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Looking behind the certain uncertainty of tax collection

BIZ INSIGHT

IF I MAY misquote Jane Austen, "It is a truth universally to be acknowledged that taxation authorities, when presented with more than one interpretation of the law, will choose the interpretation which maximises their revenue."

Any cursory examination of rulings issued by the Revenue Department will confirm that the vast majority of rulings appear to apply interpretations that favour the (immediate) collection of tax. This is perhaps not surprising, in view of the department's role as the collector of taxes. However, it does create an environment that is unfavourable to businesses and one where the costs of complying with the law are increased.

By way of illustration, in the PricewaterhouseCoopers "Paying Taxes" survey for 2014, Thailand ranked 26th out of 37 countries surveyed in the Asia-Pacific region for time required for tax compliance. The average number of hours required was 264 – covering income tax, value-added tax and labour taxes. On the principle that "time is money", this makes Thailand a significantly less competitive place to do business than Hong Kong (78 hours) or Singapore (82 hours). Even when measured against its nearest Asean competitors, Thailand fares badly, with Malaysia (133 hours), the Philippines (193 hours) and Indonesia (259 hours) all ranking higher.

Almost as unhelpful to taxpayers seeking guidance on the law are regulations or rulings that do not give a clear answer to the question. It is not uncommon to find rulings that appear merely to restate, rather than interpret, the law. In view of the significant penalties for filing incorrect returns or underpaying tax, it is not surprising that many businesses find the position frustrating.

One approach to dealing with this uncertainty is to explore alternative ways of structuring business transactions. An example of how this can be done may be found in the real-estate industry.

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There continues to be a thriving market in resort areas for high-end villas for non-Thai citizens. In view of the restrictions on ownership of land, the buyer is usually granted a 30-year lease – with the option to renew for two or even three additional 30-year periods. Commercially the period of the lease is, therefore, 90-120 years. This gives the buyer the next-best equivalent to freehold ownership. In return, the buyer pays up front the rentals for the entire period.

However, only the first 30 years of the lease may be registered. The tax question that arises is, therefore, whether the 90 years of lease payments should be recognised as income over a period of 90 years or only over the 30 years of the registered lease.

The rulings I have seen on this issue confine themselves to repeating the requirement in the regulation that income must be recognised over the period of the lease. This is not very helpful, as it does not answer the core question of whether the "period of the lease" is 30 years or 90 years. The developer is thus faced with a choice of evils. He may choose to recognise the lease payments over 30 years and pay tax earlier. Alternatively he may recognise the income over 90 years and run the risk that this is challenged by the Revenue Department. The alternative strategy to overcome this uncertainty is to find a way of matching the lease payments to the period of the lease.

A typical development structure would involve an offshore developer entering an agreement with a buyer that covers the lease of the land and the construction or sale of a villa. The offshore developer will fund the acquisition of the land by the lessor and the construction of infrastructure.

The existence of this debt between the developer and the lessor provides an opportunity to structure around the tax uncertainty. When the offshore developer collects 90 years of rentals from the buyer, he passes only 30 years to the lessor, representing the payments for the first registered lease. The balance of the payments is retained as security against the debt owed by the lessor.

Under the agreement with the buyer, this debt – which is equivalent to 60 years of rentals – is transferred to the buyer. When the lease comes up for renewal in 30 years, the buyer and lessor agree to offset the next 30 years of rentals against the debt owed by the lessor. The lessor then recognises a further 30 years of rental income. The same procedure would be followed on renewal in 60 years.

By matching the rental payments to each term of the lease in this way, there is no longer uncertainty on the period over which the income should be taxed.

As an aside, it should be noted that there is the option of recognising the payments in full in the year in which they are received. It appears this option is rarely taken by developers, as they prefer to defer the payment of tax. As there is currently no guarantee that the corporate income tax rate will stay at 20 per cent, any developer granting leases in 2014 may wish to take this option in order to ensure that the income is taxed at the current low tax rate.

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