

**UNITED NATIONS WORKSHOP ON  
TAX INCENTIVES AND  
BASE PROTECTION**

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<http://www.un.org/esa/ffd/>

**TAX INCENTIVES:  
PROTECTING THE TAX  
BASE**

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## Overview of Presentation

- Introduction to tax incentives

of tax incentives

tax incentives

orative considerations

tems in developed countries on  
effectives of tax incentives in

project change the tax  
incentives?

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## Introduction to Tax Incentives

- What are tax incentives?

overnment play in encouraging

s and costs of using tax

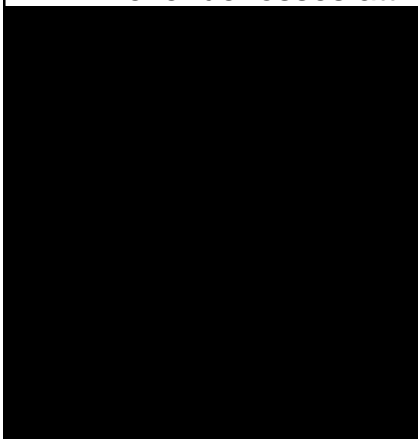
se decisions where to invest?

a desirability of tax incentives?

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## Definition of Tax Incentives

➤ “Revenue losses attributable to provisions of the tax law which allow special exclusion, exemption, or deduction from gross income or which provide for preferential rates of tax or a deferral of tax” (Congressional Budget Act of 1968)



...of which is not part of the tax in question but has been included in the tax code for some extraneous

## Prevalence of Tax Incentives around the World (James 2013)

	Number of Countries Surveyed	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	VAT exemption/reduction	R&D Tax Incentive	Super-deductions	SEZ/Free Zones/EPZ/Free port	Discretionary process
East Asia and Pacific	12	92%	92%	75%	75%	83%	8%	83%	25%
Eastern Europe and Central Asia	16	75%	31%	19%	94%	31%	0%	94%	38%
Latin America and the Caribbean	24	75%	29%	46%	58%	13%	4%	75%	29%
Middle-East and North Africa	15	73%	40%	13%	60%	0%	0%	80%	27%
OECD	33	21%	30%	61%	79%	76%	18%	67%	27%
South Asia	7	100%	43%	71%	100%	29%	57%	71%	14%
Sub-Saharan Africa	30	60%	63%	73%	73%	10%	23%	57%	47%





## More purported benefits

- Symbolic
  - Signal foreign investors that country is an “investor-friendly” jurisdiction
  - Adequate tax systems
  - Accelerated depreciation
  - Other externalities
  - Arbitration resolution procedures, etc.

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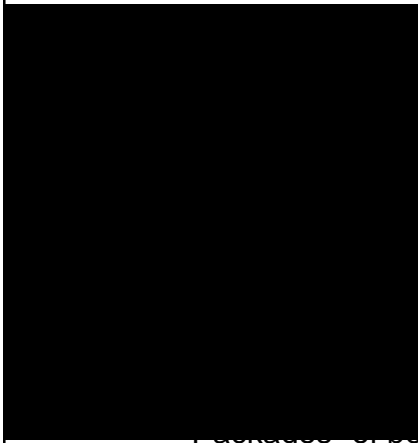
## Costs of Tax Incentives

- Erosion of tax base
  - Investments that would have taken place even without tax
- Distortions (incentives to other activities or other types of investments)
- Shifting of tax bases (labor, capital, etc.)
- Increase tax burden on non-qualifying activities
- Rent seeking activities
- Attraction of investors
- Create opportunities for corruption (at the bottom)

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## Estimates of Direct Costs of Tax Incentives

- Tax expenditure budgeting



estimating the costs of a particular tax

number of taxpayers covered by the

costs, compliance and enforcement

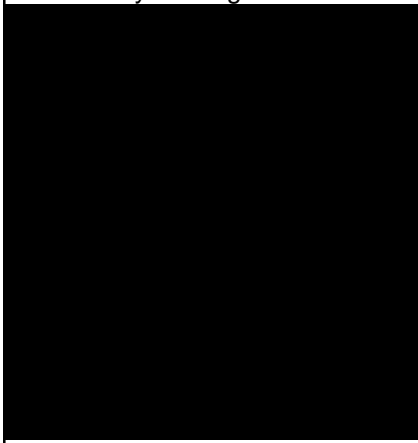
data requirement

limitations of behavioral assumptions

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## What Has Changed in Recent Years?

- Although tax incentives may have been ineffective in the past, this may no longer be true



more generous than in past years

better targeted and better designed

globalization and greater capital mobility

tax cuts, the significance of taxes in  
has increase

ed

international structure, production and

, and types of products being

old

markets, custom unions and free-trade

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## Political Economy of Tax Incentives

- Why do countries continue to use tax incentives in light of the mostly [redacted] of their effectiveness?

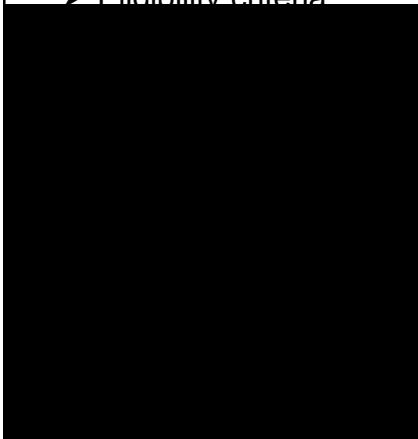
[redacted] something to improve economic growth—tax [redacted] easy to adopt and costs are less

[redacted] economic elite seeking to minimize tax liability)  
[redacted] nment agencies seeking to maximize the  
[redacted] ents without major concern for tax revenue)

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## Design Considerations for Tax Incentives

- Eligibility criteria



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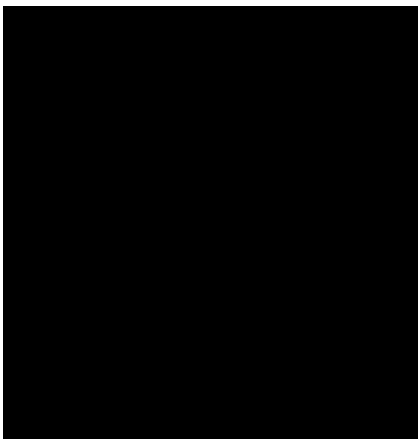
ing requirements

provisions

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## Administrative Considerations

- Which agency makes decisions?











## Specific Design Considerations (Tax holidays)

### ➤ Determination of start date

–from which taxes

g requirements

ecapture provisions

preciation provisions

et operating loss provisions

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## Determination of Start Date

### ➤ Alternatives

proved

ness” or “begin production”

profitable (current tax period)

profitable (cumulative basis)

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## Scope of Holiday

### ➤ Eligible taxes

es  
axes  
duties and export taxes)  
preferential treatment)

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## Filing & Reporting Requirements

### ➤ Reporting requirements

forms for firms operating under tax  
n required  
ation (to monitor compliance with  
ays)  
on (to allow estimation of costs of  
ons)  
sactions (to assist in identifying

<p>➤ Do tax holiday provisions or regulations:</p> <p>[Redacted]</p>	<p>on treatment during holiday</p> <p>depreciation or “minimum” ation</p> <p>tion of property acquired during er holiday period is over</p> <p>ure of depreciation upon erty</p>	<p>27</p>



## Top 10 Abuses of Tax Incentive Regimes

1. Existing firms transform to new entities to qualify for incentives.
2. Domestic firms restructure as foreign investors.
  - with related entities (sales, services, loans, contracts).
  - investments (lack of recapture rules).
  - income (or defer deductions) at the end of a
  - for depreciation, tax credit, or other purposes.
  - credits -- fictitious employees and phony
  - into domestic economy.
  - incentives and Enterprise zones – divert region or zone.
  - qualifying activities into qualifying activities.

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## Summary Principles to Design and Implement Tax Incentives (Bird 2008)

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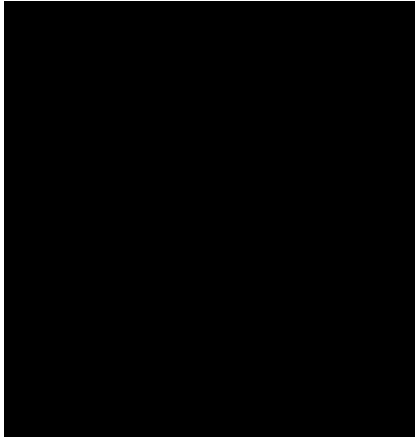


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**OECD Draft Principles to Enhance the Transparency  
and Governance of Tax Incentives for Investment in  
Developing Countries**

1. Make public a statement of all tax incentives for





## Revenue Transfer from Developing Countries to Developed Countries

- Simple model: foreign investor invest directly in a developing country either through a branch or through a subsidiary. The investor immediately repatriates any profits. The tax liability of the foreign investor is not reduced. Taxed on their world-wide income. The investor is not allowed a credit for foreign income taxes. The investor's aggregate tax liability unchanged. Tax revenue in the developing country but increased tax revenue in the developed country. The investor likely transfers tax revenues from the developing country to the developed countries (UNCTAD 2000)

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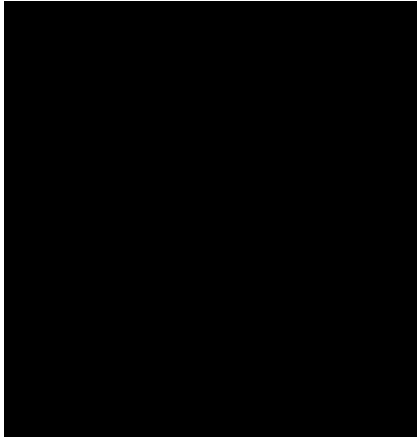
## Revenue Transfer Argument Likely Overstated

- Many developed countries tax residents under a "territorial" approach. The tax system provide for no "current" tax liability on income from foreign operations until the income is repatriated. Corporations can structure activities to minimize tax liability. Tax planning opportunities exist. Tax arrangements can be used to shift tax revenue from the developing country to the developed country.

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## Continuum of Types of International



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## Possible Tax Reform in US May Influence the Economic Benefits of Tax Incentives to Investors

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- Several proposals in the US eliminate deferral of active subsidiaries and impose a “minimum” income

