

BRIEFING ON TAX JUSTICE ISSUES

PSI Asia-Pacific QPS Forum

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Commissioned by Public Services International (PSI) to inform the Asia-Pacific QPS Forum 14-15
October 2013

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Public Services International Research Unit (PSIRU) is part of the Department of Economics and International Business in the Business School at the University of Greenwich (www.gre.ac.uk). Core work is financed by Public Services International (PSI - www.world-psi.org), the global confederation of public service trade unions.

Briefing on Tax Justice Issues

This briefing paper on Asia-Pacific tax justice issues is in preparation for the PSI Asia Pacific QPS Forum (October 16 – 18). Officers from PSI Head Office will lead a session to raise awareness amongst PSI affiliates and affiliates of other Global Union Federations (GUFs) and civic society partners on tax justice priorities. This will inform regional and country based campaign planning activities. The brief provides an overview of tax justice issues as well as showing the tax and secrecy profiles of Indonesia, Korea, Japan, Malaysia, the Philippines and Thailand.

Why is taxation important?

Taxation is an essential part of a good government. It has four main goals:

1. **Revenues** for public spending which can be used to meet the basic needs of population – food, healthcare, shelter, provide quality public services, for example, health, education, economic development stimulus, maintain institutions and governance structures.¹
2. **Redistribution of income** between high and low income groups.
3. **Representation** – an effective taxation system enables citizens to feel that they contribute and own public policies. An ineffective system can lead to social exclusion and increasing levels of inequalities.
4. **Changing behaviour** of individuals and companies – through taxes that shape/ inhibit behaviours e.g. taxes on alcohol & tobacco, taxes on environmental pollution

Taxation and Quality Public Services

Taxation plays an essential part in supporting the financing of quality public services. Without an effective taxation system, quality public services will be inadequately funded and will struggle to meet the needs of the population. There are several issues that need to be addressed through an improved system of taxation: rising inequality and the underfunding of QPS such as health and social services. The essentials of a good taxation system depend on a progressive taxation system when higher income groups pay more tax than lower income groups. The existence of an effective government tax authority, which is competent to collect taxes is also important. This depends on well- paid tax inspectors, a lack of corruption and transparency of personal and corporate financial information. Cuts in government services often affect the ability of national tax authorities to collect taxes.

Table 1: Tax revenue as % of Gross Domestic Product (GDP) 2008-2012

	2008	2009	2010	2011	2012
<u>Asia</u>					
Japan	9.3	8.7	9.1	9.8	
Korea	16.3	15.4	15.1	15.6	
Indonesia	13.0	11.4	10.9	11.8	
Malaysia	14.7	14.9	13.8	15.3	16.2
Philippines	13.6	12.2	12.1	12.4	
Australia	24.3	22.2	20.7	20.5	
Sweden	21.7	21.7	21.3	21.9	
UK	28.8	25.8	26.7	27.4	
US	10.4	8.5	9.2	10.1	

Source: <http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS>

Table 1 shows the tax revenue as a % of Gross Domestic Product (GDP) for a group of Asian countries and Australia, Sweden, United States and United Kingdom. This indicator shows how significant tax revenue is on GDP. The two countries with the lowest percentage of tax revenue as % GDP are Japan and the United States. Australia, Sweden and the UK have rates of over 20%. However, the % for Australia has dropped since 2008 and the UK level has fluctuated. Sweden has remained constant at 21%. In Asia, the rates are lower but Malaysia shows a slight increase up to 2012. Korea, Indonesia and Philippines have dropped slightly.

There are several different types of taxes:

1. Personal taxes – paid on income earned, or earned interest,
2. Property taxes – paid on property owned – annually or on buying/ selling
3. Service taxes (VAT) – paid on goods and services e.g. consumer durable goods,
4. Commercial/ business taxes – companies pay taxes on profits
5. Import/export taxes – paid on goods being imported and/ or exported.

Table 2: Progressive and regressive taxation

Types of tax	Progressive taxation	Regressive taxation
Income tax	Income taxes – higher income groups pay more tax	Low or flat rates of tax so that lower income groups pay a disproportionate part of their income in tax. Income taxes have limited liabilities
Value Added Taxes for good and services	Value Added Taxes operate with exemptions so that low income groups are not disproportionately affected	VAT is imposed without exemptions. Low income groups are more affected by VAT on good and services
Social security payments	Social Security payments must not be capped – so that high income groups pay more contributions	Social security contributions are capped so that higher income groups pay a smaller % of their income towards social security
Capital Gains tax	Capital gains taxes are part of a tax systems – there are no exemptions when compared to income taxes	Low rates of capital gains taxes and extensive exemptions from capital gains tax
Wealth / inheritance taxes	Wealth or inheritance taxes operate effectively	Many ways of avoiding paying inheritance or other forms of wealth taxes or no wealth taxes at all
Tariffs & trade taxes	Tariffs and trade taxes are used to protect new/ young industries, exploitation of natural resources or cost effective charges on low income groups	Allowances and reliefs are only available to high income groups, e.g. tax relief on pension contributions or mortgage payments

Progressive taxation and reduction of inequalities

A recent OECD study (2012) examined different patterns of inequalities in OECD countries (including Korea and Japan) and assessed the causes of labour income inequality and the impact of taxes and cash transfers.² The study found that progressive personal taxes play a significant role in reducing inequalities. Social security contributions, consumption taxes and property taxes have a more regressive effect. In addition, policies and institutions also contribute to reducing inequalities. Education, anti-discrimination and labour market policies can make the biggest impact on inequalities and also help to boost economic growth.³

Changes in patterns of taxation over time

In the Asia-Pacific region, there have been changes in the types and levels of taxation over the last 20-30 years. Many countries show a decline in personal taxes and an increase in service taxes. This affects lower income groups disproportionately and is a form of regressive taxation. There has also been a decrease in the use of trade taxes, a result of the liberalisation of trade through trade treaties that require countries to open their national markets to international companies. Countries of East Asia show an increase in taxation from direct taxation as a result of increasing economic growth and development. In contrast, countries of South Asia show the lowest levels of direct taxation and total taxation income.⁴ These changes will be discussed in the context of Korea, Japan, Philippines, Thailand, Indonesia and Malaysia.

An analysis of the taxes paid in 2012 (Table 3) in a group of Asian countries (Indonesia, Japan, Korea, Malaysia and Philippines) illustrate some of the different rates of tax for personal taxation as well as variations in the use of inheritance/ wealth taxes and sales and service taxes.

Table 3: Personal and other taxes

Country	VAT	Personal income tax	Inheritance/ wealth tax	Tariffs & trade taxes
Indonesia	10%	Maximum 30%	No	Customs duties on basis of value Excise taxes on alcohol and beverages
Japan	5%	20-50%	10-50%	Customs duties imposed on good from outside Japan Excise duties on petrol, tobacco and alcohol
Korea	10%	Maximum 41.8%	Yes	Customs duties on imported goods
Malaysia	Service Tax: 6 % Sales Tax: from 5% - 10% Current negotiations to combine services and sales taxes	Maximum 26%	No	Import duty on manufactured goods 0-60% and 0-5% for goods from ASEAN countries Export duty on depleted resources to discourage export of resources Excise tax on locally manufactured goods or good imported to Malaysia and on alcohol, tobacco and cars
Philippines	12%	Maximum 32%	Estate 5-20% Gift tax 2-15%	Customs duties on imported goods with reduced tariffs for ASEAN countries

Source: KPMG Tax profiles

The Philippines has the highest rate of Value Added Tax on services and goods. VAT affected lower income groups disproportionately because it is not determined by income but rather by need for the good or service. Korea has the highest rate of personal tax with a maximum of 41% although Malaysia has established a progressive taxation system for personal taxation but the beneficial effects of this system

were reduced through the existence of a wide range of allowances/ exemptions that benefit higher rate tax payers more than lower rate tax payers, for example, school fees, some medical expenses, purchase of computer, books, broadband fees. ⁵ Indonesia and Malaysia do not have an inheritance tax. All countries have some form of Customs duties and excise duties. Membership of ASEAN involves lower customs duties for goods from ASEAN countries.

Threats to national taxation systems

Tax havens/ off-shore finance

Tax havens offer individuals and companies the opportunities to pay little or no tax. They also enable both individuals and companies ways of hiding the details of wealth being accumulated, whether through company, property and other income generating activities, often as a result of corrupt and criminal practices. They provide individuals, companies, organisations a way to avoid adhering to rules, laws and regulations of different countries, 'using secrecy as their prime tool' and are often referred to as 'secrecy jurisdiction'. ⁶ Some examples of centres that provide this 'secrecy' are the British Virgin Islands, Cayman Islands, Jersey, Switzerland, Singapore, London, New York.

Singapore

Singapore is expected to be the world's main off shore banking centre by 2020. Switzerland is currently the largest off shore banking centre with \$2.8 trillion managed assets or 34% of the global private banking industry. Singapore has expanded from \$50 billion in 2000 to \$550 billion under management at the end of 2011, with \$450 billion assets for off-shore clients. It is currently the 4th largest offshore banking centre. ⁷ Singapore has made an attempt to appear stricter about allowing banks to engage in illegal or criminal activities by issuing guidelines, from the Monetary Authority of Singapore (MAS), requiring banks to identify 'high risk' accounts and to terminate the account if found to be illegal, by 30 June 2014.

The cross border mobility of goods, services, capital and jobs has made it more difficult for national governments to tax individuals or companies. Competition between government authorities in attempts to attract foreign direct investment (FDI) has resulted in governments lowering tax rates for global companies.

Tax base erosion and profit shifting (BEPS)

A country's tax base is eroded when multinational companies reduce the taxes that they pay in the country where their income is generated.

MNCs use cross-border payments to move profits to low or zero tax centres. These include:

1. Royalties;
2. Interests;
3. Payments for good purchased for re-sale;
4. Fees for technical and other services;
5. Payments for supplies and other equipment.

The transactions involved in these types of payments allow companies to move the profits from the types of activity listed above to be moved from one country to another. As a result, companies do not contribute to paying tax in exchange for the company's use of public services and local labour force. Even if illegal activities are identified, it is extremely difficult for a national government to enforce their tax legislation. ⁸

Tax base erosion on a country results in a government being unable to raise enough revenue to be able to provide for the needs of the population and to invest, build infrastructure and strengthen institutions. The government is unable to redistribute income from high to low income groups and the country has increasing polarisation between rich and poor. A lack of tax compliance weakens government institutions and tax legislation.

If companies avoid the payment of tax, other people have to pay and this increases inequalities. Local companies that only operate in national markets find it difficult to compete with MNCs because MNCs move their profits across borders to avoid tax. A Christian Aid report found that TNCs operating in India, with links to tax havens could have paid 30% less tax than a company which did not use a tax haven.⁹

Transfer pricing

“Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.”¹⁰ They play an important part in estimating a company’s profit or loss before taxation. As some countries have lower tax rates than others, the aim of a company is to allocate more profits to subsidiary companies operating in low tax countries than in high tax countries.

One of the underlying problems, exacerbated by increasingly rapid Information and Communications Technologies (ICT) systems which can move capital around the world, is that the current international legislation on transfer pricing is unable to deal with the rapid movement of capital or systems used by transnational companies to obscure internal company systems. The current arrangements for transfer pricing are based on the ‘arms-length principle’, which means that companies are independent and operate on an equal footing. Usually companies can set prices and national tax authorities can intervene if they feel that prices are unrealistic but this requires expertise and capacity within tax authorities, which can be undermined by the legal power of transnational companies.

Table 4 shows the corporate tax profiles of six Asian countries. Almost all countries have a corporate rate of tax of over 20%. All countries allow company losses to be carried forward and off set against tax for several years. Indonesia, Malaysia, the Philippines and Thailand all follow OECD guidelines on transfer pricing, but the extent to which specific rules are provided is unclear. Tax authorities in Korea can specifically adjust and recalculate transfer prices, an example of expertise and capacity within the national tax authority. Many countries have specific tax regimes, often with lower rates of tax, for specific sectors or locations.

Table 4: Corporate tax profiles

Country	Corporate tax	Losses offset	Transfer pricing	Special tax regimes
Indonesia	25% with some reductions	Losses can be carried forward for 5 and in some cases 10 years	Arms length and largely in line with 2010 OECD Transfer pricing guidelines (subject to interpretation)	Income tax relief for 25 sectors (to boost exports) and 17 selected locations (distant locations)
Japan	Corporation tax 25.5% + Business tax/ prefectural tax Municipal inhabitants tax	Losses offset up to 80% income	Arms length Advanced Pricing Agreements with 135 bi-lateral agreements	Mining, Shipping, agriculture
Korea	11, 22% and 24.2%	From 2009, tax losses can be offset against tax for 10 years	Tax authorities can adjust transfer price and recalculate income tax when transfer price (between Korean & foreign company) differs from arms length price	Different tax regimes for different industries

Malaysia	25% for companies resident in Malaysia	Losses can be offset indefinitely to offset against future business income	Malaysia's transfer pricing regime is largely based on OECD guidelines	Foreign-sourced income received in Malaysia by a resident company (other than a resident company carrying on the business of banking, insurance, shipping, or air transport) is exempt from tax
Philippines	Resident companies 30% net income or 2% gross income Non-resident companies 30% gross income	Losses carried over as a reduction to gross income for 3 years. Not allowed when taxpayer is exempt from income tax	The tax authority has the power to allocate income and expenses between or among related parties, in order to prevent the evasion of taxes or to clearly reflect the income among related parties. The "arm's length" test is used to evaluate transactions between related taxpayers and the guidelines follow OECD guidelines. Transfer pricing guidelines were issued by the Philippine tax authorities early in 2013 but no implementing rules have been issued	Board of Investment/ Philippines Economic Zone Authority - pioneer status – six years income tax holiday Board of Investment/ Philippines Economic Zone Authority - non-pioneer status – four years income tax holiday
Thailand	23% (2012) 20% after January 2013	Losses can be offset for 5 years	Thailand's transfer pricing regime is consistent with the OECD model (i.e. arm's length basis)	Petroleum industry (oil and gas exploration/exploitation companies): a 50% petroleum income tax is imposed on profits earned from petroleum sales. <ul style="list-style-type: none"> • SME: progressive CIT rate starting with a zero % to 20% • Foreign juristic corporations carrying on the business of international transportation: 3% tax gross income before deduction of expenses. • Banking companies 3.3% Specific Business Tax in lieu of 7% VAT

Source: KPMG tax profiles

Lost tax revenues and impact on government spending

Hollingshead (2010) estimated the tax revenue losses from transfer mispricing, using national corporate income tax rates. Overall, the loss in developing countries was between US\$98 billion to US\$106 billion annually from 2002-2006. The analysis of the countries with the largest losses in tax revenue included four countries in Asia: Philippines, Malaysia, Cambodia, Tajikistan, as set out in Table 5.

Table 5: Countries with largest tax revenue losses as % of government income Average 2002-2006 (millions \$)

Country	Average trade mispricing (non-standardised)	Average tax revenue loss (non-standardised)	Average government revenue (excluding grants)	Loss of tax revenue (as % of government revenue)
Philippines	\$12,153.94	\$4,253.88	\$13,859.11	30.7%
Malaysia	\$19,027.35	\$4,947.11	\$32,130.18	15.4%
Cambodia	\$381.97	\$76.39	\$550.93	13.9%
Tajikistan	\$128.31	\$32.08	\$241.92	13.3%

Source: Hollingshead, 2010: 4

The Philippines and Malaysia are two countries which have some of the largest tax revenue losses of (average) trade mispricing in the world. The Philippines is in 3rd place and Malaysia is 14th in terms of the percentage of loss of government revenue. The Philippines government is losing the value of almost a third of its government revenue. With this lost revenue, the quality of public services could be improved or public services could be extended to a larger proportion of the population. One example of what the tax loss in the Philippines could be spent on is extending a system of basic healthcare insurance for uninsured families. The Philippines government is working with the Mexican government to learn from its 'Seguro Popular' programme, which has extended healthcare coverage in Mexico to 43 million people between 2004 and 2010. By 2010, the Mexican government was spending US\$4,355 million on the 'Seguro Popular' programme,¹¹ which is a similar value to that being lost by the Philippines government to trade mis-pricing.

Transparency

Corporate reporting is often opaque and lacking in transparency but many countries do not have requirements to make financial and company details public. This is an additional problem that has to be addressed in the search for tax justice. Table 5 shows the results of a secrecy audit for a group of countries in Asia.

Table 5: Secrecy in Asia

Country	Secrecy score	% market for global offshore services	Is there banking secrecy?	Is ownership of public companies on public record?	Are public company accounts on public record	Are records of company ownership maintained by relevant authority
Japan	64%	2%	Yes	No	No	No
Korea	54%	1%	Yes	No	No	No
Malaysia	77%	1%	Yes	No	No	No
Philippines	73%	1%	Yes	No	No	No
Singapore	71%	3%	Yes	No	No	No

Source: Secrecy Jurisdictions <http://www.secrecyjurisdictions.com>

Both Japan and Singapore are established centres for global off-shore services. Japan launched its off-shore market in 1986 and has extended tax exemptions for companies to include Japanese government bonds, municipal bonds and corporate bonds.¹² Labuan, a tax haven in South East Asia is part of Malaysia.¹³

Singapore is a major offshore banking centre. It has many bi-lateral tax treaties which allow for 'round-tripping' where:

“an investor from, for example, India, sends capital to Singapore, where it is dressed up in financial secrecy, and then returned to India via a Singaporean shell company, disguised illegally as foreign investment, in order to obtain tax and other benefits from the tax treaty that would not otherwise have been available to the Indian investor”.¹⁴

There is also an extensive private wealth management industry in Singapore where individuals are tax exempt because they are not resident. Many national tax systems only collect income tax from residents.

How big is the problem?

The Tax Justice network has estimated that the assets held offshore, which are beyond the reach of effective taxation, are equal to about a third of total global assets, about \$21 trillion - \$32 trillion. Over half of all world trade passes through tax havens. The amount of money lost by developing countries is far bigger than the amount received through international aid.¹⁵ This is a movement of capital from poor countries to richer countries which results in poorer countries becoming more dependent on international aid and less able to generate tax revenues which could be used to build public services/ infrastructure.

Key players

Organisation for Economic Development & Cooperation (OECD) www.oecd.org

OECD - BEPS Action Plan <http://www.oecd.org/ctp/BEPSActionPlan.pdf>

Tax Inspectors without Borders <http://www.governanceanddevelopment.com/2012/05/tax-inspectors-without-borders.html>

The UN Committee of Experts on International Cooperation in Tax Matters is a subsidiary body of the UN Economic and Social Council and is responsible for keeping under review and update, as necessary, the United Nations Model Double Taxation Convention between Developed and Developing Countries and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries. <http://www.un.org/esa/ffd/tax/>

The Fair share commitment

- People around the world, from the south to the north, are raising their voices in a united demand: it's time for tax justice
- Tax justice must be put into action to end poverty, inequality and climate change
- MNCs, financiers and the very rich must pay their fair share of taxes
- National and international systems that support tax avoidance and tax havens must be stopped
- Governments must enforce fair, progressive, transparent and sufficiently resourced tax administrations
- It's time for people of every country to receive out fair share in public services and social protection
- In signing this declaration, we call on world and community leaders, organisations and people to join together to take action. We demand that governments deliver tax justice now

<http://gatj.org/>

List of tax justice campaign websites

Global Alliance for Tax Justice <http://gatj.org/>

Tax Justice Network www.taxjustice.net

Christian Aid www.christianaid.org.uk

ActionAid www.actionaid.org.uk

- ¹ Cobham A. (2005) Taxation policy & development Oxford: The Oxford Council on Good Governance
- ² OECD (2012) 'Reducing income inequality while boosting economic growth: Can it be done?' Ch. 5 in OECD (2012) Economic Policy Reforms Going for Growth Paris, OECD p.197
- ³ OECD (2012) 'Reducing income inequality while boosting economic growth: Can it be done?' Ch. 5 in OECD (2012) Economic Policy Reforms Going for Growth Paris, OECD
- ⁴ Cobham A. (2005) Taxation policy & development Oxford: The Oxford Council on Good Governance p.8-9
- ⁵ Yong Kuan Chen (2012) The Progressivity of the Malaysian Personal Income tax system Kajian Malaysia 30(2): 27–43 Penerbit Universiti Sains Malaysia
- ⁶ www.taxjustice.org
- ⁷ McCafferty G. (2013) Report: Singapore to eclipse Switzerland as tax haven by 2020 CNN October 14 May 2013 -- Updated 0115 GMT (0915 HKT)
- ⁸ Policy brief on BEPS 3rd draft 27/07/13 OECD/G20
- ⁹ Christian Aid (2013) Who pays the price? Hunger: the hidden cost of tax injustice
- ¹⁰ www.oecd.org
- ¹¹ World Bank (2013) Achieving Universal Health Care in the Philippines South-South Knowledge Exchange Hub <http://wbi.worldbank.org/sske/case/achieving-universal-health-care-philippines>
- ¹² Japan <http://www.secrecyjurisdictions.com>
- ¹³ Kim Jae-won (2010) Malaysia asked to drop Labuan from tax treaty Korea Times http://www.koreatimes.co.kr/www/news/biz/2010/08/123_71287.html
- ¹⁴ Singapore <http://www.secrecyjurisdictions.com>
- ¹⁵ www.taxjustice.org