

# **CURBING TAX EVASION IN SINGAPORE: THE ROLE OF GOVERNANCE AND CORPORATE GOVERNANCE STANDARDS IN THE TAX AGENCY**

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## **ABSTRACT**

*This article introduces a simple framework to link corruption, corporate governance and tax evasion. It argues that attempts to mitigate tax evasion have to incorporate measures to curb corruption in the public sector and raise the standard of corporate governance in the tax agency. The proposition is tested by means of a case study, involving Singapore's tax agency, the Inland Revenue Authority of Singapore. The article makes recommendations so that tax compliance could be encouraged with the greatest possible benefits.*

*“Better compliance from taxpayers will, in the long run, lead to a cost-effective tax administration”*

Koh Cher Siang, Commissioner of Inland Revenue Authority of Singapore (1997 – 2005) (IRAS, 2008: 96)

## **INTRODUCTION**

Tax evasion is a concern in many countries because it leads to loss of government revenue to finance public expenditures. Aging societies, climatic change and other long-term fiscal challenges further create the necessity to curb tax evasion (see Asher, 2003; Heller, 2003). Taxpayers evade taxes if the probability of getting caught and the penalty costs are not sufficiently high as compared to the gains that evaders expect to reap (Witte and Woodbury, 1985). Tanzi (1983) reported a direct correlation between tax evasion and tax rates. The logic is that individuals and firms care about taxes. Keeping them low raises disposable income and net profits. Taxpayers also evade taxes if they perceive that they are being treated unfairly as reflected in the increased likelihood of tax evasion when others are believed to be evading (Cowell, 1992; Kim, 2002; Richardson, 2006). Tax evasion prevails if individuals distrust the government, perceiving that public officials are not utilizing the tax revenue optimally or to their satisfaction (Torgler, 2003; Hammar et al, 2009).

While it is clear that tax evasion confers benefits to the evaders, it also imposes significant costs. Evaders who are caught cheating are slapped with penalties in the form of fines, imprisonment and confiscation of assets. Evading firms do not typically have access to the courts or other dispute resolution mechanisms since these are at the disposal of firms that operate legally. Likewise, it is harder for evading firms to obtain funds since banks and other financial institutions are generally reluctant to grant credits to firms without proper documentation.

To mitigate tax evasion, a large number of research focuses on tax rates and deterrence measures such as raising the probability of catching the evaders and the penalty costs. The success of the tax measure, however, is inconclusive. For instance, using a random

sample of tax returns for the United States Taxpayer Compliance Measurement Program (TCMP), Clotfelter (1983) found a direct relationship between tax evasion and tax rates. However, using a shorter panel data of TCMP, Feinstein (1991) showed that increasing the marginal tax rate had a negative effect on evasion. Recent corporate scandals involving some large private corporations also demonstrated the possible weak relationship between corporate tax rate and the decision to evade taxes. The decision by corporate executives to manipulate the financial statement led to higher earnings since a majority of misstatements or financial statement frauds involved either overstatements of revenue or understatements of liabilities or both. The incentives to meet analysts' earnings expectations and company performance goals promoted such behavior (Rezaee, 2005).

Several empirical studies have validated the deterrence effect of auditing and of penalty severity, showing that they could positively affect the level of compliance (Witte and Woodbury, 1985; Dubin and Wilde, 1988). However, some empirical studies found punishments to be rarely significant in explaining evasion and, if they do, the effects were quite small in magnitude (Alm, Jackson and McKee, 1992; Beron, Tauchen and Witte, 1992). Feld and Frey (2002) pointed out that at the current (low) level of probability of catching the evaders and fines imposed, individuals should not have declared their income. Yet, taxpayers complied with tax rules. Feld and Frey (2002) argued that the presence of psychological contracts to depict the moral relationship between tax agency and taxpayers enhanced the intrinsic motivation. If the Constitution "extends participation rights to the citizens, the more likely such a psychological tax contract is to emerge" (*ibid*: 5). However, by concentrating on ethical compliance, the authors have left out the legal aspect of compliance.

In this study, the role of governance standards is placed at the forefront. It deviates from a large economic literature on taxation that have nevertheless provided useful practical lessons of policy design such as imposing low taxes on wide tax bases and imposing taxes on relatively inelastic goods as means to raise tax revenue. This article demonstrates that achieving a higher standard of corporate governance at the tax agency level is important. By corporate governance, we mean measures to narrow the interest gap between the agents (tax agency) and principals (taxpayers and the public). The tax agency performs the role of the agent with the government assuring that the agent performs up to task and collects taxes effectively and in an efficient manner. The tax agency, on the other hand, has to align the tax agents' interests with those of the agency. While it is well known that the tax agency, as a public organization, has objectives other than profit maximization, this does not prevent the public organization from facing the principal-agent problem. The presence of effective governance mechanisms in the public sector in general and the tax agency in particular is therefore important to develop a perspective on long-term compliance.

The underlying argument of the article is that when the government is incorrupt and the tax agency has a good reputation, the result is likely to be higher expectations about the credibility of tax-regulations enforcements, which translates to firms and individuals complying voluntarily with tax regulations. Conversely, if the public sector and the tax agency are corrupt, an increase in the penalty and probability of catching the evaders, as well as change in the tax rate in favor of the taxpayers, are unlikely to dramatically decrease the amount of tax evasion.

It should be noted at the outset that no framework is expected to cover all possible areas of concern of the compliance problem. Unlike the classic economic approach that deals with taxpayers making choices under uncertainty and risk, this article examines how, within the principal-agent framework, good governance can influence taxpayers to comply voluntarily with tax laws. Compliance, as will be shown by means of a case study, is promoted not through heavy punishments but by giving taxpayers the benefit of the doubt by not automatically suspecting them of committing improper practices. This is particularly relevant to economies with limited resources for law enforcement since encouraging voluntary compliance to formal rules is generally more cost effective than imposing sanctions-based public enforcement.

After introducing a simple framework to link corruption, corporate governance and tax evasion, the second part of this article proceeds with a case study to appreciate the governance style of the Singaporean economy and a tax administrator, the Inland Revenue Authority of Singapore (IRAS). The Singaporean case is selected based on the premise that tax evasion is relatively less serious in the city-state at least according to international rating agencies such as the *International Institute for Management Development* (IMD). While the *Global Competitiveness Report* prepared by the *World Economic Forum* did not have an indicator on tax evasion, it considers related indicators such as efficiency of the tax system and transparency in government policy-making. Again, Singapore was ranked favorably. According to Bird (2004: 140), “countries such as Singapore are models of what can and should be done, and such models should be studied closely and, once adapted as necessary, implemented”. Corruption and tax evasion were not uncommon in the city state when it gained independence in August 1965. However, the strong political will to address these problems have yielded significant results. An incorrupt government provides the incentive for the taxpayers to comply with the tax rules. Coupled with the innovative reforms in the tax agency, the incidence of tax evasion has been significantly lowered.

### **CORRUPTION, CORPORATE GOVERNANCE AND TAX EVASION: A SIMPLE FRAMEWORK**

This section sets out to outline the principal-agent framework in the study of tax evasion. The connection between the principal-agent problem and tax evasion is not a new area of research. Tax evasion following the Allingham and Sandmo (1972) methodology focuses on how the tax agency determines the tax rate and acceptable level of the probability of detecting cheaters and penalty in the context where the taxpayers (including firms) are risk averse (Chen and Chu, 2002) or risk neutral (Lee K., 1998).

Notably, strengthening the standard of corporate governance in tax-paying organizations translates to stricter compliance with tax rules since decisions are more intensively deliberated. The role of the audit committee in particular is to ensure that the financial statements do not mislead the stakeholders, including the tax agency. The decision for greater transparency further facilitates monitoring by the external agents and mitigates the extent of which improper practices are conducted. Conversely, poor standards of corporate governance and weak institutional designs to curb corruption have been cited as the major causes of the Russian Yukos Oil debacle, which resulted in the company owing US\$28 billion in back taxes (Puffer and McCarthy, 2007).

Tax evasion is also attributed to deficiencies in the tax agency. Tasked with collecting vast sum of money and dealing with confidential taxpayers' information, tax agents may be tempted to act improperly. This can take various forms, including closing a tax audit without adequate investigation or penalties being imposed, exempting firms from paying taxes even if they do not quality and deleting taxpayers' record. Flatters and MacLeod (1995) show that collusions between taxpayers and tax collectors are central to tax evasion in developing countries. Tax evasion prevails if the taxpayers perceive that a substantial portion of the tax revenue would not come back in the form of health care, public schools, public transport, public housing and child-care benefits.

As a principal, the government appoints the tax agency (the agent) to collect tax revenue on its behalf (Table 1). To mitigate the agency problem involving the tax agency as the principal and tax officials as agents, the government plays the role of an external monitor to ensure that the tax administrator has a high standard of corporate governance. This involves drafting of the contracts to specify responsibilities of the tax agency, monitoring of contract enforcement, inspecting the performance of the agent, settling of disputes and imposing penalties for contract violation. The government assumes the task of developing regulative institutions, including the development of the judicial system to establish a well functioning tax agency. Raising the standard of corporate governance in the tax agency also requires measures like separating the role of Chairman and CEO, requiring a strong independent board to monitor the agents and building an organization-wide culture of integrity. In the case of Singapore, the Inland Revenue Authority's interest is to collect as much revenue as possible in a low tax environment, a regime favored by the state. To do so, much of the decisions within IRAS were directed towards lowering the cost of tax compliance. This is based on the premise that lower cost of tax compliance promotes greater voluntary compliance and reduced temptation to evade taxes (more about this later).

**Table 1: Principal agent framework**

	Agent	Principal
1	Tax agency	Government
2	Tax agents	Tax agency

Source: Author

But measures to raise the standards of governance entail more than just formal mechanisms. Sociologists like Granovetter (2005) have suggested building a strong social network within the working community. Appointing trusted people who are capable of doing the right things (despite having the incentive to do the contrary), allows for flow of quality information and serves as a source of reward and punishment whose impact is magnified because the information comes from someone personally known. In an environment where there is a culture of integrity and accepted beliefs and values to comply with the regulations, the necessity to monitor, inspect and punish can be significantly reduced (Stafsudd, 2009).

While raising the standards of corporate governance in the private sector corporations and the tax agency is essential, tax evasion would still arise if the government itself is poorly managed, susceptible to improper practices and unpopular with the taxpayers. For the political leaders to keep up their side of the social contract, a key requirement is that they do not misuse the power that has been entrusted to them but gain the trust and

approval from the public. In the context of tax evasion, an unpopular government further frustrates taxpayers who may choose to evade taxes since the payments end up in the pockets of the public officers. Empirically, Cebula (2009) found an inverse relationship between the approval rating of the United States Presidents (based on their tax and expenditure policies) and tax evasion, that is the lower (higher) the President's approval rating, the greater (lower) is the degree of federal personal income tax evasion. It is worth noting that countries such as Hong Kong and Singapore were able to curb corruption within a relatively short period of time. Both countries have set up strong anti-corruption agency to serve as a crucial external monitor in overseeing the activities carried out public officers, including those in the tax agency (Quah, 2003; Lee and Haque, 2006). This is a good piece of news, indicating that the fight against corruption is not unwinnable.

In summary, there are two causes of tax evasion in the context of this article. The first cause relates to mismanagement in the public sector, resulting in misuse of the tax revenue. Dissatisfied with the improper practices, taxpayers chose not to adhere to the tax regulations. Second, tax evasion is associated with misalignment of interest between the state and the tax agent and between the tax agency and tax agents. To mitigate tax evasion, it is therefore necessary to curb corruption and raise the standards of corporate governance in private corporations and the tax agency.

### **THE CASE OF IRAS AND SINGAPORE**

Singapore has been labelled as quintessential development state (Low, 2001) where the state's legitimacy is derived from its ability to develop the country economically. The real Gross Domestic Product (GDP) has grown at an average of 8.1% (1961-2008), with the real per capita GDP rising from S\$4,668 in 1965 to S\$46,255 in 2008. Political support for the political party, the People's Action Party (PAP), is generally strong to the extent that the party is often seen as synonymous with the state (Hill and Lian, 1995: 34-35). Singapore's economic success, which translates to the political legitimacy of the PAP, is attributed to Singapore's "clean and effective government, free of corruption, meritocratic, efficient and responsive, fair and impartial", which is able to "offer Singaporeans continue improvement in their quality of life with economic progress and a safe and secure environment" (Lim, 1996: 35). The downside of the economic success was the creation of the 'government-knows-best' society where the state is deemed capable to resolve problems and safeguard the assets. Information pertaining to assets of some state enterprises is largely hidden from the public. State-owned business entities such as Singapore Government International Corporation (GIC) and Temasek Holdings are not required to report their performance to the public and parliament (Worthington, 2003).

The PAP understood that in the event that the public sector is mired with corruption and inefficiency issues, in which case the public sector's scarce resources (including the taxpayers' money) are landed in the hands of the few corrupt public officers, discontentment over the public sector would arise and greater the reluctance of the public to contribute further to the public sector's pockets. Curbing corruption is seen as the essential measure to push Singapore forward both economically and fiscally.

Singapore had a fair share of corruption-related problems in the pre self governance days. Syndicated corruption was rampant especially among law enforcement officers. The Anti-Corruption Branch (ACB) of the Criminal Investigation Department (CID) (pre-1952) had to compete with the rest of the units in the CID for manpower and other resources. In addition, the ACB had problems dealing with corruption involving the police because of its close relationship with the police force. Real improvements came about after the PAP took over the domestic administrative affairs. When Singapore commenced self-control in 1959, the PAP made it a national priority to combat corruption. It directed the anti-corruption agency, the Corrupt Practices Investigation Bureau (CPIB), set up by the British in 1952, to deal with corruption. The ruling party recognized the importance of making Singapore corruption-free both in the government and business environments as a means to develop the country's economy. As the then Prime Minister Lee Kuan Yew said:

“All new governments want to prove themselves by passing many new laws and launching many new projects. We hit the ground running, before the phrase was coined. .... Most important was a bill to give ourselves (the PAP) wider powers to combat corruption. It was the first of several that strengthened the law so that offenders could be charged and convicted in court. It led to the creation of a new agency, the Corrupt Practices Investigation Bureau (CPIB), which has helped to keep Singapore clean” (Lee K.Y., 1998: 346).

The results so far have been positive. International agencies have consistently ranked Singapore as one of the least corrupt countries in the world. In 2008, Transparency International ranked Singapore as the 4<sup>th</sup> least corrupt economy. Hong Kong based Political & Economic Risk Consultancy (PERC) Limited has ranked Singapore as the least corrupt country since its inception in 1976. The World Bank's 'Governance Matters' report has also rated the city state highly, putting it among the top 10 least corrupt countries. Covering more than 200 countries, Singapore obtained a score of close to 100 for five of the six categories of the quality of governance.

The various measures to combat corruption in Singapore have been documented in Lim (1998) and Quah (2010). We would not discuss the various initiatives summarised in Table 2 other than to point out that the principles of governance, namely incorruptibility, meritocracy, rationality, use of economic incentives and markets, pragmatic and result orientated have been recognized as the governance fundamentals (Neo and Chen, 2007). Shaped by the founding leaders of the PAP, the principles have created the culture and ethos of the Singaporean public sector where the various government entities work in a coherent manner with predictable behavioral patterns. The obvious connection with tax evasion is that an effective tax administration requires a high degree of coordination and information-sharing among the government departments, particularly the tax authorities so as to acquire information about potential taxpayers and the scale of their economic activities. Without an effective and coherent public sector, firms are able to evade taxes through bribery, political connection and other forms of manipulation.

**Table 2: Measures to combat corruption and promote public sector excellence**

Measures	Description
Set up an independent agency, the Corrupt Practices Investigation Bureau (CPIB)	An agency independent of the Singapore Police Force, the CPIB is mandated to carry out all investigations pertaining to acts of corruption. It reports directly to the Prime Minister. The President approves the appointments of key personnel in the CPIB. Under a provision in the Constitution, even the Prime Minister can be investigated. The probability of catching the offenders is raised accordingly. Proper screening of the CPIB staff is carried out. The public does not hesitate to come to the CPIB, give information and assist in subsequent investigations. Discreet investigations are commonly carried out before investigations are done openly.
Increase the penalty cost	Accused are dealt with severely upon conviction to signal the society and court's disapproval of improper practices. Otherwise, would-be offenders will have a greater tendency to act corruptly. In Singapore, it is wrong to receive and pay for bribes. The political leaders have not hesitated to shame offenders regardless of their status so as to further raise the opportunity cost of engaging in acts of corruption (names and photos of offenders were often exposed to the public). The initiative imposes high cost to the offenders (and their family members) and is particularly powerful in Asian countries because Asians are generally afraid to 'lose face'. Singapore is not an exception.
Strong political leadership to inculcate the incorruptible virtue	All Members of Parliament, ministers and public officers are expected to set good examples for others to follow. All PAP members are required to declare their family assets to the Prime Minister while the ministers (including the Prime Minister) declare their family assets to the President. There were also constant appeals by the political leaders to the moral consciousness of the public servants, reminding them of the benefits of doing good and the negative implications of corruption on the nation.
Promote service excellence	Efforts are put in to improve standards of operating procedures (e.g., through the 'Public Sector in the 21 <sup>st</sup> Century' – PS21 - initiative which, among other things, emphasizes service excellence, greater efficiency in operating procedures and adaptation of the change culture). The government believes that corruption is more likely to thrive in an inefficient administration where agents can take advantage of loopholes to beat the system. Advancement of technology is leveraged to minimize direct contact with public officers (e.g., electronic tax filing system is adopted by the Inland Revenue Authority of Singapore).
Pay competitive salaries to the agents	In an article in The Straits Times dated 23 March 1985, Prime Minister Lee Kuan Yew asserted that the best way to deal with corruption is to 'move with the market'. "Pay political leaders the top salaries that they deserve and get honest, clean government or underpay them and risk the Third World disease of corruption". Salary revision exercises for political leaders in Singapore are carried out periodically to see that the wage gap between the public and private sectors does not deviate too significantly. In October 1994, a White Paper on " <i>Competitive Salaries for Competent and Honest Government</i> " was presented to the Parliament to justify the pegging of the salaries of Senior Civil Servants

	<p>and Ministers to the average salaries of top four earners in the private sector professions; accounting, banking, engineering, law, local manufacturing companies and multinational corporations. In 2008, the salary for the Prime Minister was S\$115,920 per month (US\$81,934) while Ministers and Permanent Secretaries were paid S\$59,760 per month (US\$42,239), thus making Singapore political leaders possibly the highest paid government officers in the world.</p>
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Source: Compiled from Lim (1998) and Quah (2010)

Singapore has also taken steps to strengthen corporate governance standards of its organizations, including the Government-Linked Companies, statutory boards and private sector corporations. Prior to the on-set of corporate governance studies in post 1997 Asian crisis period, the Singapore system has been judged as less developed compared to those of the United States (US) and United Kingdom (UK), particularly in terms of disclosure to shareholders (Goodwin and Seow, 1998). As a key business and financial centre in Asia, Singapore sees it as a necessity to strengthen the corporate governance and give investors confidence in Singapore's entities. The move from a regulatory system of corporate governance enshrined in statutes to a more market driven system like that of the US and UK is a logical step forward. On 16 August 2002, the Ministry of Finance and the Monetary Authority of Singapore spearheaded the formation of private-led Council on Corporate Disclosures and Governance (CCDG) to prescribe accounting standards in Singapore, strengthen the existing framework of disclosure practices and reporting standards, and review and enhance the framework on corporate governance. The CCDG first issued the Code of Corporate Governance on 21 March 2001 (the Code was revised and adopted by the government on 15 July 2005). The principles paid particular attention to the constitution of an effective board, the formation of Board Committees and the adoption of International Accounting Standards. As at 20 March 2003, the Government of Singapore required quarterly reporting for listed companies with a turnover of over S\$75 million. Comparatively speaking, rating agencies such as PERC and CLSE Emerging Markets and Asian Corporate Governance Association (ACGA) have consistently ranked Singapore as a country with one of the highest standards in corporate governance in Asia (Singapore was ranked 2<sup>nd</sup> in 2007 rankings after Hong Kong and 1<sup>st</sup> in the 2005 ranking). GovernanceMetrics International (GMI) ratings based on corporate governance standards of more than 4,000 companies in 45 countries placed Singapore as the country with the best corporate governance in Asia for 2009. Of the 45 countries surveyed, Singapore was ranked 17.

To have a sense of the taxpayers' behaviour, Table 3 shows the compliance rate in Singapore based on submission of tax returns. It suggests that a majority of taxpayers are compliant with the submission of their tax returns with the IRAS receiving more than 95% of the individual tax returns and 96% in the case of Goods and Services Tax returns. Of the corporate income tax returns issued, about 70% of them were received. Lower corporate tax compliance is not an uncommon problem. In the US, corporate tax underreporting was estimated at US\$37.5 billion in 1998 (Crocker and Slemrod, 2005: 1594), prompting the Sarbanes-Oxley Bill passed on 31 July 2002 to establish a regulatory body to oversee the accounting industry and create new standards to enhance compliance to regulatory measures.

**Table 3: Compliance Rate (based on submission of tax returns) in Singapore (in %)**

Year	Individuals Income Tax	Corporate Income Tax	Goods and Services Tax
YA1998	95.5	78.7	94.2
YA1999	95.0	78.3	94.7
YA2000	93.1	75.4	96.0
YA2001	94.5	74.3	96.2
YA2002	95.1	73.1	96.4
YA2003	95.9	69.6	96.6
YA2004	96.4	69.1	95.9
YA2005	96.6	66.8	93.7
YA2006	96.6	70.3	96.1
YA2007	96.8	74.1	97.5
YA2008	97.3	76.7	98.5

Compliance rate = (returns received/returns issued) x 100

Calculated from IRAS Annual Report (various years)

Singapore's tax philosophy since the 1970 has been expressed most succinctly by the then Minister for Finance Dr. Goh Keng Swee: "The government's policy in recent years has been to depend on fast economic expansion and improved tax administration to provide increased revenue rather than raise rates of taxation to higher levels or introduce new taxes" (1970 Budget Speech; extracted from Low, 1996: 49). As reflected in Goh's message, a low tax regime in Singapore is necessary to attract foreign investors and provide jobs for the people. Corporate tax rates in Singapore have been lowered from 55% in the early 1980s to 18% in 2008, which was lower than South Korea (24.2%), Malaysia (25%) and Australia (30%) but above that of Hong Kong (16.5%) and Macau (12%) in the same period. The tax rate for the highest income bracket fell from 40% in 1985 to the current level of 20%. Since the introduction of GST in 1994, the proportion of labor in the income tax net fell sharply from 73% in 1993 to 23% in 1994. The main beneficiaries were the lower income individuals with annual income of less than S\$30,000 with their proportion of taxpayers in the employed labor force falling from more than 50% in 1993 to just 6% in 1994.

Tax revenue remains important as a source of funds but the size of it is to be determined not by tax rates but the extent of which tax-related matters and the tax agency, Inland Revenue Authority of Singapore (IRAS), are effectively administered. IRAS is a statutory board established on 1 September 1992 to assume the tax collecting role from the Inland Revenue Department (IRD) of the Ministry of Finance. Statutory boards, like IRAS, are autonomous government agencies established by Acts of Parliament. The Acts contain special legislations allowing statutory boards to perform specific roles. A statutory board has a legal entity, which separates it from the civil service. It has the autonomy to recruit and select candidates, and determine the remuneration package and career advancement for its staff without the rigidity to follow the system established in the Singapore civil service. The main reason for transforming the IRD into a statutory board was that rapid economic growth and higher wages and profits had significantly increased the workload of the tax agent while staff strength lagged behind. IRAS inherited a backlog of assessments of nearly 50% and tax arrears that were growing at 7% each year.

Effective tax administration correlates with lowering of the cost of tax compliance. In this regard, IRAS has introduced a number of measures. For example, tax forms have been simplified. Form B, which is used to file for income tax, has been modified from an eight-page standard form to the new Form B1. Form B1 requires taxpayers to fill in only the first two sections (two pages). From the Year of Assessment 1999, the number of pages of Form C for Company Tax was reduced from eight pages to six pages. Businesses with turnover of less than S\$500,000 need no longer submit their statement of accounts with their tax returns. In 1995, the IRAS embarked on the Business Process Reengineering (BPR) program to enhance its competency and effectiveness. A notable change was the decision to leverage on the advancement in technology to support its call for voluntary compliance to tax regulations. The core area of the BPR was the establishment of the Inland Revenue Integrated System (IRIS) – “an elaborated computer system program that allows all tax types to be dealt with in an integrated one-stop service manner” (Sia and Neo, 2000: 536). In February 1998, IRAS introduced electronic-filing (or e-filing) to allow individual taxpayers to file their income tax via the phone or Internet at the comfort of their homes and offices. E-filing was later expanded to include employers, including self employed entities. Unlike countries such as the US, UK and Canada where e-filing returns are sent through some authorized agents who may charge for the services offered, the e-filing service offered in Singapore is free-of-charge.

In the case of corporate governance, it is understood that a poorly governed tax agency is likely to contribute to tax evasion since enterprises and individuals that are evading taxes are less likely to obtain an effective external audit. The main strategy adopted by the Singaporean government was to demarcate the responsibility of the government as a regulator and a tax collector with the IRAS assuming the latter role. The shift to the statutory board format is a key initiative. This essentially frees the tax agency to restructure work processes and pursue the necessary operational strategies (such as e-filing) to meet its objectives. Tax reforms that resulted in changes to tax rules or additional/removal of certain types of taxes may be initiated from time to time in respond to the changing environment, which could be read more effectively by the tax agency. Maintaining arms length relation between the regulator and tax agency lowers the possibility of taxpayers (e.g. lobbyists) from seeking favorable treatment based on their connection with the regulators. With IRAS serving as a tax agent for the government, a system is put in place to link IRAS’s financial budget to its specified targets. IRAS, for example, is allowed to retain a specified percentage of tax collected in excess of collection target. In addition to the normal agency fee of fixed 1.65% of the targeted revenue collection, the IRAS is entitled to an additional performance based fee amounting to as much as two percent of the difference between the actual and projected tax revenue collected. While additional fees are rewarded for collecting more than the target, a reduction is possible if the actual revenue collected falls short of the initial target (Asher, 2002).

However, IRAS is not left completely to its own devices. For one thing, fiscal policy is determined by the Ministry of Finance. The internationalization of the Singaporean economy and large inflows of foreign investment have been achieved through a multi-pronged strategy with tax incentives being one of the key measures. IRAS is effectively an agency undertaking administrative tasks such as collection of taxes and enforcement. The IRAS Act also requires the statutory board to submit the Annual Report and

financial statements to the Minister on the activities of the Authority during that financial year. Audited by the Auditor General, the report is presented by the Minister for Finance in the Parliament. The annual report is not particularly useful for analytical purposes although it offers the public a good source of information on some of the agency's key initiatives during the year in question. IRAS is answerable to Minister for Finance who is empowered to amend, by order published in the *Gazette*, the Third or Fourth Schedule on Specified Acts and Specified Offices, respectively. It is well known that an important reason for the agency problem to arise is the information asymmetry between the principals and agents where the latter have better knowledge about their ability and actions than the principals. By appointing the Minister for Finance as the key monitoring agent, the agency problem may be moderated since the Minister stands a better chance of uncovering any improper practices.

Furthermore, governance mechanisms are in place to mitigate the principal-agent problem. They are not meant to interfere with the day-to-day running of the agency but to safeguard the interest of the stakeholders, including the general public, against improper expropriation. Formally, the IRAS has adopted many of the best features of the Anglo American style of corporate governance. For example, like a typical large private sector organization IRAS is required to set up a Board of Directors, comprising qualified and independent members. The IRAS Board establishes three committees, the Investment Committee, the Audit Committee and the Staff Committee A to further define their duties. The investment committee sets investment guidelines and manages surplus funds available for investment. The audit committee monitors the accounting policies in the IRAS and sees that the internal controls are in place and complied with. In addition, the IRAS establishes the Internal Audit Function, which operates independently from the other divisions of IRAS. The Internal Audit Function reviews the agency's operational policies and suggest ways to minimize operational costs incurred by the taxpayers and the IRAS. The Staff Committee A serves the role of the Executive Committee, with the authority to approve remuneration policies as well as key appointments, promotion and remuneration of senior executives in IRAS. The IRAS benchmarked the salaries of its staff against those in the financial services, insurance and other statutory boards. A notable initiative was to peg the earnings of the IRAS's tax specialists such as in the areas of law and information technology to those of private sector tax partners or principals. This is seen as necessary not only to retain competent staff but to keep potential corruption at bay.

IRAS separates the role of the Chairman and the CEO (or Commissioner in the context of IRAS) with two different persons holding the positions. The practice of having separate persons as the Chairman and CEO in IRAS is similar to a typical private corporation in the UK but differs from that of the US where the same person normally holds the positions of Chairman and CEO (Conyon and Murphy, 2000). In the case of Singapore, Mak and Phan (1999) reported that about 46% of the SES listed companies separate the posts of CEO and Chairman. MacAvoy and Millstein (2003: 4) have argued that a Chairman who is not a CEO is able to "create meaningful agendas and call for management presentations around issues, not just around current problems that need resolution", and to "chair meetings with content rather than routine, based on position papers rather than reports". The way forward, according to the authors, is to reform the conduct of the board rather than merely reforming the structure and composition of the board, a conclusion they arrive at after drawing lessons from the Enron debacle.

The current IRAS board consists of nine members. It is useful to note that a majority of IRAS board members concurrently hold directorships and advisory roles in both public and private sector institutions, which undoubtedly reflects the dense network and connectivity they have acquired within the business and political arena in Singapore (Table 4). This is in contrast to the practice in several Anglo-Saxon countries. The UK Combined Code, for instance, has recommended that an executive director should not sit on more than one other board in a large listed company. Empirically, Fich and Shivdasani (2004) find that firms with outside directors holding three or more board seats have significantly lower market-to-book ratios than those firms with directors holding fewer than three board seats. Directors who serve on too many boards may be too busy, rendering them ineffective in monitoring corporate managers and detrimental to the quality of corporate governance. Beasley (1996) reports that the probability of committing accounting fraud is higher the larger the number of directorships held by outside directors. In the case of Singapore, Mak, Sequeira and Yeo (2003) find stock prices to react negatively to the appointment of busy directors with similar results obtained for family related directors' appointment. However, the market is found to have reacted positively to appointment of non-executive directors who sit on multiple boards. The market, according to the authors, could have seen these individuals as having wide contacts, reputation and experience that could eventually add value to the firm, whether or not the directors may be too busy contributing to the board.

A strong network of individuals from the private and public sectors is not unusual in Singapore. The key governance challenge is to obtain the services of competent independent board members. The task is complicated in Singapore by the country's shortage of purely private sector individuals. The positions are therefore often filled up by past and present ruling party members and civil servants. Worthington's (2003) study indicated that the public sector in Singapore dominated Government Linked Companies (GLC) directorship, accounting for more than 70% of the directorships in 1991. GLCs are partially owned by the government and comprise some of the well known companies both nationally and regionally such as the Singapore Airlines (SIA) and Development Bank of Singapore (DBS). In 1998, the public sector representation increased as it accounted for 74% of the representation in the GLCs. The fact that a majority of the Singaporean GLCs has done very well financially over the years indicates the workability of this approach (Feng and Tong, 2004; Ang and Ding, 2006). Similarly, senior members of IRAS are trusted individuals from the public sector, comprising past and present civil servants like Teo Ming Kian (current Chairman of the board who is concurrently the Permanent Secretary of the Ministry for Finance), Moses Lee (current Commissioner of IRAS and formally from the Ministry of Manpower, Ministry of Health and and Ministry of Community Development, Youth and Sports), Tan Kim Siew (current member of the IRAS board who concurrently holds the Permanent Secretary position in the Ministry of Defense), Lim Siong Guan (former IRAS board member and Head of Civil Service) and Chiang Chie Foo (former member of IRAS board who concurrently held the Permanent Secretary position with the Ministry of Education).

**Table 4: Board of Directors in the IRAS (as at January 2009)**

Members	Position in IRAS and other roles in the public/private sector
Teo Ming Kian	Chairman of the board; concurrently Permanent Secretary of the Ministry of Finance). Teo sits on the boards of several other organizations.
Moses Lee	Commissioner of the IRAS; formally Permanent Secretary in the Ministry of Health, Ministry of Community Development, Youth and Sports and Ministry of Manpower.
Tan Kim Siew	Member; concurrently Permanent Secretary of Defense Development, Ministry of Defense and a board member of Singapore Technologies Holdings Pte Ltd and Singapore Technologies Engineering Limited.
Giam Chin Toon	Member; concurrently Singapore Ambassador (non-resident) to Peru and Singapore High Commissioner (non-resident) to Ghana. He sits on the board of the Singapore Mediation Centre and Singapore Institute of Directors.
Noel Hon Chia Chun	Member; concurrently non-executive Chairman of e-Cop Pte Ltd and the President of the Singapore Scouts Association. He sits on the boards of several private and public sector corporations.
Law Song Keng	Member; concurrently board member of the Central Provident Fund and Manulife (S) Pte Ltd.
Lim Hua Min	Member; concurrently Group Executive Chairman of Philip Securities Pte Ltd, and a board member of IFS Capital Limited, ECIS Limited and King & Shaxson Capital Limited.
Lim Joo Boon	Member; concurrently advisor with Philip Private Equity Pte Ltd and OWW Capital Partners, and a board member of Singapore Pools Pte Ltd and Singapore Airlines Engineering Company.
Viswanathan Shankar	Member; concurrently board member of the Standard Chartered-Istithmar Asia Real Estate Opportunity Fund Pte Ltd.

Source: IRAS Annual Report, 2008/2009

IRAS, like the statutory boards in Singapore, provides the platform to recruit successful private sector individuals who may later be asked to join the PAP and enter Parliament. The process of incorporation into senior positions is selective based on the individuals' good performance in education or prior success in business. Former Finance Minister and IRAS Chairman Richard Hsu exemplified this process having been brought in to serve the board of the Monetary Authority of Singapore in the early 1970s after a successful career with Shell from the early 1960s. Until September 2004, the Ministers for Finance chaired IRAS and they included the current Prime Minister Lee Hsien Loong who was the Finance Minister from 2001 to 2007, and Minister for Finance (1985 – 2001) Richard Hsu. Since then, the IRAS Act was amended to allow others to be appointed, including individuals from the private sector. This has yet to take place as public servants continue to hold the Chairman post, including Lim Siong Guan and Teo Ming Kian.

There is a concern that very close link between business and politics may raise the possibility of cronyism, particularly in the aftermath of the East Asian financial crisis. The perception is that the Asian states have been transformed into crony capitalist countries in which there is a "pervasive abuse of power and misappropriation of public

resources in tandem with personalistic relationships and ‘incestuous’ dealings between political and economic elites” (Kahn and Formosa, 2002: 52). The IRAS case may have suggested that handpicking personalities by the state does not pose serious problems, but in fact may have contributed to the success of Singapore in general and the IRAS in particular. It seems that the challenge is not to discard the element of trust (for example, in the appointment of suitable candidates) but rather to eradicate offering of personal favors by these candidates using public resources, which Singapore has managed to do quite successfully.

Although we have not considered all aspects of corporate governance, this section shows that a tax agency can be effectively run. Having in place mechanisms to monitor the tax agency is highly desirable to raise the reputation of the institution and encourage voluntarily compliance with tax regulations. In this respect, the governance style of the IRAS may provide some useful lessons for others like those economies in transition. The key initiatives taken to raise the IRAS standard of corporate governance are summarized as follows.

- IRAS aligns its interest with the state to improve tax administration and lower the cost of compliance. Higher tax rates are no longer considered as the means to increase the size of tax revenue.
- IRAS answers to the Minister for Finance who serves as the shareholder representative of the citizens of Singapore.
- The government demarcates its responsibility as a regulator and a tax collector to give IRAS a freer hand to pursue its operational strategies.
- The release of the Annual Report as required in the IRAS Act allows greater scrutiny of the IRAS by the media, academics, Members of Parliament, the CPIB and others. Together, they fill the role of external monitors.

Internal measures include the following.

- IRAS board assures itself of the integrity of board members and managers (a measure includes appointments of trusted individuals from the civil service).
- IRAS separates the role of the Chairman and CEO.
- IRAS establishes incentive-based system to align managers’ interest with that of the ‘shareholders’ (Minister for Finance and the general public).

## CONCLUSION

This article argues that one of the sources of tax evasion is the lack of good governance standards in the public sector and the tax agency. Reform in tax agency must incorporate measures to raise standards of corporate governance. This is a necessary but not a sufficient condition. To serve as an external monitor, it is imperative for the economy to have in place a strong culture in which corruption is not tolerable. These measures are within reach for developing countries. Singapore and the IRAS were

mired with governance problems in the early days. With strong political will, corruption was eradicated and corporate governance standard was raised. Taken together, tax evasion has been less of a concern in the city state. Our arguments are in line with Bird and Oldman's (2000) observation who attributed the low incidence of tax evasion in the city state to three factors; (1) the Singapore citizens trusted the government; (2) the taxpayers were generally satisfied with IRAS services; and (3) taxpaying services were continuously improved to facilitate tax compliance.

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