

COMPARATIVE REVIEW OF FISCAL INCENTIVES
IN SELECTED ASIAN COUNTRIES*

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The intensified quest for development in Asian countries has impelled their governments to turn to incentive legislation in the hope that the array of incentives provided will be educative of the investment and growth potential. What follows must give a Freudian twist, but it seems a most vivid and appropriate analogy. This offering of incentives to promote investment is closely akin to the eternally feminine policy of attraction. In the competition in search of marital bliss, women employ a wide spectrum of policy instruments and devices. Some who possess a felicitous combination of natural and acquired resources achieve moderate to high degree of success; others may be lacking in natural physical and other endowments, but compensate for this by acquiring and developing sufficient skill and knowhow to devise a formidable strategy of masculine pursuit; still others, for one reason or another, simply fail to catch the elusive male of the species. As with women, so with developing countries.

This paper presents a comparative review of the fiscal incentives offered in eight Asian countries, namely: Indonesia, Japan, Laos, Malaysia, Singapore, Thailand, South Vietnam, and the Philippines. These are the countries which participated in the first conference of the Study Group on Asian Tax Administration and Research held in Manila last February.

Where possible comparison is made among these countries as to the degree of generosity of their incentives schemes as

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a whole or of a particular type of incentive. This takes into account such factors as nature and type of incentive, coverage (i.e., areas or industries included), depth, duration, etc. The paper also looks into the relative reliance placed by these countries on specific types of incentives. The relative popularity of some incentives over others indicates their wider acceptability in the investment promotion programs of these countries, and may therefore be taken as a gauge of the significance that businesses are believed to attach to such incentives.

A specific, but no less important, purpose of this paper is to see where the Philippines stands in the giving of fiscal inducements. Does she hold back some of her attractions, thus inhibiting investment and growth? Does she provide equally strong competition? Or does she overact, giving too much of herself to entice domestic and foreign investment, compared with the rest of these Asian neighbors?

The incentives discussed here are broadly grouped according to those granted to enterprises upon entry, while operating, and with respect to reinvestment or ploughing back of profits. Then there are also incentives to individual investors or shareholders in promoted enterprises.

I. INCENTIVES UPON ENTRY

Incentives granted to enterprises upon entry are in the nature of tax concessions. These may be either exemption from, reduction or refund of, import duties, registration fees, stamp duties, real property taxes, etc. Some of these concessions may be availed of for only a limited period, usually before the enterprise either made sale, started production or earned income; whereas others may extend up to the period of operations. Of the eight countries studied, only Malaysia grants no incentive upon entry.

The common tax benefits are classified into two categories, namely: (1) exemption from (or reduction of) customs duties on specified items (e.g., capital equipment, machinery, spare

parts, raw materials, component parts and accessories, and selected types of merchandise) subject to certain restrictions and limitations; and (2) inducements attached to the initial and organizational activities, such as waiver (or reduction) of registration fees, stamp duties, etc.

A. *Remission of Customs Duties*

The most common tax benefit is exemption from customs duties of certain categories of imports, almost always capital equipment. Invariably, this is subject to the condition that the imported items are not locally manufactured in sufficient quantities or acceptable quality. In the Philippines exemption is granted on capital equipment, machinery, spare parts, and merchandise of all kinds transacted in the Mariveles Foreign Trade Zone for an indefinite period. All registered preferred (i.e., pioneer and non-pioneer) and export enterprises are given a waiver from customs duties for seven and five years, respectively, on capital equipment, machinery, and spare parts shipped with such machinery and equipment. The same incentive has been availed of by basic industries, which, however, is due to expire at the end of the year. Singapore similarly allows duty-free importation of all goods stored, processed, or manufactured in the Free Trade Zone. Manufacturing industries are also given duty exemption on machinery and equipment, supplies and raw materials for an indefinite period. Laos exempts capital equipment, spare parts, raw materials and accessories imported by enterprises under license or convention for a five-year period. Similarly, waiver of import duties is granted on capital goods, basic equipment and materials in Indonesia and on capital equipment and spare parts in South Vietnam.

In Japan duty-free importation by domestic enterprises in export and manufacturing is with respect to important instruments, that is, new, "highly efficient industrial

machines" indispensable in the production process and which are difficult to produce domestically. Remission of duties may also be granted on goods for re-export, ship building or repairs, on staple products and raw materials for manufacture of exports, among others. The Industrial Investment Act of Thailand grants this privilege to all foreign and domestic enterprises in specified areas for a two-year period in respect of machineries and materials necessary to set up the factory. Further, enterprises engaged in promoting agriculture and industry are given a reduction of at least 1/10 of the regular customs rate.

B. *Waiver or Reduction of Registration Fees and/or Stamp Duties*

Another common tax concession is exoneration from or reduction of registration fees and stamp duties attached to the formation of enterprises being encouraged. This is found in Laos, Indonesia, and South Vietnam. For instance in the latter the transactions allowed exemption from registration fees and stamp duties are: 1) those associated with the formation of the enterprise; 2) increase of capital; and 3) borrowing deeds.

A waiver of stamp duties in Indonesia applies to the placement of capital at the time of incorporation for both domestic and foreign capital enterprises. In Laos, enterprises under the special system benefit from a reduction of registration fees on the articles of incorporation and on increases of capital occurring within 3 years after the formation of the company.

C. *Other Tax Concessions*

Relief from other taxes with respect to importation (i.e., other than customs duties) is likewise granted in some countries. In Laos, exemption pertains to taxes subsidiary to cus-

toms duties for a five-year period. Basic industries in the Philippines enjoy a 50% exemption from compensating tax (equal to 7% of landed cost) on machinery, equipment, and spare parts until the end of 1971, the expiration date of the incentives under the Basic Industries Law. In Thailand exemption from business tax applies to importation by domestic and foreign enterprises in specified areas, of machineries and materials necessary to set up the factory.

In addition, there may also be granted complete or partial exoneration from other taxes and charges. Laos waives the land tax on lands and industrial buildings. It also grants exemption from applicable fees and real property assets included in the composition of capital, as well as increases in capital occurring within 3 years after the formation of the enterprise. Remission from real property taxes is granted to foreign and domestic enterprises engaged in urban redevelopment in Singapore.

It is difficult to make conclusive statements regarding the extent of generosity of incentives offered by these countries to enterprises upon entry in general, in view of the multiplicity of factors involved. Nevertheless, on the whole, the Philippines emerges as the most liberal among the seven countries. It extends the broadest form of exemption, i.e., from all taxes and fees otherwise applicable, in the following areas of activity, namely: 1) Electric Cooperatives for a period of about 30 years from the date of organization, or until the enterprise shall have become completely free of indebtedness, whichever comes first;

2) Rural banks with net assets not exceeding ₱1 million; for those with assets more than ₱1 million but not exceeding ₱3 million the tax liability is in the same proportion that such excess bears to the net assets. The exemption is for an indefinite period;

3) Non-agricultural cooperatives with net assets not exceeding ₱500,000 for an indefinite period;

4) Enterprises in pioneer areas, as determined by the Board of Investments; the exemption is on a gradually dimi-

nishing scale, up to 1981. As provided by law, the exemption is only with respect to national internal revenue taxes; however there is also a substantial waiver of customs duties;

5) All mining enterprises with at least 60% Filipino ownership, for a five-year period starting from the time the enterprise makes actual bona fide order for equipment for commercial production;

6) Cottage industries capitalized at not more than P15,000 for a five-year period from the date of registration with the National Cottage Industries Development Authority (NACIDA).

In addition to the above, private development banks enjoy very generous concessions, if to somewhat lesser degree. Categorized according to capitalization as belonging to Class A (P4 million), Class B (P2 million), or Class C (P1 million), banks whose net assets (excluding the government's counterpart capital) do not exceed P30 million, P20 million, or P10 million, respectively, for each class, are fully exempt from all taxes, charges and fees except compensating tax and tariff duties. If the net assets exceed the prescribed limit for its class, a bank's tax liability is in the same proportion that the excess bears in relation to its total net assets.

Laos may be ranked next to the Philippines in generosity of incentives given in the entry stage. Aside from exemption from customs duties, exoneration or mitigation of tax liability applies with respect to registration fees, stamp duties, land tax, and taxes subsidiary to customs duties.

II. FISCAL INCENTIVES TO BUSINESS ENTERPRISES WHILE OPERATING

There are a wide array of incentives to business firms while operating, namely: exoneration from various taxes, special depreciation, tax credit, reduction of income subject to tax (through preferred treatment of specified types of income, exclusions and deductions from taxable income, and carry-over of losses, capital allowances or certain expenses), reserves, protection, etc.

A. Tax Exemption

Tax exemptions to enterprises after the start of operation are generally similar to those upon entry, except for a few major ones, like those in respect of income, production and sales taxes, which are obviously collectible only when the firm has commenced operations. Hence, the exemptions available upon entry which are not exclusively related to the initial and organizational activities of the enterprise may continue to apply up to the time that production is under way. As previously discussed, these are with respect to customs duties and other taxes relating to importation, tax on land or real property, etc.

A major one, along with waiver of customs duties, the most common tax exemption, is with respect to income tax, granted by all the countries except Japan. The period of complete exemption varies from two to six years for Indonesia; two to five years for South Vietnam; two to eight years for Malaysia; and five years for Laos, Singapore, and Thailand. In the case of the Philippines, the tax relief period is indefinite, without any fixed expiration date prescribed by law. The tax holiday, however, does not apply to enterprises covered by the two major incentives laws, the Investment Incentives Act (Republic Act 5186) and the Export Incentives Act (R.A. 6135). In Indonesia the duration of the relief from income tax varies according to nationality grouping. Thus, for approved foreign capital enterprises the period of complete exemption may not exceed five years, followed by partial exemption for at most another five years. On the other hand, domestic capital enterprises are granted a two-year waiver, subject to extension, depending on such factors as nature of investment, capital requirement, etc. The two-year income tax holiday of a pioneer company in Malaysia may be extended to as long as five years, depending on the level of fixed capital expenditure incurred by the enterprise by the end of the year following the end of the tax relief period. In some instances further extensions may be granted for a maximum of three years. Pioneer companies in Singapore, those which intend to incur fixed capital expenditure

of at leasts \$1,000,000 to produce the pioneer product, are exempted from income tax for five years from "production day".

In the matter of duration, the Philippines may be singled out as the only country which gives exemption from income tax for an indefinite period — that is, the incentive law does not specify the date of expiration of the exemption. This applies to electric cooperatives and non-profit corporations organized under the National Electrification Administration Act; rural banks; agricultural farmers' cooperatives or federations of cooperatives; non-agricultural cooperatives; and private development banks.

A feature of the export incentives designs of some countries is the exoneration from taxes otherwise applicable to export products. Thus, Laos exempts from the turnover tax reported products of enterprises under convention. In the Philippines a registered export producer or trader may not pay the export and stabilization tax if the total f.o.b. Philippine port value of exports of such product in 1968 was less than US \$5 million but which exceeds said total during a period of five years from date of registration. Likewise, in Thailand, upon the discretion of the Board of Investment, all enterprises in promoted industries may be given an exemption from, or reduction of, export duties and business taxes on exported products.

Earlier in the preceding section on entry incentives, it was mentioned that Laos and Singapore grant a waiver from tax on real property. A similar incentive exists in South Vietnam where the real estate tax holiday of three years from start of operations is enjoyed by approved domestic and foreign enterprises; at the same time, approved agricultural projects are exempted for two years from the real property tax on crops characterized by deferred investment yield.

Remission of customs duties on other imports may also be given once the firm has commenced operations, aside from those items on which the waiver applies from the time of the firm's entry in the preferred area. In Japan, domestic firms

engaged in export and manufacturing are given a refund once the goods manufactured from duty-paid materials are exported; there is also a reduction of customs duty on goods exported for processing or repair, re-import and re-export. Aside from the special laws granting duty exemption in selected industries, the Tariff and Customs Code of the Philippines also provides for a drawback equivalent to 99% of customs duties in the following instances: (a) upon exportation of locally-manufactured articles which have import components; (b) where a manufacturer uses domestic raw materials of equal quality and value as similar imported raw materials in the manufacture of export commodities; and (c) on the importation of fuels which are used in the propulsion of vessels of Philippine registry. Likewise in Thailand export enterprises are given a rebate of 7/8 of customs duties collected on raw materials used in exported products.

Certain other exemptions from taxes or fees are also contingent upon operation, production or sale. In the Philippines such exemptions are with respect to the following, among others: sales and percentage taxes of farmers' cooperatives or federations of cooperatives; franchise and privilege taxes of the radio and television industries; tax on gross receipts of licensed publishers or printers of newspapers, under certain conditions; and 7% sales tax on agricultural products sold or exchanged in the Philippines. South Vietnam grants to all approved domestic and foreign enterprises a three-year waiver from land surface and volumetric royalties in the exploration of mines and quarries.

As in the case of incentives upon entry, the Philippines emerges as the most liberal with respect to the range of tax exemptions to enterprises while operating. It is the only country with exemptions from all taxes in two areas — rural banks (according to value of net assets), and cooperative and non-stock, non-profit membership corporations and electric cooperatives organized or converted under the National Electrification Administration Act. In other instances the exemption laws are so liberal that they simply specify the tax, exemption from which does not apply. Thus, exemption from all national

internal revenue taxes except income tax is granted to pioneer enterprises (including pioneer export enterprises) by the Investment Incentives Act and the Export Incentives Act, until December 31, 1972, and gradually diminishing until December 31, 1981. Mining companies with at least 60% Filipino ownership are granted exoneration from all except income taxes for a five-year period starting from the time the enterprise makes actual bona fide order for equipment for commercial production. Other enterprises which are granted exemption from all except for one or two specified taxes, are the following: (1) Cottage industries registered with the NACIDA — except income and specific taxes; (a) Non-agricultural cooperatives with net assets not exceeding P500 thousand — except specific taxes; and (3) Private development banks, subject to ceiling requirements on net assets — except compensating tax and tariff duties.

B. Special Depreciation

Of the eight countries under consideration, six allow special depreciation, namely: Indonesia, Japan, Malaysia, the Philippines, Singapore and South Vietnam. This accelerates the recovery of fixed investment and serves to postpone but not reduce, the tax liability. In Malaysia accelerated depreciation is allowed up to 40% of residual value until fully written off, for approved hotel companies and resident enterprises which must have exported at least 20% of their production at the end of the basis period. However, the accelerated depreciation allowance cannot be availed of by a pioneer company, a company which has been given an "investment tax credit", or if the asset was used to export a primary product. The Income Tax Ordinance of Singapore is even more liberal; it allows, under certain circumstances, initial depreciation on machinery and equipment up to 100%, thus enabling an approved pioneer or non-pioneer enterprise to write off its capital expenditure in as short a period as one year. Also, expenditure on plant and machinery utilized in manufacturing and processing of goods and materials may be written off equally over a period of three years. The prescribed rate of accelerated deprecia-

tion for registered enterprises under the Investment Incentives Act of the Philippines is at most twice the usual rate if useful life does not exceed ten years, or between five years and expected life if longer than ten years. Japan has a unique and more refined scheme of special depreciation than any of the other countries included in the study. The scheme constitutes, and distinguishes between, two types of special depreciation: increased initial depreciation and accelerated depreciation. The former consists in an increase in allowed depreciation during the first year of use of plants and equipment which are required for the modernization of enterprises, over and above the amount normally prescribed. Accelerated depreciation on the other hand, consists in an increase in the ordinary depreciation allowance by a certain amount for a prescribed number of years. Special depreciation in Japan is aimed at improvement of technology and modernization of equipment in small and medium-sized enterprises, and enterprises in ocean transportation, agriculture, fishery, mining, retail trade, etc. Moreover, special depreciation also applies to specified fire-proof buildings.

C. Reduction of Income Subject to Tax

Aside from outright exemption from tax of income or corporate profits, several of the Asian countries studied grant reduction of taxable income in any of several ways, namely: (1) preferential treatment of specified types of income; (2) carry-over of losses, capital allowances, or selected expenses to the next taxable period; and (3) liberal deductions and allowances (other than depreciation). These are discussed in turn.

1. *Preferential Treatment of Certain Types of Income*

With respect to the first method, preferential treatment of specified sources of income may come in the form of exemption from tax, deductibility from taxable income, or reduction of the tax rate otherwise applicable. Indonesia grants a ten-year reduction of tax rates to mining corporations depending on the mineral commodity mined and the number of years

of operation. To encourage expansion of established enterprises, Singapore exempts from income tax the increased income resulting from expansion, i.e., new capital expenditure in excess of \$10,000,000 on plant and machinery; the tax relief period covers five years from "expansion day", subject to compliance with certain requirements. Likewise, it grants tax relief to approved export enterprises, i.e., those which manufacture products for export or are engaged in deep-sea fishing for export. Subject to minimum requirements on the value of exports and the ratio of export sales to total sales, the enterprise is given partial exemption on its export profit for 5 years, if not a pioneer enterprise. If it is also a pioneer enterprise the tax relief period extends to 8 years from "production day". Moreover, if the export enterprise incurs fixed capital expenditure of at least S \$1,000,000,000, this is extended to 15 years. Exemption of the export profit is to the following extent: (1) in the case of companies which have exported such products before, 90% of the increased export income over the average annual export profit for 3 years immediately preceding the date application was made for approval; and (2) in other cases, full 90% on a sum to be determined by the Minister. A shipping company likewise may avail itself of exemption from tax on profits derived from operation of Singapore ships. Japan for its part exempts from tax farm income from newly cultivated land and income from the second crop of improved land for five and three years, respectively. Then there is deductibility from taxable income of income from "overseas transactions of technical services" which may be of use for the development of agriculture, forestry, services, etc., in developing countries. These technical services may be in the form of patents and copyrights, processing services, production of plant and equipment, specified technical services for agriculture or fishery, etc. Deductibility from taxable income varies from 3% to 70% of such income from overseas services. In Malaysia an approved company (other than a pioneer company) in the hotel industry may be entitled to "abatement of chargeable income" subject to certain requirements. The abated chargeable

income, varying from 15% to 30% of chargeable income depending on the hotel's classification, is exempt from tax for 12 years.

2. *Liberal Deductions and Allowances (Other than Depreciation)*

Reduction of taxable income may also be effected through liberal deductions for certain expenses and allowances. The Investment Incentives Act 1968, of Malaysia grants several categories of deductible allowances and expenditures, among which are the "investment tax credit" (a misnomer — it is actually a deduction for capital expenditure), the deduction for export promotion expenses, and the export allowance. At least 25% of the capital expenditure incurred by a non-pioneer company for an approved project is deductible during the year of assessment and may be increased by at most 15% if the company meets certain specifications as to location, type of product, and percentage of Malaysian content incorporated in the manufactured product. The so-called export allowance granted only to resident non-pioneer companies, is a deduction from gross income; it is a function of, and directly related to, the increase in exports of manufactured products, wages of employees with basic wage of less than M\$500 per month, and Malaysian raw materials used. Further, under the Income Tax (Promotion of Exports) Rules, 1968, an approved company is allowed deductions from taxable income for certain expenditures which tend to promote non-primary exports significantly. Since these are in addition to deductions normally allowable for income tax purposes, the incentive is in effect a double deduction for export promotion expenses.

The two major incentives laws of the Philippines also grant quite liberal deductions. The Investment Incentives Act allows a deduction for organizational and pre-operating expenses to all registered enterprises over a period of ten years from the start of operations; an additional incentive to export enterprises is double deduction of promotional expenses and shipping costs on their exports of completely finished products. A major deduction under the Export Incentives Act is availed

of by export producers similar to that in Malaysia — this deduction is directly related to the increase in export revenue, direct labor cost, and cost of domestic raw materials and supplies. The maximum amount deductible is 100% of total export revenue for the first 3 years, and 50% for the next 2 years. An export trader is also entitled to a deduction from taxable income of an amount directly proportionate to the increase of its total export sale. Minor deductions may also be allowed as additional incentives under certain circumstances.

3. *Carry Forward of Losses, Capital Allowances and Certain Expenses*

Carry forward provisions in respect of losses, capital allowances and specified expenses previously incurred have also been incorporated in incentives measures to mitigate taxable income and hence income tax liability during the accounting period when profit is made. The Philippines allows a registered enterprise in preferred areas to carry over its net operating loss incurred in any of the first 10 years of operation, for a period of 6 years immediately following the year of such loss. A registered export producer or trader is also entitled to either a net operating loss carry-over or additional deduction from taxable income if it uses a new brand name for an export product that distinguishes it from those manufactured or processed outside the Philippines. Vietnam gives the same privilege of loss carry-over to (approved) domestic and foreign enterprises for a period of up to three years following the deficit year. Indonesia, Malaysia and Singapore, which grant exemption from income tax for specified enterprises, allow losses incurred during the tax relief period to be carried over and set off against profits of the post-tax relief period. However, in Singapore the loss that may be carried forward is only to the extent of the balance of unabsorbed allowances for wear and tear.

It is interesting to note that in Malaysia the income of a pioneer company during its tax relief period is ascertained without making any deduction for depreciation. Thus, fixed capital expenditure on any type of asset incurred during the

period is deemed to have been incurred on the day following the end of the tax relief period. "Where a loss is incurred for the whole of the tax relief period, notional capital allowance shall be calculated for each year of assessment concerned, and the aggregate of such notional allowance shall be allowed as deduction for the first year of assessment after the end of the tax relief period. The residual expenditure shall then be deemed to have been incurred on the day following the end of the tax relief period, thus qualifying for annual allowances (but not initial allowance) in respect thereof."¹ In Singapore, a pioneer enterprise can carry forward its wear and tear allowance to the post-tax relief period only when the fixed capital expenditure incurred during the tax relief period is at least S \$1,000,000. Finally, also in Malaysia, a pioneer company's export promotion expenses incurred during the tax relief period are allowed as deductions, over and above the usual deductions allowed for income tax purposes. Such deductions are not made during the tax relief period, but instead are accumulated and carried forward to the first basis period in the post-tax relief period. Hence, where the depreciation of the tax relief period is set off against the profit of the post-tax relief period, as in Malaysia and Singapore, the exempt profit made during the tax relief period is not diminished by the wear and tear allowance.

It is thus easily seen that of the five countries offering the carry forward incentive, Malaysia is the most generous, allowing as it does, pioneer companies to carry over to the post-tax relief period three types of deductions, namely: losses, capital consumption allowances, and export promotion expenses actually incurred during the tax relief period.

D. Tax Credit

Another device by which tax liability may be mitigated is through a tax credit, which involves a reduction in the tax due by the amount of the credit. This does not seem a common-

¹ "Fiscal Incentives for Investment in Malaysia," Position Paper presented by the Malaysian Delegation in the Conference of the Study Group in Asian Tax Administration and Research, February 14-21, 1971, Manila.

ly accepted incentive; only the Philippines and Japan make use of it. Malaysia's investment tax credit mentioned earlier is a misnomer, because it actually consists of a deduction from taxable income for capital expenditure incurred. Among the major tax credits granted by the two most recent incentives laws of the Philippines, is the tax credit on domestic capital equipment and spare parts equivalent to 100% of compensating tax and customs duties that would have been paid on equivalent imported machinery, under certain conditions. At the same time, a credit equal to 50% of such taxes and duties is also given to the domestic fabricator or manufacturer of such equipment. As an added incentive for exports of completely finished products, the Investment Incentives Act entitles a registered enterprise to a special tax credit on raw materials equivalent to 7% of the total cost of raw materials and supplies purchased, or an amount equivalent to the taxes actually paid by the enterprise on such raw materials, whichever is higher, to the extent used in the manufacture of the export products. On the other hand, under the Export Incentives Act an export producer is given a tax credit equivalent to the sales, compensating and specific taxes as well as duties on supplies, raw materials and semi-manufactured products actually used in the manufacture of its export products and forming part thereof. Such credit may be claimed for a ten-year period and is in lieu of the drawback. The same law grants tax credit to an export trader equivalent to the specific and sales taxes on the products bought from a registered export producer and which are subsequently exported. Further, if an export producer sets up necessary infrastructure works, it can claim a tax credit equivalent to 100% of the value of such infrastructure works, provided the title is then transferred to the Philippine government upon completion.

The emphasis placed by Japan in research and development is reflected by the tax credit on the excess of research and development expenses incurred during the period over the largest amount incurred in any preceding accounting period. The credit is 25% of such excess against the corporation tax,

but not to exceed 10% of the tax, until the accounting period beginning on or before March 31, 1972.

E. Protection of Domestic Production

About half of the countries included in the study recognize the importance of giving protection, in one form or another, to the domestic products made by the enterprises covered by their incentive programs. Laos guarantees protection to products manufactured by enterprises under license or convention for a maximum of five years from the date of issuance of the decree granting the special system. Such protection, either through increase in customs duties on, or prohibition of, similar imports, may be granted only after certified advice to the Investment Commission. Moreover, these enterprises are also guaranteed the additional advantage of preferential orders from the Administration in so far as these products are comparable in price and quality to similar imported products. Similarly, Thailand is committed to impose protective import duties and import restrictions on competing products upon discretion of the Board of Investment. Singapore guarantees preferential government buying of local products, which applies even where prices of such local products are slightly higher than those of competing imports. The Philippines guarantees protection from government competition and anti-dumping protection to registered enterprises and in addition, post-operative tariff protection to pioneer enterprises.

F. Establishment of Reserves

A feature of the Japanese investment incentives scheme that makes for its uniqueness is that which allows certain enterprises to establish reserves; the amount accruing to the reserve is deducted as an expense at the end of the accounting period. Along with special depreciation, reserves are intended to promote savings of enterprises. "Though the policy objective differs from one reserve to another, any reserve may be regarded as corporate savings because of its same effects

as tax deferment or interest-free governmental loan."² The major reserves in effect are as follows:

- a. Reserve for price fluctuations
- b. Structural improvement project reserve for small and medium-sized enterprises
- c. Drought reserve for hydroelectric power plants.
- d. Unusual risk reserve for insurance companies, etc.

Japan being a capital-exporting country, the government encourages Japanese investment in developing countries of Asia by sharing or minimizing the risk and cost involved in investments abroad. Hence, two types of reserves, namely the reserve for overseas investment loss and the reserve for petroleum development loss have been authorized; these are provisions for losses in capital investments in overseas developing areas and are deductible as expenses.

III. ON REINVESTMENT OR PLOUGHING BACK OF PROFITS

Four of the countries studied include in their incentives programs an encouragement for existing enterprises to plough back their profits for expansion and improvement. In Indonesia approved national and foreign capital enterprises in priority areas are provided remission of tax on reinvested profits for a five-year period. Laos grants to enterprises under license exemption from profits or general income tax on that amount of industrial and trading profits used for a new investment carried out in the country, which contributes directly to the increase of production. This investment must be made within a maximum of two years reckoning from the end of the fiscal year during which such profits were realized. "New" investment may refer to the establishment of

² "Incentive Measures to Promote Investment in Japan," Position Paper of the Japanese Delegation, presented during the Conference of the Study Group on Asian Tax Administration and Research, February 14-21, 1971, Manila.

a new enterprise with new capital, the expansion of the exempted enterprise or another, or the association of old and new capital. In Vietnam provisional exemption from tax of undistributed profits is allowed, where these profits will constitute built-up reserve funds for increased capitalization or expansion of existing plant. The amount of these reserves thus provisionally exempt from the profit tax is subject to a maximum of 25% of the net income of the fiscal year. The enterprise which has built up such reserve funds within three months from the end of the fiscal year submits its capital increase or expansion program to the Investment Commission. After the latter has reviewed the program, tax exemption then becomes definite for the fiscal year. A deduction from taxable income by the full amount of reinvested profits can be made by preferred enterprises and registered export producers in the Philippines. This deduction is equivalent to the exemption of such reinvested profits from income tax, as in Laos. Similarly, shipping firms are given exemption from tax on income derived from overseas shipping and construction of vessels for overseas service until September 9, 1975, provided all net profits realized during the period shall be invested in the construction, purchase or acquisition of vessels and equipment for expansion and/or improvement.

IV. INCENTIVES TO INDIVIDUAL INVESTORS

Also covered by the incentives designs of most of these Asian countries are individual investors or shareholders in the enterprises which are being promoted. The most common incentive in this category is the exemption from tax of dividends or profits distributed by the promoted enterprises. There is invariably a parallel between the income tax holiday of the enterprise and the exemption from income tax of dividends in the hands of shareholders. Thus, except for the Philippines, all these countries which provide relief from income tax to selected enterprises, also exempt from tax that portion of income or profits distributed to shareholders. This is true for Indonesia, Laos, Malaysia, Singapore, Thailand, and South

Vietnam. In Laos, the tax rate on such income is reduced by only half for a shareholder of an enterprise under license, which is the "less favored" special system.

Exemption from the tax on capital gains is another benefit derived by an individual investor. This obtains in Indonesia and the Philippines. In the latter, capital gains are allowed a basic exemption from capital gains tax of Rp. 50,000. The concession by the Philippines is exemption from tax of that portion of capital gains (i.e., proceeds from the sale, disposition or transfer of capital assets) that corresponds to the portion of the proceeds that is invested in new issues of capital stock of a registered enterprise within six months from the date of realization. To avail himself of this exemption, the investor must not dispose of such shares of stock within five years from the date the investment was made. More favorable treatment is accorded to investment made by a Philippine national in new issues of capital stock of, or in the purchase of stock owned by foreigners in, pioneer enterprises. The required holding period is shorter, that is, three years. While normally the purchase of secondary issues does not qualify for the capital gains tax exemption, the purchase of stock by a Philippine national from a foreigner is encouraged to promote Filipino ownership of a pioneer enterprise. Gains realized by a Philippine national from the sale of stock dividends issued by a pioneer enterprise are also exempt from income tax, provided the sale or transfer is made within seven years from the date of registration of the enterprise. Finally, deduction from taxable income may be allowed a Filipino investor for investment in original or increased capital stock of a pioneer enterprise, whether the investment is paid in cash or property. The maximum amount of investment deductible is 10% of taxable income. The shares must be purchased within 7 years from date of registration of the pioneer enterprise, and held for not less than 3 years.

V. OTHER INCENTIVES

Some countries also grant incentives to owners of resources and factors employed or used by enterprises such as to em-

ployees and workers, lenders of investment funds, etc. For instance in South Vietnam there has been granted a two-year exemption from tax of salaries and emoluments paid by the approved domestic or foreign enterprise to technicians recognized by the Investment Commission as indispensable for the functioning of the enterprise. A registered enterprise in the Philippines is entitled to a tax credit for tax withheld on interest payment on foreign loans. Such incentive is premised on the assumption that the tax on interest is passed on by the foreign lender to the enterprise. The conditions are that the lender-remittee does not enjoy a tax credit in his country and that the enterprise has assumed the tax liability. In effect the credit constitutes a rebate to the enterprise for the tax paid on such interest payment. In Singapore if an enterprise in any industry contracts an approved foreign loan for the purchase of productivity equipment, the non-resident lender will be exempt from the 40% tax on interest, which is normally withheld by the company. A related incentive in respect of foreign investible funds is full exemption from tax of interest earned by non-residents on their deposits in Singapore banks. The entry of foreign loanable funds in Japan is given the following inducements: (1) The interest (including redemption premiums) paid on private foreign currency bonds with maturity of at least 5 years is exempt from tax; and (2) The tax rate on interest payable on loans from foreign financial institutions in foreign currencies is reduced to 10%.

VI. SUMMING UP AND POLICY IMPLICATIONS

A. The fiscal incentives that are of universal acceptance among the eight Asian countries are in the nature of tax concessions. In turn, the concessions granted to business enterprises which hold widest appeal are exemptions from income tax and customs duties, except in Japan and Malaysia, respectively. The income tax holiday (i.e., full exemption from income tax) may be from two to eight years, except in the Philippines, where it is indefinite. The waiver of customs duties usually starts from the time of entry or registration and extends up to the period of ope-

ration, usually for a limited number of years. Next in terms of popularity are special depreciation and carry forward of losses.

On the other hand, the most common tax incentive to individuals and other shareholders of the enterprises being encouraged is exemption of dividends paid out of the exempt income. This is true for all the countries granting relief from income tax, with the exception of the Philippines. The latter has opted for an investment allowance and exemption from the capital gains tax to investors under the Investment Incentives Act and the Export Incentives Act, since both laws do not provide outright relief from income tax.

Reinvestment or ploughing back of profits does not seem to get popular encouragement — only half of these countries, namely, Indonesia, Laos, the Philippines, and South Vietnam give some inducement for this purpose, in the form of remission of tax on income or profits.

Invariably, export-oriented industries and/or those which earn foreign exchange substantially are among the most favored in the incentives programs. Along with relief from income tax, the most common tax concession is remission of customs duties on equipment and machinery, and raw materials used in the production of export commodities.

- B. The Asian countries included in the study, possibly with the exception of Japan which is a capital exporter, are locked in the race for precious investment, especially foreign investment. There is a compulsion to outbid each other or at least to follow suit in the grant of tax concessions.
- C. There is need for a regional cooperative body or forum of some sort through which unnecessary and undesirable competition for investments through tax concessions may be minimized. In an effort to equal or surpass the other's generosity, a developing country is willing to grant major

concessions which, it hopes, will sway in its favor the investor's decision as to location of enterprise. Developing countries, however, may unwittingly incur losses in terms of public revenues foregone through such concessions under any of the following situations: (a) if the investment was actually forthcoming anyway even in the absence of the concession; (b) where the concessions may be more than adequate to induce the specific investment; (c) where the tax concessions play only a minor role in generating the desired investment and may very well be a red herring device; and (d) where the concessions serve as an avenue for tax avoidance and/or evasion.

- D. Japan which holds the unique position of being a capital-exporter among the Asian countries, also has a unique incentive scheme, one that places emphasis on the crucial role of savings. The significant incentives offered, special depreciation and establishment of reserves, therefore, are mainly designed to encourage savings rather than to promote new investments. Save for complete or partial exoneration from customs duties, there is no major tax concession which has the effect of mitigating tax liability. Because Japan stands least in need of promoting new investment, its fiscal incentives are understandably the least liberal in the group.
- E. On the overall, the Philippines stands out among the group as the most liberal in the grant of fiscal incentives. It is the only country which allows exoneration from all taxes in several presumably preferred areas; likewise it alone gives exemption from income tax without any definite statutory date of expiration.

The two major incentives laws, the Investment Incentives Act and the Export Incentives Act, which are among the most generous, have shunned from granting outright relief from income tax. However, a closer look at the tax concessions by both laws reveals all too clearly that in some cases such exemption could just as well have been given, because the deductions and the tax credits

have the effect of virtuality eroding the income tax payable. For instance, under the Investment Incentives Act a pioneer export enterprise is in effect liable only to income tax and whatever customs duties are due on imports not qualifying for exemption, if there are any. However, with the diminution of the taxable income through the various deductible expenses, and with the application of the tax credit against the income tax, the enterprise may not have to pay any tax at all. The Philippines is the only country among the eight which allows deductibility of organizational and pre-operating expenses, double deduction of shipping costs, and tax credit on domestic capital equipment and on raw materials and supplies or taxes paid thereon.

- F. The Philippines has a proliferation of tax concession laws, whereas the other countries have consolidated their incentives in one or, very rarely, three laws at most. In the former, there are no less than thirteen special laws granting major tax concessions to specific industries or groups of industries. The situation wherein tax concessions to a number of industries are governed by their own separate laws rather than incorporated in the two major statutes, arises from, and at the same time results in, a fundamental failure to view such industries within a unified framework of incentives. These have therefore been considered apart from, as it were, the overall investment incentives program. There has been no attempt to place them within the purview of a comprehensive investment incentives design, such as by way of comparing the concessions they enjoy with those granted to industries governed by the two investment incentives laws. One is compelled to ask the uneasy question: Which of these concessions have been granted or are still enjoyed due to politics, or to rational policy?
- G. This comparative review of fiscal incentives in Asian countries in terms of nature and range of incentives, their scope or areas covered, and their depth and duration, must

be only a prelude to a more comprehensive study — one that will examine in depth the effectiveness of incentives and concessions granted, both on a national and a regional scale. The incentives can be meaningful only in so far as they yield the desired results. That is, they can be properly evaluated only when put to the efficiency test, which means reckoning on one hand, the opportunity cost (in terms of administrative costs and revenues foregone) of the incentive program and on the other, ascertaining the benefits, by way of measuring the desired increase in investment and its effects on the level of employment, production, foreign exchange earnings, etc. All these will have to fall back on solid, up-to-date statistical data. These should include statistics on the pattern of investments in the areas sought to be encouraged compared with that in which no incentives have been granted; employment and payrolls; growth, direction and composition of exports and imports; domestic production; use of indigenous raw materials and supplies; foreign exchange earnings generated, etc. Moreover, it will add teeth to these statistics if a survey is conducted of producer response to the incentives scheme in general and to specific incentives in particular. While the results must necessarily be taken on a *caeteris paribus* assumption, an inquiry of this nature can serve as a fairly reliable indicator of the extent to which these incentives influence investment decisions of potential and existing investors.

The empirical studies suggested are indispensable in evaluating the role of fiscal incentives. A rational industrialization program that incorporates tax and other concessions must be built on more solid grounds than mere intuitive hopes and expectations that the incentives will generate the desired investment. It is imperative that an inquiry be made as to whether the right types of incentives are being given in the right doses. Fiscal incentives, particularly as they constitute in the main, tax concessions, can impose a deadweight burden on development.

- H. Finally, it is well for a government to keep in mind that there are other factors which may in fact be more crucial than fiscal incentives, such as: political stability, size of the market, adequacy of transport and communication facilities, efficient administrative machinery, honesty and competence of public officials, etc. It is fatuous for a developing country to devise an ingenious incentives design that incorporates a host of inducements and guarantees if it cannot guarantee a basic precondition for investment — freedom from the uncertainties of a corrupt government.

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