



# Tax Bulletin

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## Capital gain or employment income - a perpetual conundrum?

### **In brief**

This Income Tax Board of Review decision in *UZF and another v The Comptroller of Income Tax [2025] SGITBR 4 (UZF)* settles a frequent dispute with respect to when payments made to employee-founders under a share sale agreement are taxable as employment income under section 10(1)(b) of the Income Tax Act 1947, and when they are capital in nature as part of the purchase price.

The Board held that payments made by the buyer to two employee-founders were capital payments in consideration for warranties and restrictive undertakings given in a sale and purchase agreement (SPA), not employment income. This is a significant outcome for structuring founder and key-employee participations in mergers and acquisitions.

## Background

The appellants, a husband-and-wife team, were senior executives of a Singapore operating company (ZDRA Pte Ltd) within the ZDR Group, historically receiving modest salaries but a large share of annual profits under a quasi-ownership arrangement dating back to 2005. Although they had no legal shareholdings, contemporaneous notes and a draft shareholders' agreement evidenced an agreement that they would ultimately own 49% of ZDRA, and they received 50 to 70% of profits over time, declared as directors' fees.

In January 2014, NIR (the 100% shareholder of the holding company, ZDR Ltd) sold all shares in ZDR Ltd to XHS Europe B.V. The SPA named the seller (NIR), the buyer (XHS), and the two appellants, with Clause 3 setting out the purchase price and payment formulae. The appellants were expressly described as key employees and parties who would give warranties and undertakings to the buyer.

Under the SPA, each appellant received: (i) a one-off 'Base Price' payment in 2014; and (ii) two annual instalments of an 'Annual Additional Price' in 2015 and 2016, with further instalments ceasing after they resigned in June 2016 and executed a release in January 2017. The Comptroller later assessed the Base Price and Annual Additional Price payments as taxable employment income under section 10(1)(b) for the Years of Assessment 2015 to 2017.

## Issues considered

In deciding if the Disputed Payments were taxable the Act as employment income, the Board needed to determine if these payments arose in respect of the Appellants' employment in ZDRA Pte Ltd.

The Board referred to the High Court's framework in *ABB v Comptroller of Income Tax* [2010] 2 SLR 837 (ABB), which considers whether a gain is obtained in the taxpayer's 'capacity as employee,' looking at the true nature of the payment and all the accompanying circumstances. The test does not require the gain to reward services; the focus is whether it is paid in return for being or acting as an employee.

Accordingly, the Board examined:

- whether the appellants were quasi-owners of ZDRA;
- the capacity in which they took part in the SPA and gave warranties/undertakings;
- the purpose of the payments under the SPA; and
- other ABB factors (payer identity, recurrence, linkage to employment agreements, etc.).

## The Board's findings

The Board found that in substance, the disputed payments were received by the appellants as consideration for the warranties/undertakings given in their capacity as quasi-owners and did not arise from their employment. Accordingly, the disputed payments were not taxable as employment income under section 10(1)(b). In arriving at this outcome, the Board considered the following:

- The appellants' quasi-ownership in ZDRA was substantiated by contemporaneous records. Handwritten and typed notes from 2005 to 2006 and a 2007 draft shareholders' agreement evidenced an intended 49% stake and escalating profit shares. The sustained profit distributions (50% to 70% through 2013) also supported that these were made to them in their capacity as quasi-owners, not as employee bonuses.
- The appellants were parties to the share sale by NIR of ZDR Ltd, and only NIR and the appellants shared in the purchase price with no other employee being a party or giving buyer-facing warranties. The warranties concerned ownership and company matters which are typically given by sellers, and their time limits were tied to completion of the SPA, not to the appellants' period of employment.
- Clauses 3.2 and 3.3 of the SPA stated that the Base Price and Annual Additional Price payments to the appellants were 'in consideration for' giving warranties and undertakings. The Board held the wording was unambiguous and, on the evidence, supported the true purpose of the consideration being provided for buyer-facing warranties/undertaking, and not remuneration for employment.
- The clawback provisions and non-payment applied only where a party became a 'bad leaver,' and similar provisions applied to NIR, which was not an employee. The Board viewed these as commercial price-adjustment mechanisms to reflect a change in value if key employees departed, not as inducements for continued employment.
- The Base Price and Additional Price formulas referenced the ZDR Group/Buyer group EBITDA and pre-completion metrics which are tied to the value and worth of the group being acquired rather than to individual performance of the appellants. The Base Price was one-off and the additional price finite in tranches unlike open-ended employment remuneration. The payments were also not provided for in either the 2005 or 2014 employment agreements.

## Concluding remarks

UZF is the latest in a line of similar cases from *ABB v. Comptroller of Income Tax* [2010] SGHC 46, *GCT v. Comptroller of Income Tax* [2020] SGITBR 3 to *GFG* and another *v. Comptroller of Income Tax* [2023] SGITBR 1, all of which produced outcomes both for and against the taxpayer. In assessing the tax consequences of transaction-related payments, there is a need to consider all relevant facts and circumstances of the transaction to understand the true nature and purpose of the payments. Invariably, the position is further complicated if the recipients are both owners and employees of the company but the distinction can nevertheless be made with clear documentation of the intention and purpose of the entire payout or its different components, where relevant. The case also showed that the decision can turn on the most minute details so it will be important to carefully structure such compensations to achieve the anticipated tax treatment.

The case also serves as a reminder that the "capacity as employee" test remains the touchstone, and that one must focus on both the form and substance of the arrangement to determine the true nature of the gain.

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