Avoiding tax avoidance when incorporating a medical practice

*By: David Li

I. INTRODUCTION

It is said that nothing in life is certain, except death and taxes.[1] This is especially true for doctors who frequently witness deaths in their occupation and, more recently, have had the taxman knocking on their doors.[2] The Inland Revenue Authority of Singapore ("**IRAS**") has been going after doctors aggressively for tax avoidance after finding out that doctors have been setting up companies primarily to reduce their tax liabilities.[3]

Against this backdrop, a doctor running his own practice as a sole proprietor may be unsure if the benefits of incorporating a company for his medical practice would outweigh the risk of committing tax avoidance. This article provides guidance for doctors on how to incorporate a company without committing tax avoidance.

It first outlines the benefits of incorporating a company for a doctor's medical practice before addressing the tax risks involved in such an incorporation. It then explores how a doctor can avoid committing tax avoidance and warns the doctor of the consequences of tax avoidance.

II. DISCUSSION

A. Benefits of incorporating a company

Doctors who are practising under a sole proprietorship often want to incorporate a company to enjoy benefits such as protecting their personal wealth against the risk of business failure and to have an easier time when selling their medical practice.

---

*Year 4 LL.B. student, Yong Pung How School of Law, Singapore Management University.

[1] Benjamin Franklin, in a letter to French scientist Jean-Baptiste Leroy in 1789.

[2] Liu Hern Kuan and Vincent Ooi, "Shining a light on tax avoidance", *The Business Times* (17 November 2018) <https://www.businesstimes.com.sg/wealth-investing/shining-a-light-on-tax-avoidance> (accessed 15 October 2021) ("Liu and Ooi").

[3] Salma Khalik, "Iras recovers $10m from high-earning tax avoiders; returns of 145 doctors, dentists under scrutiny", *The Straits Times* (15 October 2018) <https://www.straitstimes.com/singapore/iras-recovers-10m-from-high-earning-tax-avoiders-doctors-lawyers-property-agents> (accessed 15 October 2021) ("Salma Khalik").

(1) Protect your personal wealth

In certain types of medical practices, such as dentistry or surgical practice, doctors may have to borrow money to acquire expensive equipment and pharmaceutical products in their operations. If a medical practice is structured as a sole proprietorship, the doctor will be personally liable if the practice is unable to make the loan repayments.[4] However, if the practice is structured as a company, creditors will not be able to hold the doctor personally liable for the practice's debts without a personal guarantee. As such, the doctor's personal wealth can be protected in the event his medical practice is not a financial success.

(2) Ease of selling a medical practice

A medical practice structured as a sole proprietorship cannot be transferred to another person or organisation in a quick or easy manner. Instead, a doctor would often have to transfer all assets or licences to the incoming owner individually, which may prove disruptive to the practice. For example, the lease of the clinic space may not be assigned to the incoming owner directly. A doctor may have to first terminate his lease before the incoming owner negotiates a new lease with the landlord. If a new lease cannot be negotiated, the medical practice may come to an end prematurely.

However, a transfer of the medical practice through a company can be made effectively without disrupting the practice by a transfer of shares in the company from the doctor to the incoming owner.

B. Tax risks involved in incorporating a company for a medical practice

Given the benefits above, a doctor may think that incorporating a company for his medical practice is a no-brainer. However, he should be careful to avoid committing tax evasion or avoidance.

[4] ACRA website, "What is a sole proprietorship" <https://www.acra.gov.sg/how-to-guides/starting-sole-proprietorships/what-is-a-sole-proprietorship> (accessed 15 October 2021).

(1) Tax evasion

Tax evasion involves fraud and lying to IRAS about how much tax you should pay, such as claiming for non-existent expenses and failing to declare taxable income.[5] It is a criminal offence[6] and is punishable by hefty fines and/or imprisonment.[7] Tax evasion is often contrasted with tax mitigation, which is the process of structuring transactions to minimise one's tax liabilities within the law and the spirit of the law.[8]

However, it is relatively straightforward to avoid tax evasion – be honest when reporting your taxes. Therefore, this article will not discuss tax evasion in further detail.

(2) Tax avoidance

Tax avoidance lies somewhere in the middle of the spectrum but is also against the law.[9] Generally, it occurs where a seemingly legal arrangement is entered into for the main purpose of reducing tax in a way that is not intended by lawmakers.[10] In these cases, the arrangements are often "artificial and contrived", and difficult to justify on the grounds of commercial reasons.[11] For example, it does not make sense for a medical locum who provides services to various general practices on an ad-hoc basis to incorporate a company for his practice. Apart from lowering his tax liability, the company does not provide him with any real benefit. Yet, he must incur additional upkeep expenses to maintain the corporate entity.

However, as compared to tax evasion, tax avoidance does not involve lying to IRAS. There is full disclosure of one's earnings, but with an intent to take advantage of apparent tax loopholes. Tax avoidance is also different from tax mitigation as tax avoidance is against the law while tax mitigation is not.

---

[5] IRAS website, <https://www.iras.gov.sg/contact-us/report-tax-evasion> (accessed 15 October 2021).
[6] IRAS e-Tax Guide, Income Tax: The General Anti-avoidance Provision and its Application (First Edition) (11 July 2016), at 3.2 <https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_CIT_The%20General%20Anti-avoidance%20Provision%20and%20its%20Application.pdf> ("IRAS e-Tax Guide").
[7] See Income Tax Act (Cap 134, 2014 Rev Ed), section 96 ("ITA").
[8] IRAS e-Tax Guide, *supra* n 6, at 4.1.
[9] See ITA, section 33.
[10] IRAS e-Tax Guide, *supra* n 6, at 3.1.
[11] Liu and Ooi, *supra* n 2.

C. How to avoid tax avoidance when incorporating a company

Given the significant number of doctors being implicated for tax avoidance in recent years, it is crucial for doctors to know the two key criteria they need to satisfy when incorporating a company to avoid committing tax avoidance. This part then provides guidance on how to satisfy the two criteria in practice.

(1) Satisfy two criteria when incorporating your company

The IRAS has provided that incorporating a company to run a medical practice would not be found to be tax avoidance if it:

(a) was carried out for commercial reasons in good faith; and
(b) did not have tax avoidance or reduction as one of its main purposes.[12]

It is important for a doctor to be able to explain how these two criteria are satisfied at the time of the incorporation. For example, a doctor whose practice requires expensive equipment obtained through loans should be able to explain that he incorporated a company primarily to limit his business liabilities. Alternatively, if a doctor intends to sell off his practice soon, he should be able to explain how incorporating a company allows him to achieve that more easily.

If a doctor is unable or finds it challenging to satisfy the two criteria, he may be at significant risk of committing tax avoidance and should refrain from incorporating a company for his practice.

(2) Practical steps to avoid tax avoidance when incorporating a company

(a) Consider whether your medical speciality is suitable for incorporation

Sometimes, it may not be suitable to incorporate a company for a medical practice especially in certain medical specialities. For example, an anaesthetist in private practice is usually an

[12] *Comptroller of Income Tax v AQQ* [2014] 2 SLR 857, at [110] ("*AQQ*"); ITA, *supra* n 9, at s 33(7).

individual practitioner,[13] owns only a small amount of equipment for work, and is the sole person networking and marketing to promote the doctor's services.[14] In such a case, incorporating a company provides no additional benefit to the doctor, apart from tax reduction. Hence, it may not be wise to incorporate a company for many anaesthetists given the significant risk of tax avoidance.

(b) Do not incorporate only to reduce legal liability in malpractice suits

IRAS does not consider "limiting one's litigation risks of a medical nature" to be a legitimate commercial reason.[15] This is because the incorporation will not prevent his patients from lodging a complaint with the Singapore Medical Council ("**SMC**") or suing him directly for medical negligence.[16] If a doctor incorporates only for this reason, IRAS could find that the doctor has committed tax avoidance.

(c) Pay yourself an arm's-length salary after incorporation

After incorporating a company, a doctor should pay himself an arm's-length salary.[17] This ensures that a doctor pays his fair share of personal income tax. The IRAS provides two ways to calculate the appropriate salary. The first is by paying the market rate.[18] The second is by paying the doctor the company's remaining profits as salary after deducting the cost (with a slight mark-up) from the company's revenue.[19]

However, a doctor that just started out his medical practice may only be able to pay himself a low salary. In this case, IRAS requires proof that the new start-up company is not profitable in its initial years to justify the low salary.[20]

D. Consequences of tax avoidance

---

[13] Association of Anaesthetists, "Independent Practice Survey Results" <https://anaesthetists.org/Portals/0/Images/Guidelines%20cover%20images/IPC%20Survey%20January%202019.pdf?ver=2019-03-04-163250-113> (accessed 15 October 2021).
[14] IRAS, Circular: Incorporation of Companies by Medical Professionals and Relevant Tax Implications (November 2019), at 5.4-5.5 ("IRAS Circular").
[15] IRAS Circular, *supra* n 14, at Annex B2 FAQs.
[16] See Medical Registration Act (Cap 174, 2014 Rev Ed), s 39.
[17] IRAS Circular, *supra* n 14, at 5.26.
[18] *Id*, at 5.28-5.29.
[19] *Id*, at 5.30-5.33.
[20] *Id*, at Annex B2 FAQs question 4.

If a doctor commits tax avoidance, there may be serious consequences awaiting him. Should IRAS believe that the doctor had incorporated a company to avoid tax, it will unwind the tax benefits by taxing the doctor as if the company did not exist.[21] In particular, section 33 of the ITA allows IRAS to make necessary adjustments to a doctor's tax payables so that the fair amount of taxes is paid.[22]

Furthermore, from 2023 onwards, IRAS may impose an additional penalty equal to 50 percent of the amount of additional income tax payable arising from the adjustments made under section 33.[23]

In addition, the SMC has also stated that it will "take disciplinary action against doctors if they are convicted of tax offences". [24] Though the SMC has yet to take any actions against doctors convicted of tax avoidance, it had previously suspended doctors for being convicted of tax evasion.[25]

III. Conclusion

Navigating the tax maze can be tricky for doctors who want to incorporate a company for their practices. However, the tax risks can be significantly mitigated by following the steps above. When in doubt, please consult a tax lawyer for more detailed advice.

---

[21] IRAS Circular, *supra* n 14, at 2.4.
[22] ITA, *supra* n 7, section 33(2).
[23] *Id*, section 33A.
[24] Salma Khalik, *supra* n 3.
[25] See Singapore Medical Council Disciplinary Tribunal Inquiry for Dr Currie Chiang On Thursday, 21 November 2013 (6.30pm) <https://www.healthprofessionals.gov.sg/docs/librariesprovider2/published-grounds-of-decision/year-2013/dr-currie-chiang.pdf> (accessed 15 October 2021).