

Singapore: IRAS updates guidelines on general anti-avoidance

Subtitle

In brief

The Inland Revenue Authority of Singapore (IRAS) updated its guidelines on general anti-avoidance on 31 March 2023, with the release of the IRAS e-Tax Guide: "Income Tax: The General Anti-Avoidance Provision and its Application (Second Edition)" ("**Revised Anti-Avoidance ETG**").

The Revised Anti-Avoidance ETG sets out additional examples of arrangements that IRAS considers to fall under the general anti-avoidance provision set out in Section 33 of the Income Tax Act 1947 (ITA). It is helpful in providing taxpayers with greater clarity on IRAS' approach to Section 33.

More importantly, the Revised Anti-Avoidance ETG also elaborates how the surcharge under Section 33A of the ITA will be imposed and when a remission on a surcharge may be granted. This is important for taxpayers to note as the Section 33A surcharge is computed based on 50% of the tax or additional tax arising from the adjustment under Section 33. Further, the surcharge generally must be paid within one month after the date of the written notice of the Section 33A surcharge, notwithstanding any objection to the underlying Section 33 adjustment.

In addition, taxpayers should note that while the surcharge is only imposed on any tax or additional tax arising from a Section 33 adjustment made for year of assessment (YA) 2023 or a subsequent YA, the surcharge is applicable to tax avoidance arrangements entered into before the basis period of YA 2023.

In this alert, we discuss the salient aspects of the Revised Anti-Avoidance ETG and consider its impact on taxpayers.

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Key takeaways

- New categories of tax avoidance explicitly identified by IRAS help clarify IRAS' position on certain transactions as falling afoul of the Section 33 anti-avoidance provision.
- Taxpayers should take note of the surcharge provision under Section 33A, which is computed at 50% of the tax or additional tax arising from the adjustment under Section 33.
- In particular, the surcharge generally must be paid within one month after the date of the written notice of the Section 33A surcharge, notwithstanding any objection to the underlying Section 33 adjustment.
- Further, the surcharge can apply to arrangements prior to YA 2023, although the surcharge will only be imposed in respect of adjustments made from YA 2023.
- Taxpayers should thoroughly review their tax planning and transactions to ensure that there are bona fide commercial reasons for the transactions **and** that these do not have the main objective of reducing or avoiding tax to avoid falling afoul of the anti-avoidance rules and triggering the surcharge under Section 33A of the ITA.
- While a remission may be available, this is subject to conditions, and the surcharge will have to be paid upfront unless the comptroller agrees otherwise.

In more detail

Setting out Singapore's general anti-avoidance regime: Section 33 and 33A

We set out the general anti-avoidance provisions and discuss the updates to the Revised Anti-Avoidance ETG below. We then outline our recommendations to taxpayers.

Section 33

Section 33(1) of the ITA empowers the comptroller of income tax (CIT) to disregard or make necessary adjustments to any arrangement if it is satisfied that the purpose or effect of such arrangement is directly or indirectly one of the following:

1. To alter the incidence of any tax that is payable by or that would otherwise have been payable by any person
2. To relieve any person from any liability to pay tax or to make a return under this act
3. To reduce or avoid any liability imposed or that would otherwise have been imposed on any person by this act

(the "three threshold limbs" in Section 33(1)).

In interpreting the above, the Singapore Court of Appeal in the case of *CIT v. AQQ* [2014] SGCA 15 set out the following approach (which has also been restated by IRAS in its Revised Anti-Avoidance ETG):

- (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.
- (ii) If so, consider whether the taxpayer may avail itself of the statutory exception under Section 33(7).
- (iii) If not, 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.

In this regard, an "arrangement" is broadly defined under Section 33(5) to mean "any scheme, trust, grant, covenant, agreement, disposition, transaction and includes all steps by which it is carried into effect."

Section 33A

Recently introduced by the Income Tax (Amendment) Act 2020, Section 33A of the ITA, which takes effect from YA 2023, imposes a surcharge on tax avoidance arrangements where the CIT has made an adjustment pursuant to Section 33. The surcharge is computed based on 50% of the tax or additional tax arising from the adjustment made.

Prior to its insertion, Section 33 only allowed the CIT to counteract the tax advantage obtained by taxpayers from the tax avoidance arrangement.

The surcharge must be paid upfront within a month of the date the written notice of the surcharge is served regardless of any objection or appeal lodged against an adjustment under Section 33. The surcharge can be correspondingly increased, reduced or annulled if the adjustment under Section 33 is so varied following any appeal.

Updates to the IRAS' revised anti-avoidance e-Tax Guide

A. New tax avoidance categories and examples

IRAS has included new examples of arrangements that it regards as having the purpose or effect of tax avoidance within the meaning of Section 33(1) of the ITA. The categories now include the following:

- Circular flow or round-tripping of funds
- **Setting up of a conduit entity to obtain a treaty benefit for the purpose of avoiding withholding tax** (i.e., "treaty shopping") (new)
- **Assignment of debt to an offshore jurisdiction for the main purpose of obtaining a tax advantage** (new)
- Setting up of more than one entity for the sole purpose of obtaining a tax advantage
- Changes in the form of a business entity for the sole purpose of obtaining a tax advantage
- Attribution of income that is not aligned with economic reality

We briefly discuss the new categories included.

Conduit entity to obtain a treaty benefit for the purpose of avoiding withholding tax

In considering whether a conduit entity has been set up to engage in treaty shopping, the CIT will consider the following non-exhaustive list of factors: (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.

The example provided of such an arrangement that would constitute tax avoidance is a back-to-back licensing arrangement, where a conduit entity, Z Co, is set up in jurisdiction Z to take advantage of the exemption on the withholding tax rate on royalties available under the Singapore-Z treaty.

Assignment of debt to an offshore jurisdiction for the main purpose of obtaining a tax advantage

Similar factors will be considered as to whether the assignment of debt securities (and the associated rights to interest income) to an offshore jurisdiction constitutes tax avoidance: (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.

The tax avoidance example given is that of the assignment of Note 1 between two related Singapore entities, X and Y, to Y's holding company Z Co in jurisdiction Z, in exchange for Note 2 issued by Z to Y to take advantage of the low tax rate on interest income in jurisdiction Z, and the exempted withholding tax on interest payments made to Z Co under the Singapore-Z treaty. This is because the assignment and exchange of the notes has allowed the group to enjoy an interest deduction via X while avoiding tax on the corresponding interest income that would have been earned by Y in Singapore.

B. New guidance on Section 33A

In addition, a new Section 9 of the Revised Anti-Avoidance ETG has been inserted on the Section 33A surcharge that is applicable with effect from YA 2023 for an arrangement that falls within the provisions of Section 33 and for which the CIT makes an adjustment to counteract the tax advantage resulting in any tax or additional tax being assessed on the taxpayer.

The guide clarifies that the surcharge is also applicable to tax avoidance arrangements entered into before the basis period for YA 2023. However, the surcharge is only imposed on any tax or additional tax arising from a Section 33 adjustment made for YA 2023 or a subsequent YA.

To give an example, where a company engages in an avoidance arrangement and submits its income tax computation with an unabsorbed loss carried forward for YA 2023, which is used to compute tax for YA 2024, and the CIT invokes Section 33 to adjust its assessment for YA 2023 to reduce the loss carried forward, and hence results in additional tax for YA 2024, the Section 33A surcharge will be imposed for YA 2024 but not YA 2023 as there was no adjustment made to the YA 2023 assessment.

The surcharge is to be automatically applied, notwithstanding any appeal or objection submitted for the relevant tax assessment. It must be paid within one month after the date the CIT serves a written notice of the surcharge. Failure to do so can trigger additional penalties of up to 12% of the amount of tax/additional tax payable.

Remission

Section 33A(7) allows the CIT to remit the surcharge wholly or in part.

However, IRAS clarifies in the Revised Anti-Avoidance ETG that it will not grant a remission if the Section 33 adjustment arose from an audit or review by IRAS.

IRAS will consider a 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
- (ii) Have good compliance records for the current YA and immediate two preceding YAs at the time the Section 33A surcharge is imposed in terms of the following:
 - a. Prompt submission of returns and payment of tax by the due dates
 - b. No records of imposition or composition of penalties

For any self-initiated disclosure made within two years from the tax return filing due date ("**Two-Year Grace Period**"), a remission of up to 50% on the Section 33A surcharge imposed may be considered (i.e., the Section 33A surcharge will be reduced to 25% of the tax/additional tax payable).

After the Two-Year Grace Period, only a remission of up to 20% on the Section 33A surcharge imposed may be considered (i.e., the Section 33A surcharge will be reduced to 40% of the tax/additional tax payable).

To be regarded as a qualifying self-initiated disclosure, taxpayers should notify IRAS in writing of the specific tax avoidance transaction or arrangement, providing details of the entities/transaction/arrangement before the taxpayer receives an IRAS notification on the commencement of an audit/review/investigation relating to the transaction(s) involved in the tax avoidance arrangement.

It remains to be seen/clarified what would qualify for a full remission of the Section 33A surcharge.

Recommendations and conclusion

The updates to the ETG follow recent amendments to Section 33 and the introduction of the Section 33A surcharge to reaffirm Singapore's robust position against tax avoidance and deter aggressive taxpayers that might otherwise opt to shoulder the risk of a later adjustment.

Other general anti-avoidance provisions in the Goods and Services Tax Act 1993 and the Stamp Duties Act 1929 have introduced similar surcharges.

Hence, we recommend that taxpayers pay particular attention to these changes in Singapore's landscape toward countering tax avoidance. From a practical perspective, the guidelines set out in the Revised Anti-Avoidance ETG may be helpful in conducting a review of any planning that a taxpayer has undertaken in the past or will undertake in the future.

In particular, we highlight that the surcharge under Section 33A can apply to arrangements that have taken place prior to YA 2023 and that it applies automatically once an adjustment under Section 33 is made. This, together with the inclusion of the new categories of avoidance, may signal a more rigorous approach that the IRAS will adopt in conducting a Section 33 review.

As discussed, a taxpayer may consider making a voluntary disclosure (subject to the requisite conditions) to potentially avail itself of a reduced surcharge.

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