Get In On The Act On Singapore Tax Cases

Dissecting 2020 Tax Cases

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2020 marked another year of legal developments in the tax sphere, where numerous appeals relating to various areas of tax were brought before the courts. To help tax professionals keep up-to-date with the latest decisions augmenting the ever-growing body of tax case law, Accredited Tax Practitioner (Income Tax & GST) Allen Tan, Principal, and Jeremiah Soh, Senior Associate, Baker & McKenzie.Wong & Leow, shared novel insights into the legal issues of several 2020 tax cases at a webinar organised by the Singapore Chartered Tax Professionals.

TAX AVOIDANCE – WEE TENG YAU V COMPTROLLER OF INCOME TAX [2020] SGHC 236

The taxpayer was a dentist employed by an orthodontic clinic, ACOC. He incorporated a private limited company, SPL, of which he was the sole director and shareholder. On the same day, the taxpayer left the employ of ACOC. The taxpayer, ACOC and SPL agreed that:

(a) The taxpayer would provide the same dental services to ACOC's patients, but ACOC would pay for the taxpayer's services to SPL;

(b) SPL would pay the taxpayer a reduced salary and a director's fee. Tax-exempt dividends were also declared by SPL and paid to the taxpayer using the remaining profits in SPL, and

(c) During the material time, the only patients that the taxpayer had were ACOC's patients.
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The issues were whether the new arrangement fell within Section 33 of the ITA and whether the personal exertion principle applied such that the income should be attributed to the taxpayer.

INCOME TAX BOARD OF REVIEW (ITBR)'S DECISION

The ITBR found that there were two arrangements: the setting up of SPL to receive the income from providing dental services at ACOC, and the setting of the level of remuneration paid to the taxpayer by SPL such that there remained profits in SPL to be taxed and thereafter paid to the taxpayer as tax-exempt (one-tier) dividends. The reasonableness of the overt acts should be considered when determining whether the arrangements fell within Section 33. Here, the artificially low remuneration paid to the taxpayer fell within Section 33(1)(a) or (c) as there was a stark and significant difference in the level of remuneration paid to him by SPL compared to the 0072emuneration he received as an employee. The ITBR also held that the personal exertion principle should not apply in Singapore.

HIGH COURT (HC) DECISION

The HC held that there was one arrangement in two parts (that is, the incorporation of SPL and the remuneration of the taxpayer). The taxpayer received the same amount of pay from ACOC, but avoided the tax that he used to pay, since SPL could be used to extract tax benefits previously unobtainable by the taxpayer himself. As such, the taxpayer had derived a tax advantage, and fallen within the alternative threshold limbs of Section 33(1) (specifically, Sections 33(1)(a) and (c)).

Section 33(3)(b) must be read conjunctively with Section 33(1). To be exempted from Section 33(1), the arrangement must be for bona fide commercial reasons and not have as one of its main purposes the avoidance of tax. The inescapable conclusion was that the purpose of the new arrangement was to reduce the taxpayer's personal tax.

The HC held that the "personal exertion principle" is not a common law exception that allows the Comptroller to levy tax that the ITA has not provided for.

TAXABILITY OF SEVERANCE PAYMENTS – CIT V FORSYTH, JOHN RUSSELL [2020] SGHC 258

The taxpayer was employed as Managing Director of Rising Tide Asia Pte Ltd under an Employment Agreement. He was abruptly informed by the company that his appointment would cease. The taxpayer and the company signed a Separation Agreement, which extinguished the taxpayer's rights under his original Employment Agreement.

The taxpayer was paid $2,475,000 under the Separation Agreement. The CIT bifurcated the lump sum severance payment into two components:

(a) $1,350,000 as taxable employment income (ex-gratia payment pursuant to the terms of the Employment Agreement), and

(b) $1,125,000 as non-taxable capital receipt (compensation for loss of office).

The key issues were whether the CIT was right in bifurcating the lump sum severance payment, and whether the entire lump sum payment under the Separation Agreement related to compensation for loss of office and was therefore not taxable

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ITBR's Decision

Whether the sum could be bifurcated

The ITBR found that as the lump sum included all entitlements under the Employment Agreement, it was likely that the ex-gratia payment under clause 9 of the Employment Agreement was a component of the lump sum.

Whether the sum was taxable

For the lump sum payment to be taxable, it must fall strictly within the definition of any of the nine categories of payments under Section 10(2)(a) of the ITA. Redundancy payments or compensation for loss of office do not fall within the ambit of this section. Furthermore, the payment to the taxpayer was not in the character of wages or salaries under Section 10(2)(a) as it did not relate to past, present or future services rendered or that is obligated to be rendered by the taxpayer. In any case, the lump sum payment was capital in nature as it was partly compensation for loss of office and partly for a restrictive covenant.

HC's Decision

Whether the sum could be bifurcated

The HC held that the ITBR had erred in holding that the sum of $1,350,000 could be bifurcated from the severance payment of $2,475,000. If the severance payment had expressly included payment of income, then it could be bifurcated as that portion would be taxable. However, since clause 9 of the Employment Agreement was never triggered, the ex-gratia payment could not have formed a part of the severance payment.

Whether the sum was taxable

The HC agreed with the ITBR that whether an income is taxable must be determined based on the strict wording of Section 10(2)(a). The payment was compensation for loss of employment because clause 9 of the Employment Agreement, which provides that an ex-gratia payment would be made to the taxpayer (provided that he executed a deed of release) in the event of termination of employment by the company in accordance with clause 15, was never triggered. While clause 15 of the Employment Agreement provided that either party can terminate the employment by giving notice, the taxpayer was terminated without notice. Thus, the payment was not made in accordance with the Employment Agreement.

In addition, the ex-gratia payment under clause 9 of the Employment Agreement was expressed as a sum that was immediately due and payable, unlike the severance payment which was expressed as a conditional sum subject to clawbacks. Hence, the payment of $2,475,000 was compensation for loss of office, and not taxable.

DEDUCTIBILITY OF R&D EXPENSES INCURRED UNDER COST-SHARING AGREEMENTS – INTEVAC ASIA PTE LTD V CIT [2020] SGHC 218

The taxpayer is a subsidiary of Intevac US. In 2008, the taxpayer entered into an R&D Services Agreement (RDSA) with Intevac US, which provided that Intevac US would undertake R&D activities in the US for the sole benefit of the taxpayer.

In 2009, the taxpayer and Intevac US entered into a Cost-Sharing Agreement (CSA), which superseded the RDSA. Under the CSA, the taxpayer and Intevac US would each acquire the right to exploit any intellectual property and intangible property generated in the performance of the CSA within their respective sales territories, such that both parties had a direct stake in any R&D developed for the joint benefit of the parties.

Pursuant to the CSA, the taxpayer made cost-sharing payments to Intevac US and claimed deductions in its tax returns for YAs 2010 and 2011 under Section 14D(1)(d) of the ITA.

The key issues were:

(a) whether the cost-sharing payments fell within Section 14D(1)(d), that is, they were "made… to an [R&D] organisation for undertaking on his behalf outside Singapore [R&D] related to that trade or business", and

(b) whether the taxpayer has satisfied the requirement under Section 14D(3)(a), such that "there is an undertaking by the person that any benefit which may arise from the conduct of the [R&D] shall accrue to the person".

ITBR's Decision

Whether the cost-sharing payments fell within Section 14D(1)(d)

Applying the three-step approach to statutory interpretation as laid out in Attorney-General v Ting Choon Meng [2017] SGCA 6, the ITBR held that the phrase "for undertaking on his behalf" in Section 14D(1)(d) refers to arrangements where payments are made by the taxpayer to R&D organisations under outsourcing agreements for R&D activities to be conducted for the sole benefit of the taxpayer. For Section 19C to be read meaningfully as a regime that deals with tax relief for cost-sharing agreements and harmoniously with Section 14D(1)(d), an interpretation of Section 14D(1)(d) that potentially gives rise to alternative claims for the same type of expenditure should be avoided. Thus, since the taxpayer was not the only party that could benefit from the R&D activities by Intevac US, the payments did not fall within Section 14D(1)(d).

Interpretation of Section 14D(3)(a)

The phrase "any benefit which may arise from the conduct of the research and development" in Section 14D(3)(a) refers to an undertaking by the taxpayer that all benefits from the conduct of the R&D activities must accrue to the taxpayer. Section 14D(3)(a) did not apply since the payments did not fall within Section 14D(1)(d).

HC's Decision

Whether the cost-sharing payments fell within Section 14D(1)(d)

The HC found that the legislative framework created a clear demarcation between cost-sharing arrangements where the costs and benefits of undertaking R&D are to be shared amongst two or more parties, and arrangements in which the benefits of undertaking R&D accrue solely to the taxpayer. Section 14D sought to benefit companies in Singapore, and was not intended to subsidise the costs of R&D efforts which would not benefit the local economy. Hence, "for undertaking on his behalf" refers to an arrangement where payments are made by the taxpayer to an organisation which has undertaken R&D outside Singapore for the exclusive benefit of the taxpayer only. Thus, the cost-sharing payments did not fall within Section 14D(1)(d).

Interpretation of Section 14D(3)(a)

Section 14D(3)(a) requires the taxpayer to undertake that all benefits which arise from the conduct of the R&D would accrue solely to him. In light of the statutory context and the bifurcation of Sections 14D and 19C at that time, the HC noted that the word "any" in Section 14D(3)(a) must mean "all", and the word "may" must mean that the benefit (however slight) must accrue to the taxpayer. If deduction of a share of R&D costs were allowed, this would risk "revenue leakage" where Singapore may subsidise R&D expenses without obtaining the commensurate benefits from the R&D undertaken. As the taxpayer had not made the requisite undertaking, it was disentitled to relief under Section 14D(1)(d).

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