Payments for share sale or services rendered?

April 2023

In brief

In *GFG and another v Comptroller of Income Tax* [2023] SGITBR 1, the Income Tax Board of Review (the Board) considered the taxability of certain payments received by the sellers as part of a share sale and based on a proper construction of the sales and purchase agreement, held that they were payments for services provided and thus taxable.

In detail

Background

The Appellants were nephrologists and medical directors of clinic dialysis centres (CDCs). They were also shareholders in five companies which owned and operated 16 CDCs.

The Appellants first entered a Memorandum of Understanding (MOU) on 19 September 2012 for the sale of all their shares in the five companies to a buyer ("A Pte Ltd") for a total of $44 million (the "share sale"). An additional $6 million payment was classified as a payment for services rendered by the Appellants as nephrologist and medical directors of the CDCs in a separate schedule to the MOU. However, in the final sale and purchase agreement (SPA) dated 31 January 2013, the purchase consideration was stated to be a total of $50 million, with $44 million to be paid on the completion date and $6 million to be paid over two years after the completion date (the "initial period"). In addition, to qualify for the S$6 million payment, the Appellants must enter into a new Medical Director Agreement (MDA) with A Pte Ltd and remain as medical directors during the initial period. However, the Appellants will only be paid a nominal consideration of S$100 for the two-year period for their role as medical directors.

On 12 March 2019, the Comptroller of Income Tax issued additional notices of assessments bringing the full amount of the $6 million payment to tax. The Appellants argued that the $6 million constituted part of the consideration for the share sale, and that it should be capital in nature and not taxable.

Issues considered by the Board

The key issue before the Board was whether, on a proper construction of the SPA, the $6 million payment should be characterised as:

1. Forming part of the consideration for the share sale and hence a capital receipt; or

2. Payment for the Appellants' services as medical directors and hence taxable as income.

The Board's findings

The Board found the true nature of the $6 million payment to be a service fee for the Appellants in their capacity as medical directors of the CDCs. In arriving at this outcome, the Board considered the following factors:

- Relying solely on the text of the SPA and MDAs alone may not be adequate to distil the parties' intention and to understand the true bargain struck. To determine the nature of the payment, the substance of the transaction needs to be considered, and in doing so one should not be bound by the label used in the SPA. As the $6 million payment was conditional upon the Appellants staying on for the initial period as medical directors, the Board noted that it appears to be payment conditional upon services (to be rendered) and not unfettered consideration for shares.

- Evidence from pre-contract negotiation correspondence suggested that the Appellants changed the initial label of the $6 million payment with an intention not to pay taxes on the same. This was indicative that true nature of the payment has not changed from that in the MOU, where it was described as payment for services.

- Given that the $6 million payment was approximately equal to the payments received by the Appellants for similar services in prior years, the Board was unconvinced that the Appellants would have now provided their services for a nominal consideration, in what was otherwise a business transaction between arm's length parties.

- In the absence of any alternative compensation arrangement, the Board concluded that the nature of the $6 million was for the payment of medical services and therefore taxable in the hands of the Appellants. Had the Appellants been separately compensated at arm's length for their services in the MDAs or compensated based on an alternative arrangement, it might have been more convincing to suggest that the shares have genuinely increased in value.

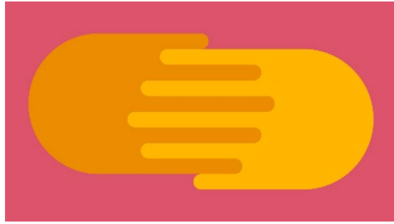
The Board also noted that the stamping arrangement in this case was not conclusive evidence that the consideration for the share sale was $50 million, noting that the overpayment was a precaution owing to the uncertainty resulting from the drafting of the SPA.

As the Board found, on a proper construction of the SPA, that the $6 million was payment for services, it need not consider the Comptroller's alternative argument that the payment structure in the SPA was a tax avoidance arrangement to which section 33 of the Income Tax Act 1947 applies.

Concluding remarks

As highlighted by the Board, there is a need to consider all relevant facts and circumstances of the transaction to understand the true nature of the bargain struck. Only then can the tax consequences be determined. Invariably, the position is further complicated if, as part of a share sale, the founders of the company being sold (sellers) are also required to stay on as key employees of the buyer, for example, to ensure a smooth transition and business continuity. Professional advice should be sought as tax treatment in these circumstances will be fact-sensitive.

GFG also serves as reminder that the true nature of a transaction cannot be determined by mere label; if something is evidently not what it purports to be, the Comptroller does not even need to invoke section 33 to strike it down.



Contact us

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