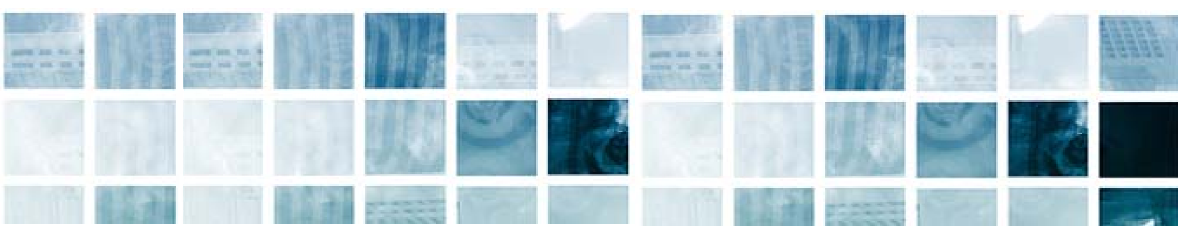

The upcoming AEC prompts rethink of thailand's tax approach

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In a globalised world like we're in today, going it alone is not a good idea. Few countries have the ability to bargain with others in the international arena on a one-on-one basis or to share with their neighbours resources such as geographical advantages, public facilities, raw materials, trade quotas, skilled labour, and tax and duty systems. This applies to Thailand and its fellow members of the Association of Southeast Asian Nations (Asean).

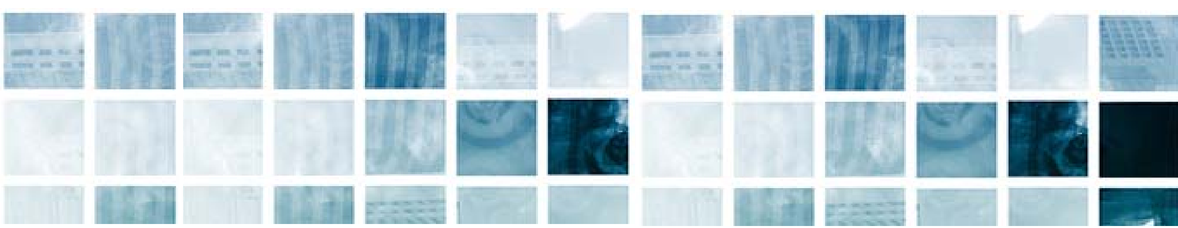
With a population of around 600 million, Asean ranks fifth worldwide in terms of purchasing power. Nonetheless, loose integration over the past four decades has not resulted in full efficiency. Trade within Asean accounts for only 20% of their total trade, compared to 50% on average in other integrated economic communities.

This means that more economic integration could increase trade among member countries, as well as their competitiveness with other parts of the world. This is why the 10-member bloc is pursuing the formation of the Asean Economic Community (AEC) in 2015. The AEC would offer a free flow of trade, investment and capital. The priority areas for integration are food, agriculture and forestry, competitive economic region (competition policy), consumer protection, intellectual property rights, infrastructure development (transport cooperation, information infrastructure, energy cooperation, mining cooperation, financing of infrastructure projects), taxation and e-commerce.

As for taxation, the AEC blueprint merely states that the member states have to "complete the network of bilateral agreements on avoidance of double taxation among all member countries by 2010, to the extent possible". In our view, the existence of the double-taxation agreements can never help strengthen the AEC. What counts is the proper use of them. In fact, the domestic tax system needs to be reviewed as well to ensure that other Asean countries will not take advantage of the flawed system.

Many foreign investors residing in countries that do not have double-taxation agreements with Thailand, or residing in countries with less favourable double-taxation agreements, have claimed tax benefits by means of "treaty shopping". The most popular structure is to opt for doing business with Thailand through a country for which a double-taxation agreement with Thailand allows tax exemptions or reductions on income that should have been taxed at a normal rate. Thailand, through ignorance, whether intentional or unintentional, allows the broad use of treaty shopping, especially for transactions in capital market.

Perhaps it is time for the kingdom to reconsider it if we want to maintain the policy of taxing capital gains from investment in the stock exchanges or to provide a permanent exemption in the provision of the laws to attract more foreign investors to the capital



market. The former requires careful thinking, especially if the government should take any step to prevent an abuse of the country's tax treaty network. The latter is far more sensitive, as it will result in the erosion of the income tax base, under which the rich should have paid tax. Hence, measuring the benefits that the country will receive or forgo in each scenario is a significant process before 2015.

Some high-ranking officials have also floated the idea that perhaps Thailand should change its tax system from the so-called "residential country" (whereby worldwide income of a Thai company is currently taxed in Thailand) to a "source country" (whereby only income sourced in Thailand will be subject to Thai tax) in order to encourage offshore investment.

The more extreme approach is for Thailand to permanently abolish income tax at the shareholder level, which consists mainly of dividends. The move will completely change the tax system from the current two-tier to one-tier _ only income tax at the corporate level.

There are a number of actions to consider and implement before the full integration. Many countries in Asean have already focused on a customs union, which will abolish customs duties within the domestic market of each Asean country. Goods from outside Asean will be subject to customs duties when they are imported into the Asean market. However, once imported into Asean, they will become goods in "free circulation" and can move around Asean countries tax-free. This is one of the big advantages for the AEC. Customs duties are being reduced substantially and could become zero soon after the full implementation of the AEC.

If we look at the European Union (EU), it has long had a customs union in place. So, the case study of the EU Customs Union should be a good precedent for Thailand to follow and to determine the economic consequences of free circulation.

In the next article, we will discuss more about the AEC impact on the Revenue Code.