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Towards a Coordinated Taxation Policy in an Integrated ASEAN Regime

Mc Reynald S. Banderlipe II
De La Salle University, Philippines
mc_banderlipe@dlsu.edu.ph

The integration of many countries into a single economic community opens doors of opportunities for its members to achieve their goals on development. As both small and large economies benefit from the increased openness to trade and from a more open system of liberalized markets, such move unifies the actions of the different member countries to strengthen their position towards competitiveness by improving efficiency through enhanced economies of scale. When taken as a whole, an integrated economic community can seek better prospects for accessing greater capital and technology that serves as the main drivers of economic growth.

Such is the case of the highly anticipated emergence of a regional economy in Southeast Asia happening in 2015. In January 2007, the members of the Association of Southeast Asian Nations (ASEAN) signified their commitment towards an integrated economic region that will promote free movement of goods, services, investments, skilled labor, as well as capital flows. This can only take place if they foster openness to trade, seek outward-looking strategies, promote inclusive growth, and stimulate a market-driven economy, coupled with compliance and commitment towards various aspects of regional integration. According to Das, Menon, Severino, and Shreshta (2013), the commitment that is expected among the ASEAN economies defines how each member places value on such endeavor. In turn, it then determines the quality and responsiveness of their efforts to achieve what they invoke and what they aspire for in this process.

For an economic community to fully reap the benefits of integration, it necessitates an engaging process of harmonizing economic and business-related regulations that will affect the entire community (Letete, 2012). Thus, in the case of the ASEAN Economic Community (AEC) member countries, taxation is an important concern that needs to be addressed in laying out their economic development plans.

The call for addressing tax-related impediments on the integration of Southeast Asian countries has been described in the Roadmap for an ASEAN Community for the years 2009-2015 published in 2009. To promote freer flow of investment among the member countries, it is imperative to "work towards establishing an effective network of bilateral agreements on avoidance of double taxation among ASEAN countries" (p. 28). Moreover, the same roadmap calls for the enhancement of withholding tax structures as a way of widening the base for debt issuance in the ASEAN region that affects the different capital markets of its member countries.

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For this reason, the roadmap highlighted suggestions on the conduct of workshops and seminars to address taxation matters, the crafting of bilateral agreements to reduce double taxation, and the creation of technical committees that will support the harmonization efforts of the different member countries' tax systems. But, how these efforts can be justified to meet the 2015 goal?

This note seeks to shed light on the efforts towards strengthening cooperation in addressing tax-related issues in preparation for the country's integration to the AEC. We look at the similarities and differences of the tax structures across the ASEAN member countries, as well as formulating more enhanced integration mechanisms towards becoming a competitive economic region in Asia and the world. This is in line with the end goal of transforming ASEAN as a single market and as a single production base, where emphasis is placed on equitable development so that it can emerge as a competitive region that can be fully integrated in the global economy.

The paper is structured as follows: In the next section, I provide an overview and literature review of tax competition and tax harmonization. Next, I present summative information on the taxation policies in the different countries in ASEAN region and how tax competition have influenced by the differences in taxation policies across these countries. From there, I provide suggestions as to how taxation systems can be harmonized in line with the on-going ASEAN integration that is taking place, as emphasized in its 2009-2015 roadmap of the ASEAN Economic Community.

DIFFERENTIATING TAX COMPETITION FROM TAX HARMONIZATION

In this section, I differentiate tax competition from tax harmonization in the view of globalization and economic integration. Asher and Rajan (2001) argued that the continuous process of globalization influenced the practices and policies of both private and public sectors. As each country's present taxation system emerged from meeting the needs of their domestic economy as well as from adopting the national framework for sovereignty, globalization and the increased mobility of labor and capital has changed the course of these policies in terms of the level, mix, and design of specific taxes that will affect its administration and the compliance of taxpayers.

Aligned with the view on the existence of fiscal externalities, tax competition is defined as a "situation where fiscal activities in one jurisdiction induce fiscal externalities in other jurisdictions" (Winner, 2005 as cited in Berlianto, 2009). When this condition exists, a higher tax burden in one country triggers the government to shift the burden in other countries. The other countries, in turn, will react to such move resulting to a tax burden that is too low in their respective jurisdictions. In this regard, the government uses low effective tax rates for purposes of attracting capital and investments to their country, thereby resulting in the decline of tax revenues. An externality exists because this situation leads to the under-provision of public goods, which could have resulted from greater adequacy of taxation.

This was confirmed in the study of Asher and Rajan (2001) who argued that globalization might potentially reduce the progressive nature of tax structures in open economies just to maintain adequate amounts of public spending. Since the economy is left to depend intensively on a narrower base consisting of those members of the

workforce that are lacking education and those coming from the rural sector, taxes are levied directly on immobile factors without the tendency for these sectors to avoid the tax burden.

Such undesirable effects of tax competition necessitate offsetting through harmonized tax policies. While there is no agreed technical definition of tax harmonization, the term was defined in Berlianto (2009) as harmonizing not only the tax rates so that it becomes similar, but also harmonizing the rules encompassing the harmonization of such rates. It can be either explicit where countries agree to set a minimum or a single tax rate, or implicit when jurisdictions require taxpayers to pay taxes on income earned from outside. Note that harmonization of tax rates does not imply the implementation of unitary tax rates since that will require an accord to unify the accounting principles and to set the standards in determining the taxable amount (Kuroda, 2002). Unitary tax rates might cause serious double taxation that the AEC integration blueprint seeks to avoid.

Tax harmonization can be achieved by employing certain measures that result to the different levels of tax harmonization as shown in Figure 1 using political commitment as a criterion. According to Velayos et al. (2007) and Berlianto (2009), standardization is the highest level of tax harmonization since it requires each country to have the same tax so that, under the same conditions, it will generate the same tax burden. Below standardization is compatibility, where efforts to amend the tax structure is in effect to compensate for the possible distortion of the tax burden as a result of integration. However, this level of harmonization does not mean an identical state of the elements in the tax structure in terms of rates and benefits (Hayes, 2008).

To achieve coordination, efforts must be geared as a result of the use of complementary mechanisms that may not fall under the first two phases and the last two phases in the level pyramid in which codes of conduct are included.

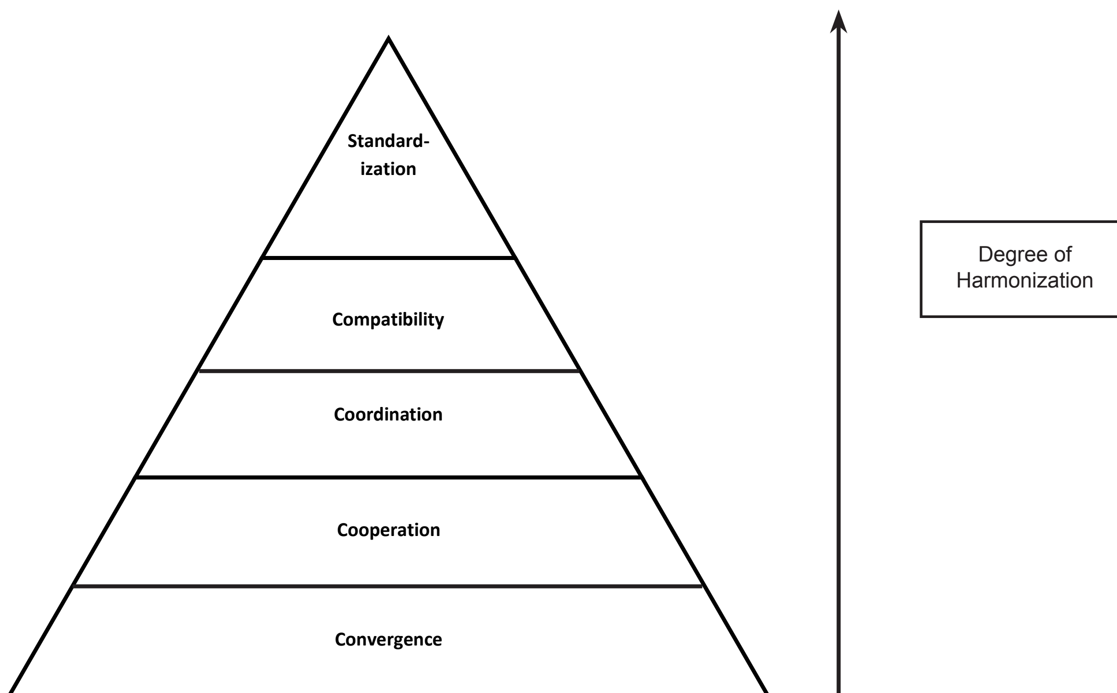

Figure 1. Levels of tax harmonization
(Velayos, Barreix, & Villela, 2007; Berlianto, 2009)

Cooperation, on the other hand, involves sharing of tax-related information among countries arising from a common interest to agree upon and to deal with double taxation issues to achieve a more unified stand in the taxation process. This contributes to the consistent application of tax systems by aligning tax administrations through bilateral agreements. Lastly, convergence takes place as a result of unstructured dynamics in the same type of taxation policy that can be triggered by pressures from globalization and competition for inflows and investments. It emanates from the voluntary stance of the government to undertake political commitment (Velayos et al., 2007). These strengthen the premise of prior literature that tax harmonization is the key to a more competitive integrated economic community.

TAXATION POLICIES IN THE ASEAN REGION

Having distinguished tax competition from tax harmonization, this section presents an overview of taxation systems based on the policies implemented across the different member countries of the ASEAN region. While this paper focuses only on the key important highlights, I make reference to a more comprehensive tax guide issued by KPMG (2013). I will also attempt to identify the potentials barriers to coordination of tax efforts in the region.

Appendix A presents an overview of the taxation systems across countries in the ASEAN region. As shown in Panel A, standard corporate tax rates ranges from 20% to 25%, with some countries planning to reduce their rates over the next couple of years. Except for Brunei Darussalam, individual income tax rates range from 20-37%, with corresponding reductions in some countries over the succeeding years. The table also presents the various tax rates for non-resident aliens, the indirect tax rates for VAT and other consumption taxes, as well as the capital gains tax (CGT) rates. Countries such as Singapore and Laos do not impose taxes on capital gains, while Cambodia and Thailand incorporates capital gains in determining taxable income.

Panel B of the same appendix shows how each ASEAN country laid down their principles on the carry forward of operating tax losses, incentives on research and development, transfer pricing, and thin capitalization. Thin capitalization policies are intended to prevent companies from providing capitalization to their subsidies using debt rather than equity. For this reason, ASEAN countries provide incentives for pioneer industries and for industries that are essential for the advancement of the economy and for stimulating international trade.

According to the report of KPMG (2013), there was an obvious fall in the corporate tax rates in the ASEAN region during the post- ASEAN blueprint signing. It is expected that these rates will converge to a possible tax rate of 20%, with the exception of Singapore, whose corporate tax rate is the lowest in the region. The Philippines, on the other hand, still has the highest corporate tax rate of 30% that nearly doubles the corporate tax rate in Singapore. While several member countries began providing incentives in the form of either tax exemptions or tax reductions, the possible flow of foreign direct investment in the region will still be affected by a host of other factors such as the predictable nature of tax systems, the presence of corruption, the promotion of intellectual property rights, the challenges brought about by bureaucracy, and the fostering of transparency and accountability in governance systems.

The same report, however, shows that there is an increasing dependence on indirect taxes to 15.5% globally whereas in Asia, it already reached 12.24%. As the ASEAN opens its doors to different countries in the world as a unified regional economic community, it will push the disposable incomes higher—leading to higher rates in consumption. This could be attributed

to the growing affluence of the middle class that demands greater volume of high value products and services. Moreover, freedom for trade is expected to bloom when import taxes and duties are to be eliminated upon integration, except for the items included in the ASEAN Sensitive and Highly Sensitive list of unprocessed agricultural products that require longer time for the implementation of tariff reduction.

Such scenario confirms the shifting of tax burden emphasized in Berlianto (2009) wherein the shift is directed to less mobile goods that were imposed by indirect taxes such as goods and services taxes and value-added taxes. In terms of convergence, such junction is not visible as presented in the study of Apergis and Cooray (2013) using a non-linear club convergence factor model that incorporates an idiosyncratic, time-varying component for technological progress. Because of this, tax competition and harmful bidding for investment and capital inflows lead to undervaluation of tax revenues that may be detrimental as countries continue to race to the bottom, instead of to the top.

Double taxation, according to the ADB Institute in its Second ADBI Regional Tax Forum in 2009, consists of juridical double taxation and economic double taxation. The former arises when a person is taxed by more than one state and total tax burden is greater than when only one state has imposed a tax burden on that person's income. On the other hand, the latter takes place when a tax burden is imposed to two different taxpayers in respect of the same income level. Eliminating the detrimental effects of double taxation among countries is possible by engaging in treaties that will allow a better system of taxing rights, thereby removing excessive tax burdens.

In line with the move towards the elimination of double taxation through international treaties, ASEAN member countries are seeking to negotiate new tax treaties to avoid double taxation. As seen in Table 1, Cambodia has yet to sign at least one treaty with all other ASEAN members while others have started enforcing treaties although the treaties between Laos-Indonesia and Myanmar-Indonesia are not in force as of this moment. Be it noted that the absence of a comprehensive treaty among member countries that addresses double taxation translates to missed investment opportunities since foreign investors, as much

Table 1. ***Summary of ASEAN Double Taxation Treaty Coverage***

Country	Brunei Darussalam	Cambodia	Indonesia	Laos	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam
Brunei Darussalam	x		0	0	0			0		0
Cambodia		x								
Indonesia	0		x	NIF	0	NIF	0	0	0	0
Laos	0		NIF	x	0	0			0	0
Malaysia	0		0	0	x	0	0	0	0	0
Myanmar			NIF	0	0	x		0	0	0
Philippines			0		0		x	0	0	0
Singapore	0		0		0	0	0	x	0	0
Thailand			0	0	0	0	0	0	x	0
Vietnam	0		0	0	0	0	0	0	0	x

Note: 0 = Treaty in Force, NIF = Not in Force.

Source: KPMG (2013).

as possible, naturally shield themselves from the circumstances where they have to shoulder increased business costs, administrative burdens, as well as profit disincentives (Dupal, 2012).

With regards to the move of eliminating withholding taxes to allow free trade and capital flows, the current situation in the ASEAN region discourages trade among its member countries. KPMG (2013) noted that the withholding taxes arising from bilateral agreements outside the region are much lower compared to those within the boundaries of ASEAN, thereby promoting trade flows external to the region. While it is necessary for the region to retain an outside focus, there must be a move towards facilitating inter-ASEAN trade by providing incentives to do so. The treaties employed among the member countries are expected to serve as take-off points for multi-lateral treaty negotiations towards promoting inter-ASEAN trade.

WHAT CAN BE DONE? THE CONCLUDING REMARKS

Considering the status of taxation in the ASEAN region, is it possible to harmonize the taxation mechanisms of different member countries given that the integration will take place in 2015? This section highlights the suggested courses of action towards the pursuit of coordinating the efforts in addressing tax-related issues in the light of ASEAN integration.

To add to the existing efforts for harmonization, a foreign tax credit system can be used by the AEC, as suggested by Kuroda (2002) to allow credit for taxes paid in foreign countries to prevent international double taxation. Such system ensures sustained international competitiveness of domestic companies. Following the principle of capital export neutrality where taxation does not affect the decisions of domestic businesses on whether to invest at home or abroad, foreign tax credit ensures the validity of the principle when businesses are subject to foreign taxes in the source country.

In the case of ASEAN countries (with emphasis on Cambodia) that have not yet entered into any tax treaty with their neighboring countries, it is highly suggested that they finally enter into such agreements. However, these treaties should rest on the tenets identified in the Organization for Economic Cooperation and Development (OECD) Model treaty (ADB Institute, 2009). Such treaty settles, on a uniform basis, the most common problems arising from international double taxation. Moreover, the treaty harmonizes international cooperation between the signing countries to combat double taxation and the adverse effects of tax evasion through the rigorous enforcement of state laws.

Other things to be considered in crafting the treaties in accordance with the OECD model are the granting of certainty to investors that rules will not change from year to year, and that changes in unilateral and bilateral laws will not generally affect their tax situation. This ensures that economic relations are continuously fostered among different nations. Discriminatory taxation should also be eliminated as in the case of WTO and bilateral investment agreements where legitimate distinctions are accounted for to consider different taxing situations. Treaties should also be ratified to become part of domestic legislation and should override conflicts with domestic law because as special rules, they prevail over general legislation. Lastly, tax treaties should limit the taxing rights because only the state or the domestic law can exercise its sovereign powers to create or modify taxation policies.

In addition, KPMG (2013) suggested the implementation of anti-avoidance measures that allows easier movement of profits and capital to take advantage of favorable tax regulation. This is a preventive measure to avoid being subjected to the harsh consequences as a result of abuse from the different tax regimes. Successful

implementation of such measures requires emphasis on tax morality and good corporate behavior. At the onset of integration, ASEAN countries should also consider adjusting their laws on local taxation to suit the emerging market conditions. Not to mention, there is also a pending need to review tax policies regarding e-commerce, intellectual property, and investment protection.

We cannot discount the importance of tax cooperation in tax administration among ASEAN member countries. Kuroda (2002) stressed the importance of cooperation to ensure that appropriate taxation of economic activities across national borders is taken into account. Particularly, Kuroda emphasized that "(W)hereas companies are obliged to comply with tax laws in each country as they invest or conduct economic activity abroad, tax authorities aim to preempt and resolve problems in tax administration for cross-border business activities by conducting multilateral exchange of views among tax authorities (p. 1)."

Thus, a transparent and appropriate tax administration can be carried out through capacity building for its personnel since they will be responsible for the administration of taxation in their country. Now, more than ever, having an effective tax administration mechanism also fosters multilateral assistance in tax collection to avoid double taxation. This was stressed in the efforts exerted by the Study Group on Asian Tax Administration and Research (SGATAR) where they conducted an exchange of views on the issues regarding taxation and how it can be addressed to ensure that efforts are coordinated and sustained considering that the integration is currently taking place.

Following these courses of action would result in greater chances of success in the ASEAN integration with respect to the harmonization of taxation policies. Although the tangible results will be felt after some time, a harmonized taxation system in the AEC would be a shining success in the history of public finance.

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Appendix A

Overview of ASEAN tax systems

Panel A: Tax rates

Country	Standard corporate income tax	Top personal income tax rate	Non-resident withholding taxes			Indirect tax (i.e. VAT/GST) standard rate	Capital gains
			Dividends	Royalties	Interest		
Brunei Darussalam	20%	No personal tax on individuals	None	10%	15%	No VAT or consumption-based tax system	No capital gains tax (CGT)
Cambodia	20%	20%	14%	14%	14%	10%	No separate CGT. Capital gains are treated as taxable income and subject to 20% profit tax
Indonesia	25%	30%	20%	20%	20%	10%	Subject to tax
Laos	24%	24%	10%	5%	10%	10%	No CGT
Malaysia	25%. Reduces to 24% from YA 2016	26%. Reduces to 25% from YA 2016	None (assuming single tier dividend)	10%	15%	Service tax: 6%. Sales tax: Generally 5 or 10%. GST of 6% will be introduced on April 1, 2015	No CGT other than on disposal of interests in Malaysian real property or shares in real property company
Myanmar	Company: 25% Branch: 35%	Employment income: 25%. Other income: 30%. Income of non-resident foreigners: 35%	None	20%	15%	No standard rate. 5% for services, Between 3 to 100% for goods.	Subject to tax at 10% for resident taxpayers and 40% for non-resident taxpayers
Philippines	30%	32%	30%	30%	30%	12%	Capital gains on the disposal, sale or exchange of shares, and land and buildings are subject to CGT
Singapore	17%	20%	None	10%	15%	7%	No CGT
Thailand	20% (for two accounting periods beginning on or after January 1, 2013	37%. This is expected to be reduced to 35% from the 2013 tax year	10%	15%	15%	10%, although a reduced 7% rate applies beginning September 30, 2014	No separate CGT. Capital gains are treated as taxable income
Vietnam	25%. This is to be reduced to 22% beginning January 1, 2014, and 20% beginning January 1, 2016	35%	None for corporate investors. 5% for individual investors	10%	5%	10%	CGT is applied to both corporate and individual investors

Source: KPMG (2013)

Panel B: Summary of selected taxation principles

Country	Tax losses	R&D incentives	Other incentives	Transfer pricing regime	Thin capitalization regime
Brunei Darussalam	Can be carried forward for six years and back one year.	R&D activities may be classified as qualifying activities for pioneer service companies, which are provided certain exemptions. Certain approved R&D expenditure is allowed as deductible expenditure.	Pioneer industry tax exemption; Tax relief for capital expenditure in excess of BND 1 million; Withholding tax exemptions for interest on certain loans from non-residents.	Yes	None
Cambodia	Can be carried forward for five years subject to continuity of ownership provisions. Cannot be carried back	None	Tax on profits exemption; Accelerated depreciation on manufacturing assets; Import duty exemption on production equipment, raw materials, and manufacturing inputs. Right to employ foreign labor.	None. However, it is generally accepted that cross-border transactions must be arm's length.	None. However, interest expenditure allowable as a deduction is limited to an amount equal to the total interest income plus 50% of net non-interest profits earned for the year.
Indonesia	Can be generally carried forward for five years (not subject to continuity of ownership). Cannot be carried back.	R&D expenditure undertaken in Indonesia is deductible expenditure	Incentives are available for certain industries	Yes	The law allows the tax authority to issue a decree defining the maximum ratio of debt to equity in determining deductible interest. However, such a decree has not yet been finalized.
Laos	Can be carried forward for three years. Cannot be carried back.	Tax incentives under the Law on Investment Promotion (see right) may apply to scientific research and development expenditure.	The Law on Investment Program provides tax incentives for certain investors.	None	None
Malaysia	Can be carried forward indefinitely, provided the company is not dormant (in which case the continuity of ownership test must be met). Cannot be carried back.	R&D Tax incentive scheme includes tax exemptions and double deductions for certain R&D expenditure incurred in Malaysia.	Tax incentives are available for a wide range of companies and industries, as well as specific activities promoted by the Malaysian government.	Yes	Malaysia has thin capitalization legislation, but implementation of this regime has been deferred.
Myanmar	Can be carried forward for three years, but cannot be carried back. Losses from capital assets cannot be carried forward or offset against gains on other assets.	None	Companies registered under the Myanmar Foreign Investment Law can be granted a wide range of tax incentives. Incentives are also available for foreign investors carrying out business in a Special Economic Zone.	None	None. However, the deductibility of interest is limited.
Philippines	Can be carried forward for three years, subject to the continuity of ownership test. Cannot be carried back.	A multinational company may establish a Regional Operating Headquarters (ROHQ) to render R&D services and product development to affiliates, branches, or subsidiaries.	Incentives are available for enterprises engaged in preferred areas of investment and registered with the Board of Investments (BOI) or the Philippine Economic Zone Authority (PEZA). Further, tax incentives are available for regional headquarters, enterprises operating in developing regions and special economic zones.	Yes	None. However, guidelines which identify thin capitalization and earning stripping have been issued.

Singapore	Losses can be carried forward indefinitely, subject to the continuity of ownership test. Limited losses can be carried back one year.	An R&D tax incentive regime provides for enhanced R&D deductions.	Intellectual property incentives available for acquisition or licensing costs, or costs for protection of intellectual property. Tax incentives for activities that enhance economic or technological development are available. In addition, international and regional headquarter tax incentives are available.	Yes	None
Thailand	Can be carried forward for five years. Cannot be carried back.	Tax exemptions on license fees under the Board of Investment, and a double reduction for qualified R&D expenses.	Tax-related relief and other incentives are granted to Thai and foreign companies investing in Board of Investment promoted projects.	Yes	None. However, if a tax incentive has been granted by the Board of Investment, the thin capitalization ratio cannot exceed 3:1.
Vietnam	Can be carried forward continuously and entirely for five years. Cannot be carried back.	Corporate taxpayers incorporated under Vietnamese laws can set aside a fund up to 10% of its annual taxable income for R&D purposes and deduct the same amount from its taxable income.	Intellectual property incentives are available for certain high technology projects, scientific research, technology developments, and software production projects. Other preferential tax treatments are limited to encouraged sectors and encouraged special economic zones, or areas with difficult socio-economic conditions.	Yes	None. However, certain restrictions to the same effect can be found in the regulations on foreign loans and corporate income tax.

Source: KPMG (2013)