

Regulatory framework for tax incentives in developing countries after BEPS

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A NEW MODEL OF GLOBAL GOVERNANCE IN INTERNATIONAL TAX LAW MAKING



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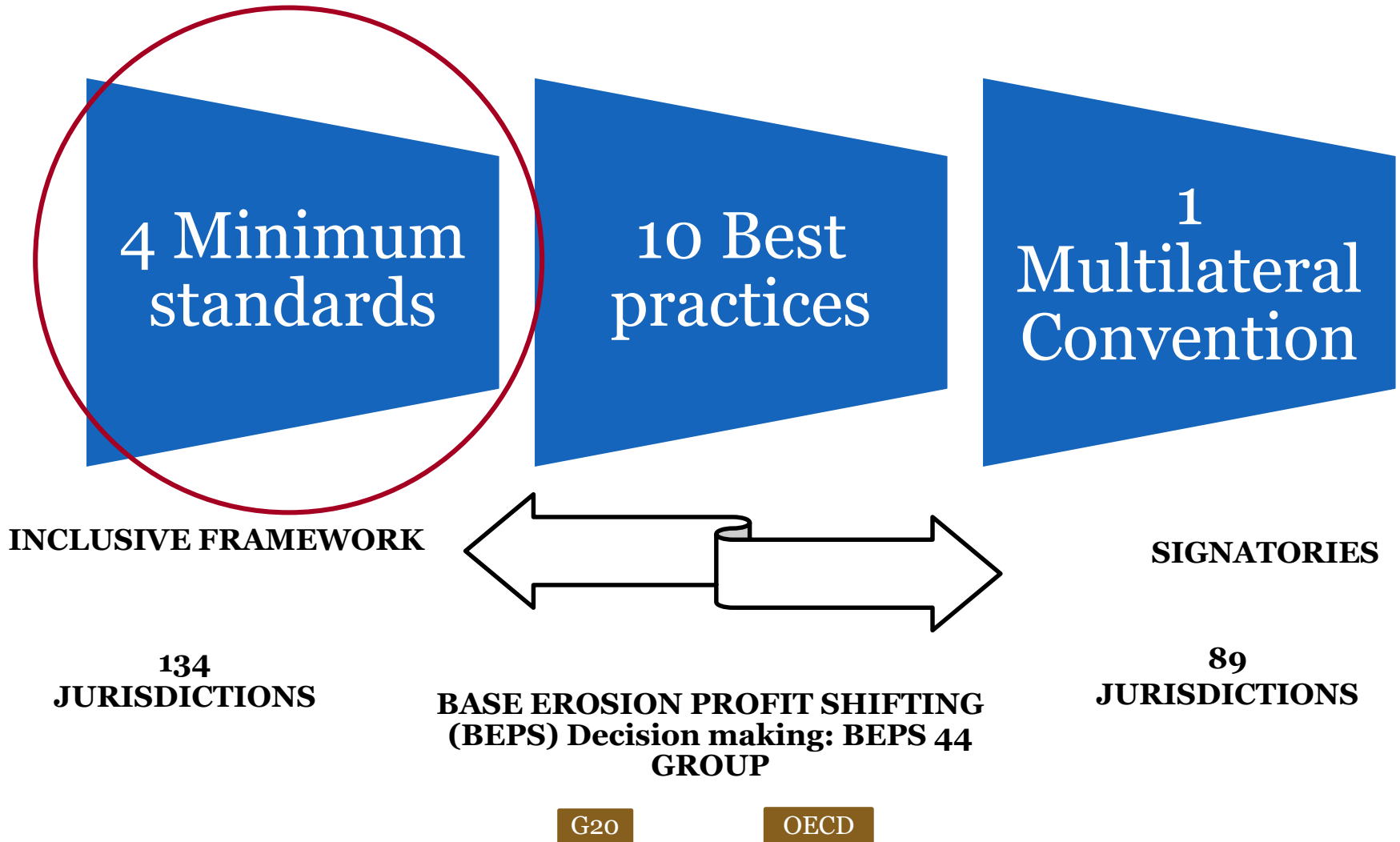
A New Model of Global Governance in International Tax Law Making

- Research Project awarded Starting Grant by the European Research Council

The ERC Starting and Consolidator Grants are part of the main ERC frontier research grants 2019 funded by the European Union's Horizon 2020 Framework Programme for Research and Innovation. The ERC's main frontier research grants aim to empower individual researchers and provide the best settings to foster their creativity. Scientific excellence is the sole criterion of evaluation.

- Period February 2018- January 2023
- Team
 - Principal Investigator Irma Johanna Mosquera Valderrama
 - PhDs researchers
 - Postdoctoral researcher
- Host Institution: Institute of Tax Law and Economics, Leiden University, the Netherlands

TAX GOVERNANCE – OECD and G20



TAX GOVERNANCE: EU AND THIRD COUNTRIES

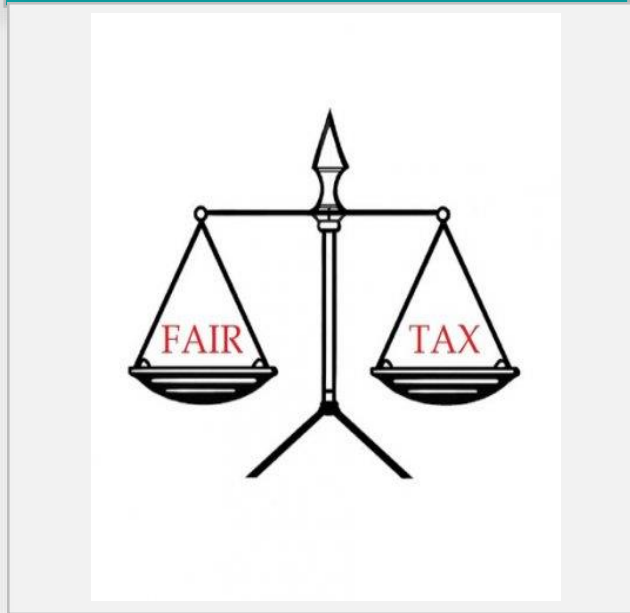
Anti-Tax Avoidance Directive (1 and 2)



State Aid Investigations



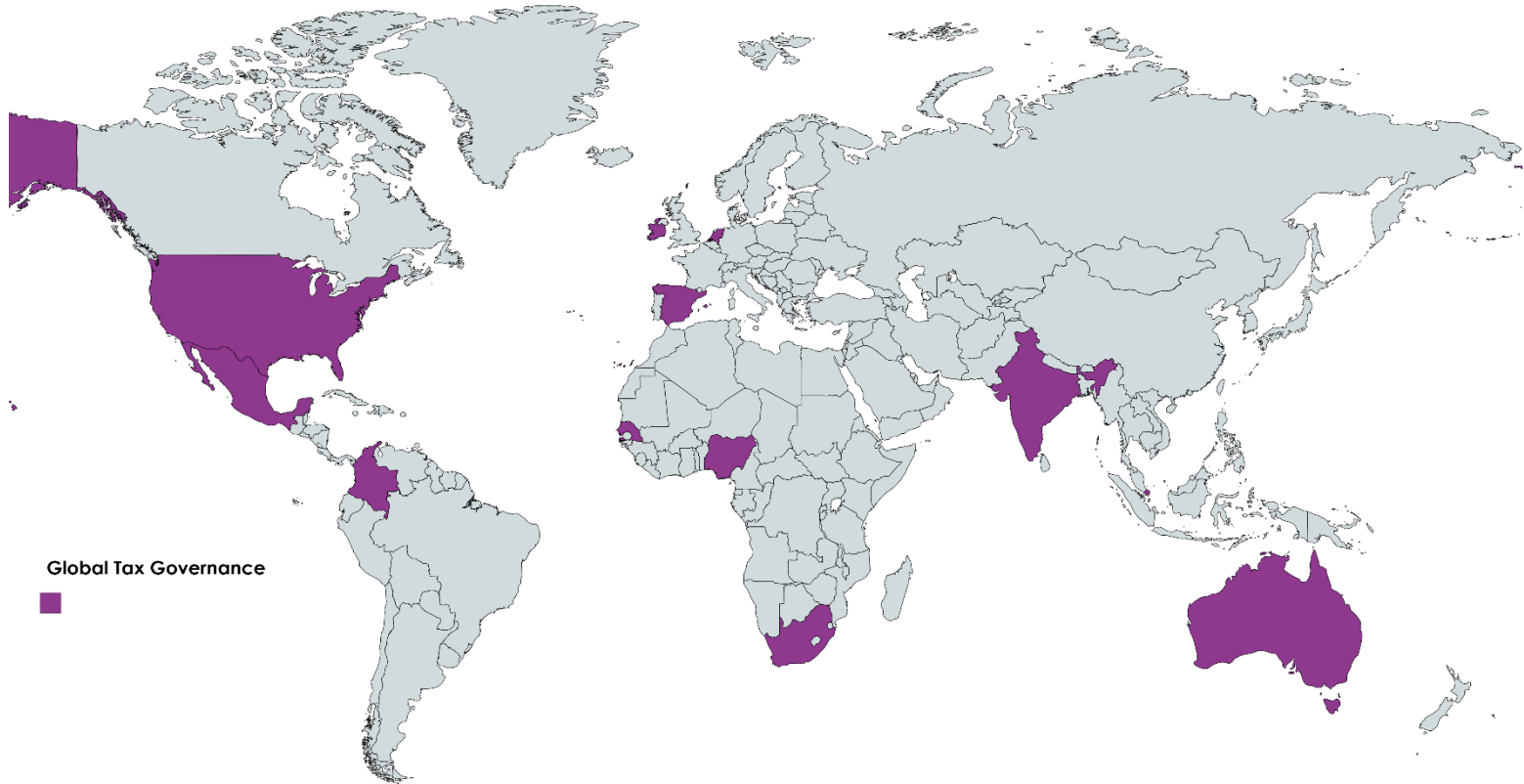
Fair Tax Competition



RESEARCH QUESTION

Under what conditions can the OECD-G20 and the EU models of global tax governance be feasible and legitimate for both developed and developing countries?

Global Tax Governance: GLOBTAXGOV



Research objectives

- To investigate the transplant of BEPS 4 minimum standards (desk and empirical research)
- To investigate the conditions under which the OECD can set standards in the current model of global tax governance
- To investigate the legitimacy of the EU initiatives with respect to EU and third (non-EU) countries

Main Scientific Results

2018

Presentations in more than 10 countries, 2 articles in journals, 2 book chapters, one blog with more than 20 blogposts and also participation in tax policy making OECD, G20 and EU, academia fora, tax administration meetings, and our own event on the 7th of November 2018 on Tax Competition.

2019

- Workshop “Tax and Development: The link between International Taxation, the Base Erosion Profit Shifting Project and the 2030 Sustainable Development Agenda” at the United Nations University – Centre Regional Comparative Studies CRIS, Bruges, 14 January 2019.
- NIAS-Lorentzcenter workshop: How countries learn to tax; complexity. Legal transplants and legal culture 25 Feb to 1 March 2019
- Presentations conferences and articles in journals and book chapters
- Blog with more than 30 blogposts
<https://globtaxgov.weblog.leidenuniv.nl/>

BEPS 4 Minimum Standards

BEPS Action 6

- 1 article on principal purpose test and international customary law; 1 article on GAARs and PPT
- Presentations on the challenges of PPT for developed and developing countries. Available at <https://globtaxgov.weblog.leidenuniv.nl/presentations-2/>
- 3 blogposts CIAT
- 1 blogpost GLOBTAXGOV

Topics

Tax incentives

**BEPS Action 5 and
EU developments**

After BEPS



1. Tax Incentives

- Tax incentives in developing countries aim to attract foreign direct investment to increase economic growth by creating more jobs, transfer of technology and improvement of economic conditions in a specific sector/region.
- Examples
 - free trade zones, reduction of corporate income tax rates, carry back/forward of losses, accelerated depreciation, investment tax credits, favourable tax treatment for expenditures on research and development.
 - the scope of application can be geographical (based on location) or specific for a sector/industry (e.g. hotel industry, agribusiness, research and development, etc).

Literature:

- 2013 Y. Brauner. The Future of Tax Incentives for Developing Countries' in Yariv Brauner & Miranda Stewart (eds), Tax Law and Development, 25 (Cheltenham: Edward Elgar Publishing, 2013)
- 2015: IMF, OECD, WB and the UN, Options For Low Income Countries' Effective And Efficient Use Of Tax Incentives For Investment.
- 2018: UN and CIAT. Report design and assessment of tax incentives in developing countries

2. BEPS Action 5

- No specific reference was made to the word incentives in the content of BEPS Action 5.
- However, countries are also being reviewed in their tax incentives mainly in the requirement of substantial activity factors to no or only nominal tax jurisdictions.
- This has allowed the OECD and the OECD Forum on Harmful Tax Practices to review tax incentives (including free trade zones, reduction of corporate income tax rates).
- 287 tax regimes have been reviewed by the OECD. In the most recent peer review report of Action 5 (July 2019), some regimes have been placed under review (Dominican Republic, Jamaica, Morocco, Qatar), other regimes have been abolished (Cabo Verde, Malaysia, Mongolia, Morocco), and three regimes were amended to remove the potentially harmful features (Cabo Verde, Malaysia, Mauritius)

2. EU Standard of Good Tax Governance

- EU introduced the concept of fair taxation, including elements to evaluate a tax regime by the EU Code of Conduct Group.
 - (1) whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents,
 - (2) whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base,
 - (3) whether advantages are granted even without any real economic activity and substantial economic presence within the third country offering such tax advantages,
 - (4) whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD
 - (5) whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.

If the tax regime is considered having harmful tax measures in the area of business taxation, the country is required to change the regime, otherwise, the country can be included in the list of non-cooperative jurisdictions.

3. Tax Incentives in developing countries after BEPS

- What type of incentives after BEPS?
- Same approach OECD BEPS and EU Code of Conduct Group?
- Legal certainty for taxpayer in case that country decides to change their tax incentives?
- How attracting investment by means of tax incentives can contribute to SDGs?

3.1. What type of incentives after BEPS?

2015 Toolkit on Tax Incentives for Low-Income Countries

“Tax incentives generally rank low in investment climate surveys in low-income countries, and there are many examples in which they are reported to be redundant—that is, investment would have been undertaken even without them. And their fiscal cost can be high, reducing opportunities for much-needed public spending on infrastructure, public services or social support, or requiring higher taxes on other activities”.

Recommendations:

National level: Improve the design of tax incentives (for example by placing greater emphasis on cost-based incentives rather than profit-based ones; and by targeting tax incentives better), strengthen their governance (for instance through more transparency, better tax laws and a stronger role of the Minister of Finance) and by undertaking more systematic evaluations.

International level: countries may gain by coordinating their tax incentive policies regionally, so as to mitigate the negative spill overs from tax competition

3.1. What type of incentives after BEPS?

2018: UN-CIAT Design and Assessment of Tax Incentives in Developing Countries

- Tax incentives cannot compensate for the deficiencies in the design of the tax system or inadequate physical, financial, legal or institutional infrastructure. Better to bring the corporate tax rate regime closer to international practice and to correct the deficiencies rather than provide investors with additional tax benefits.
- Easier to provide tax incentives than to correct deficiencies in the legal system or to improve the infrastructure of one country.
- Cost/benefit analysis:
 - Costs: revenue costs, resource allocation costs, enforcement and compliance costs, and the costs associate with corruption and lack of transparency
 - Benefit: to attract investment, to correct market inefficiencies or general positive externalities.
- Checklist for drafting tax incentives legislation. List of things to be considered to maximise clarity and administration. Consistency of legal drafting with the policy underlying the tax incentive.

3.2. Approach OECD BEPS and EU Code of Conduct.

- ECOFIN Council 1 Feb 2019: Letters signed by the Chair of the Code of Conduct Group, were sent by the General Secretariat of the Council to Barbados, Belize, Curaçao, Mauritius, Saint Lucia and Seychelles.

<https://data.consilium.europa.eu/doc/document/ST-5981-2019-INIT/en/pdf>

- **Barbados:**

Criterion 2.2, jurisdictions should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction.

Barbados needs to ensure that legal mechanisms do not exist that enable the granting of advantages only to non-residents or in respect of transactions carried out with non-residents and that sufficient substance is required for entities doing business in or through your jurisdiction. No grandfathering mechanism.

3.2. Approach OECD BEPS and EU Code of Conduct.

- Belize:

Criteria: Targeting non-residence, ring fencing and substance.

Code of Conduct Group has identified the introduction of a new preferential tax measure: exemption of foreign income. Similar effect to previous regimes already abolished (International Business Companies and Export processing zones).

Belize will amend or abolish this regime by 31 December 2019, without any grandfathering mechanism.

3.3. Legal certainty for taxpayer.

- Legal certainty for taxpayer in case that country decides to change their tax incentives?

Colombia: Tax incentive (exemption) for hotel industry (30 years). Introduced by Law 788 of 2002

- Law 1819 of 2016: Changes to the incentive to introduce 9% CIT as of 2017: Freedom of law-maker to repeal preferential treatment.
- Constitutional review: Legitimate expectations, certainty, good faith, non-retroactivity
- Constitutional Court C235/19
- Taxpayer has enjoyed the benefit and it is not possible to change the conditions of the tax benefit taking into account the principle of good faith and non-retroactivity. One dissenting opinion.

3.4. Investment and SDGs

Suggested analysis:

- Benefit: Effectiveness of tax incentives in achieving their aims (social and economic growth)
- Cost: Efficiency in terms of revenue loss, fair taxation, and equal opportunities for all citizens

To differentiate between tax incentives:

- For companies (foreign, local)
- For individuals (gender/ education/ religion/ family status)

To link the tax incentives not only to foreign direct investment but also to enhance economic and social development at country level. Examples from investment law: performance requirements (jobs/ transfer of technology)

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- GLOBTAXGOV project receives funding from the EU H2020 Research & Innovation Programme and European Research Council
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