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Tax Liability Insurance in Singapore: Benefits, Trends, and Challenges

Introduction

Tax liability insurance products fully or partially indemnify the insured's tax risks, offering coverage for scenarios such as tax liabilities imposed by tax authorities, defence costs against tax claims, and gross-up taxes on proceeds. This coverage effectively transfers tax liability to the insurance company, providing businesses with financial protection against unexpected tax liabilities.

Benefits & Coverage

Tax liability insurance is a strategic risk management tool designed to provide comprehensive coverage for a variety of tax-related risks that businesses may face. These insurance products offer both full or partial indemnification for the insured party's tax exposures, thereby mitigating the financial impact of unexpected tax liabilities.

These insurance policies typically cover a broad spectrum of scenarios, including but not limited to:

1. *Tax liabilities imposed by tax authorities:* This includes liabilities arising from various tax assessments, such as income tax, goods and services tax ("**GST**"), stamp duties, property tax and other levies imposed by tax authorities. It encompasses situations where tax authorities challenge the tax treatment of certain transactions or dispute the accuracy of tax filings.

2. *Defence costs for tax claims:* Tax liability insurance often covers the expenses incurred in defending against tax claims, including legal fees, expert opinions, and other related costs. This coverage provides businesses with the financial resources needed to mount a robust defence against tax authorities' challenges.

By offering coverage for these scenarios, tax liability insurance effectively transfers the financial burden of tax risks from the insured party to the insurance company. This transfer of risk provides businesses with comfort and security, knowing that they have financial protection in place to safeguard against unexpected tax liabilities that could potentially impact their financial stability and operational continuity.

Market Trends

Compared to America and Europe, the tax liability insurance market in Asia is still nascent, presenting significant growth opportunities. Notable players in the region include India, Singapore, and Australia, where tax liability insurance is readily available. India leads the pack as the largest market, driven by substantial mergers and acquisitions (M&A) activity and a litigious tax authority. Singapore and Australia

benefit from political stability, sophisticated legal systems, and transparent tax authorities, making them conducive to insurance coverage.

As Asian markets gain prominence, insurers are expanding the coverage scope in the region. Presently, Singapore, Australia, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, the Philippines, South Korea, and Thailand are recognised as potentially insurable Asian jurisdictions.

Types of Tax Challenges in Singapore and Expectations for the Future

In Singapore, income tax continues to be a significant concern for businesses, particularly with the ever-evolving tax landscape and the implementation of stringent anti-avoidance provisions. Notable cases before the Singapore Courts have underscored the broad scope of Singapore's anti-avoidance provisions, particularly section 33 of the Income Tax Act 1947 ("**ITA**"). This provision, which aims to prevent tax avoidance schemes, has been consistently enforced by the Inland Revenue Authority of Singapore ("**IRAS**"). The recent case of *Wee Teng Yau v Comptroller of Income Tax and another appeal* [2020] SGHC 236 focused on the lack of commercial reasons for the incorporation of a wholly-owned company by a dentist and the tax advantages that were unduly derived therefrom, thus reaffirming the wide-ranging application of section 33 of the ITA.

Furthermore, transfer pricing controversies have become increasingly prevalent in Singapore, resulting in adjustments and penalties imposed by IRAS especially for royalty rates derived by the owners of intellectual property rights and cross-border related party financial transactions. IRAS has heightened its scrutiny of transfer pricing practices to ensure compliance with the arm's length principle. This increased focus underscores the importance for businesses to maintain robust transfer pricing documentation and to comply with Singapore's transfer pricing regulations. Doing so would help avoid, in particular, the lengthy and costly dispute resolution process under the Mutual Agreement Procedure governed by Singapore bilateral tax treaties with other jurisdictions for cross-border transfer pricing disputes.

Additionally, GST litigation has seen a rise in Singapore, with recent cases highlighting taxpayer-friendly interpretations by the Singapore Courts. Notably, the case of *Herbalife International Singapore Pte Ltd v Comptroller of Goods and Services Tax* [2023] SGHC 54 (which was successfully litigated by our tax team as covered in our Legal Update here), emphasised the importance of clarity and consistency in interpreting GST provisions. However, despite these favourable interpretations, businesses must remain vigilant in their GST compliance efforts to avoid unintended tax consequences and uncertainties.

Looking ahead, expectations for the future include continued scrutiny in areas such as income tax, transfer pricing, and GST, as well as potential focus on new tax challenges. A new development is the recent introduction of section 10L of the ITA, which imposes income tax on gains derived from the disposal of foreign assets. Furthermore, Budget 2024 announced that Singapore will implement an Income Inclusion Rule and Domestic Top-Up Tax to align its tax policies with BEPS Pillar 2 which would

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come into force from 1 January 2025. As Singapore adapts its tax framework to align with the BEPS Pillar 2 recommendations, businesses can anticipate a rise in tax controversies.

Legal Counsel

An assessment of the insured tax risk is often required when obtaining tax liability insurance. Insurers will typically require a legal opinion analysing the tax risk and providing a level of comfort with respect to the materialisation of the tax risk before providing quotations for coverage. This is essential for both the insured and insurers. Thorough evaluation of the tax risk mitigates risks for tax insurance providers and prevents the insured from paying higher premiums due to unnecessary uncertainty.

Our team possesses extensive expertise in tax insurance, demonstrated by the following notable engagements:

1. We advised a real estate company on Singapore taxation risks related to a restructured sale and leaseback arrangement, facilitating the acquisition of tax insurance coverage.

2. We offered specialised guidance to a top tax insurer concerning tax risks stemming from a complex share transfer arrangement, particularly focusing on compliance with the general anti-avoidance rule outlined in section 33A of the Stamp Duties Act.

3. We assisted a prominent real estate developer in assessing taxation risks associated with the disposal of a sizable commercial building in Singapore, guiding the client in securing tax insurance coverage.

4. Our team provided expert advice to a leading tax insurer on Singapore tax risks pertaining to the treatment of accrued preference share dividends, ensuring comprehensive coverage.

5. We advised an innovative business process management company on Singapore tax risks relating to gains from the disposal of shares in an investment holding company, facilitating informed decision-making regarding tax insurance coverage.

Conclusion

In conclusion, tax liability insurance presents significant opportunities for businesses to manage tax risks effectively. However, navigating the complexities of tax insurance requires careful evaluation of risks, thorough due diligence, and collaboration with experienced tax practitioners. As the market continues to evolve, businesses should stay informed and proactive in addressing their tax risk management needs.

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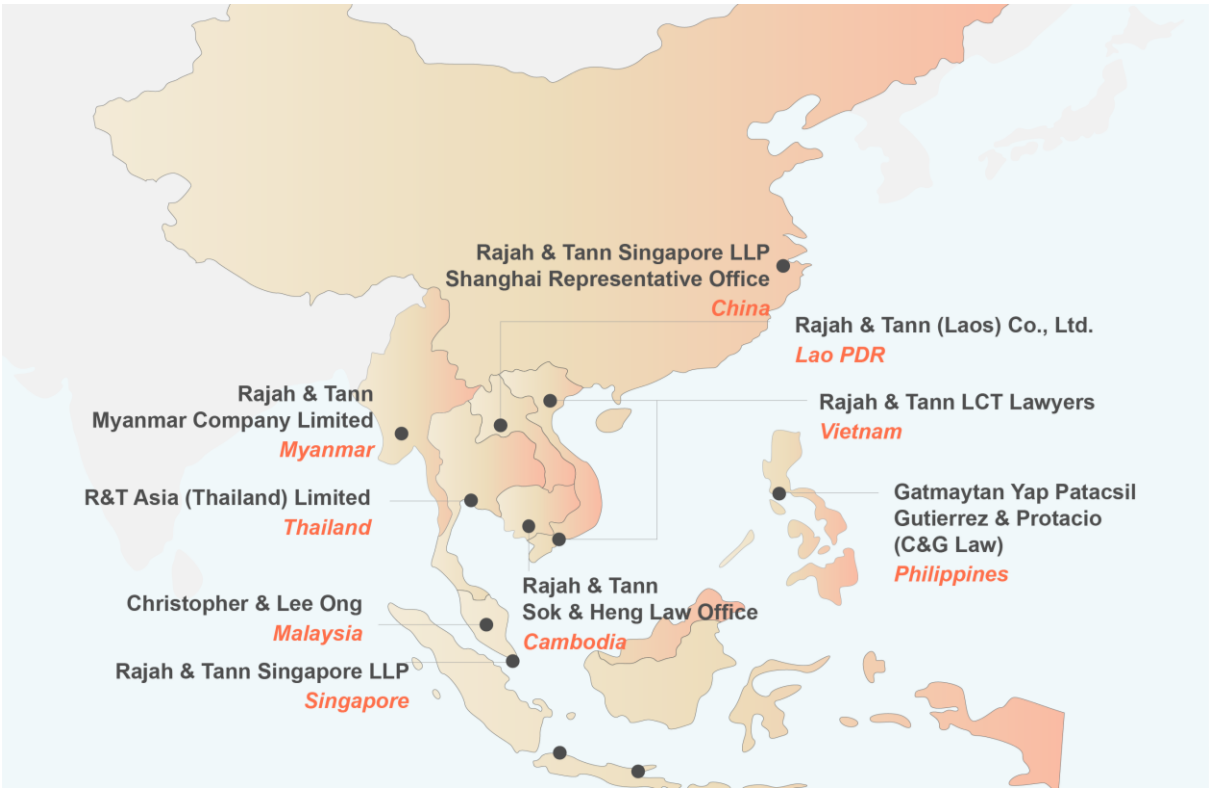

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