Can Tax Planning be Whiter than White?

By **CHRIS WOO**, Tax Leader, PwC Singapore

In this age of interconnectedness and demand for greater transparency, tax systems around the world have grown incredibly complex as they attempt to reconcile the demands of international businesses and domestic needs of their populace. A by-product of these attempts is tax planning, a legitimate exercise that is nevertheless fraught with subjective considerations. But what exactly does tax planning entail, and what should boards be mindful of?

Governments around the world face complex and interconnected choices about how to keep their countries competitive, how to encourage job and wealth creation that feeds local economies, and how to reward such activity whilst ensuring sufficient tax revenues to fund public spending. Singapore, for instance, is pressed to fund better healthcare and education, support young parents, and keep the country secure.

Almost without exception, the solution to these issues has been taxes. However, in recent years, there has been much concern internationally about tax systems and those operating them. These concerns, like the tax systems themselves, sit within a broader dynamic of societal, economic and political change; *and* they are framed by an apparently eroding level of public trust.

Framing the debate on tax

The debate on tax is complex. It comprises multiple interconnected issues, each of which is of a different nature and requires specialised responses. For many businesses, the entire context matters, not only because of the financial costs, but because multi-country taxes have real and significant risks for their business models.

When we talk about "the tax system", it is important to remember that – at least as far as society is concerned – this includes both the rules of the system itself (driven by underlying tax policies) and the behaviour of all players operating within it (taxpayers, advisers and intermediaries, and tax authorities).

It is also important to appreciate that there is no such thing as an "international tax system" per se. Every tax system is inherently local, grounded in country-based legal systems, and aimed at benefiting the local economy. There are, however, some common principles which determine how local tax systems should interact in relation to international business or other cross-border activities. It is this area of interaction that has caused the greatest concern and tension.

Where we are now

Most tax systems are broadly designed to achieve an outcome in which tax is paid, once and only once, on profits generated in the country where the business operates (i.e. trading "in", rather than trading "with").

However, in recent decades, businesses have evolved to the point that the value attributable to intellectual property, increased remote selling through digital platforms, and the resulting taxable profits have become increasingly separated from the location in which the sales actually take place. In many cases, they have become more closely associated with the location of "higher value-add" activities.

Alongside that evolution, in an effort to enhance their own economies and national welfare, many countries, including Singapore, compete with other favourable tax regimes to attract activities and entities that create value. In turn, this generates domestic tension as countries grapple with what their future tax systems need to look like and how they need to transition.

Countries are also having to think about their future in a connected world, and this has generated tension. The conflict between the US and the EU – expressed through conflicting tax reform and retaliatory measures – is a case in point, as are the perceptions about tax havens.

Categories of concern

In an attempt to "unpick" a tangled debate, the concerns can be split into three categories:

- Tax fraud
- Tax planning with intended outcomes
- Tax planning with unintended outcomes

The intended and unintended outcomes relate to what is intended/unintended by the authorities. Though the issues are complex and it is often difficult to draw clear lines between them, these categories help bring some clarity to boards. In particular, they help the board focus on the most appropriate responses to the different issues that arise – including the very real possibility that a company's profits may be subject to tax in multiple jurisdictions.

"Blacker than Black" - Tax fraud

This category encompasses tax evasion, the hiding of taxable income and assets from tax authorities, the fraudulent claiming of reliefs, and "the hidden economy".

All boards cannot legally – either in Singapore and elsewhere – be knowingly involved in any way in tax fraud or evasion. Many countries specifically mandate an official notification if either activity is suspected; and, increasingly, intermediaries have a legal responsibility to detect and prevent such activity.

A robust corporate tax policy and appreciation of the need for tax compliance is key. Specifically, boards need to ensure that a system of tax controls are put in place by in-house and independent tax professionals. Technology can also help flag irregularities and identify areas that warrant further internal investigation, so that they can be properly addressed and disclosed, without warranting an intervention by the authorities.

"Whiter than White" - Tax planning with intended outcomes

In this category are government-sponsored incentives and all forms of planning that are consistent with the intention of the government's tax laws.

It does not, however, automatically follow that these laws, and the policies behind them, are either known about and well understood by ordinary citizens or are considered "fair". It also does not mean that governments of other countries (or, for that matter, NGOS and the public) will agree on what is an "acceptable" outcome. This is especially if countries feel that they are not getting an appropriate share of tax from globalisation. Such tensions and disagreements are very likely to worsen.

These issues are exacerbated by international tax competition and tax systems that have not kept up with the digital age.

"Lux Leaks" is a classic example where the tax structures involved were known to, and endorsed

by, both the Luxembourg tax authority and several EU member states, but the other member states branded them as unfair competition.

Against this backdrop, boards have to make longer-term strategic decisions, all of which carry domestic and international tax implications. They must also make informed decisions about their tax obligations, the choices available to them as they balance their responsibilities to stakeholders, and the management of tax cost and risk of operating in multiple jurisdictions. Singapore companies with operations outside Singapore need to be very aware of and take proactive steps to manage this.

"Shades of Grey" - Tax planning with unintended outcomes

This category encompasses tax planning that, whilst having a valid basis in a strict interpretation of the law, may not reflect either the tax law in question or commercial reality. The result is an outcome that's unintended by the authorities.

Drawing a line between the second and third categories presents significant challenges given the aforementioned tax competition and the lack of consensus and/or alignment of intent and philosophical approach to tax between individual countries and the broader region. Even without that international dimension, intent can be difficult to ascertain when applying law to a wide range of specific circumstances, some of which may never have been envisaged at the time of drafting the law.

It is, of course, easier to spot a course of action that is clearly within the legislature's explicit intent, but the wide ground in between requires professional judgement and a sophisticated understanding of different stakeholder perspectives – qualities that are not always present during heated tax debates.

Indeed, much of the ethical debate about taxes concerns both categories of tax planning. While the act in itself is legal, leveraging an arrangement for a tax advantage is often perceived as unethical.

Taxing the board

A fundamental issue is to whom does the company owe a duty? Is it the company's duty to maximise profits for shareholders, which in turn makes tax planning ethical, or is its duty to be mindful of the broader community that it operates in – which may make tax planning unethical?

The judgement of the board must canvass all these issues in all their complexity. The short answer to the questions posed above is that responsibility cannot be limited to what is technically legal. The board must assume a position of full transparency (including the full disclosure of relevant facts and circumstances) towards tax authorities.

Any tax professional's advice must be provided on a similar basis, and include a well-considered assessment of the broader economic, commercial and reputational risks of different options available to the board.

As tax regimes in various countries evolve, boards must become more involved in tax matters and consider the various broad tax implications associated with the strategic decisions they make. This is especially so given the regional and global footprint of modern businesses. The risks of double or even triple taxation are higher and there are also potential reputational risks. ■