 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 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. If CIT determines that an arrangement falls within section 33 of the ITA, CIT will make a section 33 adjustment to counteract the tax advantage. If the taxpayer disagrees, the taxpayer can appeal to the Income Tax Board of Review ("ITBR"). The taxpayer can appeal against the ITBR's decision further up to the High Court (General Division) and thereafter to the High Court (Appellate Division).

9. Section 33A Surcharge

9.1 This section explains the surcharge under section 33A that will be applicable with effect from YA 2023.

9.2 The surcharge under section 33A applies if an arrangement falls within the provisions of section 33 and CIT makes an adjustment to counteract the tax advantage resulting in any tax or additional tax being assessed on the taxpayer. The surcharge is computed based on 50% of the tax or additional tax arising from tax adjustment made under section 33 of the ITA.

9.3 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 year of assessment, the surcharge would apply. In other words, the surcharge under section 33A is also applicable to tax avoidance arrangements entered into before the basis period for YA 2023. However, the surcharge is imposed only on any tax or additional tax arising from adjustment made under section 33 for YA 2023 or any subsequent YA.

How the surcharge will be imposed

9.4 The following are some scenarios where the section 33A surcharge will be imposed:

Example 8

9.5 Company A engages in an avoidance arrangement. Company A submits its income tax computation with tax payable for YA 2023.

Following a review, CIT invokes section 33 of the ITA and makes a section 33 adjustment to the YA 2023 tax computation which results in an additional tax of say, $X for Company A. A section 33A surcharge at 50% of $X will be imposed for YA 2023.

Example 9

9.6 Company B engages in an avoidance arrangement and elected loss carry back ("LCB") relief.

Company B submits its income tax computation with a current year adjusted loss for YA 2023. Company B elects for LCB relief under section 37D of the ITA to utilise the adjusted loss from YA 2023 to set off its chargeable income in YA 2022. There are no other unabsorbed capital allowances or donations in YA 2023.

Following a review, CIT invokes section 33 and makes a section 33 adjustment to reduce the current year adjusted loss in YA 2023. Consequently, the LCB will be reduced, resulting in an additional chargeable income for YA 2022. A section 33A surcharge will be imposed on the additional tax for YA 2022 as a result of the section 33 adjustment made in YA 2023.

Example 10

9.7 Company C engages in an avoidance arrangement and utilises the unabsorbed loss in the following YA.

Company C submits its income tax computation with an unabsorbed loss carried forward for YA 2023. There are no other unabsorbed capital allowances or donations in YA 2023. For YA 2024, the income tax computation submitted shows a chargeable income after utilising the unabsorbed loss brought forward from YA 2023.

Following a review, CIT invokes section 33 of ITA and makes a section 33 adjustment to YA 2023 which reduces the unabsorbed loss carried forward. Consequently, the unabsorbed loss available for set off in YA 2024 is reduced and results in an additional chargeable income and additional tax for YA 2024.

A section 33A surcharge will be imposed for YA 2024 but no surcharge will be imposed for YA 2023 as there is no additional tax arising from the section 33 adjustment.

Example 11

9.8 Company D engages in an avoidance arrangement and elected to transfer current year loss under the group relief ("GR") system.

Company D submits its tax computation with a current year adjusted loss for YA 2023. Company D (i.e. transferor company) elects for the GR claim to transfer the loss to its subsidiary, Company E (i.e. claimant company), thereby reducing its chargeable income for YA 2023. There are no other GR claims available or made by Company E.

Following a review on the transferor company, Company D, CIT invokes section 33 of the ITA and makes a section 33 adjustment to reduce the current year adjusted loss for YA 2023. Consequently, the GR claim is reduced. This results in an additional chargeable income and additional tax in the claimant company, Company E for YA 2023. A section 33A surcharge will be imposed on the transferor company, Company D for YA 2023 based on the additional tax payable by Company E. No surcharge will be imposed on the claimant company, Company E.

Remission of section 33A surcharge

9.9 Section 33A surcharge is imposed on the tax payable/ additional tax payable arising from the section 33 adjustments. CIT, may, for good cause, remit the surcharge wholly or in part.

9.10 No remission of the section 33A surcharge would be considered if the section 33 adjustment arose from an audit or review by IRAS.

9.11 IRAS will only consider **partial** remission of the section 33A surcharge for taxpayers that come forward with timely self-initiated disclosure of their tax avoidance arrangements and meet the following conditions:

(i) Have been cooperative and have provided responses and required documentation within the timeline set by IRAS; and

(ii) Have good compliance records for the current YA and immediate two preceding YAs at the time of imposition of section 33A surcharge in terms of:
   - prompt submission of returns and payment of tax by the due dates; and
   - no records of imposition or composition of penalties.

9.12 The disclosure of tax avoidance arrangement by a taxpayer is considered timely and self-initiated only when it is made before the taxpayer receives an IRAS' notification on the commencement of audit/ review/ investigation relating to the transaction(s) involved in the tax avoidance arrangement. A mere mention of the transaction/ arrangement in the tax return without specific details will not be considered as a self-initiated disclosure. Instead, taxpayers should notify IRAS in writing of the specific tax avoidance transaction or arrangement, providing details of the entities/

transaction/ arrangement for the disclosure to be regarded as a self-initiated disclosure for which a partial remission of the section 33A surcharge could be considered.

9.13 For any self-initiated disclosure made within two years from the tax return filing due date, a remission of up to 50% on the section 33A surcharge imposed may be considered (i.e. section 33A surcharge will be 25% x tax payable/ additional tax payable).

9.14 For any self-initiated disclosure made after two years from the tax return filing due date, a remission of up to 20% on the section 33A surcharge imposed may be considered (i.e. section 33A surcharge will be 40% x tax payable/ additional tax payable).

Example 12 - how the two-year grace period is applied

Assuming a section 33 arrangement has been in place since YA 2023. A self-initiated disclosure is made in Jun 2027 in respect of the assessments for YA 2023 to YA 2026.

Up to 50% of the section 33A surcharge may be remitted in respect of the section 33 adjustments made to the YA 2025 and YA 2026 assessments and up to 20% of the section 33A surcharge may be remitted in respect of the section 33 adjustments made to the YA 2023 and YA 2024 assessments.

Payment of surcharge

9.15 Notwithstanding any objection to the section 33 adjustment, the section 33A surcharge must be paid within one month after the date of the written notice of the section 33A surcharge is served.

10. Contact Information

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

(a) ctmail@iras.gov.sg (Corporate); or
(b) se@iras.gov.sg (Individual)

11 Updates and Amendments

	Date of amendment	Amendments made
1	31 Mar 2023	Inserted new tax avoidance categories and examples in section 6: • Setting up of conduit entity to obtain treaty benefit for the purpose of avoiding withholding tax • Assignment of debt to an offshore jurisdiction for the main purpose of obtaining tax advantage Inserted section 9 on section 33A surcharge