



EXECUTIVE SUMMARY

TOWARDS SUSTAINABLE TAX POLICIES IN THE ASEAN REGION: THE CASE OF CORPORATE TAX INCENTIVES

June 25th 2020



IT IS HIGH TIME

For all ASEAN member states to collaborate with one another and agree upon the common minimum standards for corporate tax incentives in the region to prevent harmful tax practices that drain essential public revenue and create unnecessary competition among members, and to achieve a common goal of building a sustainable and resilient region.

EXECUTIVE SUMMARY

The ASEAN region is experiencing unprecedented economic inequality, as some countries still have the highest poverty levels in the world and most countries in the region are failing to invest sufficiently in essential public services. Progressive tax collection and social spending on essential public services such as healthcare, education, and social protection are the most effective ways to fight poverty and inequality. However, most countries in the region fail to invest sufficiently in those services. For some countries (Cambodia, Laos, Vietnam, Malaysia, and Myanmar), the situation is so critical that the Asian Development Bank has already warned that if they do not mobilize significantly greater revenues in the coming years, the 2030 Sustainable Development Goals (SDGs) will not be met.

The most worrying aspect is that this lack of spending is being seen at a time when countries in the region already seeing their fiscal space stretched. Most ASEAN countries have suffered persistent budget deficits for a long period. Malaysia, Myanmar, and Laos are expected to experience these deficits throughout 2000-2020. Vietnam, Cambodia, Indonesia, and the Philippines will have run the deficits for 17 to 20 years in the same period. In 2018 alone, six ASEAN countries had significant budget deficits, and some have high levels of public debt. On average, the ASEAN region saw a budget deficit of 1.5% of gross domestic product (GDP) in 2018. Budget deficits and consequently public debt are likely to see further significant increases due to the extra budgetary efforts that will be required to overcome the current economic challenges and the health crisis created by the COVID-19 pandemic. It is expected that nine ASEAN countries face budget deficits in 2020 with the average one at 4.2% of GDP.¹

Estimated Budget Indicators in ASEAN Countries, 2018 (% GDP)²



¹ Based on the IMF's Fiscal Monitor Database, no available data in Brunei to calculate its budget deficits

² The authors' calculations based on the IMF's Fiscal Monitor Database. Data at a general government level. No available data for Brunei.

In the ASEAN region, levels of revenue collection, measured as a proportion of GDP, remain very low compared with OECD countries. The average ratio across the region was 19.1% of GDP in 2018, lower than half that collected on average in the OECD countries and lower than in the Latin America and the Caribbean region. These low ratios mean that countries in the region have little budget capacity and are running public deficits, and this gap has dramatic consequences for the quality of public services, infrastructure, and levels of good governance.

Even before the COVID 19 pandemic, the situation in ASEAN was already unsustainable. Now the situation is even more dire. Initial estimates from the OECD³ predict that the pandemic will have significant negative impacts on tax revenues, while at the same time budget burdens will increase due to governments' efforts to introduce supportive packages to help cope with the disease. In ASEAN countries, the expected budget spending in response to the coronavirus is enormous. Singapore, for example, will spend a sum equivalent to about 13% of its GDP on extensive fiscal stimulus measures and Thailand 9%, while in the Philippines, Indonesia, and Vietnam the figure will be about 3% of GDP.⁴

Despite decades-long sustained economic growth, why do countries in the ASEAN region still collect such low amounts of revenue? Because these countries are still highly dependent on revenues from corporate income tax (CIT); however, they are giving up huge amounts of revenue by offering large tax incentives to both domestic and foreign investors.



Photo: Crunchy Frog/Oxfam in Vietnam

³ OECD (2020), *Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience*. https://read.oecd-ilibrary.org/view/?ref=128_128575-o6raktc0aa&title=Tax-and-Fiscal-Policy-in-Response-to-the-Coronavirus-Crisis.

⁴ Hayat, R. (2020), *How COVID-19 will impact ASEAN: Deep recessions and a weak recovery*. RaboResearch - Economic Research

International institutions have repeatedly warned countries in the region to stop offering redundant tax incentives. Tax losses due to corporate tax incentives were estimated to be 6% of GDP in Cambodia and 1% of GDP in Vietnam and the Philippines.⁵ These lost revenues could have been crucial now in covering large parts of the extra budget spending on responses to COVID-19: These in the Philippines and Vietnam, for example, are equivalent to a third of their financial efforts in response to the COVID 19 pandemic.

Tax competition among ASEAN State Members⁶

There has been a long history of tax competition between the Philippines, Vietnam, Thailand, and Indonesia, with the four countries vying with one another for manufacturing investments and using tax incentives as a tool to attract foreign direct investment.

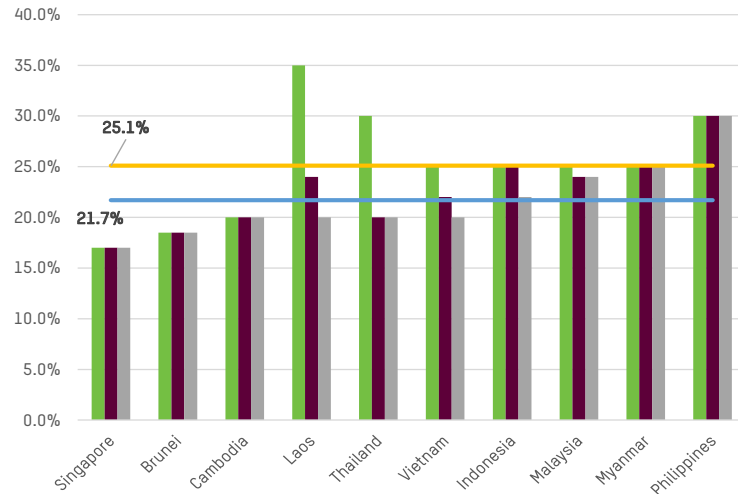
In 1996, competing to lure investment from the US firm General Motors, the Philippines offered a CIT exemption of eight years and Thailand offered a similar exemption, but with an additional amount equivalent to USD15 million. In 2001, hoping to win investment from Canon of Japan, Vietnam offered an exemption of 10 years, but was out-competed by the Philippines, which offered an exemption of 8-12 years. In 2014, in an attempt to entice investment from Samsung of South Korea, Indonesia offered a CIT exemption of 10 years while Vietnam offered one of 15 years.

Just like in many other regions in the world, countries in the ASEAN region are competing with one another in a race to the bottom by reducing their CIT rates and offering aggressive tax incentives to foreign multinational corporations. Across the region, the average CIT rate has fallen over the last ten years from 25.1% in 2010 to 21.7% in 2020.

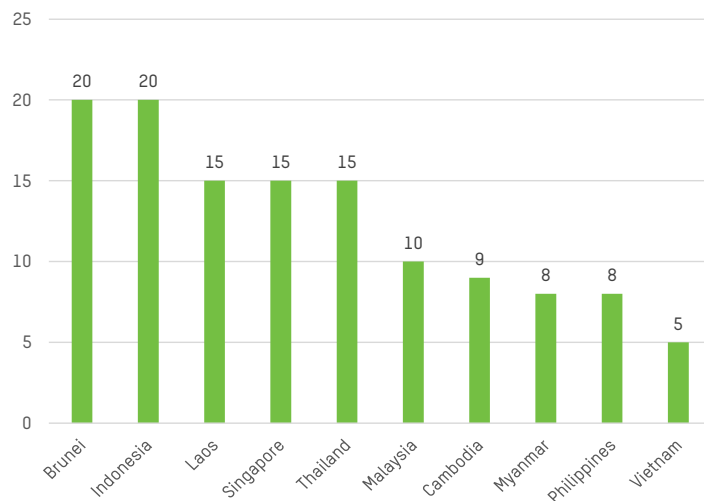
5 OECD (2019), *OECD Investment Policy Reviews: Southeast Asia*. www.oecd.org/investment/oecd-investment-policy-review-southeast-asia.htm.

6 Budiantoro, S. (2015), *Anticipating Tax War in the ASEAN Economic Integration Era*. PRAKARSA Policy Review, 2-4.

Standard CIT Rates in ASEAN Countries, 2020⁷



Maximum Period of Tax Holidays in ASEAN Countries, 2020 (Number of years)⁸



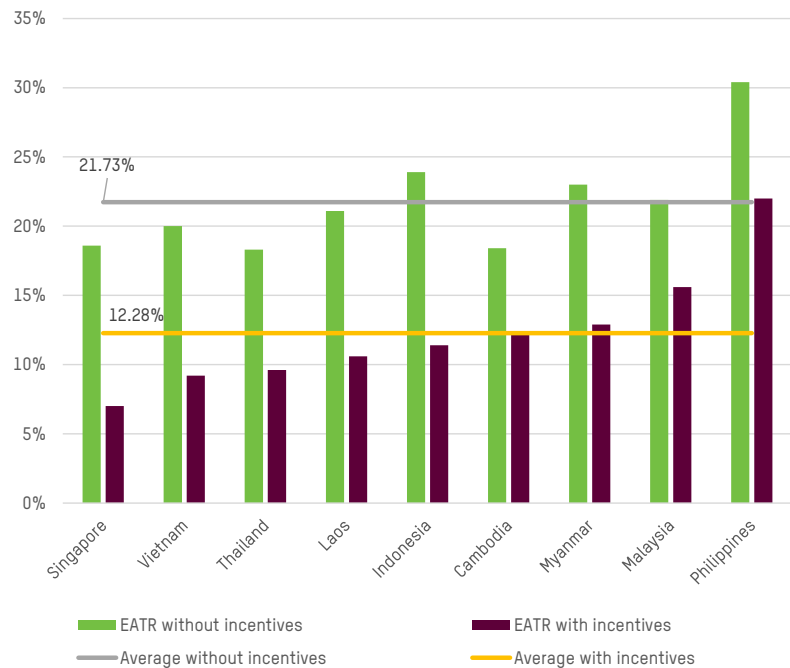
Taking into account the tax holidays of up to 20 years and other enormous profit-based incentives offered to multinationals by some countries, the effective CIT rate is on average 9.4 percentage points lower. This makes ASEAN a region with effectively some of the lowest CIT rates in the world for large companies. Aggressive tax competition is also a fertile ground for profit shifting. Countries like Thailand, Indonesia, and Malaysia are estimated to lose at least between 6-9 percentage points of potential corporate tax revenues due to profit shifting.⁹ The race to the bottom is a lose-lose game.

⁷ *Trading Economics (2020), List of Countries by Corporate Tax Rate.* <https://tradingeconomics.com/country-list/corporate-tax-rate> (Accessed 6 May 2020).

⁸ *The authors' review from legal documents*

⁹ *Wiedemann, V. & Finke, K. (2015). Taxing investments in the Asia-Pacific region: The importance of cross-border taxation and tax incentives. Discussion Paper No. 15-014.*

Average Effective Tax Rates with and without Incentives in ASEAN countries, 2015 (%)¹⁰



The ASEAN countries need to stop this race to the bottom in taxation at the political level to improve their domestic revenue mobilization if they plan to overcome sustainable development challenges like climate change, widening inequality and high levels of poverty while recovering from the COVID-19 crisis.

ASEAN countries need to stop this race to the bottom in taxation at the political level to improve their domestic revenue mobilization if they are serious about overcoming sustainable development challenges such as climate change, widening inequality and high levels of poverty while also recovering from the COVID-19 crisis.

There is no significant evidence that corporate tax incentives increase foreign direct investment—indeed, quite the contrary.¹¹ Most corporate tax incentives currently offered by ASEAN countries are not aimed at attracting long-term investments, but rather are an attempt to compensate for weak governance and poor infrastructure, and they feed the short-term desire of shareholders to cut corporate tax payments to the bare minimum. Furthermore, tax incentives created an unfair investment environment for small and medium local enterprises who rightfully deserve at least equal benefits. In Vietnam, the effective CIT rate for foreign companies in the manufacturing sector in 2016 was 8%, but for domestic enterprises, it was 14.5%, and it was even higher for large state-owned enterprises at 16%.

¹⁰ Wiedemann, V. & Finke, K. (2015). *Taxing investments in the Asia-Pacific region: The importance of cross-border taxation and tax incentives*. ZEW Discussion Paper No. 15-014.

¹¹ James, S. (2014). *Tax and non-tax incentives and investments: Evidence and Policy Implications*. Investment Climate Advisory Services. World Bank Group.



Unlike in other regions, ASEAN has never taken any political action against the race to the bottom on CIT. Member countries should grasp the opportunity offered by their next summit to begin a process of phasing out the most redundant tax incentives and should establish a clear rulebook for tax incentives in the region. The current race to the bottom is increasing economic and social divergence in the region. ASEAN needs to make sure that its members' tax policies serve the collective good and help create a stable fiscal environment. The handling of the coronavirus pandemic also highlights two pressing issues for the region: first, governments need sufficient resources for a fairer recovery and to cope with future shocks; and second, ASEAN will only ever be as strong as its weakest link.

The ASEAN countries are too far apart on many macro-level indicators and this is sustained by the aggressive race to the bottom in taxation. Each country tends to prioritize its own interests when implementing fiscal policies and compete for gains rather than making joint decision and devising a mechanism for the common good. It is a major challenge for ASEAN countries to unite and address complex emerging issues at the regional level, particularly corporate tax incentives. However, if ASEAN wants to remain cohesive, its Member States need to converge.

Photo: Tiara Audina / Oxfam

In light of this, the report recommends ASEAN to take the following actions to strengthen tax cooperation across the region:

RECOMMENDATION 1: DRAW UP A WHITELIST AND A BLACKLIST OF TAX INCENTIVES

ASEAN members should together draw up a blacklist of all tax incentives that should no longer be allowed and establish a plan to phase them out across the region by a certain date. In parallel with this, they should agree on a whitelist of tax incentives that are acceptable and allowed. The blacklist should include first and foremost profit-based tax incentives, i.e. incentives that offer a low rate of tax on profits made, such as tax holidays, significant tax exemptions, loss carry-backs, and preferential rates. Academics and international organisations like the OECD have already called on countries in ASEAN to stop offering these kinds of incentive due to their harmful nature and marginal positive effects. The whitelist should include investment-based tax incentives, i.e. incentives that focus on the investment itself. Such incentives are proven to be much more productive than profit-based incentives. However, these incentives should be monitored for their effectiveness and abuses should be avoided like super deductions, or super tax credits.

A mechanism should be put in place at the ASEAN level to monitor developments in tax policies and to decide which incentives should be blacklisted or whitelisted. This mechanism should be transparent and inclusive, and should involve both political representatives and technical experts from governments, civil society, and academia in its operation.

RECOMMENDATION 2: AGREE ON A MINIMUM TAX STANDARD ACROSS THE ASEAN REGION

The race to the bottom across ASEAN needs to stop, and while international policy developments towards a worldwide minimum effective tax rate are ongoing, member countries need to agree on an approach tailored to the region. The ASEAN countries should agree that corporate tax incentives offered should not be set below the level of a minimum effective tax rate. The appropriate rate is a subject for discussion, with a possible range of 12.5% to 20%.¹² This would protect countries' domestic tax revenues and stop the beggar-thy-neighbor policy approach to policy making that has existed until now.

RECOMMENDATION 3: ESTABLISH RULES FOR THE GOOD GOVERNANCE OF TAX INCENTIVES

The ASEAN countries should agree on a good governance rulebook for tax. All tax incentives should have a legal basis in a country's corporate tax code and no tax incentives should be given to companies arbitrarily. In all cases, tax incentives should have a clear timeline and end date included in legislation.

¹² The rate should be discussed thoroughly between ASEAN countries without undermining the global approach on this issue. The range suggested here is a proposal intended to balance global practice and the lack of fiscal revenues faced by ASEAN countries.

The ASEAN countries should also incorporate all tax incentives into the relevant corporate tax code, with clearly defined criteria. Finally, all countries in the ASEAN region should publish an annual tax expenditure report; this should be transparent, and published along with the annual budget documents.

For the purposes of transparency and good governance, a cost-benefit analysis on potential provisions should be carried out as a prerequisite for the approval of any tax incentive. Where tax incentives have been granted, authorities (preferably tax authorities) must monitor their impact by conducting a mid-term evaluation to establish whether outcomes are meeting their expectations.

KEY STATISTICS ON THE ASEAN REGION¹³

Poverty and Inequality

- In 2018, an estimated 73.6 million out of 653.9 million people (11.3%) were living in poverty.
- High economic inequality: over 0.35 Gini index for income in all countries in a 2010-2017 period, with the Philippines (0.45); Malaysia (0.42); Singapore (0.40); Indonesia (0.39); Myanmar and Thailand (0.38); Cambodia (0.37); and Laos and Vietnam (0.36). Wealth inequality is even alarming with 0.85 Gini index in Thailand and Laos, 0.84 in the Philippines and Indonesia, 0.82 in Malaysia, 0.74 in Vietnam and 0.70 in Cambodia.

Stretching fiscal space

- The average budget revenue ratio to GDP at a general government level stood at 19.1% in 2018, lower than half that collected on average in OECD countries and lower than in the Latin America and the Caribbean region.
- The greater share of overall budget revenue is mobilized through regressive VAT: Vietnam, Indonesia, Cambodia, and Laos obtained 27%, 25%, 24% and 22% respectively through VAT, higher than OECD average of 18%.
- In 2018 alone, six of the nine countries (excluding Brunei) had significant budget deficits. The ASEAN region saw an average budget deficit of 1.5% of GDP in 2018. It is expected that all of the nine countries face budget deficits in 2020 with the average one at 4.2% of GDP.
- In a 2000-2020 period, seven ASEAN countries witness persistent budget deficits in 17-21 years out of 21 years.
- Four ASEAN countries, Singapore, Laos, Vietnam, and Malaysia are under great pressure from public debt with their ratios to GDP above 50% in 2015.

¹³ See detail sources on statistics in the full paper.

- Failing to invest sufficiently in essential public services (health, education, and social protection): using the average proportion of government spending on these services in the OECD countries as a benchmark (63.0%), the ASEAN's average rate (33.6%) was little more than half the benchmark. The lowest one (18.7%, Myanmar) was about a third of the benchmark (Data from CRII, 2018).
- A shortage of financial resources to reach the SDGs on essential public services with major fiscal stress (relative stress >20%) in Laos, Cambodia, and Myanmar, and manageable fiscal stress (relative stress between 10%-20%) in Vietnam and Malaysia.

A race to the bottom on corporate income tax

- The average CIT rate has fallen over the last ten years from 25.1% in 2010 to 21.7% in 2020. Taking into account the tax holidays of up to 20 years and other enormous profit-based incentives offered to multinationals by some countries, the effective CIT rate is on average 9.4 percentage points lower. This makes ASEAN a region with effectively some of the lowest CIT rates in the world for large companies.
- Singapore offers the lowest CIT rate at 17%, its effective CIT rate drops by 11.6 percentage points with corporate tax incentives.
- For profit-based incentives, ASEAN countries provide tax holidays from 5 to 20 years, with average of 12 years; use tax preference with CIT reductions of 50-100%. Four countries, Cambodia, Thailand, Indonesia, and Malaysia provide the most attractive preferential tax rate (100%).

Cost of corporate tax incentives

- Tax losses due to corporate tax incentives were estimated to be 6% of GDP for Cambodia and 1% of GDP for Vietnam and the Philippines. These figures in the Philippines and Vietnam are equivalent to a third of their financial efforts in response to the COVID-19 pandemic.
- Vietnam's tax expenditure from CIT incentives was estimated to be USD2.7 billion in 2016, equivalent to 7% of state budget revenue, 30% of CIT revenue, and large than state budget spending on health.
- The Philippines gave away an estimated USD22.17 billion due to tax incentives and exemptions to a select group of 3,150 companies from 2015 to 2017.
- Thailand, Indonesia, and Malaysia were estimated to lose at least between 6-9 percentage points of potential corporate tax revenues due to profit shifting.
- In Vietnam, the effective CIT rate for foreign companies in the manufacturing sector was 8% in 2016, but 14.5% for domestic ones, and even more than 16% for large state-owned ones.



Photo: Oxfam in Vietnam

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