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KEY POINTS

- The coronavirus disease (COVID-19) pandemic has reduced government revenues by about 14% in Southeast Asia where governments were already struggling to efficiently apply and collect taxes before the pandemic.
- Our analysis identified several common challenges facing Southeast Asian tax regimes prior to the pandemic. These include low levels of fiscal decentralization, limited tax progressivity, outsized contributions of the informal economy, international tax avoidance, underreporting and misrepresentation of business income, lack of administrative capacity, and excessive administrative burden of compliance.
- Improving tax systems can have major benefits for the region. Suggested policy actions focus on three broad areas: expanding the tax base, increasing tax compliance, and improving tax administration.
- The Asian Development Bank (ADB) has made domestic resource mobilization (DRM) and international tax cooperation a key priority.

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Strengthening Domestic Resource Mobilization in Southeast Asia

CHALLENGES FACING TAX REGIMES IN SOUTHEAST ASIA

Despite strong and steady gross domestic product (GDP) growth in many Southeast Asian countries in recent years, tax yields have not increased proportionately. Even prior to the COVID-19 pandemic, many countries had not achieved the desired tax yield of 15% of GDP—a level now widely regarded as the minimum required for sustainable development (Gaspar, Jaramillo, and Wingender 2016). The pandemic has worsened the situation by increasing pressure on public expenditures and decreasing tax revenue, leaving little room for governments to increase external borrowing and therefore highlighting the importance of DRM.

Table 1 presents the major revenue categories for governments in Southeast Asia and the respective GDP share in each country.

A country's tax capacity—its ability to extract revenues to provide public goods—depends on several economic and demographic factors, including population size, resource endowment, industry sector composition, level of corruption, size of the informal economy, and quality of its bureaucracy. Our analysis identified common challenges facing Southeast Asian tax regimes.

The first common challenge relates to subnational taxation. Despite rising rates of urbanization and limited allocation of central funds to local development, fiscal decentralization is low. Property tax collection presents unique challenges in the interaction between the local administrations responsible for property tax collection and the central administration.

The structure of tax systems in many Southeast Asian countries can also be strengthened. Equity considerations in tax policy will remain critical as countries transition from crisis response to recovery. Tax progressivity, one key indicator of the equity of the tax system, is limited across the region. Informality is another major issue, resulting in foregone taxes on both personal and corporate income in many Southeast Asian countries.

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Table 1: Tax Revenue from Major Tax Categories as a Percentage of Gross Domestic Product, 2018

	Income and Profits	Social Security	Payroll	Property	Goods and Services	Other Taxes	Total
Cambodia	4.4	0.0	0.0	0.1	11.7	2.4	15.8
Indonesia	5.1	0.0	0.0	0.2	5.0	1.2	11.9
Lao PDR	2.5	0.0	0.0	0.1	7.2	0.7	11.2
Malaysia	8.6	0.0	0.0	0.0	3.2	0.4	12.5
Myanmar	2.5	...	...	0.1	4.1	0.7	7.8
Philippines	6.5	3.0	...	0.5	7.8	1.0	18.2
Singapore	6.1	0.0	0.0	1.8	3.9	1.3	13.2
Thailand	6.0	1.0	0.0	0.5	9.9	0.1	17.5
Timor-Leste	18.3	...	0.0	0.0	5.3	0.0	23.6
Viet Nam	6.2	0.0	0.0	0.0	9.5	2.7	18.5

... = data not available, Lao PDR = Lao People's Democratic Republic.
Note: Data for Brunei Darussalam are not available.
Sources: Asian Development Bank estimates; OECD. 2020. *Revenue Statistics in Asian and Pacific Economies 2020*. Paris: OECD Publishing.

International tax avoidance and the taxation of cross-border services is a third structural issue relevant to the region. Globalization and growth in the digital economy have resulted in increased cross-border activity. However, tax avoidance actions that artificially shift profits on economic activities to lower-tax locations where such activities are limited or absent, known as base erosion and profit shifting (BEPS), are curbing tax authorities' ability to collect revenues from domestic activities.

Our analysis revealed common challenges to administering tax systems across the region. Southeast Asian countries regularly lose tax revenues from businesses underreporting or misrepresenting income, and through unlawful value-added tax (VAT) recovery claims from tax authorities (Walpole 2014). Institutional capacity is a key predictor of a country's ability to effectively mobilize domestic resources, with weak tax administrations often beset by internal corruption, tax evasion, and tax revenue leakage. Finally, tax compliance that is burdensome and discourages taxpayers from filing is a roadblock to effective DRM.

POLICIES TO STRENGTHEN DOMESTIC RESOURCE MOBILIZATION

As Southeast Asian countries look to shore up their finances post-COVID-19, strengthening DRM will be key. Fortunately, there are significant opportunities to improve tax collection and ease compliance. These opportunities can be grouped into four categories: expanding the tax structure, improving compliance, simplifying the process of paying taxes, and supporting international tax cooperation.

1. Expanding the Tax Base

One way for governments to generate more revenue is to expand the tax base. The effective introduction of measures to expand a country's tax base requires the government to balance social equity, economic activity, and tax revenue maximization.

Broadening personal income tax. Reforms targeting tax exemptions and evasion can increase revenue from taxpayers and have significant medium-term impact if accompanied by measures to increase tax compliance and reduce the size of the informal economy (Coady 2018).

Taxing wealth. Wealth taxes and intergenerational taxes are some of the most progressive tax measures, yet they feature only marginally in Southeast Asia. Inheritance tax, a form of wealth tax on intergenerational transfers, is still limited given administrative challenges related to disclosure and valuation. Evidence on the use of one-off taxes on wealth shows that while they possibly impact entrepreneurship levels and consumption, they can be an effective measure at times of fiscal or economic distress (OECD 2018).

Taxing property. Property taxation, if well designed, is one of the best forms of taxation contributing to social equity because of its progressive nature. It also has the advantage of being difficult to avoid given the high visibility and immobility of land and buildings (ADB 2020b). In the Philippines, ADB supported a governance reform project to establish a real property valuation and transactions system that centralizes valuation, thereby mitigating political pressure on local government units to keep the taxable values of land artificially low (ADB 2019).

Taxing environmental externalities. Despite significant environmental challenges, environmental tax regimes in the region are limited. Conversely, fossil fuel consumption subsidies are common. A key barrier to reforming these subsidies is the absence of a strong safety net to protect the poor from rising energy prices, which should be considered in the context of similar reforms (Walpole 2014).

Taxing digital services. As the digital sector emerges as a key growth engine, identifying tax models that balance revenue collection with supporting sector growth is paramount. Under current regulations, corporations are taxed based on where production occurs, rather than where products are consumed, presenting a challenge for the taxation of digital services. Some countries have started imposing tax obligations on foreign sellers, service providers, and foreign e-commerce platforms. Care must be taken with these approaches; if poorly designed, they could jeopardize growth in the digital economy and lead to reciprocal action from overseas markets that could potentially jeopardize the share of tax revenues in Southeast Asian countries.

2. Increasing Tax Compliance

Approaches to strengthen tax compliance can vary in complexity, reach, and nature, offering combinations of policy and operational measures, including leveraging emerging technologies.

Shrinking the informal economy. Bringing the informal sector to the tax system has been linked to accelerating the growth of firms in the formal economy, sustaining tax morale, improving governance, and expanding the tax base (Prichard, Joshi, and Heady 2012). Unregistered individuals also fail to benefit from social protection measures. Mobile applications offer an opportunity to reach rural segments of the population (ADB 2020c) and tax intelligence software can help reduce leakage by identifying high risk cases so that audit resources could be used more efficiently. Cambodia recently launched an online portal for business registrations (in English and Khmer) that approves registrations within eight working days and links business and tax registration to a dedicated bank account (Medina 2020).

Strengthening value-added tax collection. The collection of VAT can be weakened by activities such as the failure of businesses to register, underreporting or suppression of sales, misclassification of supplies to obtain a reduced tax rate, failure to account for VAT on transactions, and the smuggling of goods into a country (Walpole 2014). Given the large size of the informal sector in the region, addressing these issues is especially important from a revenue gathering perspective.

The growth of the digital economy, and in particular online sales, has created additional complexity and increased the risks of underreporting. At the cutting edge of innovation, the application of blockchain to tax functions has huge potential for tracking and monitoring taxable assets and transactions.

3. Improving Tax Administration

Complexity is a key barrier to tax compliance, particularly for micro, small, and medium-sized enterprises with limited administrative resources. A transition toward e-administration can make online lodgment simpler, ease the tax payment process, and enhance communication with taxpayers.

Making online lodgment and payment easier. Providing multichannel payment options can reduce the burden of making tax payments. For example, Thailand's new tax payment options include ATM, counter services, internet banking, mobile banking, credit and debit card payment, QR codes, and a tax smart card (Nitithanprapas 2020). Well-designed tax portals can allow taxpayers to file their returns, track refunds, make online payments, and obtain copies of previous returns or income details, all through a single access account that improves tax compliance (OECD 2016).

Enhancing communication with taxpayers. Taxpayer education can foster a better understanding of obligations and raise awareness of the role of taxes in society (OECD 2019). Countries can use messaging services to communicate policy changes to taxpayers and send reminders for filing and payment.

4. Supporting International Tax Cooperation

Perceptions about equity in the distribution of tax burden are important in strengthening overall community confidence in the tax system. One way to bolster these perceptions is to demonstrate effective supervision over the wealthiest taxpayers in the community, particularly multinational enterprises and high-wealth and high-income individuals, who are often perceived by the general community to engage in aggressive tax planning, including the use of international profit shifting, to minimize their taxation. Effective supervision of these taxpayers depends on a number of factors, including domestic legal frameworks, and the capacity of the revenue body (ADB forthcoming).

CONCLUSION

The way forward for each country in the region will depend on their domestic situation, including government capacities and priorities. Implementing a property tax, for example, requires certain prerequisites such as land registries and a cadastre (an institution conducting land surveys and providing legal information relating to real estate). There may also be important considerations related to the political feasibility of certain tax reforms.

Countries will need to conduct individual assessments on the impact of a combination of the proposed policy actions to bring about additional resources. For some countries, the focus should be on "basic readiness" measures relating to foundational reforms. For other countries that are at an "advanced readiness" stage, the measures should focus on more complex or additive interventions to fully capture tax opportunities.

Southeast Asian governments must also cooperate more closely with one another to manage aggressive tax planning and combat tax evasion. ADB has made addressing BEPS and international tax cooperation a major priority. As an example of this commitment, ADB is setting up a regional hub to solicit greater cooperation among the region's fiscal authorities in pursuing needed reforms. The hub will support governments' efforts to enhance their capacity for DRM while moving toward international tax standards.

The regional hub will be an open and inclusive platform that brings together practitioners from tax policy and tax administration bodies to promote institutional and capacity development, including the exchange of information; knowledge sharing across partners, international financial institutions, bilateral revenue organizations, and developing economies; and collaboration and development coordination across development partners. In establishing the hub, ADB will mainstream DRM and international tax cooperation in its technical assistance and policy-based lending (ADB 2020a). As the world recovers from the impact of the COVID-19 pandemic, regional cooperation will be more important than ever for capturing additional international taxes and minimizing losses from BEPS.

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