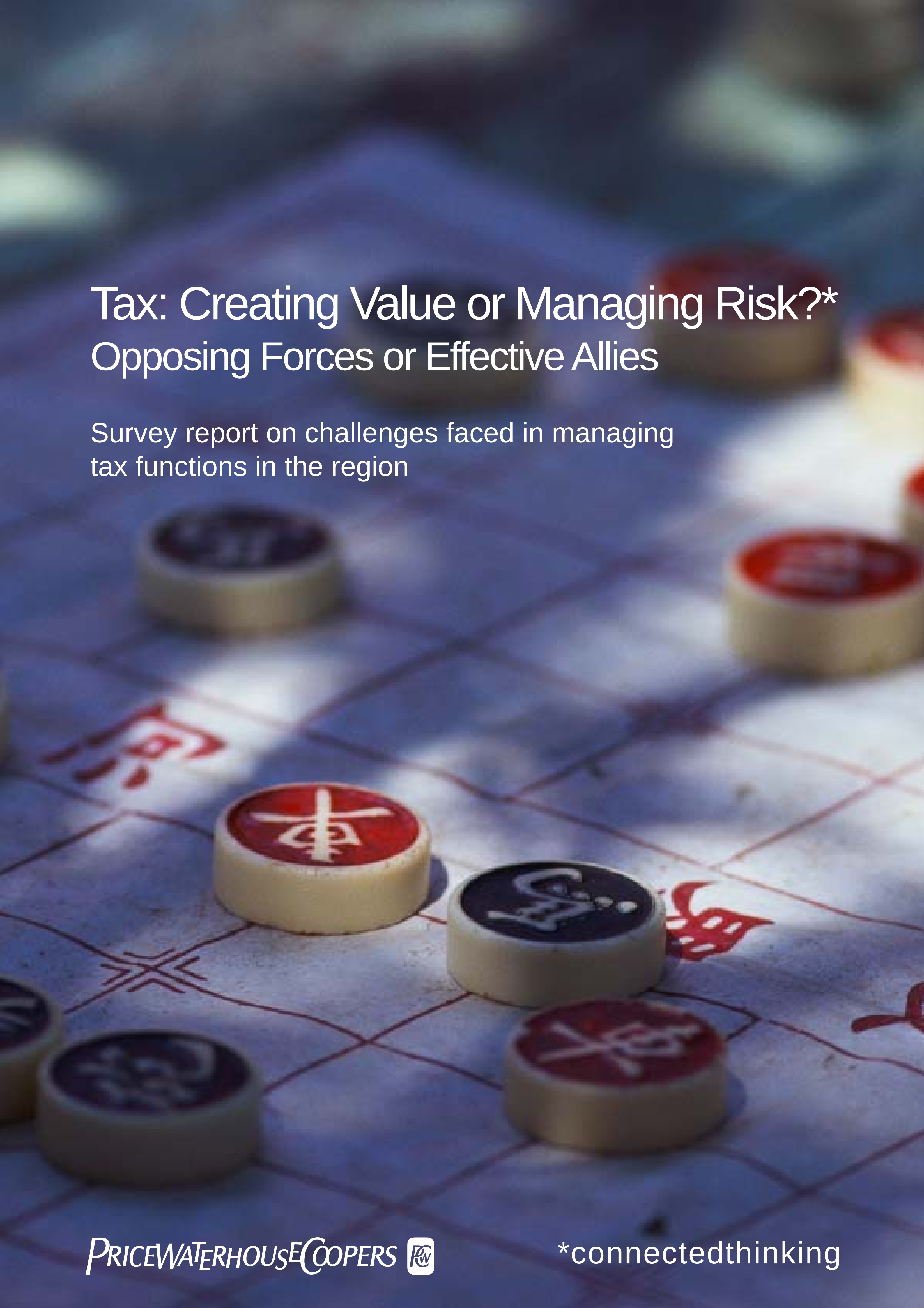


Tax: Creating Value or Managing Risk?*

Opposing Forces or Effective Allies

Survey report on challenges faced in managing tax functions in the region

PRICEWATERHOUSECOOPERS

*connectedthinking

Foreword

The tax affairs of organisations are rarely perceived as glamorous. Compliance with tax laws and regulations involves necessary but mundane activities. So why is it important to manage an organisation's tax affairs? The obvious answer is that effective tax management can have a material impact on an organisation's bottom line. However, in today's corporate world it goes further, impacting on areas such as reputation, directors' liabilities and future shareholder value.

We have seen corporate scandals, the introduction of the Sarbanes-Oxley legislation in the US and similar legislation in other countries. There is an increasing global focus on risk management. Today's organisations must develop and implement tax strategies that address the twin goals of value creation and risk management.

The economic growth in the Asian region, fuelled in particular by the growth in China, has led to the expansion of regional activities of both local and multinational organisations. This presents tax challenges as cross border transactions increase whilst tax laws and practices continue to develop and change throughout the region.

In this increasingly difficult tax environment for organisations in the region, we decided to conduct a survey to provide insights into the key tax challenges they face today. Based on the information provided by respondents, we have summarized the findings in this report. It provides feedback and observations on their priorities, attitude to risk and the strategies and processes they have in place to manage risk and create value. We wish to extend our sincere thanks to all the participants for their contribution.

Rod Houng-Lee
Regional Leader – Taxation Services
PricewaterhouseCoopers

Contents

In this increasingly difficult tax environment for organisations in the region, we decided to conduct a survey to provide insights into the key tax challenges they face today.

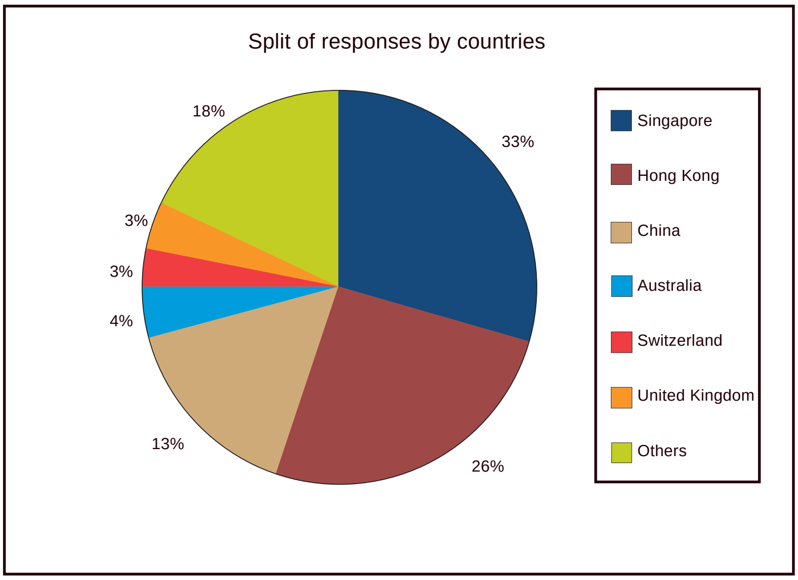
1.0
Survey Participants and Methodology

We conducted an online survey in November 2004 to seek the opinions of management involved in making strategic tax decisions in their companies.

The survey comprises 12 key questions on tax challenges, risks and extent of implementation of tax strategies and processes. The results provided us with valuable insights into the key challenges facing tax functions in the Region.

It was made available online to management in charge of making strategic tax decisions across the region and across industry groups. Responses have been collated and aggregated to ensure confidentiality of respondents.

Profile of participants: Ninety clients took the opportunity to respond. The majority of the responses were from Singapore and Hong Kong/China. A split of the responses by country is shown below:



We are aware that the "Tax Function" can take many different forms in companies in the region. Some have large global and regional tax teams staffed with experienced tax professionals. Others have a tax function that is part of the Finance Department or is split with responsibilities in Finance and the local business units. Some Tax Functions may report to local CFOs, Finance Departments or business units, others may report directly to a global Head of Tax. In addition, some may do all work in-house while others may have outsourced all or some tax work to external service providers.

We recognise that the models differ from company to company. However, we believe that this does not change the overall corporate responsibility of ensuring compliance with tax laws and enhancing shareholder value through effective tax planning. The form of tax function should have no significant impact on the key issues faced by senior management responsible for making key tax related decisions.

The results of the survey will also help us plan our upcoming regional tax conference held between 15th–17th May in Singapore focusing on topics that are relevant to our clients. We hope the survey responses will also provide you with useful insights into the key tax issues facing tax functions, whatever form they may take.

2.0
Report Highlights

This report outlines the results of our survey on the challenges faced in managing tax functions in the region.

The results highlight that value creation and risk management are primary objectives of tax managers today. As a result, formal tax strategies to achieve both the management of material tax risks and the creation of shareholder value, remain high on the agenda for all tax functions.

They also align with our own view that tax risk management and value creation are symbiotic in nature. One objective cannot be viewed or managed in isolation from the other. A successful tax function must be capable of managing tax risk, ensuring compliance, advising businesses and managing people to both protect and create value for the organisation.

Highlights of our survey are as follows:

- China ranks a clear number one in the list of countries that provide the greatest tax challenge in the region with India ranked as number two. Korea, Japan, Australia and Indonesia follow. These results reflect the level of economic activity and investment into China and India, as well as the complexity of local laws and practices. Korea, Japan and Australia are more mature locations for multinational investment but the local tax laws remain complex and management of local tax authorities present significant challenges.
- Transfer pricing is the area of taxation that presents the greatest risk for tax functions with 66% of respondents identifying it as high risk and only 6% identifying it as low risk. This result is not unexpected given the uncertainties created by transfer pricing practices in the region and the difficulties and costs associated with risk management strategies such as advance pricing agreements.
- The most challenging corporate tax issues are the creation of permanent establishments and management and service fees. Along with the transfer pricing, tax issues associated with cross border trading and management structures are causing significant difficulties for tax functions in the region.
- The number one challenge for tax functions is value creation. This is an interesting result at a time when there is an increasing focus on risk management and compliance. Tax planning is still the most highly valued attribute of the tax function. This is further supported by the survey results that show 80% of respondents would undertake any tax planning opportunities provided they are supported by a credible basis in tax law and 86% would change a commercial transaction to take advantage of tax planning opportunities.
- While value creation remains a top priority, only 19% of respondents have fully implemented processes to measure value creation as a performance indicator for the tax function.

- While a significant majority of tax functions have some form of tax strategy in place, only 26% have a strategy that is fully documented and agreed with senior management and only 37% have fully implemented a process to identify and report the risks that they manage. Given the importance of financial risk management for companies today it is a concern that these figures are not higher.
- The majority of tax functions are actively involved in providing tax advice to their businesses. Some degree of tax function sign off is usually required for tax sensitive transactions and tax is often involved at an early stage.
- Most companies have implemented some processes to provide effective tax compliance, accounting and payment functions but in fewer instances are these functions highly automated. There is generally a medium to high degree of comfort that sufficient controls are in place to address compliance risk.
- The majority of respondents had a moderate or high understanding of the requirements of Sarbanes-Oxley Section 404 and had made good progress to meeting these requirements where they applied to their company.
- 37% of respondents had a low degree of comfort that controls are in place to cover risks associated with tax disclosure in the financial statements.
- When looking at the management of relationships, people and costs, the top two priorities are the management of relationships with fiscal authorities and finding tax staff with the required experience. Most respondents were of the view that both priorities were adequately or well managed.
- The majority of respondents indicated that their budget for work by external consultants had increased over the last three years with the focus on both compliance and tax planning and advisory services.

In conclusion the survey highlights China as the most challenging country and transfer pricing as the most challenging area of tax. Tax risks associated with international trading and management structures in the region are high on the agenda for tax functions.

The emphasis on planning and value creation demonstrates that tax functions have come a long way from the days when they were little more than embedded tax compliance teams. However, in today's environment, companies cannot lose sight of the fact that they need to remain compliant with tax laws and practices. Value creation and value protection are the twin goals of today's tax function.

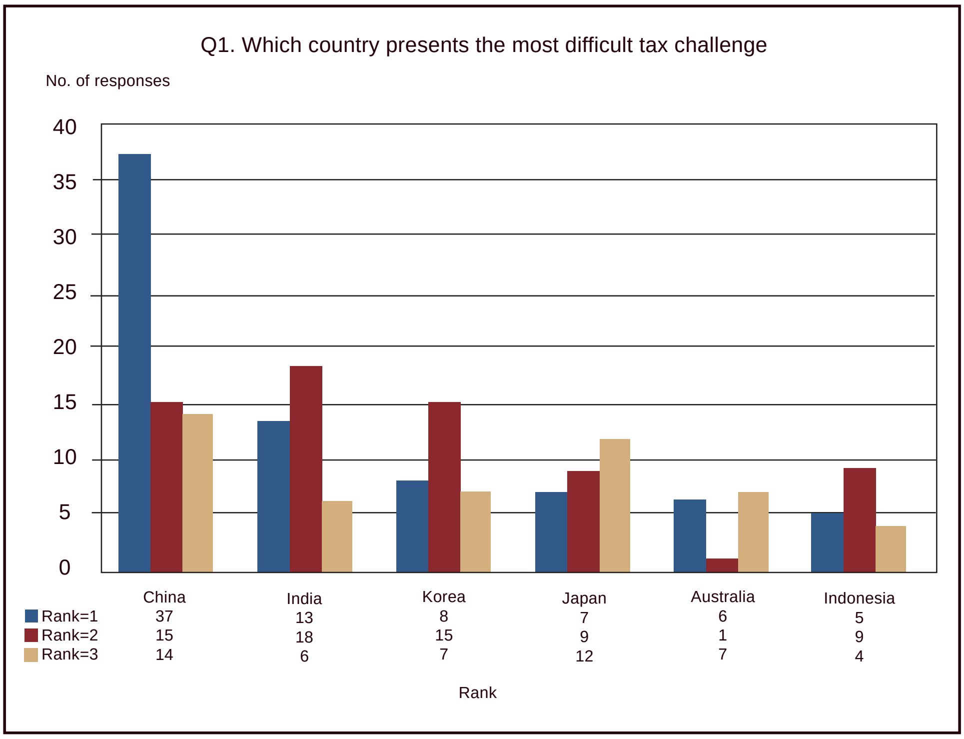
3.1

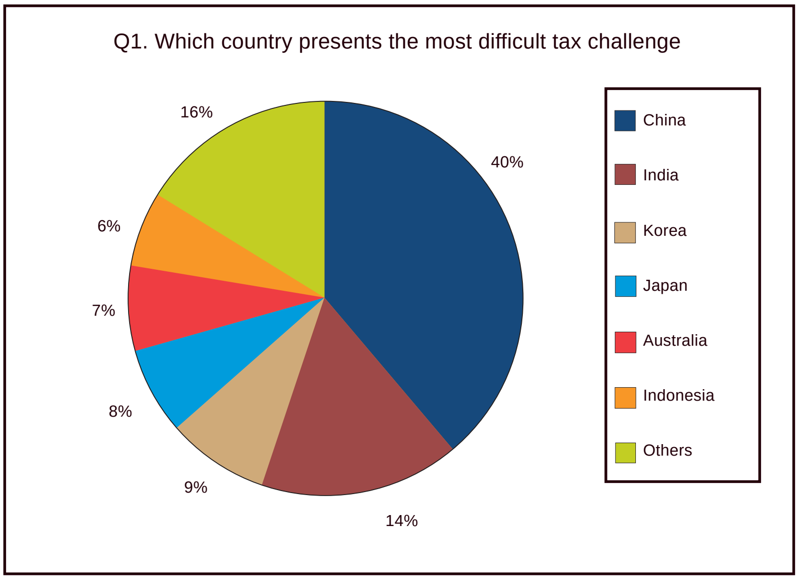
Which Asian Countries Provide the Greatest Tax Challenges?

Question:

Rank the 3 Asia Pacific countries that present the most difficult tax challenges for your company.

Summary of Responses:





Comment:

The survey results clearly place China as the country that presents the greatest tax challenge for companies in the region with India ranking a clear second. Korea, Japan Australia and Indonesia follow.

These results are not unexpected. There are several reasons which explain this. Firstly, the growth in economic activity in China and India means that both domestic and inbound companies are expanding their operations in these countries. Regions of high growth and expansion invariably present significant tax challenges.

A second reason is the complexity of the local tax legislation in these countries. Companies have to deal with complex local tax legislation as well as develop relationships with and understand the views of local tax authorities. As one respondent commented - “customs and tax rules and actual practices/ implementation in China pose a challenge due to differences in interpretation”. Further, we must not discount the cultural and language differences as factors contributing to the difficulties faced by companies entering these markets.

Not surprisingly, China did not rank highly for respondents in certain business sectors where the opportunities for business expansion are limited by government regulations. However, the high overall ranking further indicates the importance of China to companies that have business operations in country.

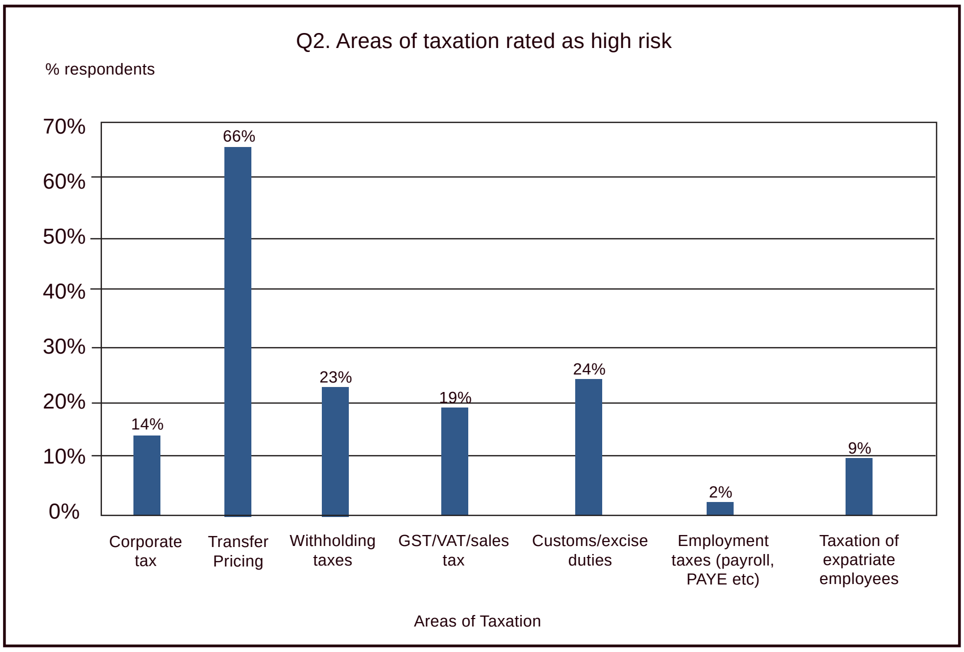
Korea, Japan and Australia are more mature markets but continue to present challenges for many companies, particularly inbound investment by multinational companies. Again uncertainties in the application of complex local tax laws and the practices of the local tax authorities are often cited as the reasons for the difficulties companies face.

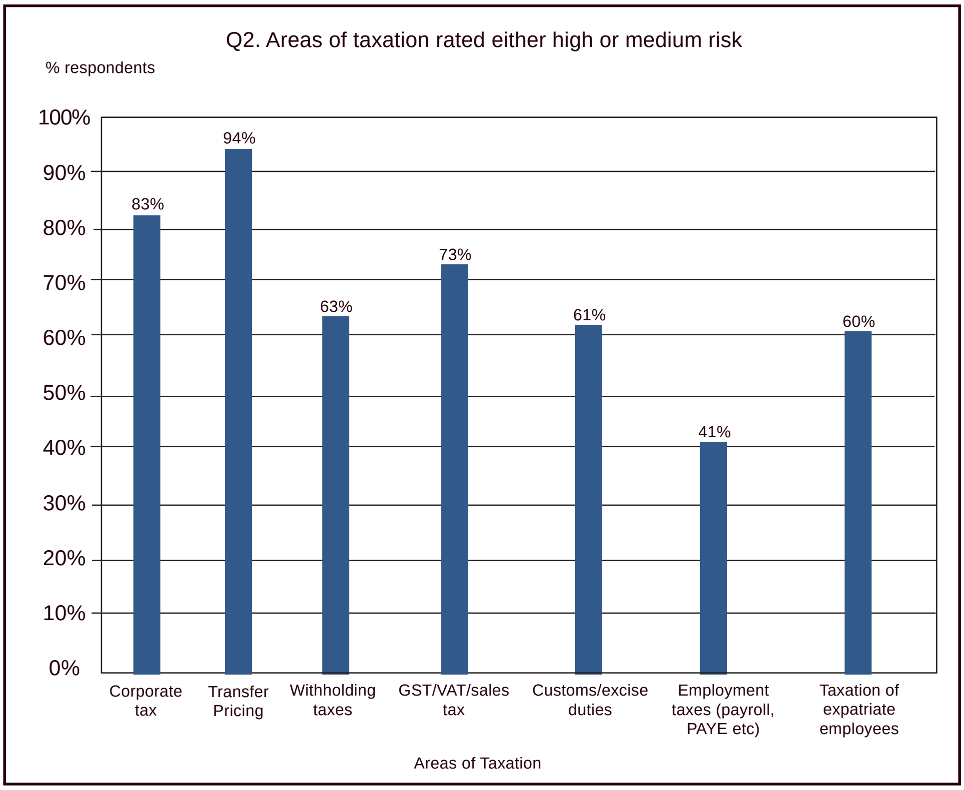
Transfer pricing stands out with 66% of respondents rating it as high risk.

3.2
Areas of Tax Risk

Question:
What degree of risk do you associate with each of the following areas of taxation?

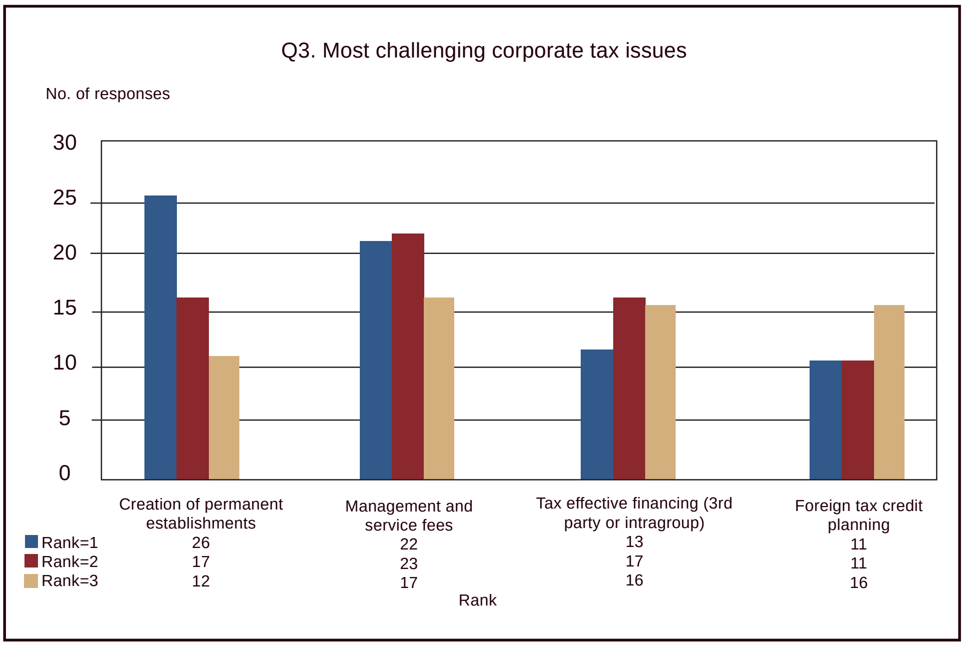
Summary of Responses:

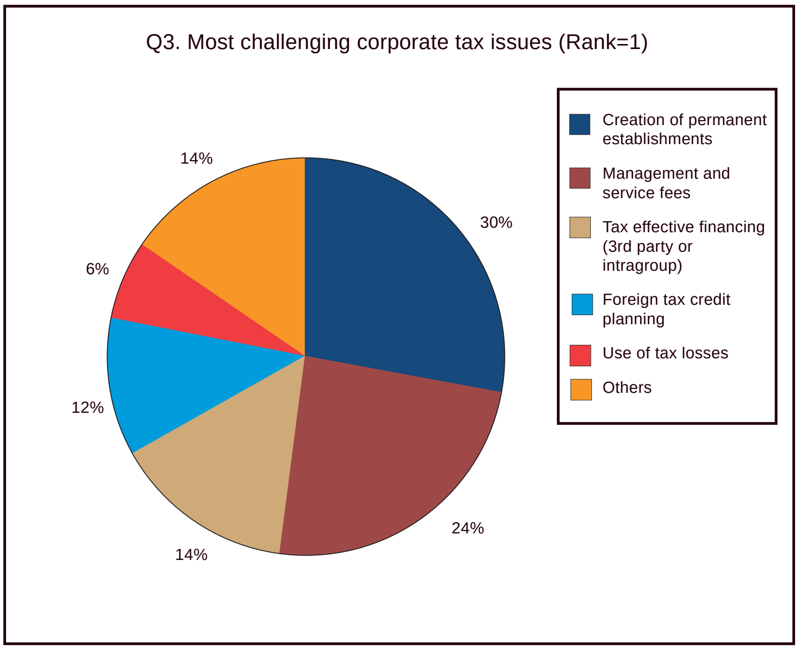




Question:
Rank the top three areas of corporate tax that present the most difficult challenges for your company

Summary of Responses:





Comment:

Transfer pricing stands out with 66% of respondents rating it as high risk. This is consistent with the results of other recent surveys. It is also interesting to note that once we narrow down the focus of the question to corporate tax issues, the two top challenges are the creation of permanent establishments and management and service fees. These issues interlink and demonstrate the challenges of international trading and service structures in the region.

The majority of respondents rate other areas of tax associated with international trade and services as medium to high risk. These include customs and excise duties, GST/VAT and withholding taxes.

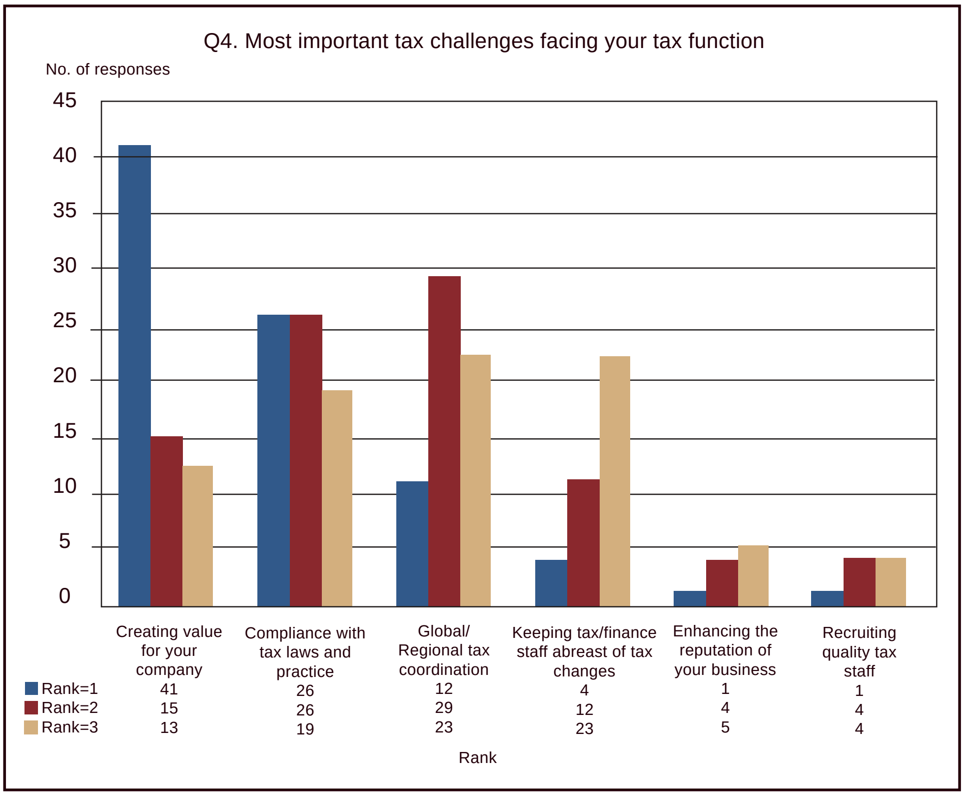
Other areas of concern highlighted are interpretation of tax treaties, recovery of common costs, specific elements of transfer pricing, and principal/distributor structures. The results indicate that these fundamental issues associated with international trade and the provision of services in an international group are areas of immediate concern compared with the more complex tax structuring options associated with areas such as tax efficient financing, foreign tax credit planning and loss utilisation strategies.

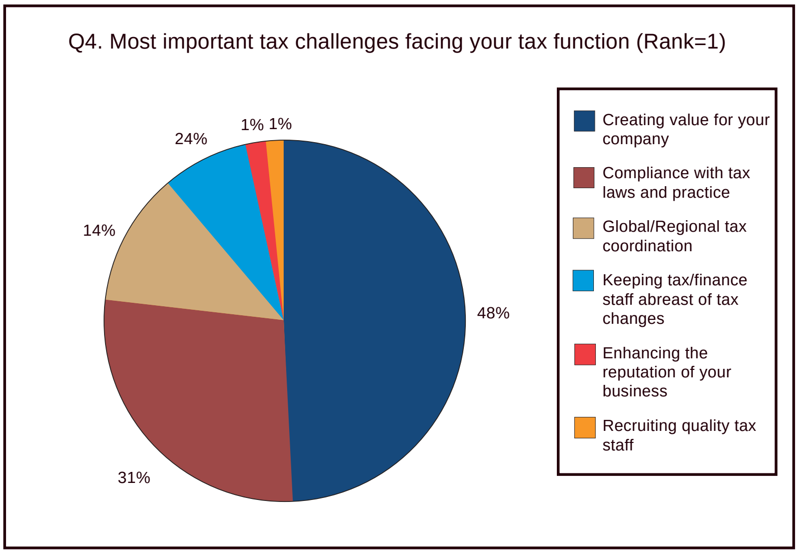
While issues associated with transfer pricing, the creation of permanent establishments and service fees may be fundamental, they are also areas where the practices of the local tax authorities in each country in the region are critical. In many cases, the views of the authorities are still developing and the only solution to avoid material tax exposure is to engage in a dialogue with the local tax officials. This is evidenced by the increasing use of advance pricing agreements in the region.

3.3
Challenges for the Tax Function

Question:
Please rank the most important tax challenges facing your tax function

Summary of Responses:





Comment:

In the current environment, it is interesting to note that value creation is viewed by almost half of our respondents as the most important challenge facing the tax function with 77% rating this within their top two challenges.

The importance of value creation is very encouraging. It indicates that the majority of tax functions are focusing on adding shareholder value rather than just acting as a tax compliance factory. Some key points to note:

- Based on the responses to question 3.4 below, only 19% of respondents have fully implemented a process to measure value creation as a key performance indicator. Metrics for value creation are difficult and all have their problems. Some respondents indicate that effective tax rate management should be used as a performance indicator. This is one tool but other measures are needed to cover the impact of timing differences that can also create value. Taking risk can also create value but companies must define their tolerance for risk and measure value add only when it falls within the tolerance level. It is possible to book tax benefits today only to see them reversed on a subsequent audit or investigation by the fiscal authorities. Any measure of value created by a tax function must take such risks into account.
- The results illustrate the importance of tax compliance with 58% of respondents including it in their top two challenges and 31% rating it as their top challenge. With increasing regulation on accounting processes, controls and disclosure, companies must remain focused on their compliance obligations as well as seeking opportunities to create value.
- The responses also show that global and regional tax coordination remain a significant challenge. This highlights the problems faced by companies as they expand their operations throughout the region, often into countries where they have little in-house tax expertise on the ground.

3.4

Indicators that a Tax Strategy is in Place

Question:

Please indicate the extent to which the following have been implemented in your company:

Summary of Responses:

	Fully Implemented %	Partially Implemented %	Not Implemented %
A documented tax strategy agreed with senior management	26	54	20
Your total tax bill is communicated to and understood by senior management	40	53	7
Regular communication with senior management on tax matters	48	50	2
Clear roles and responsibilities defined for all areas of tax	33	65	2
Value creation is measured as a key performance indicator for the tax function	19	54	27
Risks managed by the tax function are identified and reported	37	58	5

Comments:

Only 26% of respondents have a fully documented tax strategy that is agreed with senior management. This is of some concern as taxes, in their various forms, are a material expense and/or a material area of risk for the majority of companies.

It is encouraging to note that 40% of respondents have fully implemented, and a further 53% have partially implemented, tax strategies to communicate the total tax bill to senior management and 37% have fully implemented (58% partially implemented) processes that can confirm that the risks managed by the tax function are identified and reported. These really go hand in hand.

As noted above value creation is a key objective for most tax functions, yet 27% of respondents have not implemented any processes to measure value creation as a key performance indicator. This highlights the problems of objectively and reliably measuring the value added by the tax function.

3.5

Indicators that the Tax Function is Operating Effectively

Question:
Please indicate the extent to which the following have been implemented in your company:

Summary of Responses:

	Degree of Implementation		
	High %	Medium %	Low %
A process for indicating the impact of tax changes	22	61	17
Tax function sign off for acquisitions and divestments	56	29	15
Tax function sign off for changes to corporate structure	62	26	12
Tax function for sign off for changes to systems/business processes	24	45	31
Early involvement of Tax in tax sensitive transactions	44	45	11
Effectively controlled tax compliance, accounting and payment functions	43	48	9
Highly automated tax compliance, accounting and payment functions	19	45	36

Comments:

These results indicate that the majority of respondents have a reasonable degree of confidence that some process is in place to manage the tax risks arising from tax sensitive business transactions.

It is interesting to note that far fewer companies have fully implemented a requirement for a tax sign off for changes to business systems and processes.

Tax returns, whether for direct taxes such as corporate tax or indirect taxes such as GST/VAT or excise duties, are generally based on the underlying accounting records. The information recorded in particular tax sensitive accounts is critical to the final outcome recorded in the tax return. Changes to business systems and processes can result in changes to the data that is recorded in particular accounts or in the way that the information is made available for inclusion in a tax return. It is therefore important that the tax function understands all changes that could impact on tax reporting.

As we have noted in many of the comments above, tax compliance must remain a focus for all companies. We would therefore have expected a significant majority of companies to have fully implemented processes to ensure effectively controlled tax compliance, accounting and payment functions. In fact, only 43% of respondents had a high degree of implementation.

We would also have anticipated that more companies would have had highly automated tax compliance, accounting and payment functions. Only 19% of respondents had a high degree of implementation. Manual handling of data such as the use of spreadsheets increases risk. The more data that can be handled through integrated systems the more the risk may be reduced.

3.6
Tax Planning – Attitudes to Risk

Question:
Please choose the most appropriate answer with regard to the following questions regarding tax planning in your company:

Summary of Responses:

	Strongly Agree %	Agree %	Disagree %	Strongly Disagree %
We will undertake any tax planning opportunities provided they are supported by a credible basis in tax law	30	50	17	3
We will undertake tax planning only if it is part of a wider commercial transaction	13	56	31	0
We will change a commercial transaction to take advantage of tax planning opportunities	11	65	22	2

Comments:

The responses to these questions are very interesting, particularly in light of continued tightening of disclosure and anti-avoidance laws in many countries.

76% of respondents agree or strongly agree that they would change a commercial transaction to take advantage of tax planning opportunities. This is a very strong response, given that there are countries with anti-avoidance laws that could apply specifically where such changes are made. The results demonstrate a continuing appetite for creative tax planning in the region.

Indeed one respondent even stated that "creative tax planning appears to be lacking ever since the Enron case". However the respondent then went on to highlight the difficulty of obtaining advice against the background of complex and uncertain tax laws and practices. Another comment notes that "there are a lot of uncertainties as to whether tax planning is within the law, clients have to take the risk most of the time, however fees have to be paid and as such there is no value creation for the company".

While these comments were aimed at the limitations of obtaining creative advice from consultants, they also highlight the problem associated with tax planning in the current environment. The survey results indicate a strong demand for tax planning in business transactions but that it is becoming increasingly difficult to provide definitive solutions. Risk management therefore must go hand in hand with creative tax planning.

It is interesting to compare the above results with the responses to the same questions asked of PricewaterhouseCoopers clients at a seminar in Europe. The responses indicate that less than 50% of the clients would undertake tax planning opportunities provided they had a credible basis in tax law (compared to 80% in our survey); less than 30% would only undertake tax planning if it was part of a wider commercial transaction (compared to 69%); and, in line with the results above, approximately 75% would change a commercial transaction to take advantage of tax planning opportunities. Europeans appear less inclined to undertake tax planning opportunities than their counterparts in the region but are more inclined to undertake tax planning on a standalone basis outside of any commercial transaction.

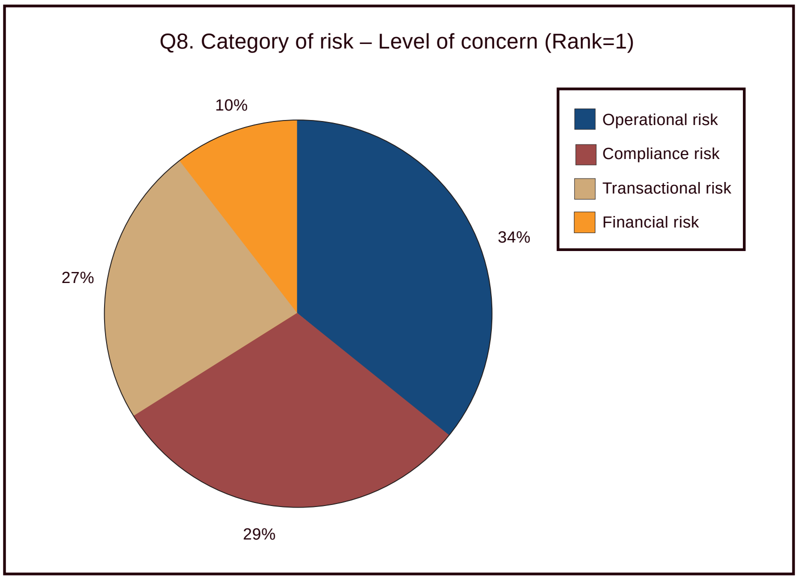
3.7

Management of Tax Risk
(including awareness of Sarbanes Oxley Requirements)

Question:
Please rank the following in order of concern and indicate your degree of comfort that controls are in place in your company to address each category of tax risk:

Summary of Responses:

	Degree of comfort that controls are in place			Rank in order of concern			
	High %	Medium %	Low %	1 %	2 %	3 %	4 %
Operational Risk	27	62	11	35	29	24	12
Compliance Risk	32	60	8	29	40	18	13
Transactional Risk	24	37	39	27	19	34	20
Financial Risk	30	33	37	10	12	23	55



Definitions:
- Operational risk – risk of not applying tax laws to routine operations
- Compliance risk – risk of failing to meet tax compliance obligations
- Transactional risk – tax risk arising on transactions (eg. acquisitions and disposals)
- Financial risk – risks associated with inappropriate disclosure in financial statements

Question:

Please indicate your level of knowledge of the requirements of Sarbanes-Oxley – Section 404 and the progress your company has made to meeting the requirements:

Summary of Responses:

	High %	Moderate %	Low %	Not Applicable %
Level of understanding of SO Section 404	30	50	17	3
Progress made towards meeting SO Section 404 requirements	13	56	31	0

Comments:

The results show a continuing theme. Less than 50% of respondents have a high level of comfort that controls are in place to address each type of tax risk faced by a company. This is a concern, particularly with regard to compliance risk and financial risk. These are areas where a significant majority of companies should have a high degree of comfort as they involve compliance with laws and regulations.

Similarly, those companies impacted by Sarbanes-Oxley section 404 should have a high level of understanding of the requirements of the legislation yet only 46% of those impacted fell into this category.

The results indicate that many companies have some way to go before they can be comfortable that they have controls and processes in place to effectively manage tax risk. For companies impacted by SO Section 404, it is a requirement that such controls and processes be implemented for any taxes that are material to the financial statements.

It is interesting to compare the responses to the first question above to those received from a similar survey conducted in Europe. When asked to rank the areas of risk in order of concern, far fewer Europeans ranked compliance risk as number one (only 12% as compared to 29% of respondents to this survey) and far more ranked financial risk as number one (25% compared to 10%). These results indicate a more mature European tax market where there is greater comfort that compliance risks are under control but a greater concern over accounting disclosure.

3.8

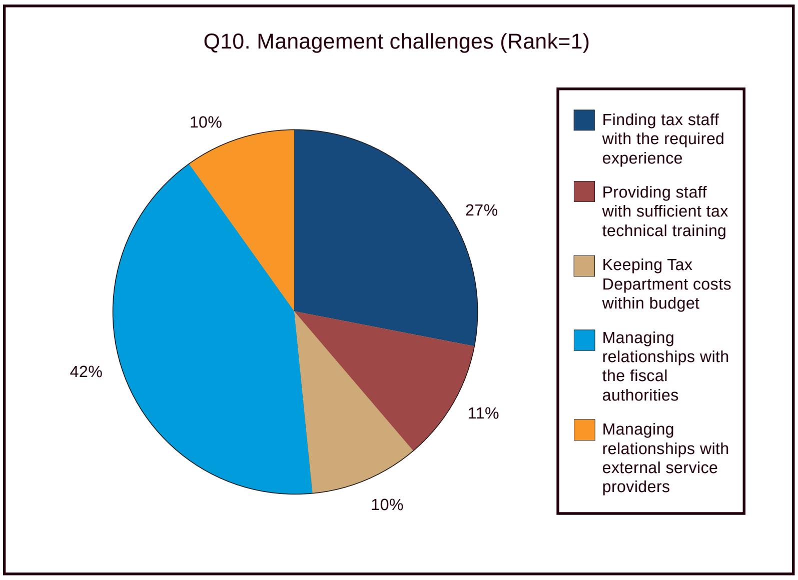
Management Challenges for the Tax Function

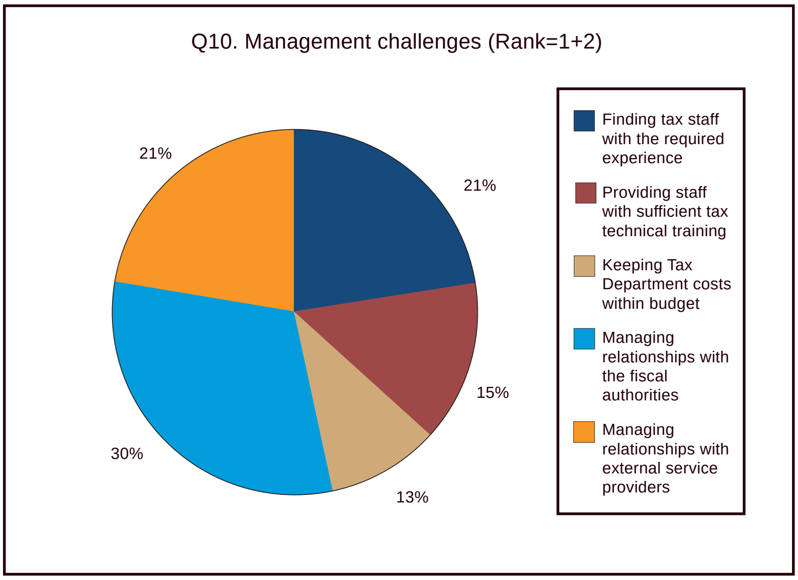
Question:

Please rank by level of importance each of the following challenges in your company and indicate the extent to which they are effectively managed:

Summary of Responses:

	Degree to which effectively managed			Rank in order of concern				
	Good %	Acceptable %	Poor %	1 %	2 %	3 %	4 %	5 %
Finding tax staff with the required experience	33	54	13	27	14	13	24	21
Providing staff with sufficient tax technical training	20	62	18	11	19	29	31	10
Keeping tax department costs within budget	32	64	4	10	16	22	12	40
Managing relationships with the fiscal authorities	27	65	8	42	20	16	13	9
Managing relationships with external service providers	43	56	1	10	31	20	19	20





Comments:

The above question addresses the management of relationships, people and costs. It looks at the management of the internal tax function.

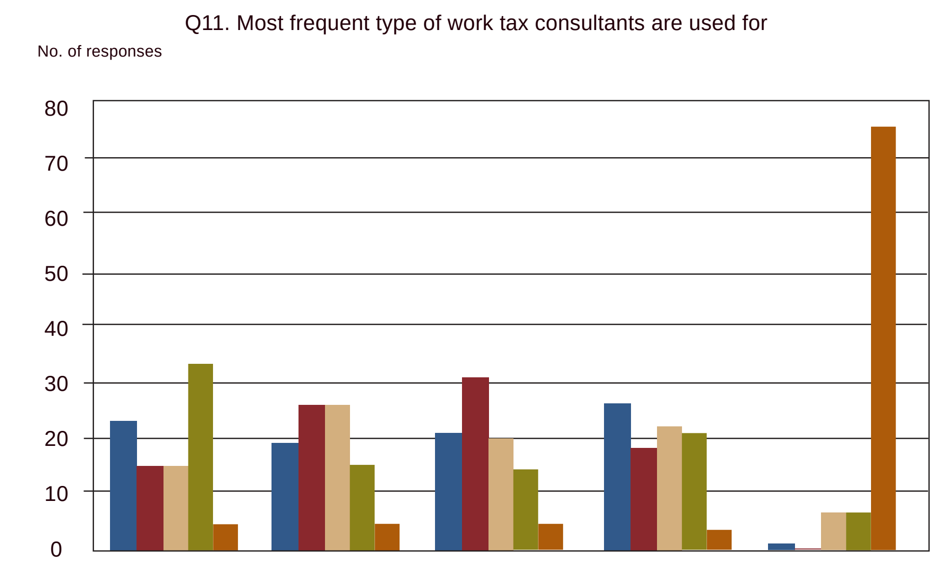
The number one priority is managing relationships with fiscal authorities. This is a key area both in terms of creating value and managing risk. It covers lobbying, rulings, audits, investigations, litigation and overall cooperation.

The second priority is finding tax staff with the required experience, followed by the management of relationships with external service providers. It is encouraging to note that a significant majority of respondents were of the view that all of these priorities were adequately or well managed.

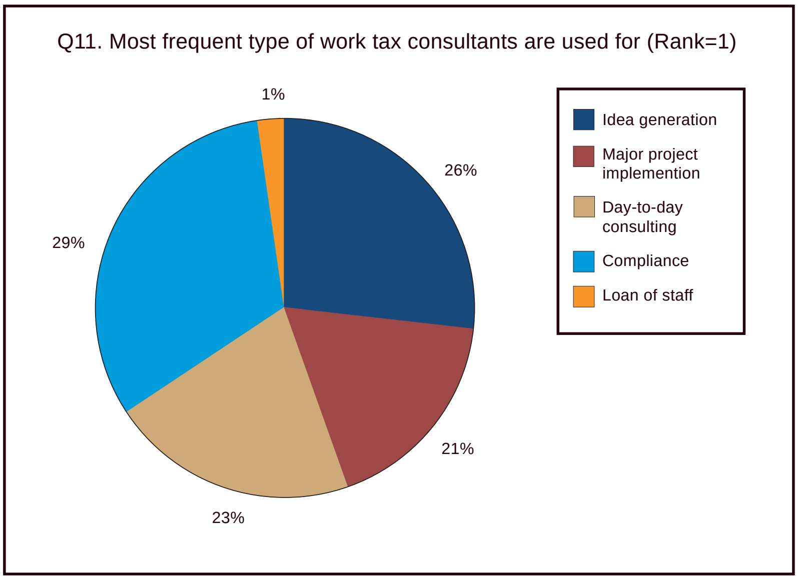
3.9
Use of Tax Consultants

Question:
What types of work are external tax consultants most frequently used for:

Summary of Responses:



	Idea generation	Major project implemention	Day-to-day consulting	Compliance	Loan of staff
Rank=1	23	19	21	26	1
Rank=2	15	26	31	18	0
Rank=3	15	26	20	22	7
Rank=4	33	15	14	21	7
Rank=5	4	4	4	3	75



Question and Summary of Responses:

	Increased	Same	Decreased
In the last 3 years how has your budget for work by external tax consultants changed	58%	32%	10%

Comments:

The majority of respondents indicated that their budget for work by external consultants had increased over the last three years. The services requested from consultants cover all areas of tax. There appears to be no clear focus on any one type of service. Compliance ranked slightly ahead of other services as a first priority. However, overall there is a strong demand for advisory services covering routine consulting work through to advising on transactions and the generation of tax planning ideas. Secondment of professional services staff to clients did not rank highly.

8 Cross Street
#17-00 PWC Building
Singapore 048424

Tel 65 6 236 3388
Fax 65 6 236 3715

www.pwc.com/sg/tax

Tax Partners

Paul Cornelius
65 6 236 3718
paul.cornelius@sg.pwc.com

Paula Eastwood
65 6 236 3648
paula.eastwood@sg.pwc.com