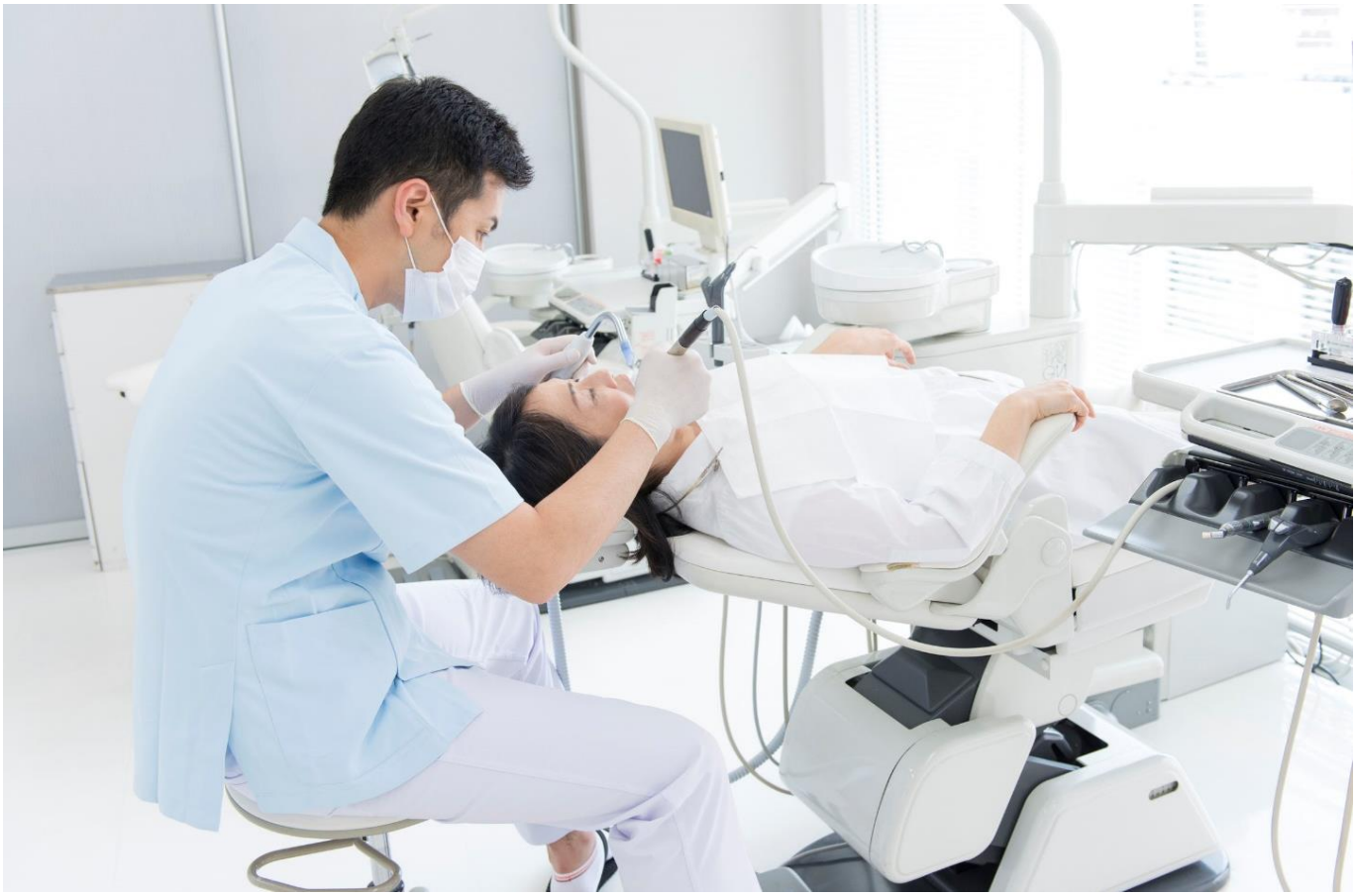
KPMG

Tax Alert

ISSUE 4 | **MARCH 2021**

Case commentary:

Wee Teng Yau v Comptroller of Income Tax



In our previous issue of Tax Alert Issue 10 | June 2020, we examined the case of ***GCL v Comptroller of Income Tax*** [2020] SGITBR 1, where the appeal by a dentist against the Comptroller of Income Tax (the Comptroller) was dismissed by the Income Tax Board of Review (the Board). The dentist's subsequent appeal against the decision of the Board was in turn dismissed by the High Court (the Court) in ***Wee Teng Yau v Comptroller of Income Tax*** and another appeal [2020] SGHC 236. In this issue of Tax Alert, we examine the Court's decision which affirmed the Comptroller's decision to invoke the anti-avoidance provision and subject the income derived by the dentist's wholly-owned company to tax in the dentist's personal capacity.

Background

From January 2011 to May 2012, a dentist, WTY (an individual), was an employee of ACOC (a company). WTY's role and responsibilities were to provide dental services to the patients of ACOC.

On 1 May 2012, WTY incorporated a wholly-owned company, SPL, of which he was the sole director and shareholder. WTY then continued to provide the same dental services to patients of ACOC. However, instead of ACOC paying WTY a salary for his services as in the past, ACOC paid SPL for the services rendered. In turn, SPL paid WTY a salary and a director's fee. The remaining profits of SPL was distributed as tax-exempt dividends to WTY as the sole shareholder of SPL.

On the facts of the case, the Comptroller was of the view that WTY had unduly derived a tax benefit from the abovementioned arrangement, and invoked the anti-avoidance provision under section 33 of the Income Tax Act (the Act) to assess the income of SPL, in the name of WTY.

The dentist's appeal to the Board and his subsequent appeal to the Court were both dismissed. In this issue of Tax Alert, we examine the decision delivered by the Court.

The decision of the Court

In arriving at the judgment, the Court acknowledged that medical professionals who set up private limited companies with a compendium of purposes, such as delegating the management of the business and limiting the liability of the medical professional, are not the intended target of the anti-avoidance provisions of the Act.

In the present case of *Wee Teng Yau*, however, upon an examination of the facts, the Court was of the view that the main, if not only, purpose of the arrangement was to enable WTY to avoid tax. In this regard, the Court had clearly placed significant weight on the fact that despite the incorporation of SPL: (1) WTY continued to provide the same dental services to ACOC's patients as he had done when he was under the direct employment of ACOC and (2) the only patients that SPL/ WTY had throughout the relevant tax period were ACOC's patients.

Yet, the annual remuneration of WTY from SPL which ranged between $40,000 to $110,000 for the relevant period) was significantly lower than the $279,194.60 which WTY had earned directly from ACOC immediately before the relevant period. The consequence was that the overall income tax borne directly/ indirectly by WTY was substantially reduced after the incorporation of SPL due to the lower income tax rate imposed on companies and the beneficial tax treatments available to companies.

In light of the above, the Court held that the arrangement had "as one if its main purposes the avoidance or reduction of tax" and was therefore not exempted from the anti-avoidance provisions of section 33(1) of the Act.

Our Comments

Key factors which may have tilted the balance

The decision of the Court to dismiss the taxpayer's appeal ultimately comes down to the learned judge's view that WTY's intention, as inferred from the surrounding facts and circumstances, was to reduce his personal income tax liability, such that the exclusion under section 33(3)(b) would not be available as a defence to WTY.

In our view, the decision of the Court was not merely due to the low level of remuneration paid by SPL to WTY in his capacity as an employee and director of SPL. Instead, the learned judge has placed weight on the fact that WTY had continued to provide the same dental services to ACOC's patients and that the only patients that SPL/ WTY had throughout the relevant tax period were ACOC's patients. The lower taxable remuneration received by WTY therefore failed the "smell" test when a holistic analysis of the facts suggests that there was no real change on the ground during the relevant period.

Following from the above, we are of the view that WTY may have a stronger case in challenging the position of the Comptroller if SPL/ WTY had, during the relevant period, provided dental services to other patients who are not the patients of ACOC. This would in turn support WTY's contention that the incorporation and use of SPL as a business vehicle was to facilitate the expansion of the business.

As regards the relatively low level of taxable salary and directors' fees received by WTY compared to the remuneration received by WTY when he was an employee of ACOC, there may well be various *bona fide* reasons for such an arrangement. Many multinational companies (and particularly those which are at the start-up or growth stage) are reported to remunerate their Chief Executive Officers with a $1 salary. Well known examples include Steve Jobs, Mark Zuckerberg and Larry Page. In many instances, the reduction of tax may not even be at the back of the minds of these key employees.

The business practice of start-up companies paying key employees a "sustenance" salary also recognises the fact that there is no guarantee that the start-up would survive and thrive. The lower salary remuneration in the earlier days could well lay the foundation for a higher salary to be paid when the business is on track and has stabilised.

Importance of contemporaneous documentation

It is also worthwhile noting that the judgment of the Court seemed to suggest that the terms of (1) the termination of WTY's employment with ACOC and (2) the continued service by WTY (through SPL) to ACOC, could be critical in influencing the outcome of the judgment. Unfortunately, no such documentation was made available by WTY during the proceedings.

Presumably, the learned judge was of the view that such documentation could help shed light on the intentions of the parties in entering into the arrangement and could possibly be relied upon by WTY in defending his position that the avoidance or reduction of tax was not one of the main purposes for entering into the arrangement. This goes to show the importance of putting in place contemporaneous documentation as supporting evidence that the taxpayer had entered into a particular arrangement with a "compendium of purposes", and that the avoidance or reduction of tax was not one of the main purposes for entering into the arrangement.

No personal exertion principle

While the Court affirmed the Comptroller's decision to invoke the anti-avoidance provisions, the "personal exertion" principle advocated by the Comptroller was notably rejected by the Court as having no application in Singapore. The clarification provided by the Court is of particular importance as taxpayers now have the assurance that the Comptroller does not have the *carte blanche* to disregard corporate vehicles set up by individuals and impose tax on the individuals, where the case on hand does not involve tax avoidance.

Revenue law is a creature of statute and no tax is to be imposed unless the legislation specifically provides for it. In this regard, we agree with the Court that the "personal exertion" principle is not a common law exception that allows the Comptroller to levy tax that the Act has not provided for.

Increased scrutiny on tax avoidance arrangements

The case of *Wee Teng Yau* is the latest in a series of cases in recent years which relate to tax avoidance arrangements. According to the Inland Revenue Authority of Singapore (IRAS), the anti-avoidance provisions have to-date been applied to more than 100 cases involving medical professionals and there are currently 13 appeal cases before the Board.

As the ambit of the anti-avoidance provisions become clearer with each successive case, it is expected that there will be greater scrutiny and enforcement actions from the IRAS in respect of tax avoidance arrangements. This is especially so as the fiscal needs of the country accelerate in the aftermath of the COVID-19 pandemic.

The recent coming into operation of the Income Tax (Amendment) Act 2020 on 7 December 2020 is particularly noteworthy as it underscores the Government's commitment to deter taxpayers from entering into tax avoidance arrangements. Under the previous section 33, the Comptroller "may" exercise powers to disregard or vary the tax avoidance arrangements. In contrast, under the new section 33, the Comptroller "must" disregard or vary such tax avoidance arrangements and does not have the flexibility to choose whether or not to make tax adjustments.

The introduction of a 50% surcharge under the new section 33A, in respect of the additional tax arising from the adjustments made by the Comptroller, also serves as a strong deterrence against aggressive taxpayers who put in place creative and complex arrangements to avoid tax which is rightfully payable under the Act.

Concluding comments

While legitimate tax planning is permissible, tax avoidance arrangements which are artificial, contrived or have little or no commercial substance are increasingly under attack from tax authorities worldwide.

In many cases, however, it may be difficult to draw a clear line between legitimate tax planning and undesirable tax avoidance.

How we can help

As your committed tax advisor, we welcome any opportunity to discuss the relevance of the above case to your business, as well as any transactions which your business may be contemplating.

To uncover more insights on the global tax implications of COVID-19, read our COVID-19 Global Tax Developments Summary

Read more of our insights and perspectives at the KPMG in Singapore Webpage

Author

See Wei Hwa
Partner
Property Tax & Dispute Management
T: +65 6213 3845
E: wsee@kpmg.com.sg

Contact us

Ajay K Sanganeria
Partner
Head of Tax
T: +65 6213 2292
E: asanganeria@kpmg.com.sg

BANKING & INSURANCE

Alan Lau
Partner
T: +65 6213 2027
E: alanlau@kpmg.com.sg

REAL ESTATE & ASSET MANAGEMENT

Teo Wee Hwee
Partner
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Agnes Lo
Partner
T: +65 6213 2976
E: agneslo1@kpmg.com.sg

Anulekha Samant
Partner
T: +65 6213 3595
E: asamant@kpmg.com.sg

Leonard Ong
Partner
T: +65 6213 2038
E: leonardong@kpmg.com.sg

ENERGY, TECHNOLOGY, MEDIA & TELECOMMUNICATION

Gordon Lawson
Partner
T: +65 6213 2864
E: glawson1@kpmg.com.sg

Larry Sim
Partner
T: +65 6213 2261
E: larrysim@kpmg.com.sg

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

Mark Addy
Partner
T: +65 6508 5502
E: markaddy@kpmg.com.sg

INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Chiu Wu Hong
Partner
T: +65 6213 2569
E: wchiu@kpmg.com.sg

Toh Boon Ngee
Partner
T: +65 6213 2052
E: btoh@kpmg.com.sg

Dean Rolfe
Partner
T: +65 6213 3199
E: deanrolfe@kpmg.com.sg

CONSUMER & RETAIL

Tan Chee Wei
Partner
T: +65 6213 2470
E: cheeweitan@kpmg.com.sg

CORPORATE TAX PLANNING & COMPLIANCE

Mak Oi Leng
Partner
T: +65 6213 7319
E: omak@kpmg.com.sg

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

Contact us

PERSONAL TAX & GLOBAL MOBILITY SERVICES

Anna Low
Partner
T: +65 6213 2547
E: alow@kpmg.com.sg

Lee Yiew Hwa
Principal Advisor
T: +65 6213 2866
E: yiewhwalee@kpmg.com.sg

INDIRECT TAX

Lam Kok Shang
Partner
T: +65 6213 2596
E: kokshanglam@kpmg.com.sg

Gan Hwee Leng
Partner
T: +65 6213 2813
E: hweelenggan@kpmg.com.sg

Shirley Shen
Partner
T: +65 6213 3288
E: shirleyshen@kpmg.com.sg

TRANSFER PRICING CONSULTING

Felicia Chia
Partner
T: +65 6213 2525
E: fchia@kpmg.com.sg

Lee Jingyi
Partner
T: +65 6213 3785
E: jingyilee@kpmg.com.sg

PROPERTY TAX & DISPUTE MANAGEMENT

Leung Yew Kwong
Principal Advisor
T: +65 6213 2877
E: yewkwongleung@kpmg.com.sg

See Wei Hwa
Partner
T: +65 6213 3845
E: wsee@kpmg.com.sg

R&D & GRANTS CONSULTING

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

US TAX SERVICES

Daniel Joe
Partner
T: +65 6213 2626
E: danieljoe@kpmg.com.sg

TAX – DEALS, M&A

Adam Rees
Principal Advisor
T: +65 6213 2961
E: adamrees@kpmg.com.sg

INDIA TAX SERVICES

Bipin Balakrishnan
Partner
T: +65 6213 2272
E: bipinbalakrishnan@kpmg.com.sg

GLOBAL COMPLIANCE MANAGEMENT SERVICES

Cristina Alvarez-Ossorio
Partner
T: +65 6213 2688
E: cristinaalvarez@kpmg.com.sg

TAX TRANSFORMATION & GOVERNANCE

Catherine Light
Partner
T: +65 6213 2913
E: catherinelight@kpmg.com.sg

KPMG
16 Raffles Quay #22-00
Hong Leong Building
Singapore 048581
T: +65 6213 3388
F: +65 6220 9419
E: tax@kpmg.com.sg

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