Q&A
Towards Sustainable Tax Policies in the ASEAN Region: The Case of Corporate Tax Incentives

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Key Information and recommendations

Who conducted the research?

Oxfam commissioned Vietnam Institute for Economic and Policy Research (VEPR), The PRAKARSA in Indonesia, and Tax and Fiscal Justice Asia Network (TAFJA) to produce this paper. The research team built a research protocol to investigate macro-economic issues and practical uses of corporate tax incentives in each ASEAN country to write country reports in all ten countries, then Oxfam and VEPR consolidate country reports to produce this final paper.

Why do corporate tax incentives matter in the ASEAN region?

The ASEAN region is experiencing unprecedented economic inequality, as some countries still face the highest poverty levels in the world and most countries in the region fail to invest sufficiently in essential public services. Progressive tax collection and social spending on essential public services like healthcare, education, and social protection are the most effective ways to fight poverty and inequality.

Despite decades-long sustained economic growth, the ASEAN region collects low amounts of revenues because these countries are still highly dependent on corporate income tax revenues and lose huge amounts of revenues by offering large tax incentives to both domestic and foreign investors.

The ASEAN countries are competing with each other by reducing their corporate income tax rates and offering aggressive tax incentives to both domestic and foreign investors. International institutions like OECD and UNTACD have repeatedly warned ASEAN to stop offering redundant tax incentives due to their costs on budget revenue, tax base erosion, and creating room for tax avoidance and evasion.

There is no significant evidence that tax incentives increase foreign direct investments but quite opposite to it. Most current corporate tax incentives in ASEAN do not aim at attracting long-term investments. Rather, they try to compensate for weak governance, poor infrastructure and feed the short-term desire of shareholders to cut corporate tax payments to the bare minimum. Furthermore, tax incentives created an unfair investment environment against local small and medium enterprises who rightfully deserve at least equal benefits.

Redundant and harmful tax incentives in the region drain away essential revenues that can go into improving the lives of millions. These practices foster inequity and unfairness and create self-harming and counterproductive competition among members countries.

However, tax competition in this region is still happening and reinforcing its members' low budget revenue ratios to GDP. These low ratios mean that countries in the region have limited fiscal space and are running public deficits, and this gap has dramatic consequences for the quality of public services, infrastructure, and levels of good governance. The situation in ASEAN was already unsustainable. The fiscal pressure increases significantly further due to the extra budgetary burdens to overcome the current economic challenges and health crisis created by the COVID-19 pandemic.

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.

The report indicates that the situation on corporate tax incentives in ASEAN now is more dire during the COVID-19. How to prove that?

Initial estimates from the OECD (see: https://read.oecd-ilibrary.org/view/?ref=128_128575-o6raktc0aa&title=Tax-and-Fiscal-Policy-in-Response-to-the-Coronavirus-Crisis) show the pandemic will have significant negative impacts on tax revenue 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. Meanwhile, 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. 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.

It is expected that nine ASEAN countries face budget deficits in 2020 with the average one of 4.2% GDP.

How can ASEAN prevent the race to the bottom on corporate tax incentives?

ASEAN needs to collectively stop this race to the bottom in taxation at the political level. 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. ASEAN needs to make sure that tax policies in the region serve the collective good and help create for a stable fiscal environment.

Why do ASEAN countries need to collaborate rather than tackle this issue on their own?

ASEAN is one of the regions in the world with the lowest effective corporate income tax for foreign companies. Aggressive tax competition is fertile ground for profit shifting as well. Countries like Thailand, Indonesia and Malaysia are estimated to lose at least between 6-9 percentage points of corporate tax revenues due to profit shifting.

The race to the bottom is a regional, or even global issue. If only one ASEAN country removes redundant tax incentives, multinational companies, while doing business in that country, would make efforts and employ tactics for profit-shifting, tax avoidance or phantom foreign direct investment (FDI). By doing so, multinational companies maximize their after-tax profits, but tax rights are not guaranteed in ASEAN countries.

In fact, each country in the ASEAN region tends to prioritize its own interests when implementing fiscal policies and compete for gains, rather than sitting down with its neighbours and designing a mechanism for the common good. The tax competition among ASEAN countries continue to cause substantial costs on budget revenues and insufficient fiscal resources for essential public services.

Preventing this competition requires coordination mechanisms among countries; the Organisation for Economic Cooperation and Development (OECD) has led negotiations on the Base Erosion and Profit Shifting Agreements (BEPS) towards a global agreed minimum effective corporate tax rate for multinationals which would be applied on a per-country basis. According to preliminary OECD calculations this minimum rate would raise governments' tax revenues by USD100 billion a year - equivalent to a 4 percent increase in global corporate income tax revenues.

Whatever the outcome of the OECD negotiations, international policy decisions will have to be translated into legislative changes in the ASEAN region. ASEAN Member States should not wait passively for a global agreement but should set their own region-specific standards in order to defend their tax bases and seek better rules. A minimum tax standard for the ASEAN region

should be seriously considered and discussed, and should be set at a level that is at least equivalent to the level now being discussed in the BEPS 2.0 process.

How can ASEAN tackle this issue collectively

The report provides three concrete recommendations:

First, ASEAN should agree on a whitelist and a blacklist of tax incentives. The blacklist should include foremost profit-based tax incentives, such as tax holidays, large tax exemptions, loss carry-backs and preferential rates. The white list should include investment-based tax incentives, i.e. incentives that focus on the investment itself.

Second, as BEPS, The ASEAN countries should agree that corporate tax incentives offered should not go below a minimum effective corporate tax rate. This rate should be discussed with a possible range from 12.5% to 20%. This will protect the countries' domestic tax revenues and stop the beggar-thy-neighbor policy orientation.

Third, ASEAN should agree on a tax good governance rulebook, including clear and fair tax incentive provisions in tax laws, and cost-benefit analysis on potential tax incentive provisions, and publishing an annual tax expenditure report in each ASEAN country.

Why does the report recommend the minimum effective corporate income rate in the ASEAN region range from 12.5% to 20%?

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.

Based on the report's recommendations, what should each country in the ASEAN region do?

First, the ASEAN countries need to actively participate in discussions in ASEAN on the common minimum standards for corporate tax incentives in the region to prevent harmful tax practices that drain on essential public revenue and create unnecessary competition among members.

Second, the ASEAN countries should actively phase out profit-based tax incentives, implement good governance on providing tax incentives, and publish an annual tax expenditure report.

Macro-economic and budget indicators

What are divergences in the ASEAN region? Why they affect the race to the bottom?

There are enormous differences between ASEAN countries in terms of their macro indicators, ranging from the income level and population to human development.

The income gap (GDP per capita, current $) between countries has been increasing in absolute terms. The gap between the country with the highest per capita income (Singapore) and the lowest (Myanmar) was at over $63,000 in 2018, but around $23,000 in 2000.

Two countries, Singapore and Brunei, have the smallest populations in the region and the highest per capita incomes and the highest scores on the Human Development Index (HDI). Their GDP per capita (in terms of purchasing power parity, or PPP) are also among the highest in the world, at over US$70,000 in 2018; those of the other ASEAN countries meanwhile are all lower than $30,000, most of them substantially so.

The ASEAN countries are too far apart on many macro-level indicators, and this is exacerbated by the aggressive race to the bottom on taxation. One of the biggest challenges for ASEAN countries is to come together and address complex emerging issues at the regional level, in particular corporate tax incentives. However, if ASEAN wants to remain cohesive, its Member States need to converge.

The summary and full report shows high poverty rates and inequality levels in the ASEAN region. How you calculate that?

For poverty, the report employs data on poverty headcount ratio at national poverty lines (% of population) from World Development Indicators of the World Bank to estimate poverty rates in the ASEAN region in 2018 by using geometric mean of changes (year to year) in poverty rates. We show that an estimated 73.6 million (11.3%) out of 653.9 million are living in poverty in 2018.

For inequality, the report uses Gini index to show inequality levels. A Gini index of 0 represents perfect equality, while an index of 1 implies perfect inequality. The report collects wealth and income Gini indices in World Development Indicators of the World Bank and World Economic Forum's reports: The Inclusive Development Index 2018 Summary and Data Highlights. On average, Gini index for all ASEAN countries was over 0.35 in a 2010-2017 period, with 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 Philippines and Indonesia, 0.82 in Malaysia, 0.74 in Vietnam and 0.70 in Cambodia.

What is a benchmark to say low revenue collection levels in all ASEAN countries?

We use an average ratio of budget revenue at a general government level to GDP in the OECD countries as a benchmark. The average ratio in the ASEAN region was 19.1% GDP in 2018, lower than half that collected on average in OECD countries (39.6%) and lower than in the Latin America and the Caribbean region. The highest ratio was in Cambodia (23. 9%) and lowest in Indonesia (14.9%).

Why does the report say countries in ASEAN highly depend on CIT revenues?

We use World Revenue Longitudinal Dataset of the IMF to calculate budget revenue's structures in the ASEAN countries.

Some countries are highly dependent on revenues from CIT, which accounted for more than 28% of the total budget revenue in Malaysia, 27% in Indonesia in 2017. On average, about one-fifth of

the budget revenues were collected from CIT in 2017 in the seven ASEAN countries (excluding Myanmar, Brunei, and Lao due to no available data).

The report shows that most ASEAN countries suffer persistent budget deficits in a long period. How did you state this?

The report extracts data on budget revenues and expenditures (% GDP) at a general government level during a 2000-2020 period from the IMF's Fiscal Monitor Database to count the number of years in budget deficits. No available data for Brunei, so we estimate budget deficits in the nine ASEAN countries.

Seven ASEAN countries suffer persistent budget deficits in a long period: Malaysia, Myanmar, and Laos are expected to experience these deficits throughout 2000-2020; Vietnam, Cambodia, Indonesia, and Philippines witness the deficits in 17-20 years in that period.

In 2018 alone, six out of the nine countries had significant budget deficits. On average, the ASEAN region saw a budget deficit of 1.5% GDP.

Due to the COVID-19, it is expected that all nine ASEAN countries face budget deficits in 2020 with the average one of 4.2% GDP.

Why does the report indicate some countries have high levels of public debt?

Four ASEAN countries, Singapore, Laos, Vietnam, and Malaysia, face the highest ratios of public debt to GDP.

While Singapore has shown strong capacity to control public debt, with its budget balance reaching a surplus of 3.7% of GDP in 2018, for Laos public debt pressures have been increasing, with a large budget deficit ratio of 4.7% of GDP that year.

In addition, Laos's external public debt remains large, reaching 51% of GDP in 2018, the highest of any ASEAN country. Data on public debt is collected from the IMF's Global Debt Database, data on external public debt is collected from the WB's World Development Indicators.

How the report says the ASEAN countries have low commitments to reducing inequality?

Development Finance International (DFI) and Oxfam (2018) developed the Commitment to Reducing Inequality Index (CRII) to emphasize the key roles played by fair taxation, public spending on health, education, and social protection, and labor regulations in tackling inequality. All the ASEAN countries are ranked in the bottom half of this index (157 assessed countries).

Based on Data from CRII, 2018, we calculate the average proportion of government spending on essential public 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.

Corporate tax incentives and their cost on the ASEAN's economy

How does the race to the bottom happen in the ASEAN countries?

Across the region, the average CIT rate has fallen over the last 10 years, from 25.1% in 2010 to 21.7% in 2020. No ASEAN countries increase their CIT rates during this period.

According to calculations by Wiedemann and Finke (2015), the average effective CIT rate with incentives in the ASEAN region is 9.4 percentage points lower than the rate without incentives, while the gap in selected countries in the Asia and the Pacific region is 7.3 percentage points on average. Singapore offers the lowest CIT rate at 17% in 2020 and the effective corporate tax rate with incentives drops by 11.6 percentage points.

In Box 1, we provide multiple cases for a tax competition among Philippines, Vietnam, Thailand, and Indonesia, in which, these four countries have been facing each other over manufacturing investments and using tax incentives as a tool for FDI attraction.

How to calculate effective CIT rates with and without incentives?

We use the calculations from 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.

In Vietnam, VATJ (2019) calculates effective CIT rates by enterprise's ownership based on Vietnamese Enterprise Census (VEC). We show that tax incentives create an unfair investment environment for small and medium-sized local companies. In Vietnam, the effective CIT rate for foreign companies in the manufacturing sector in 2016 was 8% but for domestic companies it was 14.5%, and it was even higher for large state-owned enterprises at 16%.

Why does the report say profit-based corporate tax incentives should be phased out?

Academics and international organizations like the OECD have already called on countries in ASEAN to stop offering 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, due to their harmful nature and marginal positive effects.

Profit-based tax incentives current 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. Besides, such incentives closely associate with high redundancy levels and forgone revenue without promoting development objectives and investments' spillover effects.

The report indicates that the ASEAN countries provide various profit-based incentives. How can you confirm this situation?

The research team screened all types of corporate tax incentives in the ASEAN countries. All ASEAN countries provide profit-based corporate tax incentives. They 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%).

The ASEAN countries provide tax incentives with expectation of attracting foreign investments. Why does the report indicate there is no significant evidence that tax incentives increase foreign direct investments?

James, S. (2014), *Tax and non-tax incentives and investments: Evidence and Policy Implications. Investment Climate Advisory Services* shows that the degree of redundancy of tax incentives for investors was high in the ASEAN countries assessed, and that tax incentives did not meaningfully affect investment decisions. For example, In Thailand, a study by World bank affiliate the Foreign

Investment Advisory Service (FIAS) demonstrated that 81% of investments would have been made even without incentives.

Besides, we employ an Ordinary Least Squares (OLS) technique to regress FDI/GDP by good governance and gaps from incentives in the ASEAN region to examine significant correlations among these factor in the ASEAN region. We show that in the ASEAN region, there is a statistically significant and positive correlation between FDI/GDP and good governance; however, no correlation has been confirmed between FDI/GDP and tax incentives, as measured by gaps in tax rates with and without incentives .

Analysis from UNTACD also points out that MNCs always set the quality of governance and investment environment as the first criterion when selecting investment locations. To attract long-term foreign investments, The ASEAN countries should focus on providing good governance and conditions for investment, such as good quality infrastructure, availability of skills, macroeconomic stability, and better protection and enforcement of intellectual property rights.

During the Covid-19, many extra tax incentives are provided. Should these be good practices to bailout the economies?

Additional tax incentives applied during the pandemic are not substitutes for other tax incentives that already exist, however, and it is expected that they will just be temporary solutions to bail out economies in the short term.

It is crucial to support businesses in an emergency context of this kind; however, support should be targeted towards the most affected and most vulnerable sectors rather than being applied in an unplanned way, which risks creating another 'new normal' race to the bottom once the pandemic is over.

Besides, transparency and cost-benefit analysis should be seriously respected in providing these tax incentives.

The report indicates tax losses due to corporate tax incentive are 6% in Cambodia and 1% GDP in the Philippines and Vietnam. How do you calculate that?

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

Besides, VATJ (2019) uses data from VEC and Computable General Equilibrium (CGE) technique to estimate tax expenditure from CIT in Vietnam. The results show that Vietnam's tax expenditure from corporate tax incentives was estimated to be USD2.7 billion in 2016, equivalent to 7% of state budget revenue, 30% of CIT revenue, 5% of total state expenditure, and large than budget spending on health.

And how does the report calculate tax losses or tax expenditures from CIT in other ASEAN countries?

By now, the ASEAN countries' governments do not publish tax expenditures; therefore, we do not have official data on tax expenditures in these countries. Our case studies and values for tax expenditures are collected and cited from other research papers like Vietnam Alliance for Tax Justice (VATJ) (2019), OECD (2019), and DOF (2019).

How do corporate tax incentives lead revenue losses through profit shifting in some countries?

In principle, multinational corporations shift their profits from countries with high effective CIT rates with incentives to countries with low ones for tax avoidance. We use data on revenue losses due to profit shifting from calculations at https://missingprofits.world/. 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.

Why does the report say transparency in providing tax incentives matters?

The lack of transparency in the process of giving incentives is one of the causes to exacerbate fiscal cost of corporate tax incentives. For example, in Laos incentives for investments in concession agreements are negotiated on a case-by-case basis and no details of the final agreement are released for public scrutiny. This can increase the risk of corruption and undermine good governance objectives that are fundamental to creating an attractive investment environment. It can also give investors more bargaining power during the negotiation phase and can create opportunities for rent-seeking.

Another example is that Brunei has a secrecy jurisdiction within its business ecosystem known as the Brunei International Financial Centre. This lacks any effective exchange of information and, consequently, lacks transparency.

The report says corporate tax incentives create economic inefficiency. How do you prove that?

Shukla et al. (2011), when proposing a ‘good tax system’ for Vietnam, criticize tax incentives for their economic inefficiencies in the allocation of resources because, instead of focusing on expanding production, companies seek to minimize the amount of taxes they pay. Therefore, negative externalities can be created as a result of offering tax incentives.

In Vietnam, the preferential tax regimes offered to foreign-invested companies create an unfair investment environment: the effective CIT rate in the manufacturing sector in 2016 was 8% for foreign-invested companies but 14.5% for domestic firms, and even higher at 16% for large state-owned enterprises.

Who is the winner in the tax competition?

There are no winners among the ASEAN countries for this competition.

Some countries can attract some foreign investors when providing more incentives than others, some can have more fiscal gains than others through multinationals’ profit shifting.

However, all ASEAN countries lose in this competition. They erode tax bases, implement harmful tax practices, and do not have sufficient resources for investing in essential services to tackle inequality. All ASEAN countries are in the bottom half of the ranking on Commitment to Reducing Inequality (157 assessed countries).

All ASEAN countries have to face low ratios of budget revenue to GDP, including high-income countries like Brunei and Singapore. Even when Singapore does not face persistent budget deficits in a 2000-2020 period, this country witnessed high public debt ratio to GDP (more than 100%).