POLICY BRIEF

# Tax Reforms to Support a Strong Pandemic Recovery for Southeast Asia


Governments in Southeast Asia have swiftly responded to the pandemic with a wide array of coordinated health, social, and economic interventions. Photo credit: ADB.

*Governments must rethink and refine tax policy and administration measures to not only address development challenges but also to build back better.*

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## Introduction

In Southeast Asia, domestic resource mobilization has been part and parcel of fiscal challenges even before the coronavirus disease (COVID-19) pandemic struck. Developing countries in the region were not achieving a tax yield of 15% of gross domestic product (GDP)—the level considered to be the minimum for sustainable development. This not only signifies the low capacity of tax authorities to raise tax revenues but also limits capacity of the government to provide sufficient public services.

Given the magnitude of the pandemic-induced shocks, a further decline in tax revenues is most possibly substantial. In addition, the post-pandemic economic recovery is by and large uneven and uncertain due to mixed progress on vaccine rollouts and emergence of new COVID-19 variants.

Learning from the past crises, governments should not embark on fiscal consolidation too prematurely as there is still an utmost need to strike a fine balance between sustaining fiscal stimulus and mobilizing fiscal revenues for long-term development.

These emerging challenges to fiscal policy reiterate the ever-increasing importance of domestic resource mobilization in Southeast Asia. The post-pandemic era is an unprecedented time for the governments to rethink and refine their tax policy and administration measures to not only address short- to medium-term development challenges but also to build back better and usher in inclusive and sustainable development.

This policy brief is adapted from a report of the Asian Development Bank (ADB) that examines the different stages of tax policy and administration among countries in the region based on the most recent publicly available data. The findings point to common issues and challenges surrounding domestic resource mobilization, while recognizing that tax policy options need to be customized to address different sets of issues and challenges and take into consideration the country-specific political, institutional, and socioeconomic landscape. The assessment reveals a set of “low-hanging” tax policy and administration measures that can help the governments quickly boost tax revenues without compromising the momentum toward an economic recovery. At the same time, it is indispensable for the governments to realize that the pandemic is a structural shock to the global economy and will shape the new roles of tax and fiscal policy. Therefore, while the countries are struggling to restore strong growth trajectories, the governments should start contemplating structural tax reform strategies and road maps for addressing a country’s long-term socioeconomic challenges, such as aging population, climate change, and inequality.

## Short- and Medium-Term Policy Recommendations

One root cause of the generally narrow tax base in Southeast Asian countries is attributed to a relatively large informal sector (shadow economy). Economic activities that operate outside the tax system are as large as 43% of GDP in Thailand, 35% in Cambodia, 28% in the Philippines, 25% in the Lao People’s Democratic Republic, and 23% in Indonesia.

There are various reasons for a large informal economy—such as weak tax enforcement, inefficiencies of tax administration, and tax avoidance behaviors, among others. Yet, high costs of tax compliance, such as costly, time-consuming tax registration, tax filing, accounting, and tax payment, are together a key factor that discourages small taxpayers, especially micro, small, and medium-sized enterprises (MSMEs), to operate in the tax systems and comply with tax rules and regulations. Therefore, in the context of Southeast Asian countries, there is a huge opportunity for tax authorities to leverage on tax administration measures that aim to reduce costs of compliance and promote voluntary compliance by simplifying tax registration, filing, and payment for individual taxpayers and MSMEs.

These tax administration measures can be applied readily within the existing legal frameworks for key tax types, especially personal income taxes, corporate income taxes, and value-added taxes (VAT). The Tax Administration Diagnostic Assessment Tool (TADAT) of the International Monetary Fund (IMF) would offer a diagnostic tool for tax authorities to assess tax administration performance and identify gaps. In addition, it is important for tax authorities to recognize that efforts to lower costs of compliance may entail lower tax revenue flows from each taxpayer; however, improved tax compliance means an expanded tax base—more and more taxpaying individuals and firms entering a tax system—thereby enhancing total tax revenues.

Digital transformation of tax authorities is another area that can help the government quickly boost revenues without amendments of the existing rules and regulations. Tax authorities can leverage on new information technology (IT) for tax administration, such as big data and blockchain technology, to improve taxpayers' services and gain more control and access to data for monitoring of noncompliance risks.

In addition, the use of digital technology will also reduce transaction costs and enhance transparency of tax authorities, resulting in more efficient revenue mobilization. Following the use and adoption of electronic services or e-services, such as e-filing and e-payment, many Southeast Asian countries see an increase in tax collection. Almost all countries in the region offer a wide range of electronic filing and payment options. Singapore also has an extensive pre-filing system, where returns are prepopulated from the records of the revenue body. Expectedly, these jurisdictions recorded the best ranking in the World Bank's Paying Taxes database.

Strengthening subnational taxation may offer the other tax administration lever for boosting domestic resource mobilization. Real property taxes are the main and stable source of local governments' tax revenues. However, real property tax revenue is low in Southeast Asia, less than 1% of GDP in Cambodia, Indonesia, the Philippines, and Thailand. The challenges of low real property tax revenues in the region rest with an inefficient and outdated property transaction database, which results in outdated market values of properties for real property tax assessment. In addition, the business processes for property valuation and real property tax payment are manual.

The lack of centralized monitoring and reporting systems imply that subnational governments administer real property valuation and real property tax collection independently; consequently, they are subject to local political pressure to keep property values lower than what they should be in the market. Digital technology platforms and IT tools offer a solution to these issues by modernizing business processes of real property taxation, ranging from a transaction database to valuation functions.

These real property tax measures are progressive in nature as they generate tax revenues from wealthy property owners and are likely to yield significant gains in the short term.

# Long-Term Policy Recommendations

Tax reforms that have so far been implemented in Southeast Asia are complex and will take time to complete. Country contexts and challenges vary considerably, and national development priorities and Sustainable Development Goals (SDGs) are also country-driven. The governments will need to strengthen their policy and institutional frameworks to manage these challenges. Government authorities will have to work with key stakeholders, including the private sector, civil society organizations, and the public to make these happen.

Southeast Asia's tax reform journey presented in the report underlines that meaningful and successful tax reforms necessitate the government's long-term perseverance and commitment to addressing overarching development challenges, such as poverty, income inequality, environmental issues, and macroeconomic and fiscal sustainability. International organizations, such as ADB, IMF, and the Organisation for Economic Co-operation and Development (OECD), encourage tax bodies to develop and implement the medium-term revenue strategies (MTRSs) to address the unpredictable and inconsistent tax reform efforts that often fail to deliver any benefits. In the aftermath of the COVID-19 pandemic, rethinking tax reform priorities and refining the existing MTRSs to address emerging development challenges, such as income inequality, climate change, and an aging society, will likely constitute an integral part of fiscal consolidation and domestic resource mobilization strategies in the region.

With an exponential increase in digital service transactions amid the COVID-19 pandemic, the governments in Southeast Asia have moved toward unilaterally imposing digital service taxes on multinational digital companies. For example, Indonesia, Malaysia, the Philippines, and Thailand have imposed or are introducing new levies on digital service providers. These measures are part of the global attempt in bringing the borderless digital economy into domestic tax systems, in response to increasing scrutiny of whether these multinational digital service providers are fairly paying taxes on their earnings.

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) offers an exceptional opportunity for Southeast Asian countries to take part in global efforts and address this issue collectively at the multilateral level. The governments should, to the extent possible, participate in ongoing discussions at the OECD Inclusive Framework on BEPS and the Global Forum on Transparency and Exchange of Information for Tax Purposes. Enacting a sound domestic legal framework and participating in international forums to enhance consistency, cooperation, and information exchange, are important in supporting jurisdictions in their efforts to protect the domestic tax base from erosion.

Carbon taxation is another emerging area for harnessing domestic revenue mobilization to address the increasingly severe impacts of climate change. In Southeast Asia, energy-related carbon emissions are expected to rise by as much as 61% between 2014 and 2025, and effective pricing of externalities presents an opportunity to facilitate energy transition and strengthen environmental tax regimes. Currently, excise taxes on fuel products (or phasing out of energy subsidies) are a common approach to pricing carbon in the region. However, excise taxes on fuel products typically incur high administration and compliance costs and are often subject to fuel smuggling, tax leakages, and distortive effects on fuel markets.

Southeast Asian countries have large potentials to develop the emission trading scheme (ETS), also known as the “cap-and-trade” system, first introduced in the European Union. The government sets a cap on the total amount of greenhouse gases to be emitted. Then, a market where emission allowances are traded is created. For each year, a business will have to surrender enough allowances to fully cover its emissions; otherwise, heavy fines are imposed. However, the progress has been slow and quite patchy in the region. Indonesia, the Philippines, and Thailand have started introducing the ETS. Private sector support is often limited, and participation in the ETS is on a voluntary basis due to the absence of a domestic legal framework, coupled with limited technical knowledge and infrastructure of the responsible government agencies.

## Country-Specific and Multilateral Solutions

ADB will continue to work with its Southeast Asian member countries to ramp up revenue performance and to tailor the various policy options to suit country-specific priorities and contexts. It has established the Asia Pacific Tax Hub to help develop multilateral, consensus-based solutions to support domestic revenue mobilization and foster international tax cooperation. It serves as an open and inclusive platform for (i) strategic policy dialogue, (ii) knowledge sharing, and (iii) development coordination among our members, development partners, and ADB. The regional tax hub can also help countries formulate consistent policies, thereby preventing unilateral tax measures, which could lead to double or triple taxation, threatening cross-border trade and investment.

The COVID-19 pandemic gave a glimpse of what the future of tax policy and reform could look like in Southeast Asia. To make up for lost ground and reinstate a strong growth trajectory, the governments have an exceptional opportunity to reshape their tax systems and find new ways of mobilizing domestic resources to create more equitable and environmentally sustainable societies. This is no easy task. The path toward a fair and efficient tax system conducive to inclusive and sustainable development necessitates the governments’ long-term commitment to tax reforms and working with stakeholders and development partners.

## Resources

A.Chongvilaivan and A. Chooi. 2021. *A Comprehensive Assessment of Tax Capacity in Southeast Asia.* Manila: Asian Development Bank.

OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting.

Tax Administration Diagnostic Assessment Tool (TADAT).


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Asian Development Bank (ADB)

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