

ASEAN Research Digest

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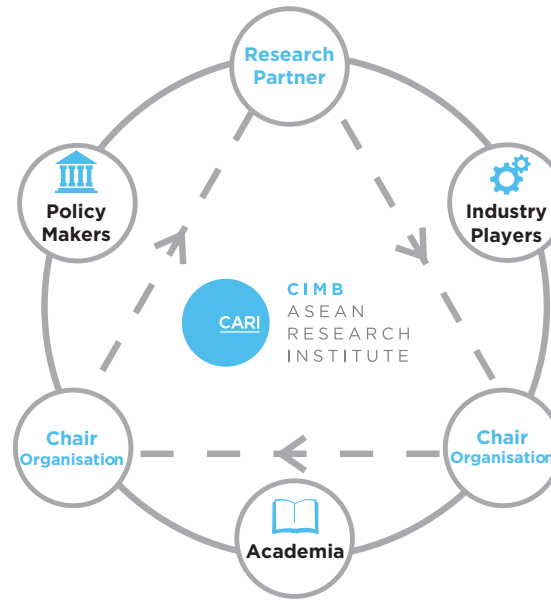
Research objectives:

The CIMB ASEAN Research Institute (CARI) in collaboration with the ASEAN Business Club (ABC) launched the Lifting-The-Barriers Initiative (LTBI) in 2013 as an integrated year long research platform involving core research as well as stakeholder engagement.

The objective was to adopt a vertical approach by means of identifying bottlenecks and barriers hindering free trade of prioritised sectors in the context of the ASEAN Economic Community (AEC).

The LTB Initiative 2014 targets six identified sectors which have pressing relevance to the business landscape in ASEAN and will play a major role in the successful formation of the AEC. The six sectors were Retail, Legal & Tax, Food & Beverages, Financial Services & Capital Markets, Minerals, Oil & Gas and Automotive & Manufacturing.

RESEARCH STRUCTURE



Two leading **ASEAN corporations** were selected to champion each sector, providing the direction and experiential insight into their industry. The input from these champions, or chair organisations, were key to understanding the issues faced by industry stakeholders and to develop the recommendations as part of the discourse.

CARI's Research Working Committee and its Strategic Advisors also worked closely with each of the six nominated Research Partners in producing these reports.

The Research Partners were either top management consulting firms or academic institutions who provided the technical knowledge and quantitative analysis required.

METHODOLOGY

The Lifting-The-Barriers Initiative (LTBI) is divided into four phases.

PHASE I

PRELIMINARY RESEARCH

Core research and compilation of qualitative and quantitative input from targeted sectors.

PHASE II

ABC FORUM



LTB Roundtables



Plenary Sessions

PHASE III

LTB REPORTS

The final outcome, a set of white papers, for ASEAN policy makers and community to effect real changes in the region.

PHASE IV

FINDINGS SOCIALISATION

The findings from the LTB reports will be prioritised and presented to various stakeholders including policymakers.



REDUCING TAX COMPLEXITY IN ASEAN SUPPORTS ALL BUSINESSES, ESPECIALLY SMEs

Title of Study: Lifting the Barriers Report: Tax
By: EY Published by: CARI, September 2014



BACKGROUND

Research objective:

To examine at the current global and ASEAN tax landscapes, as well as explore the potential of reducing tax complexity and having an AEC tax agenda.

- The AEC Blueprint 2015 addressed taxation under the AEC, but there were only two specifically identified initiatives:
 - ▶ Enhance the withholding tax structure, where possible, to promote the broadening of investor base in ASEAN debt issuance (item 31)
 - ▶ ASEAN member countries should complete the network of bilateral agreements on avoidance among all member countries by 2010 (item 58)
- There are other AEC initiatives that have knock-on impacts to tax policies such as:
 - ▶ the reduction in tariffs on goods
 - ▶ the measures to enhance ASEAN investment climate
- Tax policy should play a more central role within the framework of the AEC, given ASEAN's current stage of development and the new global tax landscape, which is going through unprecedented amount of change.

THE TAX IMPACT ON BUSINESS

- As is well known, nations compete for foreign direct investment (FDI) through lower corporate income tax rates and other tax incentives.
- What is less well known is the impact of **tax complexity** and **uncertainty** on FDI and domestic business growth.

DEFINITION

Complexity of a tax regime may be measured in terms of the number of taxes, tax rates and tax bases, as well as the cost of complying with tax law. Complexity is increased if a tax regime has many types of taxes requiring different information and numerous schedules to complete. Increased complexity increases the cost of compliance.

Uncertainty in taxation arises from tax complexity itself. Tax legislation that is imprecise or vague in language also adds to uncertainty. But the greatest contributor to taxation uncertainty is frequent changes in tax law or practice.

- Various studies have found that total business tax compliance costs as a percentage of sales are significantly higher for SMEs.
 - ▶ Tax compliance has a significant fixed cost component, thus SMEs face a higher burden of tax compliance relative to income.
 - ▶ Tax complexity and uncertainty should be pro-actively reduced for SMEs, as they are often the driver for domestic business growth.
 - ▶ Increased tax complexity is particularly challenging to SMEs as only the largest companies are able to invest in the necessary resources to navigate and manage tax challenges.

THE GLOBAL TAX LANDSCAPE

- Governments today are more focused on raising revenue through taxes due to fiscal deficits.
- Meanwhile, tax activism and media coverage in many countries has sparked a broad public debate on business taxation.
- According to the OECD, the next few years are critical to reshape the international tax architecture and avert global tax chaos.

The global tax environment is therefore currently characterised by:

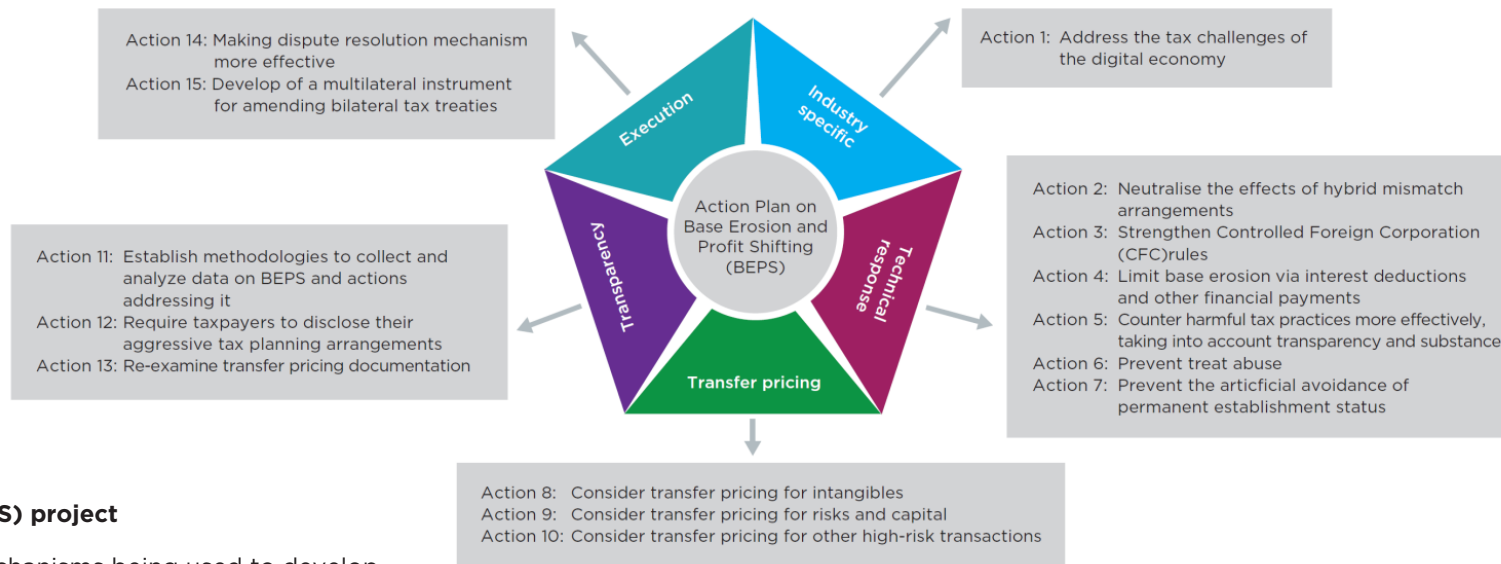
- Tax fairness** – whether companies are paying their fair share of taxes.
- Austerity and stimulus policy mix** – used by a growing number of countries.
- Indirect taxes (e.g. GST, VTA)** – as governments seek sustainable ways to rebalance their budgets and stimulate growth.
- Tax transparency** – the debate on taxation of multinationals has led to a growing call for increased levels of transparency.
- Cooperative compliance** – a framework for an “enhanced” relationship between taxpayer and tax authority.
- Transfer pricing disputes** – Transfer pricing continues to be a leading area of dispute for businesses. Documentation requirements are also being strengthened.
- Aggressive tax audits** – businesses report experiencing a significant increase in the volume of tax audits, coupled with more aggressive behaviour adopted by tax authorities throughout the course of an audit.



REDUCING TAX COMPLEXITY IN ASEAN SUPPORTS ALL BUSINESSES, ESPECIALLY SMEs



KEY FINDINGS



The OECD Base Erosion and Profit Shifting (BEPS) project

- The OECD BEPS project is one of the key mechanisms being used to develop recommendations on possible coordinated action to address concerns of base erosion and profit shifting.
- The OECD has released the 15 point BEPS Action Plan, which sets out the OECD's view that the international tax system has been weakened by:
 - ▶ gaps in the interaction of domestic tax rules of various countries,
 - ▶ the application of bilateral tax treaties to multijurisdictional arrangements,
 - ▶ and the rise of the digital economy with the resulting relocation of core business functions.
- The Action Plan reflects the high-level political concern about BEPS issues in many OECD countries and proposes an extraordinary amount of work to be undertaken.
- With the current environment being a patchwork of disparate but aggressive enforcement activities by tax authorities - now increasingly encouraged by the media and some political figures - this puts businesses at risk for both the cost of increasingly visible and expensive tax disputes and the less visible burden of unrelieved double taxation.

DEFINITION

Transfer pricing is the price of goods and services sold between related legal entities within an enterprise, such as the cost of goods paid by a subsidiary company to a parent company.

Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.

CURRENT ASEAN TAX LANDSCAPE

- ASEAN is a diverse region in varying stages of economic development and growth, with 10 different tax systems in place.

Tax Systems and Types of Taxes

- A study from the Asian Development Bank (ADB) projected that only a semi-integrated market will be achievable with some compromises:
 - ▶ The number of different taxes that are applicable within each of the ASEAN countries varies significantly, from five in Brunei to 12 in Vietnam.
 - ▶ The variance can also be seen in terms of the headline corporate tax rates of the various ASEAN countries, which range from 17% in Singapore to 30% in the Philippines.
 - ▶ Complexity as measured by total tax compliance hours ranges from 82 in Singapore to 872 in Vietnam.
 - ▶ Six out of the ten ASEAN countries use worldwide systems while the remaining four use territorial tax systems.
- When taken as a whole, ASEAN's tax regimes are clearly both incredibly complex and uncertain.

Tax Systems and Types of Taxes

- Other than differences in key features in the tax system, there are also significant variances in tax administration, resulting in a myriad of rules and regulations that can be challenging for investors.
 - ▶ One example would be transfer pricing, which businesses consistently view as their most important tax concern.



REDUCING TAX COMPLEXITY IN ASEAN SUPPORTS ALL BUSINESSES, ESPECIALLY SMEs

- Transparency and certainty of tax policy, law and administration increase business activity and improve efficiency by allowing companies to focus on doing business instead of trying to survive and compete based on tax strategy.
- Complete tax harmonisation may be neither achievable nor desired, but clarity in policy and law may be achieved, while leaving individual nations free to determine taxation.
 - ▶ Standards of administration may be achieved without detracting from national sovereignty.
 - ▶ Interpretation of cross border matters, such as tax treaty interpretation and customs valuation of imported goods, may also be agreed upon at an ASEAN level to promote fairness and transparency for all.
- This level of standardisation, while not being full harmonisation, may be sufficient and could be a step to increasing business investment and activity for all of ASEAN.

OPPORTUNITIES AND RISKS FOR ASEAN

- ASEAN is one of the few “bright spots” of growth globally, in particular for business growth potential.
 - ▶ For example, 73% of the respondents of the ASEAN Business Outlook Survey 2014 indicated that ASEAN would become more important to their companies’ worldwide revenues over the next two years.
- Inbound FDI contributes significantly to ASEAN’s GDP growth.
 - ▶ In terms of net inflow of FDI, FDI as a percentage of GDP hovered around 5% in 2012.
- Tax complexity and uncertainty is likely to have a significant negative impact on FDI and we should not forget the impact to SMEs that are the engine of Intra-ASEAN growth.
- It is important to note that while many of the global tax initiatives currently being debated are targeted at the MNCs, these tax measures, when implemented globally, could have a significant impact on MNCs’ overseas investments.
 - For example, incentives can come under “attack” with the BEPS developments, and rules that could nullify the effectiveness of certain incentives will erode ASEAN’s competitiveness in terms of attracting inbound FDI.
- Any improvements to the tax environment in ASEAN will enhance ASEAN’s operating environment, streamline and reduce the cost of doing business for companies, further increase its attractiveness to MNCs and also support domestic business growth.
- The AEC supports ASEAN to “promote and market” itself as a collective region to MNCs in this fierce global competition for FDI.

THE POTENTIAL OF REDUCING TAX COMPLEXITY

- This paper does not seek to provide a definitive list of the areas where improvements to the tax systems and tax administration in ASEAN could enhance the business and investment environment. Instead we highlight two example case studies where improvements would assist business and facilitate AEC’s broader objectives.

Case Study 1 – Taxation of Business Travellers

Intra ASEAN mobility of business travellers

- With increased cross border investment between ASEAN member states, mobility of people is exponentially on the rise, including permanent relocation, long term work assignments, short term work assignments and frequent or infrequent business trips.
- People who relocate permanently or for work assignment typically require a working permit and incur personal income taxes in the host location.
 - For example, an executive with regional responsibilities might visit a key location for a week each month as part her regional role, which may trigger personal tax and immigration obligations
- Many companies therefore invest resources to avoid this imposition of tax, which also artificially reducing the business flows for that country.

Tax treaties

- Six of the ASEAN member states have an extensive tax treaty network with each other, as well as with other major economic partners. Cambodia, Laos, Brunei and Myanmar however do not.
- The OECD model tax treaty generally allows for a resident of one member state to exercise employment within another member state for up to 183 days without incurring a host country income tax liability.
- Where a tax treaty is in place, prima facie protection exists if an employee of one ASEAN country works in another ASEAN location for less than the stated number of days.
- However, for businesses the position is more complicated than understanding the tax treatment of an individual employee.
 - For example, in the case of a revolving group of employees working for short terms over an extended period at a site overseas, a PE may



Tax treaties concluded between ASEAN member states

Country	Indonesia	Malaysia	Philippines	Singapore	Thailand	Brunei	Vietnam	Laos	Myanmar	Cambodia
Indonesia		X	X(b)	X	X	X	X	X(a)		
Malaysia	X		X	X	X	X(a)	X	X	X	
Philippines	X(b)	X		X	X(b)		X			
Singapore	X	X	X		X	X	X		X	
Thailand	X	X	X(b)	X			X	X	X	
Brunei	X	X(a)		X			X	X		
Vietnam	X	X	X	X	X	X		X	X	
Laos	X(a)	X			X	X	X		X	
Myanmar		X		X	X		X	X		
Cambodia										

(a) The treaty is not yet in force.

(b) The treaty has been renegotiated but the renegotiated is yet to be ratified

Tax treaties

- Singapore and Malaysia provide for de-minimis periods of physical presence in their domestic tax law, allowing for physical presence of up to 60 days, without incurring a personal income tax liability, regardless of the existence of any tax treaty.
 - Such domestic law provides greater degree of certainty and attracts businesses.

AEC - the tax opportunity

- With bilateral tax treaties, or absence thereof, across 10 countries, there are 90 different scenarios for consideration.
- If consistent pan-ASEAN rules were created, there is the possibility to reduce these 90 scenarios to one scenario.
 - For example, ASEAN might provide a domestic tax exemption for business travellers between member states for a de-minimis period of 60 days per calendar year.
- ASEAN countries might also clarify visa requirements for business travellers between member states.
 - For example travellers may be exempted from work visa requirements if they exercise employment on behalf of an employer who is resident in another member state, for less than the de-minimis period in a year.
- The definition of PE could also be refined to exclude business travellers who meet the requirements mentioned above.

Case Study 2 - Transfer Pricing

Harmonisation of transfer pricing rules

- Every cross-border dealing has a transfer pricing impact that will be felt in countries at both ends of the transaction. Common concerns include:
 - Transfer pricing compliance requirements across countries are becoming more cumbersome as tax administrations seek additional information.
 - Risk of double taxation when transfer pricing rules are not aligned.
 - Such cases can be resolved with double taxation agreements. In some cases these are effective, but they could be improved with more harmonisation.
 - Alternative dispute resolution mechanisms such as arbitration may also be considered.

Existing reference points

- The OECD transfer pricing guidelines are the most widely-adopted reference point for transfer pricing globally.
 - The **“arm’s length principle”**, as set out in the OECD transfer pricing guidelines is the international consensus on transfer pricing.
- The United Nations (UN) also has a transfer pricing manual, which also advocates the arm’s length principle but seeks to provide a voice from more developing countries.
- The EU has also set up a transfer pricing forum in an attempt to harmonise transfer pricing approaches with some success but hasn’t yet reached a harmonised transfer pricing within the EU.
- These transfer pricing principles are simply reference points and do not automatically become law. Implementation varies greatly between countries.

AEC - the tax opportunity

- Transfer pricing has an array of aspects that could be harmonised and if tax administrations were able to agree on some or all of these aspects it would lead to a reduction in cost for companies with intra-ASEAN cross-border transactions within their group.
- Perhaps not all aspects of transfer pricing could be addressed initially, but each of them individually would improve the ability of companies to do business across ASEAN.
- The authors suggest these first steps:
 - Confirmation of key areas in ASEAN where tax administrations differ in the application of transfer pricing rules
 - Multilateral discussions to reach agreement on transfer pricing
 - Publication of a document that clarifies these points
 - Amendments to local law, regulations and guidance



Opportunities for consistent transfer pricing rules

Considerations	Benefit	Barriers
Technical positions Despite most countries broadly following the OECD Transfer Pricing Guidelines, there are differences in technical positions taken.	Consistency would allow for a policy that meets the requirements of all AMS tax administrations, as well as avoid double taxation.	OECD transfer pricing rules are not accepted by all tax administrations. Conflicting concerns within ASEAN countries is likely.
Documentation and reporting The reporting requirements vary considerably between countries	Consistency in requirements is likely to lead to timely documentation and cost saving.	Significant existing rules. Reluctance to give up on certain requirements may lead to a large increase in all AMS.
Dispute resolution Many double taxation treaties in ASEAN allow for Mutual Agreement Procedure (MAP) and Advanced Pricing Agreements (APA) and countries are at various stages of developing rules and guidelines to enable such dispute resolution.	The effectiveness of MAP and APAs could be improved with harmonisation of processes, expectations of taxpayers and what is permissible. An agreed means of arbitration may also be developed as an alternative to APAs and MAP.	Resource availability in tax administrations.

CONCLUSIONS

- It is important for ASEAN to maintain its ability to attract FDI to the region as well as to encourage intra-ASEAN business growth. Global tax developments and ASEAN's tax agenda can therefore have a major impact on businesses.
- Increased complexity of tax systems and tax administration places considerable resource demands upon companies, putting SMEs at a disadvantage to large MNCs.
- To reduce tax complexity is to support all businesses, but SMEs will be a leading beneficiary of any such reform.
- The two case studies above are two examples of how such reforms can benefit businesses.

Recommendations

1. Enhancing transparency and certainty
 - ▶ Aligning standards of:
 - Clarity of tax policy and law
 - Administration of tax, including assessment, dispute resolution, enforcement, advance rulings, APAs and overall transparency
 - Interpretation of cross-border matters
2. Tax initiatives aimed at supporting intra-ASEAN business and community
 - ▶ For example, countries currently negotiate tax treaties bilaterally and it is not uncommon to see instances whereby an ASEAN country has provided more attractive terms to a non-ASEAN country than an ASEAN country.
 - ▶ ASEAN should consider providing more advantageous tax treaty terms for AMS to ensure the attractiveness of intra-ASEAN investment and trade.
 - ▶ While other factors, such as foreign ownership rules, play a more significant role in achieving this objective, tax policy should play its part.
3. Creating an AEC tax agenda
 - ▶ Creating a specific ASEAN tax agenda will entail a greater focus on the various tax policies each ASEAN country has in place, and will bring to light the issues that investors are currently facing.
 - ▶ It will also allow the AEC to make a concerted effort to push for initiatives that would benefit ASEAN as a whole in terms of attracting inbound FDI.

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