PRAKARSA Policy Brief

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Bridging the Gap: Towards Fair Corporate Tax Practices in ASEAN

Key Points:

- ASEAN boasts strong economic growth and has become a prime target for foreign investment. The COVID-19 pandemic has widened economic and social disparities among its member countries, prompting them to compete by offering tax incentives such as tax holidays, exemptions, and deductions to attract investments. The lack of uniform fiscal policies could lead to harmful tax competition, reducing tax revenue and weakening long-term growth prospects.
- The average Corporate Income Tax (CIT) rate in ASEAN in 2023 is 20.85%, with Singapore offering the lowest rate at 17%, followed by Brunei at 18.5%. The global minimum tax policy of 15% set by the OECD is considered too low for ASEAN, as some companies in Vietnam pay well below 15%, showing that OECD standards do not reflect the needs of developing countries in ASEAN.
- Post-pandemic Foreign Direct Investment (FDI) inflows into ASEAN are recovering, yet tax incentives have not shown significant independent effects on FDI. Factors such as good governance and legal certainty are more crucial in attracting foreign investment. This confirms that a holistic strategy including regulation and business support is necessary for sustainable investment.

'Race to the Bottom' in Tax Incentives in ASEAN

Southeast Asia, a geographically strategic region with solid economic growth and a young population, is a focal point for foreign investment. Annually, ASEAN countries gather to strengthen economic, social, and political stability in the region, primarily focusing on economic integration and enhancing cooperation among its members.

However, in 2020, the COVID-19 pandemic had a significant impact on ASEAN member countries. The pandemic not only disrupted economic activities and changed lives but also widened the economic and social disparities among ASEAN members. Although the economic conditions of ASEAN countries were depressed due to the COVID-19 pandemic, economic growth in the region soon recovered. Foreign investment began to return as economic growth improved and institutions strengthened (ADB, 2022; Dang & Nguyen, 2021). Influencing factors include economic diversity and the quality of governance in ASEAN countries. Additionally, ASEAN countries are also striving to attract foreign investment by offering various tax reliefs to investors. Some countries even lowered direct rates for Corporate Income Tax (CIT), while others provided tax holidays, tax exemptions, tax deductions, and other tax reliefs.

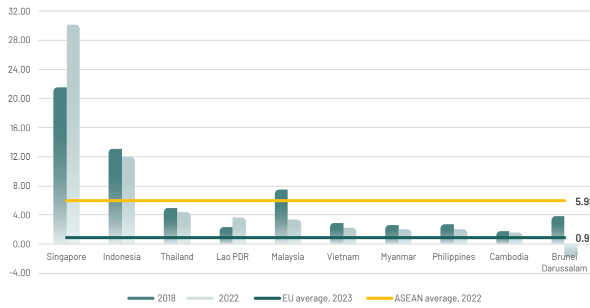
These tax relief policies certainly affect ASEAN countries due to the diverse fiscal situations among the member states. Some countries have more resources than others, which contributes to the variance. Additionally, fiscal policies in ASEAN are often uncoordinated, which can lead to negative externalities such as harmful tax competition. This lack of coordination can reduce the overall economic efficiency of the region and weaken long-term growth prospects. For example, if one ASEAN country lowers its corporate tax rates to attract foreign investment, other countries in the region might feel compelled to do the same to stay competitive. This scenario could lead to a "race to the bottom" in corporate tax policies across ASEAN.

Granting tax incentives and FDI (Foreign Direct Investment)

FDI is a key strategy for boosting the economy and the revenue ratio of a country. The revenue ratio varies across ASEAN countries, with an average of 19.25% in 2022. This figure is less than half the OECD average of 41.73% (IMF, 2023). Brunei Darussalam had the highest budget revenue to GDP ratio in 2022 at 28.91%, while Myanmar had the lowest at 13.25%.

Within ASEAN, Singapore was the top country in terms of net FDI inflow, with 141.2 billion USD in 2022, while Brunei recorded a negative FDI of about 284 million USD in the same year (World Bank, 2023).

Graphic 1. Net foreign direct investment (FDI) inflows to ASEAN countries, 2018-2022 (% of GDP)

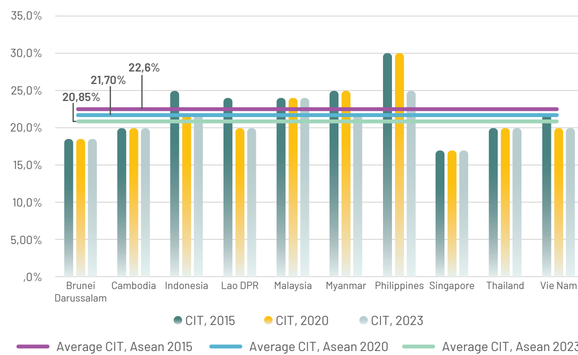


Source: World Bank (2023).

Post-COVID-19 pandemic, the inflow of Foreign Direct Investment (FDI) has rebounded strongly in Singapore, primarily because it continues to serve as a tax haven. Singapore is known for offering aggressive tax incentives to corporations, even during the pandemic. In contrast, Brunei Darussalam has seen a decline in foreign investment, experiencing negative FDI inflows (as shown in Graphic 1).

Corporate Income Tax (CIT) is a tax imposed on the income of corporations or legal entities. CIT plays a crucial role in the economies and revenues of ASEAN countries. The average CIT rate across ASEAN was only 20.85% in 2023, which represents a decrease of 1.75 percentage points from 2015.

Graphic 2. The CIT Rate in ASEAN (2015 - 2023) has decreased on average



Source: PRAKARSA, 2024

The variation in Corporate Income Tax (CIT) rates across ASEAN countries is significant. In 2023, Singapore remained a tax haven for corporations with the lowest CIT rate in ASEAN at 17%, followed by Brunei at 18.5%. Most other countries, such as Vietnam, Laos, Cambodia, and Thailand, have set their rates at a steady 20%. In response to the COVID-19 pandemic, Myanmar and the Philippines have reduced their rates to 22% and 25%, respectively. Indonesia implemented a rate of 22% in 2023, although there had been plans to reduce it to 20%, which were later cancelled.

This situation of reducing CIT rates raises concerns about a "race to the bottom", where countries compete to offer the lowest CIT rates. According to Dezan Shira & Associates (2018), countries with lower CIT and more stable tax policies are more attractive to investors. This situation calls for collective action from ASEAN to avoid the negative consequences of unhealthy tax competition.

In addition to lowering standard CIT rates, countries also provide profit-based incentives such as tax exemptions, tax holidays, preferences, and deductions, as well as non-tax incentives such as land incentives. For example, tax exemptions have been implemented for agriculture in Vietnam and Cambodia. The duration of tax holidays in ASEAN ranges from six to 20 years, with an average of about 13 years. Vietnam, Laos, and Malaysia are three countries that have extended the maximum period of tax holidays: from five to six years in Vietnam, 10 to 15 years in Malaysia, and 15 to 17 years in Laos. Indonesia and Brunei Darussalam have set the longest periods, lasting 20 years each.

With the implementation of various tax and non-tax incentives, ASEAN countries claim they can create a more attractive and competitive environment for foreign direct investment. However, the excessive use of these incentives needs to be reevaluated as a measure to prevent the phenomenon of a "race to the bottom" in the region. The competition among ASEAN countries to offer low rates and numerous incentives could risk reducing national revenues. This competition may not only undermine fiscal stability but also encourage short-term gains at the expense of long-term economic health. Therefore, a balanced approach to fiscal incentives is essential to ensure sustainable investment without compromising the financial integrity of the countries involved.

Global corporate minimum tax rates are still low

The global minimum corporate tax rate set by the Organisation for Economic Co-operation and Development (OECD) at 15% is considered too low, especially in the context of ASEAN countries. While corporate tax rates in ASEAN generally exceed 15%, the OECD standard still benefits multinational companies that can pay substantially lower effective tax rates. For example, in Vietnam, some multinationals may pay actual tax rates as low as 6% to 8% during preferential periods, which is significantly below the OECD's proposed 15% (Vu Sy Cuong, Luu Huyen Trang, 2023). Practices like these make Vietnam competitive in the ASEAN market.

Setting OECD standards must consider more than just OECD member countries, which are predominantly developed nations. For instance, countries like Germany and Luxembourg, where the minimum CIT is 15.8% and 18.2% respectively, and Canada in North America with a CIT of 15%, all have economic structures that differ markedly from those in ASEAN, which are mostly developing countries with an average CIT around 20%. Globally, corporate taxes range from 20%-30%, most commonly around 25% (Tax Foundation, 2023).

The influence of developed countries in shaping global tax policies presents challenges for developing nations, like those in ASEAN. Discussions dominated by developed countries leave developing nations with limited options—often a choice between bad and worse (GATJ, 2021). ASEAN countries require a more suitable approach that aligns with

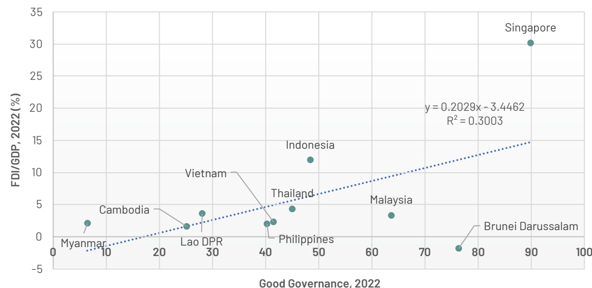
the diverse economic conditions of the region, ensuring that tax policies support sustainable development rather than imposing undue burdens.

Significant Corporate Income Tax (CIT) incentives are not the primary determinant of Foreign Direct Investment (FDI) flows into ASEAN

The influx of Foreign Direct Investment (FDI) into ASEAN has shown signs of recovery post the COVID-19 pandemic. FDI in Southeast Asia saw an increase of 4.58% year-on-year. According to UNCTAD data (2023), in 2022, the total FDI in ASEAN reached 222.3 billion USD, with an average of 22.2 billion USD per country per year. Is this solely caused by the tax incentives provided by ASEAN countries?

We found that tax incentives do not have a significant independent impact on FDI (Figure 1). This testing aims to measure the relationship between the scores of good governances and the estimated incentive gap relative to the FDI to GDP ratio. This will help us understand the impact of independent variables on the attractiveness of direct foreign investment.

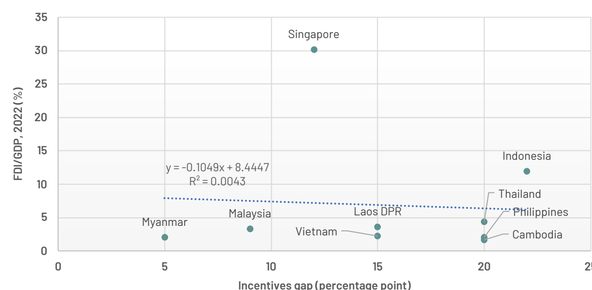
Figure 1. FDI and Good Governance in ASEAN Countries in 20221



Source: Processed by researchers from the World Bank, 2023.

The statistical analysis in Figure 1 shows that the correlation coefficient indicates a positive correlation between Foreign Direct Investment (FDI) and good governance, with a value of 0.69.

Figure 2. Estimated incentive gap with FDI in 2022



Source: Processed by researchers from Word Bank, 2023.

Meanwhile, the analysis regarding the correlation between FDI and the incentives gap shows a coefficient of -0.065 (Figure 2), which means it is not significant. This coefficient may suggest a negative impact of the tax incentive gap on FDI. COVID-19 has played a role in these results, indicating that incentives cannot be relied upon as a dependable tool for attracting investment.

This finding does not align with the theoretical notion that incentives are a key factor in attracting Foreign Direct Investment (FDI). Instead, it suggests that legal certainty within a country is equally important for attracting foreign investment (Aribowo et al, 2021). This view is consistent with The Global Competitiveness Report 2017-2018, which asserts that relaxation facilities and various tax incentives are not the primary factors desired by investors when investing in a country. In Indonesia, the six main determinants of investment include conditions of corruption, bureaucratic efficiency, financial access, infrastructure, policy certainty, and governmental stability. In Malaysia, the key investment factors are financial access, foreign exchange policies, bureaucratic efficiency, inflation, tax rates, and corruption. In the Philippines, the main determinants are bureaucratic efficiency, infrastructure, corruption, tax policies, and policy/stability certainty. In Vietnam, significant factors influencing investment are financial access, a skilled workforce, corruption, work ethics, tax policies, and policy certainty.

The levels of Foreign Direct Investment (FDI) in a country are influenced not only by tax incentives but also by several other factors. These include efficient licensing processes, legal certainty, support for business development, improved accountability and national governance, legal certainty again, and enhancements to the taxation system. This indicates that a holistic strategy, encompassing various aspects of regulation and business support, is required to attract healthy and sustainable investment.

Policy Recommendations

1. ASEAN countries should strengthen their cooperation in taxation, especially in the areas of double taxation agreements (DTAs), tax and customs information exchange, and improvements in tax and customs administration governance.
2. ASEAN Forum on Taxation (AFT) can facilitate discussions to establish a minimum tax rate higher than the OECD standard of 15% to prevent a "race to the bottom" and protect national tax revenues. Through the AFT, tax harmonization can be achieved by standardizing the types of taxes, and tax rates, and aligning the tax base, leading to an equitable distribution of tax burdens among ASEAN countries. It is proposed that ASEAN countries agree to a regional corporate tax rate of 25%.
3. AFT should consolidate ASEAN members to promote the UN Tax Convention as a platform that ensures all countries, including ASEAN members, have an equal voice in establishing international tax rules, benefiting not just developed countries.
4. AFT needs to build consolidation among ASEAN member states related to the implementation of Pillar One of the OECD-developed BEPS framework to mitigate challenges and losses for ASEAN members, such as reduced fiscal

autonomy due to adhering to standards dominated by developed countries.

5. ASEAN member states need to review the optimization of tax and non-tax incentives to ensure that the tax incentives provided genuinely attract high-quality and sustainable investments. Besides tax incentives, ASEAN countries should focus on non-tax incentives like simplifying licensing processes, developing good infrastructure, and business support to attract foreign investment. This includes expediting dispute resolutions and ensuring that contracts and agreements are respected.

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Managing Director :

Ah Maftuchan
The PRAKARSA Executive Director

Written by:

- Bintang Aulia Lutfi
- Eka Afrina Djamhari
- Victoria Fanggidae

Designed by:
Bambang Nurjaman

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PRAKARSA
Welfare Initiative for Better Societies

Jl. Rawa Bambu I Blok A No.8-E
Pasar Minggu, Jakarta Selatan
Indonesia 12520

Phone +6221 781 1798
perkumpulan@theprakarsa.org

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