Tax Management in the Dark: How Do You See The Light?
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Once again, Budget season casts tax in its annual limelight. In the excitement of possible new incentives, schemes and reliefs, one should not forget the risks that could be associated with managing your company's tax affairs. Are you in the dark about tax? If your tax footprint is a black box to you, how can you manage your tax risks?

The question may not be whether you want to comply with your tax obligations (we assume you do), but whether you know how to. In order to properly address compliance issues and develop the appropriate tax strategy, management needs access to information on all the taxes the business bears and collects. It only seems logical that management should not be left groping in the dark. Yet, observers may be surprised at how few taxpayers have clarity over their overall tax position when it can be such a significant line item.

For many Singapore-based businesses, the tax risks go beyond local shores. Many manage regional operations from here and Singapore is far from being the only jurisdiction with a changing tax environment. Complex and often unclear tax rules, aggressive tax authorities and significant tax rates in Asia add to a regional controller's headaches. Businesses are often overwhelmed by the rapid pace of change, lack of in-house tax resources, and handicapped by limited experience in tax disputes. If you think your Singapore tax matters are a grey area, then your Asian tax matters could be a complex web of dark matter.

Measurement also goes beyond the obvious corporate tax bill. The World Bank-PwC Paying Taxes study 2013[1] found that on average, corporate income tax is only 36% of a business' overall tax cost globally. Other tax costs may consist of indirect, property and labour taxes. The proportion of each tax type varies with the operating environment and varies with each taxpayer's profile. What your actual overall tax footprint is is difficult to gauge without a proper measurement framework.

What's more, the devil is in the detail. Even if you get your territorial and type of taxes right, you may still get, for instance, the classification of income and direct expenses to different tax rates wrong. In a tax incentive filled world like Singapore, businesses have always been expected to meet and maintain compliance requirements before qualifying for tax incentives. Obtaining a tax incentive goes beyond the (sometimes) attractive concessionary tax rates available. With great incentives, come great responsibilities. Tax incentives require compliance with detailed conditions applied to complex practical situations, the process of which management may not be familiar with. As they say, there is no such thing as a free lunch.

[1] A copy of World Bank-PwC's Paying Taxes 2013 study can be downloaded for free via http://www.pwc.com/payingtaxes

What Happens if You Get Tax Wrong?

These are but some ways to trip up if businesses do not have clarity over their own tax matters. Tax authorities expect taxpayers to get their house in order. Implications of non-compliance could be severe and costly.

Take Singapore as an example. The Inland Revenue Authority of Singapore (IRAS) is revising its focus on tax management and compliance, and linking it to certain tax reliefs or incentives. On the Goods and Services Tax (GST) front, GST-registered businesses who wish to apply or renew this Major Exporter Scheme status (MES) to enjoy relief from import GST have to undergo an Assisted Self-Help Kit (ASK) review from 1 January 2013. Businesses who fail the ASK review may not be granted or extended MES status.

For income tax, IRAS is stepping up review of key risk areas. It is scrutinising the classification of income and direct expenses for incentivised businesses, issuing health-check questionnaires and more in-depth queries. Hefty penalties of up to 200% (or more) of tax underpaid and / or disciplinary action can be imposed when errors are discovered.

Conversely, carrots are dangled to encourage taxpayers to self-assess and self-correct their tax ”oversights”. The Assisted Compliance Assurance Programme for GST is partially subsidised to encourage businesses to self-assess their controls and enjoy auto-renewal of certain relief schemes. Another initiative - IRAS' multi-tax Voluntary Disclosure Programme, offers reduced penalties of 0% or 5% (a good deal compared to 200%) of tax underpaid and was enhanced as of 1 January 2013 to encourage taxpayers to step forward with self-initiated correction of errors.

How Then, Do You See the Light?

Much as businesses may wish to manage their tax affairs, the task may prove challenging until they have clarity over their tax liabilities and risks.

As awareness grows, more businesses are seeking ways to provide management with regular and comprehensive updates on their tax footprints. Some have relied on tried and tested frameworks such as PwC's Total Tax Contribution[2] (TTC) methodology to measure and analyse all the taxes and contributions borne and collected locally, regionally or globally.

[2] TTC is an economic study of a business' overall cash-tax footprint borne and collected as well as the associated resources spent on corresponding tax management. More information about the TTC framework can be found via http://www.pwc.co.uk/tax/issues/what-is-total-tax-contribution-framework.jhtml

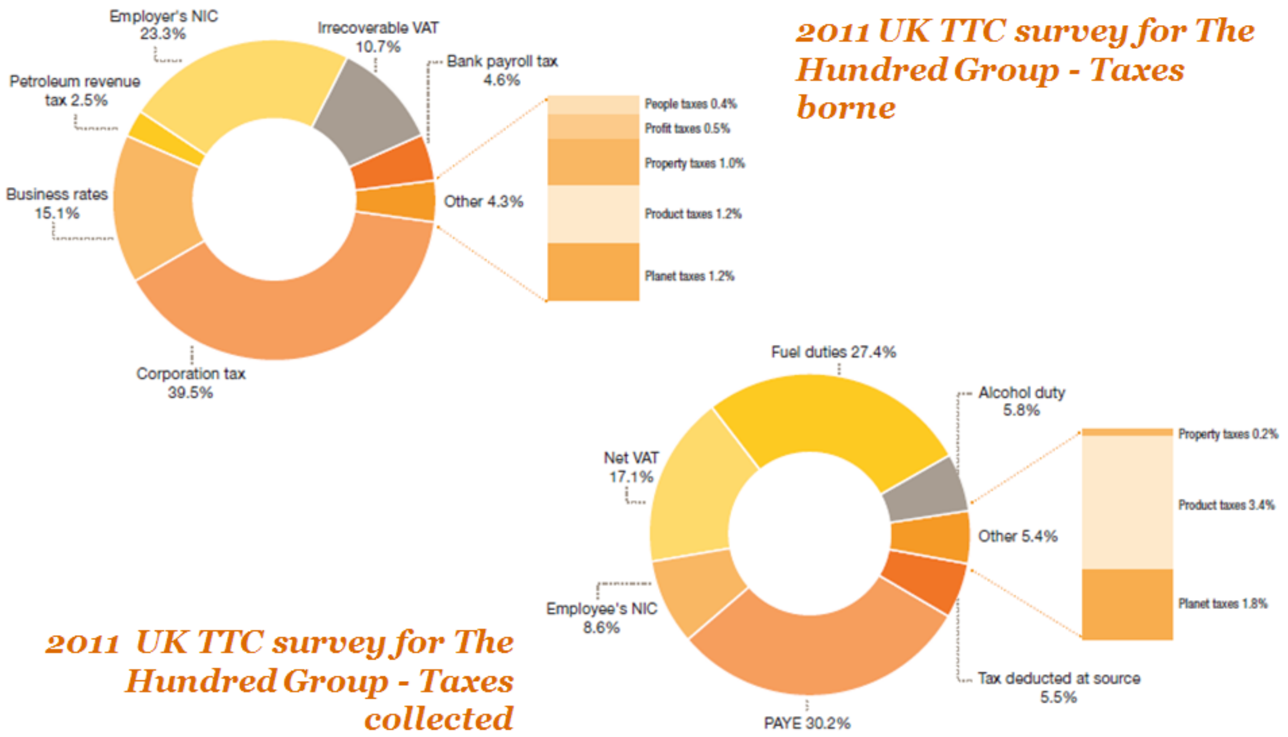

Figure 1: Example of an overview of the taxes borne and collected from PwC's 2011 Hundred Group survey (an annual study of the TTC for UK's hundred largest corporations).

Whichever method used, a robust methodology provides visibility of potential tax planning areas and expected tax costs (i.e. light!). It allows businesses to anticipate, analyse and plan for timely action to correct errors. It facilitates dialogue about whether each tax type is managed and adequately resourced with the right expertise in each jurisdiction. It allows benchmarking where data is available. TTC users also often leverage on findings to provide regular updates to their directors (and in some instances, the public) on their comprehensive tax positions.

At the end of the day, managing your taxes is simply a matter of good corporate governance. If not done, or done poorly, the implications can be costly. Measurement is the first step to illuminating the way forward in a complex tax terrain. So, if you have not yet started measuring your tax footprint (and if you do not want to trip over in the dark), it is timely to have that discussion sooner rather than later.

This article first appeared in Singapore Business Review. For more information, please contact Soo How or Kexin at 6236 3388.