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Discussion Paper
First High-Level Follow-up Dialogue on Financing for Development in Asia and the Pacific
Incheon, Republic of Korea
30-31 March 2016

THE ASIA-PACIFIC TAX FORUM FOR SUSTAINABLE DEVELOPMENT (AP-TFSD): A PROPOSAL

DP/01

March 2016

ESCAP secretariat






UNITED NATIONS ESCAP
Economic and Social Commission for Asia and the Pacific

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Discussion Paper

Macroeconomic Policy and Financing for Development Division

The Asia-Pacific Tax Forum for Sustainable Development (AP-TFSD): a Proposal

by

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March 2016

Abstract

Taxes, and more generally the public revenue system, have provided the fiscal backbone for the remarkable development of Asia and the Pacific over the past few decades. However, growing public spending requirements for infrastructure, social and environmental investment for implementation of the SDGs, and the region's unprecedented urbanization, call for strengthening fiscal positions. Additionally, globalization and cross-border business activities have created new challenges for national tax administrations. In response to these new trends and the needs of Asia-Pacific countries, the idea to create a new regional tax forum was brought up at ESCAP's 70th Commission Session in 2014 and further developed at a number of regional events. The proposed tax forum would seek to address the key issues that are most pertinent to the region, but yet to be addressed by existing international and regional tax cooperation mechanisms. This paper highlights the rationale of the proposed forum, discusses five potential focal areas for the forum and suggests a working blueprint for the forum.

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I. Introduction

Low taxes have assisted Asia and the Pacific countries in their remarkable developments over the past few decades. However, growing public spending requirements for infrastructure and the social sector development and the need to deal with environmental challenges, including those related to the region's unprecedented urbanization, now call for strengthening fiscal positions. Furthermore, the effective implementation of the 2030 Agenda for Sustainable Development and the potential of pro-active fiscal policies to support economic growth call for an additional mobilization of public domestic resources. Thus, the strengthening of public finances to meet current and future spending needs and to secure a sustainable and prosperous future has become a top priority in Asia and the Pacific, especially when the fiscal positions of many countries of the region are characterized by single-digit tax-to-GDP ratios and persistent fiscal deficits.

At the same time, with globalization deepening beyond trade and investment and the world becoming more interlinked, the tax implications of international investment are becoming increasingly more challenging for national tax administrations. In this regard, tax evasion by enterprises undertaking economic activities in multiple countries is a growing global issue, as highlighted by the high priority that the G20 and the OECD accorded to their base erosion and profit shifting (BEPS) project over the past few years. However, dealing with complex international tax system issues, such as those addressed in the BEPS project, is beyond the capacities of tax authorities in smaller and low-income countries with little expertise in the field, while the policies, standards and practices recommended by G20-OECD in this area might not always be the most suitable for the region's developing countries. A second consequence of increasing globalization is that – in the absence of any form of tax coordination among countries of the region – it is leading to increasing cross-country competition through lowering of rates and through tax incentives. Although tax incentives are common in most, if not all, countries in the region, they reduce tax revenues, increase tax complexity and facilitate corruption and tax evasion.

In response to these new trends and the needs of the Asia-Pacific countries, the idea of creating a regional tax forum with a focus on supporting the region's sustainable development and its developing countries was brought up at ESCAP's 70th Commission Session in 2014. Since then, the idea has been discussed in a number of regional events, and was further developed based on extensive background studies and at the tax expert meeting in November 2015 (annex 1). The consensus reached in this meeting was that the proposed tax forum could provide a useful platform for regional cooperation and coordination in tax matters that would add significant value to its prospective members over existing international and regional tax cooperation mechanisms.

Keeping in view the Asia-Pacific region's key challenges in taxation and public finance, the work of existing tax cooperation forums, and the need to support the implementation of the 2030 Agenda for Sustainable Development, the proposed Asia-Pacific Tax Forum for Sustainable Development (AP-TFSD) would aim at serving five key objectives:

- Supporting tax revenue enhancement efforts;
- Strengthening and rationalizing municipal financing to support the region's continuing urbanization;

- Promoting tax policies that directly support inclusive growth and sustainable development;
- Facilitating exchanges of information and coordination to address harmful tax competition;
- Providing an open platform for developing countries to discuss and coordinate their positions on new international tax standards and practices.

The next section provides further discussion on the rationale for this proposal. Section III provides a brief stocktaking of existing tax forums for cooperation in tax matters. Section IV assesses cooperation gaps of the region's tax forums and highlights the main features and value added of the proposed AP-TFSD. Section V provides initial ideas for a blueprint of the new forum to facilitate further discussion.

II. Proposed focus areas of the AP-TFSD

A. Supporting tax revenue enhancement efforts

An important function of the government is to collect taxes for the provision of public goods such as education, healthcare and infrastructure. While the 'optimal' tax-to-GDP ratios depend on a number of factors, such as the country's preference for public goods and structural characteristics of its economy, there is room to increase tax revenues in a number of Asia-Pacific countries. Many countries have expressed a desire for ambitious public programmes such as universal health coverage, but their tax revenue collection is well below their estimated 'potential'.[1] This apparent mismatch could be resolved by putting in place an efficient and fair tax system that delivered the necessary revenues.

Intuitively, tax revenues can be below 'potential' for two reasons: (i) tax laws that allow for various exemptions, and (ii) an inefficient implementation of the tax laws. While tax exemptions, holidays and deductions offered to specific taxpayers or to economic activities erode the tax base, weak enforcement and inefficient taxpayer services have also a negative impact on tax compliance. The relative significance of these two 'gaps' varies across countries. Some countries have successfully rationalized tax expenditures (revenues foregone due to tax exemptions) but continue to experience revenue shortfalls due to a weak administrative capacity. In other countries there have been significant reforms in tax administration – for instance, through reorganization along functional lines and taxpayer segmentation – but tax collection is undermined by legislation and policies that allow for generous exemptions and provide ample opportunities for noncompliance.[2] Box 1 illustrates the challenges of revenue enhancing reforms in the case of Pakistan.

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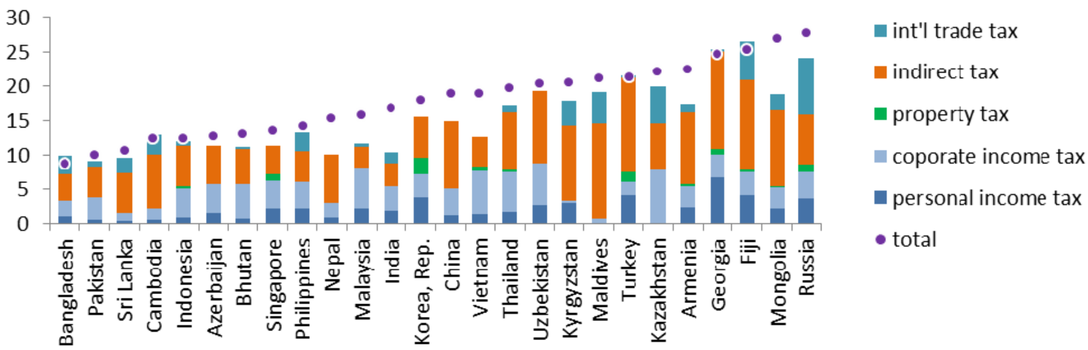
[1] For instance, Indonesia, with a view to achieve universal health coverage by 2019, has allocated 5% of its 2016 national budget to health expenditures, compared with 3% in 2014. However, the budget has come under pressure amidst revenue shortfalls. ESCAP analysis suggests that Indonesia's 'potential' tax-to-GDP ratio is approximately 4 to 5 percentage points higher than the actual level. See ESCAP (2014).

[2] For instance, agricultural income receives special tax treatment in several South Asian countries, without proper distinction between poor and wealthy farmers. Besides the legally lost revenues, this creates opportunities for tax evasion, as taxpayers can abuse the legislation by declaring business income as agricultural income. See Reva (2015).

This implies that efforts to enhance tax revenues require the engagement of various stakeholders, including legislators, ministries of finance and national tax administrations.[3] Moreover, there seems to be significant scope for knowledge and experience sharing between countries, which could also encourage a healthy dose of peer pressure for reforms. For instance, with a view to improving tax legislation and policy, countries could discuss how the tax mix, or composition, could be enhanced, for which cross-country comparisons can be useful (figure 1).[4] It would also be very useful for countries to discuss best practices for the measurement of tax expenditures and to evaluate whether or not they meet their intended policy objectives and how they compare to present and future direct spending.[5] With a view to improving tax administration, countries could discuss how to effectively engage taxpayers in the process of registration, collection, audit and appeals; how to make good use of information technology and modern tools of enforcement such as withholding and third-party information sharing; and how to ensure the integrity of tax administrations. In some countries, expanding the tax base and simplifying tax paying procedures seem to be low hanging fruits (figure 2).[6]

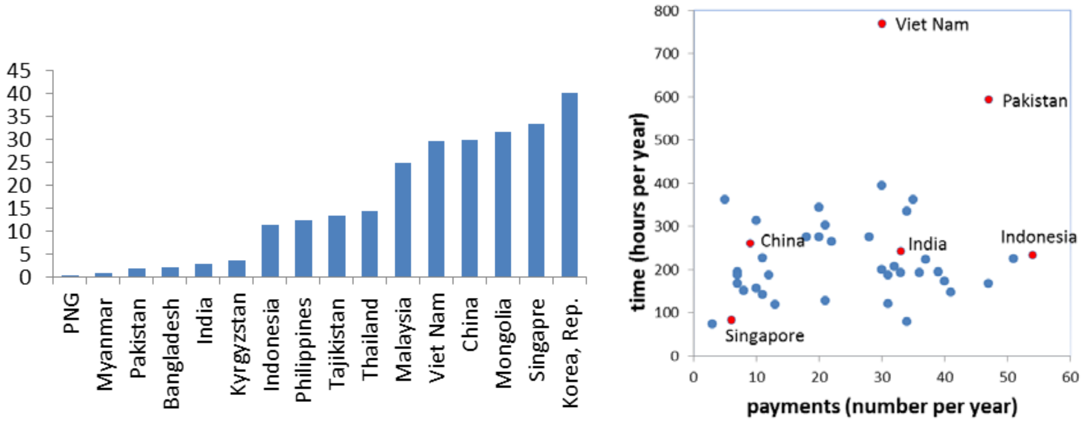
Figure 1. Tax composition and revenues, % of GDP, in selected Asia-Pacific countries



Source: ESCAP, based on Government Financial Statistics, World Revenue Longitudinal Dataset, and CEIC Data.
Note: 2014 or latest available year. Differences between the 'total' and the sum may arise from gaps in data and definitional issues. For instance, countries such as India and Viet Nam have various goods and sales taxes in addition to standard VAT, as well as excise taxes that are not captured under 'indirect tax.'

[3] Boards of investment and other bodies that grant tax incentives are also important. For instance, in the Philippines, as many as 18 investment promotion agencies are allowed to grant tax incentives under 180 pieces of legislation. Regional and local governments should also be engaged in countries with significant degrees of tax decentralization.
[4] Having a balanced tax mix can help raise revenues in an efficient and fair manner. This could be achieved through either adjusting existing taxes (e.g. rates, thresholds) or introducing new taxes (e.g. property, inheritance taxes).
[5] According to the Open Budget Survey 2015, there were 14 countries in the region whose governments publish at least some tax expenditures. Foregone revenues range from 1.5% of GDP in the Philippines in 2011 to nearly 5% in India in 2013, although coverage varies across countries. The Republic of Korea adopted performance-based tax expenditures in 2014, in which special treatments are time-bound and new ones are adopted only when existing ones have expired. Promoting further exchanges of information on this matter will be extremely useful for policy makers.
[6] For instance, in Pakistan, the number of active personal income tax filers is less than 1 million, significantly below the number of 5.7 million people reportedly earning above the income tax threshold, and far lower than the 15.6 million broadband internet subscribers. The government has issued notices to potential taxpayers and is integrating the national taxpayer identification system with the national identity card database. See Cevik and others (2015).

Figure 2. Registered taxpayers, % of population and ease of paying taxes



Source: ESCAP, based on national sources, Araki and Claus (2014), and World Bank, *Doing Business 2016*.
Note: Registered taxpayers for individual income. Data for 2013 or latest available year. Ease of paying taxes shows two indicators – the number of hours per year to prepare, file returns and pay taxes; and the number of payments per year – for a medium size company; based on surveys conducted in 2014.

Box 1. The challenge of revenue enhancement in Pakistan

Like a number of other South Asian countries, Pakistan's tax revenues are very low in relation to the GDP, averaging about 10% in the past decade. This is partly explained by the relatively low diversification of the country's tax structure, which relies disproportionately on personal and corporate income taxes and sales taxes. In addition, the industrial sector contributes over 60% of the total tax revenue although it represents about 20% of the GDP, while the agricultural sector contributes only 2.5% of the total tax revenue although it represents about 25% of the GDP.

The country's narrow tax base is an even more important challenge, with 92% of the population falling below the minimum income bracket for taxation and 3% of the registered General Sales Tax (GST) payers accounting for roughly 90% of the total