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Asian Tigers: comparison of their tax systems' attractiveness for foreign direct investments

Topic and Research Question

This research paper addresses the issue of tax systems (as a whole as well as their particular components) in reference to the foreign direct investments flows within four East Asian countries, commonly called Asian Tigers. There has been made an attempt to answer the question, which country (Hong Kong, Taiwan, Singapore or South Korea) has the best constructed tax system, when it comes to the attraction of foreign direct investments (FDI). Therefore, throughout the paper there have been crystallized suitable criteria that allowed the appropriate analysis of the existent fiscal policies within the aforementioned regions. There has been made an attempt to find some patterns with regard to the amount of inward FDI and consequently there have been made final comparisons and conclusions. The main research question reads as follows:

Which one of the four Asian Tigers has the most investors-oriented/friendly tax system?

State of the Art

The state of the art regarding the influence of the taxation systems on the FDIs is very rich and simultaneously outstandingly heterogonous - beginning with the models implying that taxes have only a minor impact on attracting foreign direct investments, up to the ones stating that it can be a decisive factor, especially when other circumstances in the analyzed host countries are similar. Going through the whole spectrum of opinions, there are representatives of the view, that tax systems play only a negligible role in investors' considerations regarding the choice of location for their future FDIs, yet there are many supporters of the view, that this influence is significant. The first group constitutes a minority and is represented, inter alia, by Hartman (1981) and Beyer (2002). Opposed to those views, there is a significant group of researchers favoring the opinion that taxes are of a great importance when attracting FDI. Those are among others Benassy-Quere et al. (2005), Asano (2010) or Desai et al. (2004).

Methodology and Approach

For the needs of this paper, a framework constructed upon the content of a scientific article written by Jacques Morisset and Neda Pirnia has been used. They state that the host countries implement a whole variety of mechanisms serving to attract FDI, as they realize how beneficial such investments might be to their economic development and general welfare. Each of the chosen countries that comes under scrutiny has been analyzed with regard to the relative attractiveness of the following components of its tax system:

Corporate tax → ***low rate on a broad base*** → ***tax holidays*** → ***tax allowances*** → ***investment tax allowances***
Exemptions from: → ***local taxes*** → ***custom and excise duties***
Write-offs for investment expenditures
Change of the whole fiscal system (decreasing the effective tax rate)
Becoming a tax haven
Export Processing Zones
Harmonization of tax systems
Bilateral tax treaties

There has been also made an attempt to investigate, whether host countries respond to the tax avoidance strategies of the companies and how effective such counteracting is. For the purposes of this paper there has been used the mix of descriptive, comparative and explanatory research methods.

Main Facts

Hong Kong: The corporate tax rate is among the lowest ones in the region. Capital gains, offshore profits, bank deposit interests and dividends are non-taxable. There is offered a wide range of preferential tax treatments such as lowered tax rates, tax exemptions and alike. The biggest share of the tax incentives is targeting financial sector, R&D, know-how acquisition, environmental friendly technologies, vehicles etc., attracting much foreign capital to those areas. In Hong Kong there are only few local taxes and they are generously endowed in exemptions. Hong Kong is also known as one of the world's most known free ports and a tax haven.

Taiwan: The taxation system in Taiwan is characterized by being both taxpayer-friendly and simultaneously somehow complex due to the constant changes in the legislation. The corporate tax is among the lowest ones in the region; however, there is a profit retention tax and income basic tax, which cause much confusion among taxpayers. There are numerous tax exemptions and tax holidays available, which target among others R&D, automated production equipment and technologies, clean energy sector etc. Custom and excise duties regulations are particularly complex, burdensome and almost no exemptions are available. However, a crucial advantage of Taiwan is the fact that there are located several export processing zones on its territory.

Singapore: Singapore has an extremely friendly tax system from the investors' perspective, characterized by the relatively low corporate tax rate and numerous tax incentives. There are available tax holidays and exemptions granted to companies investing in manufacturing, services, maritime sector, trade, financial services and R&D. The other meaningful incentive targets start-ups (Start-up Tax Exemption scheme). Singapore is a free port, thus boosting import and export activities. Additionally, there is a contentious issue of being perceived as a tax haven.

South Korea: South Korean tax system is perceived as relatively complex and undergoing continuous reforms. Although the government has realized the importance of taxes as a tool serving the attraction of the foreign capital, seemingly it puts more emphasis on using it to regulate its inner economic situation. The top corporate tax rate is 24.2%. Investors can count on some exemptions and tax holidays, particularly within the free economic zones it has established. Those target mainly enterprises in a field of technological innovations. To the investors' detriment, many of the incentives have been abolished due to the deterring fiscal situation and decreasing tax revenues to the national budget. South Korea can be perceived as very export and import friendly, as it has one of the lowest duties worldwide.

Results

The analysis shows that each of the Asian Tigers has some strong and weak points. Though, it can be easily stated that the South Korean tax system is the least friendly one for investors. Although it has a strong advantage in form of export processing zones and numerous bilateral tax treaties, its complicated regulations accompanied by frequent changes, relatively high tax rates and few preferential tax treatments, classify South Korea as the least favorable place for foreign investors. Taiwan performs somehow better. It offers a broad range of tax exemptions, tax holidays, export processing zones and very low effective tax rate. It performs badly in terms of introduction of additional taxes and intricate legislation. Hong Kong and Singapore are both characterized by very liberal attitudes reflected in extremely friendly fiscal policies. They definitely outperform their competitors in terms of legislation clarity, well targeted tax incentives, low tax rates, very few types of taxes imposed as well as by the fact that they are (or are perceived) as tax havens, thus allowing tax savings. Hong Kong is extremely attractive for investors, but because it perceives its tax system as very favorable in general, it does not introduce additional incentives targeting very specific kinds of investments. Singapore is also characterized by a very investors' friendly environment, however it shapes this situation more consciously. Namely, it specifically targets chosen industries by the use of fiscal tools so as to redirect the foreign capital to the sectors it considers important.

In an attempt to rank the four Asian Tigers in accordance to the degree of their tax systems' friendliness towards investors, both Hong Kong and Singapore would be ranked first, Taiwan right after as a third one and South Korea much behind on the last place.

References

All references can be found in the full version of the MA thesis available at http://othes.univie.ac.at/

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Examination Date: 08.01.2016