

CIRCULAR

INCORPORATION OF COMPANIES BY MEDICAL PROFESSIONALS AND RELEVANT TAX IMPLICATIONS

By IRAS

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Disclaimer:

The guidelines and accompanying examples in this circular are not exhaustive. The Comptroller of Income Tax (CIT) may update this circular with new guidelines and examples of arrangements where necessary.

For the avoidance of doubt, arrangements that are not covered within this circular should not be taken as definitely falling outside the ambit of section 33(1) of the Income Tax Act (ITA) and acceptable to the CIT.

All names used in the examples in this circular are fictitious. Any resemblance to actual persons is entirely coincidental.

1. Objective of the Circular

- 1.1. IRAS conducts regular audits on different groups of taxpayers and will educate taxpayers on common mistakes and appropriate tax treatments. Through our audits, IRAS has encountered medical practices with business arrangements that are considered to be set-up for tax avoidance.
- 1.2. This circular explains the concept of tax avoidance and its legal consequences, and provides case studies to illustrate common business arrangements in the medical industry that may give rise to tax avoidance concerns. It also lays out IRAS's approach in dealing with such business arrangements.

2. Background

- 2.1. Many medical professionals in private practice earn income which is largely derived from the provision of their personal services. IRAS has through its audits observed medical professionals incorporating one or more companies to manage their practice and receive this income.
- 2.2. In some cases, there were little or no commercial reasons for the set-up of companies and the arrangement allowed the taxpayer to reap the following tax advantages:
 - i. An overall lower effective tax rate due to a lower corporate income tax rate versus the higher marginal personal income tax rate

The highest marginal personal income tax rate is 22% (since Year of Assessment (YA) 2017) while the corporate income tax rate is 17% (since YA 2010). Corporatizing one's personal business may allow one to benefit from the lower corporate tax rate.

- ii. Corporate tax exemptions and rebates ¹

Companies are eligible to enjoy lower tax rates under the Start-up Tax Exemption Scheme and Partial Tax Exemption Scheme, which are schemes introduced to encourage entrepreneurship. Companies may also receive tax rebates in some years. Artificially splitting income earned from one source or a set of operation into several companies may allow one to unduly benefit from multiple sets of tax exemptions and rebates. In some cases, businesses re-incorporate themselves every three years so that they can continuously take advantage of the start-up tax exemption, which only applies to companies in their first three YAs.

- 2.3. There were also cases where the set-up of a company was supported by commercial reasons, but the remuneration paid to the medical professional performing the bulk of the services was not aligned with market value of similar services. This resulted in an over-

¹ Details can be found at www.iras.gov.sg. *Home > Businesses > Companies > Learning the basics of Corporate Income Tax > Corporate Tax Rates, Corporate Income Tax Rebates and Tax Exemption Schemes*

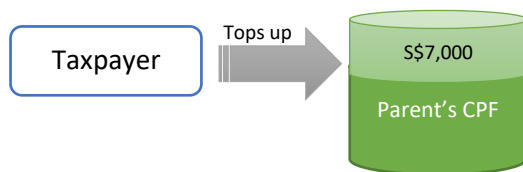
attribution of income to the company (which is taxed at the lower corporate tax rate), and an under-attribution of income to the medical professional (who would otherwise have been taxed at the higher marginal personal income tax rate).

- 2.4. While taxpayers have the prerogative to determine the structure of their businesses, obtaining a tax advantage cannot be one of the main purposes of the chosen arrangement. The act of structuring one's business into an arrangement which has little or no bona fide commercial reasons and which provides substantial tax reduction is tax avoidance. IRAS evaluates whether there are valid commercial reasons for the corporatization and whether the remuneration policy of personnel within the business is aligned with economic reality. Where IRAS is of the view that the taxpayer has arranged its business with an intention to avoid tax, IRAS will apply Section 33² of the Income Tax Act, a general anti-avoidance provision, to negate any undue tax advantage obtained by the taxpayer.

3. Tax Avoidance and its legal consequences

- 3.1. Some taxpayers may seek to minimize their tax liability through tax planning, a legitimate process of structuring a transaction or series of transactions to minimize one's tax liability within the intent of the income tax law.

Example of Tax Planning

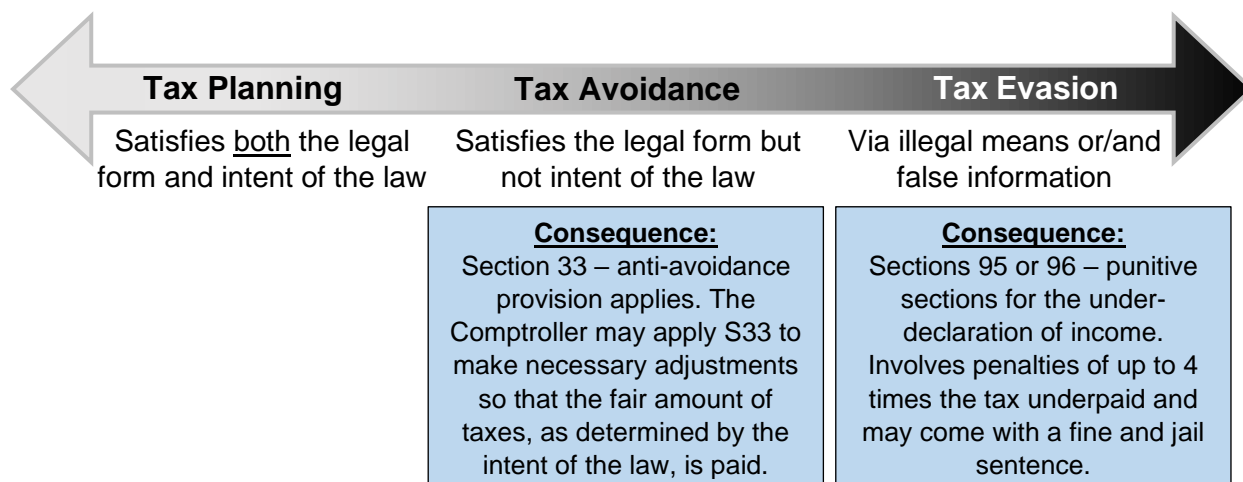


Alan, a taxpayer, gives his mother a monthly allowance. After he gets to know about the CPF top-up relief, Alan decided that instead of giving a monthly cash allowance to his retired mother, he would perform a cash top-up of \$7,000 into his mother's CPF account which was below the minimum sum requirement. In doing so, Alan was able to enjoy an additional \$7,000 in tax relief for the CPF top-up the following year. This is considered as legitimate tax planning as the action of topping-up his parent's CPF account is aligned with the objective of encouraging children to support their parents in retirement.

- 3.2. Tax avoidance, on the other hand, involves an arrangement that is artificial, contrived or has little or no commercial substance, and is designed for the main purpose of obtaining a tax advantage not intended by Parliament. Tax evasion is the opposite of tax planning and is against the law.

² Section 33 of the Singapore Income Tax Act is a general anti-tax avoidance provision which was enacted to address tax avoidance arrangements in Singapore. Section 33 empowers the Comptroller of Income Tax to disregard or adjust, for tax purposes, arrangements which are carried out with tax avoidance as one of their main purposes and not for bona fide commercial reasons.

3.3. The following diagram depicts the spectrum of tax minimization activities and the corresponding consequences:



4. How does IRAS determine if tax avoidance has taken place?

The Court of Appeal's Three-Step Approach

4.1. The legal principles behind the determination of tax avoidance are encased in Section 33 of the Singapore Income Tax Act, and has been set out in case law. IRAS adopts the following 3-step approach laid out by the Court of Appeal in **CIT v AQQ [2014] SGCA 15**:

- 1) Consider whether an arrangement prima facie falls within any of the three threshold limbs of S33(1) such that the taxpayer derives a tax advantage. A tax advantage is deemed to have arisen if the objective of the arrangement was:
 - a) To alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;
 - b) To relieve any person from any liability to pay tax or to make a return under this Act; or
 - c) To reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act,
- 2) If such a tax advantage had been derived. consider whether the taxpayer may fall under the statutory exception in s 33(3)(b); and if not,
- 3) Ascertain whether the tax advantage obtained was due to a specific provision in the ITA that was within the intended scope and Parliament's contemplation and purpose, both as a matter of legal form and economic reality within the entire agreement's context.

In this section, each of the steps above is explained in detail, and is reinforced with IRAS's perspective as well as illustrative examples.

Step 1: Consider whether, objectively, an arrangement falls within any of the three threshold limbs of section 33(1)(a)-(c) of the ITA such that the taxpayer has derived a tax advantage.

4.2. IRAS will examine the arrangement to determine whether there has been a reduction in tax liability by comparing it with the original arrangement, or an alternative that is simpler or more straightforward.

Illustration 1.1

- 4.3. Dr Bob has been operating a general practice through his sole proprietorship, Bob Clinic since 2010. He is the sole doctor and did not employ any staff. In 2015, he incorporated a company Bob General Clinic Pte Ltd even though there was no change in business operations. The corporatisation of the business resulted in an overall reduction in the income tax payable by Dr Bob and his company from 2015. Therefore, this arrangement falls within the three threshold limbs of Section 33(1)(a)-(c).
- 4.4. **Step 2:** *Consider whether the taxpayer may avail himself of the statutory exception under section 33(3)(b) of the ITA, i.e. the arrangement must have been carried out for bona fide commercial reasons ('bona fide commercial condition') and must not have had as one of its main purposes the avoidance or reduction of tax ('main purpose condition');*
- 4.5. In evaluating Step 2, IRAS will seek to understand the following from the company through fact-finding:
- Why was the company incorporated;
 - What functions are performed by the company and by whom. Examples of functions performed by the company could include providing manpower to the business, providing a place of operation, managing contracts for the business;
 - Whether the company is well-capitalized and owns/utilizes substantial assets necessary for the operations;
 - Whether any risks are undertaken by the company e.g. contractual risks, risks associated with the workplace or with employment matters; and
 - Whether arm's length remuneration was received by director/doctor for the services that he/she has provided.
- 4.6. The amount of functions performed, assets owned/utilized, and risks assumed by the company are factors generally used to ascertain whether there are bona fide commercial reasons for the incorporation. The role of the company in the business is considered when determining if the avoidance or reduction of tax was a main purpose for the business arrangement.
- 4.7. "Bona fide commercial reasons condition"
- To evaluate if there are adequate bona fide commercial reasons behind the business arrangement, the taxpayer will be asked to explain how the use of a company structure may be necessary in the furtherance of the business. IRAS will evaluate the reasons provided based on all objective evidence available, such as the testimony of the parties involved or drawing requisite inferences from the surrounding facts, to substantiate that the taxpayer has pursued or attempted to pursue the said course of business.
- 4.8. "Main purpose condition"
- Any tax reduction must be an incidental outcome and not one of the main purposes of the arrangement. If the amount of tax reduced is substantial versus the commercial advantages or reasons for using the arrangement, then tax reduction may be considered as one of the main purposes for the arrangement.
- 4.9. **Both** conditions must be satisfied to avail oneself of the S33(3)(b) exception.

Illustration 1.2

- 4.10. In the same year, Dr Bob's business grew substantially such that he decided it was necessary to hire one or two staff to support him in his existing practice. As an employer, there were obligations to be fulfilled under the Employment Act. With the addition of staff, the clinic would need to conform to the Workplace Safety and Health Act. The company served to insulate Dr Bob from personal liability from employee related responsibilities, shielding him against litigation risks. Dr Bob continued to pay himself an arm's length remuneration and director fees for his stewardship of the company.
- 4.11. In this case, Bob General Clinic Pte Ltd acted as an employer and bore responsibilities and risks associated with the workplace. These may be considered to be bona fide commercial reasons for using the company to manage the business. Dr Bob had paid himself an arm's length remuneration that was taxable in his personal capacity at a higher income tax rate than the corporate tax rate. As such, it is unlikely that one of the main purposes of the arrangement was the reduction of taxes payable. Both the "Bona Fide Commercial Reasons Condition" and the "Main Purpose Condition" are satisfied, and Dr Bob would be able to avail himself of the S33(3)(b) exception.
- 4.12. **Step 3:** *Ascertain whether the taxpayer has satisfied the court that the tax advantage obtained was within Parliament's contemplation and purpose. In this case, Sections 43(6) and 43(6A) were enacted by Parliament to encourage enterprise risk-taking, help enterprises grow, and allow them to plough back more of their profits into their business to explore growth opportunities.*

Illustration 1.3

- 4.13. In this illustration, Bob General Clinic Pte Ltd has satisfied the "bona fide commercial reasons" condition and the "main purpose" condition i.e. Step 2, hence contemplating Step 3 is unnecessary. For completeness, however, the following depicts how IRAS considers Step 3:

Dr Bob envisioned that he would set up a chain of General Practices all over Singapore. As a result, Dr Bob did not declare dividends from Bob General Clinic Pte Ltd, retaining earnings in the company. These earnings were re-invested to set up other General Practices or take over other clinics. The clinics employed some medical doctors and they were paid a remuneration that was derived based on market practices.

In this example, Dr Bob demonstrated that the growth and incorporation of Bob General Clinic Pte Ltd from its sole-proprietorship entity had satisfied Parliament's intent under Sections 43(6) and 43(6A) to encourage entrepreneurship and support growth in Singapore businesses³.

Illustration 2

- 4.14. Dr Tom is a medical locum, providing his services to various general practices on an ad-hoc basis. In 2015, Dr Tom incorporated a company Tom Pte Ltd. Notwithstanding that the locum fees of \$400,000 per year received from the general practices were for the provision of Dr

³ See Parliamentary debate on the Income Tax (Amendment) Bill, dated 17 November 2004 and 2001 Budget Speech by Dr Richard Hu (Minister for Finance, as he was then), dated 23 February 2001

Tom's personal services, Dr Tom treated the income as earned by Tom Pte Ltd, paying himself only a nominal salary from Tom Pte Ltd.

- 4.15. Tom Pte Ltd. has no operating business premises, owns one computer and does not employ any other staff. Dr Tom's reasons for incorporating Tom Pte Ltd was that a company, being a separate legal entity would indemnify him from any malpractice suits as such legal actions would be taken against the company (with limited liability).
- 4.16. Did Dr Tom set out to avoid tax and can S33 of the ITA be invoked to counteract any tax avoidance?
- 4.17. **Step 1:** The locum fees paid to Dr Tom were for his personal services. Prior to the incorporation of Tom Pte Ltd, these fees were reported by Dr Tom in his personal income tax returns. After incorporation, Dr Tom 'assigned' the income meant for himself to his company.
- 4.18. Without the arrangement, the service fees would have been taxed in Dr Tom's name and subjected to individual tax rate of up to 22%. Conversely, with the arrangement, the locum fees enjoyed full tax exemption (of up to \$200,000) and the residual income were subjected to the corporate tax of 17%. The arrangement has resulted a reduction in Dr Tom's overall tax liability.
- 4.19. **Step 2.1: "Bona fide commercial reasons condition"**

Dr Tom cited personal protection from malpractice as a commercial reason for providing his services through Tom Pte Ltd. This is not a valid reason as the company's separate legal entity status offers scant protection for Dr Tom. It does not prevent an aggrieved patient from taking personal action against him for medical malpractice or negligence, notwithstanding that the service was said to have been provided via a company. Dr Tom, as a locum or a freelance doctor of the medical clinic, does not have to assume any other business risks e.g. fire or equipment failure.

- 4.20. **Step 2.2: "Main purpose condition"**

Tom Pte Ltd is effectively a shell company with little and no substance as it has no functions other than operating a bank account to receive income, has minimal assets and no staff. With little or no commercial purpose for its existence, it would be regarded as having been incorporated for the main purpose of receiving the service fees so that start-up tax exemption can be exploited to reduce Dr Tom's tax liability.

- 4.21. Since the above 2 conditions cannot be met, Dr Tom cannot avail himself to the statutory exception under S33(3)(b) unless Step 3 is met.
- 4.22. **Step 3:** Given that Dr Tom has failed Step 2, it is necessary to ascertain if the tax advantage obtained was within Parliament's contemplation and purpose, both in terms of legal form and economic reality within the context of the entire arrangement.
- 4.23. The tax advantage arose from provisions in the Income Tax Act which provided a tax benefit for newly incorporated companies. The start-up tax exemption, under Section 43(6A), was introduced as 'part of Government's efforts to encourage entrepreneurship'. In Dr Tom's case, there was no entrepreneurship exhibited through the incorporation of Tom Pte Ltd since Dr Tom provided the same services before and after the incorporation. In fact, Tom Pte Ltd. did not serve any additional purpose apart from receiving the service fees earned by Dr Tom in his personal capacity.

4.24. Having applied the 3 steps above, IRAS concluded that the arrangement may be caught under S33(1)(a) and/or (c) of the ITA, and that the statutory exception under Section 33(3)(b) of the ITA is unlikely to apply to the arrangement. As such, the Comptroller of Income Tax exercised his powers to vary the arrangement, i.e. to disregard the company structure and assess the locum fees in Dr Tom's individual name. The income earned by Dr Tom will be taxed in his personal capacity. Any corporate tax assessments previously imposed on the company will be revised to zero and any corporate tax paid will be used as credit to offset the additional taxes payable by Dr Tom.

5. Common Arrangements in Tax Avoidance

5.1. Lower corporate tax rates and corporate tax exemption schemes have led to companies being used as vehicles in tax avoidance arrangements. Frequently used arrangements typically involve

- a) the shifting of income derived mainly from one's personal efforts or skills to a company;
- b) the artificial splitting of income through the incorporation of multiple companies;
- c) the artificial re-incorporation of the same business;
- d) attribution of income between company and individual not aligned with economic reality.

(a) Shifting of income derived mainly from one's personal efforts or skills to a company

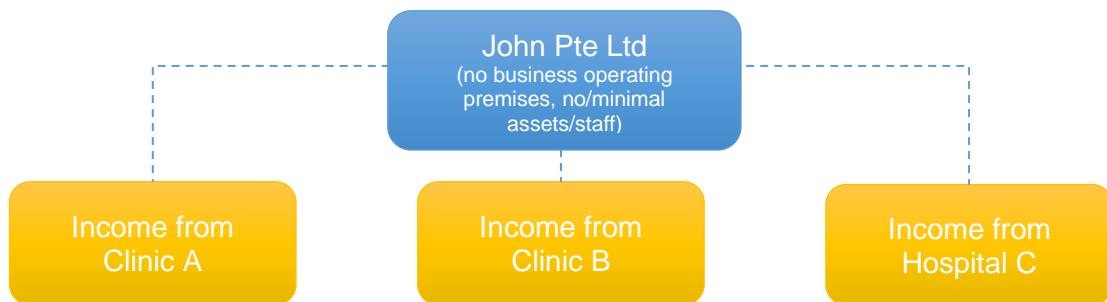
5.2. For businesses where the company's income is predominantly derived from the provision of personal services by an individual and the company has one or more of the following characteristics:

- Performs no or limited function(s) (e.g. other than to receive revenue from services rendered by the medical professional)
- Requires minimal asset(s)
- Has no staff who participates in the day-to-day operations of the company
- Does not operate out of a premise
- Bears little or no risk of its own (e.g. business risk such as litigation due to accidents happen in the clinic)

the incorporation of the company may be considered to have little or no bona fide commercial reasons. Where such an arrangement results in a reduction in tax, it would likely be inferred to have been undertaken with the main purpose of obtaining a tax advantage.

5.3. In such instances, the income will be taxed in the hands of the person providing the services notwithstanding that income has been accounted for under the corporate entity. Please refer to the case studies below for illustration.

Case Study 1



- 5.4. Dr John is an anaesthetist who has provided anaesthetic and sedation services to clinics and hospitals since 2010. In 2013, Dr John set up John Pte Ltd to receive income earned from the services provided by Dr John. There was no change to how Dr John provided his services after the incorporation of John Pte Ltd, except that invoices were now issued in the company's name. John Pte Ltd had no other employees. The company owned a small amount of equipment which Dr John used in the course of his work. The company did not provide any other support to Dr John, who continued to be the sole person providing all the sedation services, as well networking and marketing to promote his services.
- 5.5. Dr John rented a room in another unrelated clinic, which was shared amongst a group of anaesthetists. The room was primarily used as an administrative office since anaesthetic and sedation services were not provided in these premises, but instead at clinics and hospitals. The cost of the clinic's staff, utilities, supplies and the rental of the room were divided amongst the group of anaesthetists. On its own, John Pte Ltd did not own any business premises to treat patients nor employed any staff or owned any assets. The company's income from anaesthetic and sedation services are wholly attributable to Dr John as they were received wholly as compensation for his personal efforts and skills. Even though the company owned some assets, these were ancillary to the provision of personal services by Dr John. In this case, IRAS will disregard the company for tax purposes and assess all of the income in Dr John's personal capacity for tax to be paid at the individual tax rate instead.

Case Study 2



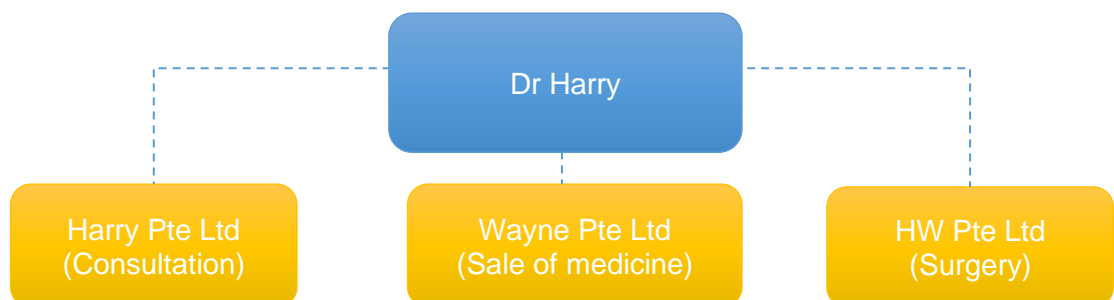
- 5.6. Dr Lynn is a dentist who joined a well-established dental group ABC Dental Group Pte Ltd. The parties entered into a service agreement where Dr Lynn would be the anchor dentist in a specified dental clinic due to be opened. All operating expenses such as equipment cost, renovation expenses, staffing and accounting services would be borne by the dental group. Under the service agreement, Dr Lynn will provide her services to the clinic in return for a basic salary and a significant portion of the operating profit.

- 5.7. Dr Lynn subsequently incorporated a company, Lynn Dental Services Pte Ltd (LDS) and requested that ABC Dental Group Pte Ltd pay her share of operating income into the company instead. LDS was set up for the sole purpose of receiving the profit originating from services provided by Dr Lynn to the dental group. LDS has neither physical premise nor asset.
- 5.8. In substance, services to the dental group were provided by Dr Lynn using her professional skills and she was personally liable for the requisite services as a dentist under the agreement. Therefore, the operating profit paid to LDS should be regarded as compensation paid to Dr Lynn as a direct consequence of his contractual obligation. Both Dr Lynn's share of the profit and basic salary will be taxed in Dr Lynn's hands.

(b) Artificial splitting of income through the incorporation of multiple companies

- 5.9. Income may be deemed to have been split along artificial or contrived lines when multiple companies have been incorporated and the companies have one or more of the following characteristics:
- Perform same or similar function(s);
 - Share the same asset(s);
 - Share the same pool of staff who participate in the day-to-day operations of the company;
 - Operate out of the same premise(s);
 - Split up what is usually a single business operation.
- 5.10. In such instances, the incorporation of multiple companies may be considered part of an arrangement without bona fide commercial reasons and was undertaken to obtain a tax advantage.
- 5.11. As a result, income received from the business operations would be regarded as having been earned by a single company and would be aggregated to be brought to tax under one company, or in the key person's individual capacity. The latter applies if the income is deemed to have been earned wholly from the provision of personal services and there are no bona fide commercial reasons in setting up the company (see (a)). Please refer to the case studies below for illustration.

Case Study 3



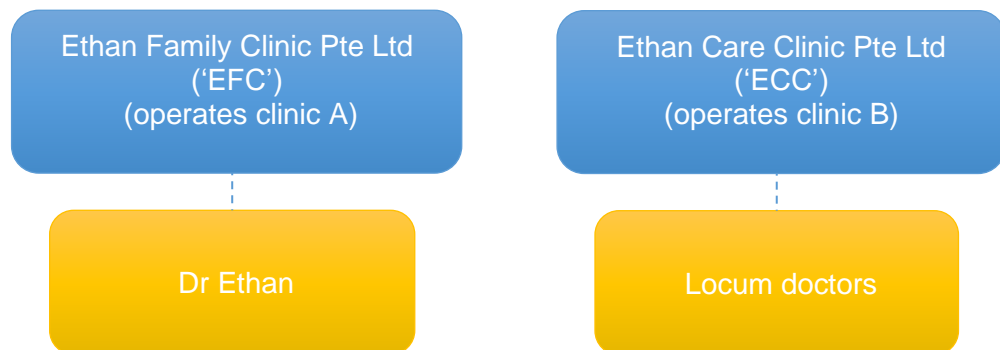
- 5.12. Dr Harry owned and managed a specialist clinic. He incorporated Harry Pte Ltd to provide consultation services to patients in the clinic. Consultation income was treated as being earned by Harry Pte Ltd. In addition, Dr Harry incorporated Wayne Pte Ltd to sell medicine

to patients from the same clinic The sale of medicine was made to patients following medical consultation services at Harry Pte Ltd. Some patients required surgery which Dr Harry performed in a hospital; such surgical income was booked into his third company, HW Pte Ltd. Dr Harry was the only medical practitioner in the 3 companies and he considered himself as working full-time for the three companies concurrently. Besides Dr Harry, Harry Pte Ltd also employed a nurse and a receptionist, whose services was 'shared' by his other 2 companies.

5.13. In this instance, the income received by the 3 companies would be regarded as having originated from one set of operations. Consultation, the sale of medicine and surgery are activities associated with the principal activity of providing specialized health services hence are regarded as one activity or service, thereby generating one stream of income. As Dr Harry required service support such as provision of premises, reception services and nurses to earn the income, a company structure may be used to assume the functions and risks of providing these support services to Dr Harry.

5.14. As such, IRAS would deem the splitting of income into multiple companies as artificial and contrived to gain undue tax advantages. Income from the 3 companies would be consolidated to be brought to tax under one company. At the same time, IRAS will evaluate if income had been distributed on an arm's length basis between Dr Harry and the company i.e. in accordance with their respective contributions towards the generation of the income.

Case Study 4



5.15. Dr Ethan started a clinic using a company, Ethan Family Clinic Pte Ltd (EFC) to run his general practice. He incorporated a second company, Ethan Care Clinic Pte Ltd (ECC), to run another general practice at a different location. Dr Ethan only practised at EFC and did not practise at ECC. He employed locum doctors to provide medical consultation at ECC. EFC and ECC do not share the same premises, receptionists, office equipment and medical equipment, and are able to run independently from each other. Dr Ethan receives an arm's length remuneration and the locums are paid at market rate.

5.16. In this instance, IRAS would regard the use of two companies to manage 2 separate sets of operations as acceptable for tax purposes as each company had distinctive functions, assets and risks.

(c) Artificial re-incorporation of the same business

5.17. As the start-up tax exemption is applied to companies in their first 3 YAs, some business owners may incorporate a new company to take over an on-going business every 3 years

even though there are no changes to the business. This enables them to continue to benefit from the start-up tax exemption scheme, even though the first 3 YAs have passed.

- 5.18. In such instances, the reincorporation may be considered as an arrangement undertaken without bona fide commercial reasons and whose main purpose was to obtain a tax advantage.
- 5.19. Accordingly, the re-incorporation would be deemed as artificial and disregarded. The start-up tax exemption applied to the re-incorporated company would be disallowed. Please refer to the case study below for illustration.

Case Study 5



- 5.20. Dr Tim incorporated Company 1 (Co 1) to start a general practice from YA 2014. As a newly incorporated company, Co 1 enjoyed start-up tax exemption from YA 2014 to 2016, its first 3 years of business.
- 5.21. From YA 2017, Co 1 would no longer enjoy the start-up tax exemption. Cognizant of this, Dr Tim struck-off Co 1 in YA 2017 and incorporated Company 2 (Co 2) to continue running the same general practice. As a “newly” incorporated company, Dr Tim hoped that his business, now under Co 2, would continue to enjoy start-up tax exemption from YA 2017 to 2019, notwithstanding it was simply continuing the business of Co 1.
- 5.22. In substance, the operation of Co 2 is the same as that of Co 1 and is in fact a continuation of Co 1. Co 2 will not be considered as a newly incorporated company and will not be entitled to the start-up tax exemption. As such, the start-up tax exemption enjoyed by Co 2 will be disallowed. However, the start-up tax exemption given to Co 1 from YA 2014 to 2016 remains.

(d) Attribution of income or profit not aligned with economic reality

- 5.23. This issue is relevant to transactions between related parties. Family owned businesses are typical examples of related party arrangements where the owners/shareholders also act as the directors/decision-makers/employees in the business. A typical scenario amongst medical practitioners would be specialists who set up and own their own practice in the form of a company, and at the same time have their relatives or themselves act as a director and the sole medical practitioner in the company.
- 5.24. Companies are separate legal entities from their owners/shareholders. Some medical practitioners cite ring fencing and risk management as reasons for using companies to manage their businesses. In the same way, Singapore tax laws treat companies and their owners as separate taxable persons. As such, any transactions between the company and doctor must be conducted at arm’s length so that the correct tax treatment can be applied to both parties.

5.25. An arm's length transaction with a related party may be defined as one that would have been if it were made under comparable conditions and circumstances as that with an independent party. To meet the arm's length condition, any income earned from the medical practice should be attributed to the doctor and company according to their respective contributions towards the generation of that income.

How do I ascertain the arm's length remuneration to pay myself?

5.26. An arm's length remuneration from your company would be one which adequately rewards you for all your contributions to the business, in a similar fashion which you would have to pay a third party to provide the same services.

5.27. You may consider using either one of the following methods to determine if there has been an arm's length attribution of income/profit between your company and yourself:

5.28. Market Salary Benchmarking – remunerating the doctor based on his/her contributions

Market Salary Benchmarking attempts to determine the due amount of remuneration that doctors should be paid using available comparables. Factors taken into consideration include:

- Area of expertise and specialisation
- Years of experience
- Roles and duties performed
- Availability of similar specialist services in the market and remuneration for such services

5.29. The doctor who incorporates his own company typically performs a combination of roles in the company. Other than working as a medical practitioner, the doctor may also provide stewardship as a director, perform marketing and networking duties, lend his reputation to the business etc. The doctor/owner is to be remunerated for each of these roles. It may be difficult to attribute a value to each of these areas, especially for specialists with unique profiles in terms of their specialization, level of expertise, experience and reputation. Hence alternative methods may be considered.

Cost Plus Method – attributing profits to the company based on its value-add

5.30. As a result of the difficulties ascertaining the market salary benchmark for doctor/owners, an alternative used is the cost plus method, to be applied on the company. It is derived from transfer pricing methodology, a tax concept conventionally used to determine arm's length pricing between related parties.

5.31. The cost plus method is applied where the company provides support services only to related parties, such as doctors practicing in corporatized medical practice which they own and have control of.

5.32. In such medical practices, the company provides support functions such as management services, technical support services, administrative support, and customer support to facilitate the provision of medical services by the doctor in exchange for a fee. For specialists in particular, the value of the business lies largely in their personal skills and reputation. A percentage mark-up is applied to the company's cost base to determine the company's share of profit based on its value-add to the business i.e. the company's remuneration for the

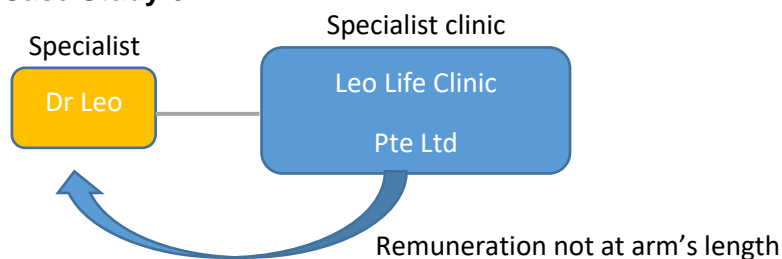
support services provided to the business. The remaining profits are attributed to the doctor (cum owner) for his contributions.

- 5.33. The following framework serves as a general guide to the amount of mark-up that can be applied to the cost base to determine the company's share of the profits. While the recommended guidelines have been derived from industry benchmarks, IRAS will accept other justifiable mark-up margins or basis of apportionment:

Categories	Specialist services	Dental services/General practitioner services ("GP")
% Mark-up	10%	15%
Explanation	<p>Production of income relies wholly on the owner doctor(s).</p> <p>Primarily derived from the provision of one's personal services</p> <p>Company provides some routine support services</p>	<p>Production of income may not be wholly reliant on the owner doctor.</p> <p>Company provides relatively more value add in the production of income e.g. inventory management for the clinics, management of a few clinic premises and some assets</p>

- 5.34. Refer to Annex B2 for the remuneration calculator which uses the cost plus method explained in this section to calculate how much the doctor should be remunerating himself.

Case Study 6



- 5.35. The following example illustrates how income is attributed between the company and the individual using the cost plus method.
- 5.36. Dr Leo owns and manages a specialist clinic with the assistance of a nurse and receptionist. He is the sole director and shareholder of Leo Life Clinic Pte Ltd, where he provides medical consultation services to patients. To take advantage of the lower corporate tax rate, Dr Leo retained most of the earnings from the clinic in the company, paying himself a nominal salary of \$15,000 per annum. The company declared a substantial tax-exempt dividend of \$400,000 to Dr Leo.

5.37. The company incurred a total cost of \$300,000. The cost plus mark-up approach is applied using the recommended 10% mark-up for specialist services:

Calculation of Deemed Remuneration	
Revenue [A]	1,000,000
Cost of sales (i.e. cost base <i>includes Dr Leo's salary of \$15,000</i>) [B]	(300,000)
10% mark-up to be regarded as company profit [C= 10% of B]	(30,000)
Additional remuneration due to Dr Leo [D= A – B – C]	670,000
Original salary declared by Dr Leo [E]	15,000
Deemed remuneration for Dr Leo [D + E]	685,000

Dr Leo will thus be taxed based on a total of \$685,000 as his personal income according to prevailing individual tax rates.

6. What to Expect from IRAS's Reviews?

- 6.1. In order to understand the reasons for adopting the corporate structure or arrangement, IRAS will request and review information provided, and may seek clarification as required. This may include queries such as those listed in paragraph 6.5. Information may be requested via letters, telephone calls or face-to-face interviews.
- 6.2. Using objective facts surrounding each case, IRAS will assess if tax avoidance is a risk present in the corporate arrangement by applying the 3-step approach explained in paragraph 6.
- 6.3. If the Comptroller of Income Tax is of the view that there was tax avoidance, Section 33 of the Income Tax Act will be exercised to vary the arrangement. Depending on the case facts, any, or a combination, of the following three outcomes may occur:

Outcome	The company structure would be disregarded and all income initially attributed to the company would be taxed in the individual's capacity	In the case of income splitting, income attributable to the same operation would be consolidated to be taxed under one company	If the key personnel of the company is under-remunerated, the market salary benchmark, if available, or the cost plus method will be applied to determine the arm's length amount due to the key personnel.
Action by IRAS	Corporate tax assessment(s) will be revised to zero and assessments will be raised on the individual.	Tax assessments for the companies will be consolidated under one company.	The remuneration of the individual will be adjusted accordingly. A corresponding deduction will be allowed to the company for this adjustment.
When would I know if the review of my companies have been finalised by IRAS?	IRAS will engage you as it conducts the review. When the review is completed, you will receive a letter of completion of review from the Individual Income Tax or/and Corporate Tax Division.		

Other Possible Tax Implications

- 6.4. As a result of the consolidation, there may be changes to the Goods and Services Tax (GST) obligations of your company(ies), e.g. they may be liable for GST registration. IRAS will inform you of such changes, if any.
- 6.5. Any government grants (e.g. Productivity Innovation Credit cash payout, wage credit scheme) previously disbursed to your company(ies) may be reviewed and adjusted accordingly if it was uncovered during our review that your company(ies) does not meet the qualifying conditions for these grants.

Administrative Procedures

- 6.6. It is your decision whether to strike off companies that have been disregarded by IRAS, for tax purposes, in the case of tax avoidance. If you wish to retain your company but relieve yourself from the obligation to file annual corporate tax returns, you may complete the Waiver to file Form C/C-S and submit it to IRAS. Please request for the Waiver Application Form from the IRAS auditor upon the completion of our review.

7. Seek Further Advice

- 7.1. If you are unsure if tax avoidance rules apply to your company arrangement, please contact us using either of the following email address:
 - ctmail@iras.gov.sg for corporate tax matters
 - iit_compliance@iras.gov.sg for individual tax matters

Annex

Annex B1 Glossary of terms

1. Arrangement

Any scheme, trust, grant, covenant, agreement, disposition, transaction and includes all steps by which it is carried into effect.

2. Arm's length principle

The arm's length principle is the international standard to guide transfer pricing. It requires the transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party.

3. Cost plus method

A transfer pricing method where a comparable gross mark-up is added to the costs incurred by the supplier of goods or services in a related party transaction to arrive at the arm's length price of that transaction.

4. Related party

Two persons are related parties with respect to each other if:

- (a) Either person, directly or indirectly, controls the other person; or
- (b) Both persons are, directly or indirectly, controlled by a common person.

The exact wordings of the definition are provided under Section 13(16) of the ITA.

5. Transfer pricing

Transfer pricing concerns the prices charged in transactions between related parties.

6. Year of Assessment

The year in which income tax is calculated and charged. The assessment is for the income earned in the preceding year.

For example, for YA 2018, if the company's year-end is 31 December, the assessment is for income earned from 1 January 2017 to 31 December 2017.

Annex B2 FAQs

1. *I have incorporated a company to isolate litigation risks of a medical nature to the company, does this count as a bona fide commercial reason for incorporation?*

No. IRAS holds the view that the nature of the medical practice requires medical practitioners to be personally accountable for medical services provided by them. As such, a company structure does not help to assume litigation risks of a medical nature on behalf of the medical practitioner.

2. *I am an anaesthetist. I feel that it is unfair that due to the nature of my job, I cannot incorporate a company.*

All individuals have the prerogative to choose the business structure that best suits their needs. However, IRAS may review the business arrangement to assess if one of the objectives of the business arrangement was to obtain a tax benefit. If there was a tax benefit arising from the business arrangement, IRAS will apply s33 of the Income Tax Act to negate any undue tax advantage gained.

3. *Does paying a dividend matter in determining arms-length remuneration?*

A company structure is a separate legal entity and transactions between related parties (say a doctor owner and the company) have to be carried out on an arm's length basis according to the value-add or contributions of each party in the arrangement.

For example, in the case of a company with a doctor who is also the sole-shareholder providing the bulk of services, has one or two staff and operates from his own clinic, we would expect that the doctor to receive most of the income in the form of employment income. The remaining profits retained in the company can be paid out as dividends.

4. *For general practitioners (GP) just starting out in private practice, the GPs pay themselves nominal salaries as opposed to the market rate as the new start-up may be suffering losses and face cash-flow problems. Since the purpose of paying themselves nominal salaries was not to avoid taxes, would this be then considered arm's length or bona fide arrangement?*

S33 will be applied to vary the arrangement if we deem that one of the main purposes was to avoid taxes. The GP must demonstrate that as a new start-up company that is not profitable in its initial years, the low salary was the result of poor cash flow and not the avoidance of tax. Once the company's business has stabilized with a steady income stream, we would expect that the salary be adjusted at arm's length. In any case, if the company has run a loss, a tax advantage cannot be gained hence tax reduction would not be considered a main purpose of setting up the company.

5. *I have paid myself nominal remuneration so that the company has sufficient retained earnings to finance my business expansion plans. Is this acceptable?*

You should still remunerate yourself at arm's length and pay your fair share of taxes. Any remaining profits or additional capital funds can then be pumped into the company to finance your business expansion plans.

6. *Most doctors are advised by tax professionals on their business structures, but now doctors have to bear the responsibilities. Will IRAS impose any penalties on these tax agents?*

Every individual is personally responsible for his own tax affairs. In addition, as a company director, you are responsible for ensuring the company meets its statutory obligations, including the company's tax matters. As part of your responsibility, you will need to carefully evaluate advice given

to you by consultants or advisors you choose to engage. If a tax agent has abetted a taxpayer to avoid tax, IRAS will consider taking actions against the tax agent.

7. *My company's tax returns are currently under review by IRAS. How should I file the company's current year tax returns?*

While your company's tax matters are under review, you may continue to file your tax returns as before. Any necessary adjustments will be made at the conclusion of IRAS' review.

8. *I want to declare the income earned from my medical practice under my individual name, however I still want to retain my company's corporate structure so that I can continue to sign contracts with my suppliers, what should I do or take note? Do I still need to comply with the statutory requirements of a business and do I need to file Form C with IRAS?*

You can retain your corporate structure and continue to sign contracts with your suppliers. As the business is still registered under ACRA, all statutory obligations will remain applicable. For tax purposes, you will need to declare the income from your medical practice under your personal tax return (Form B) as a trade income.

To ease your Tax Return filing, you can apply for a waiver to submit Form C if the only source of income derived by the company is your medical income declared in your Form B, and the company does not own any investment assets (e.g. shares, real properties, fixed deposits) where it receives income such as dividend, rental and interest

9. *I have incorporated a company to provide medical services since 1999, before the Start-Up Tax Exemption scheme (SUTE) or Partial Tax Exemption scheme (PTE) were introduced. My remuneration policy has not changed since then, even after the SUTE/PTE were introduced. Will IRAS deem that I am avoiding tax if I continue to retain most of my profit in the company?*

IRAS will examine the arrangement based on the principles laid out in paragraph 4 of this circular and take into account all relevant facts of the case.

Annex B3 Arm's Length Remuneration (ALR) Calculator for private practice doctors

This [ALR calculator](#) may be used to determine the attribution of income between the company and the doctor using the recommended cost plus method.