Tax incentives in developing countries after BEPS

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GLOBTAXGOV
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

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- 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

4 Minimum standards

10 Best practices

1 Multilateral Convention

INCLUSIVE FRAMEWORK

SIGNATORIES

134
JURISDICTIONS

BASE EROSION PROFIT SHIFTING (BEPS) Decision making: BEPS 44 GROUP

89
JURISDICTIONS

G20

OECD

TAX GOVERNANCE: EU AND THIRD COUNTRIES

Anti-Tax Avoidance Directive (1 and 2)

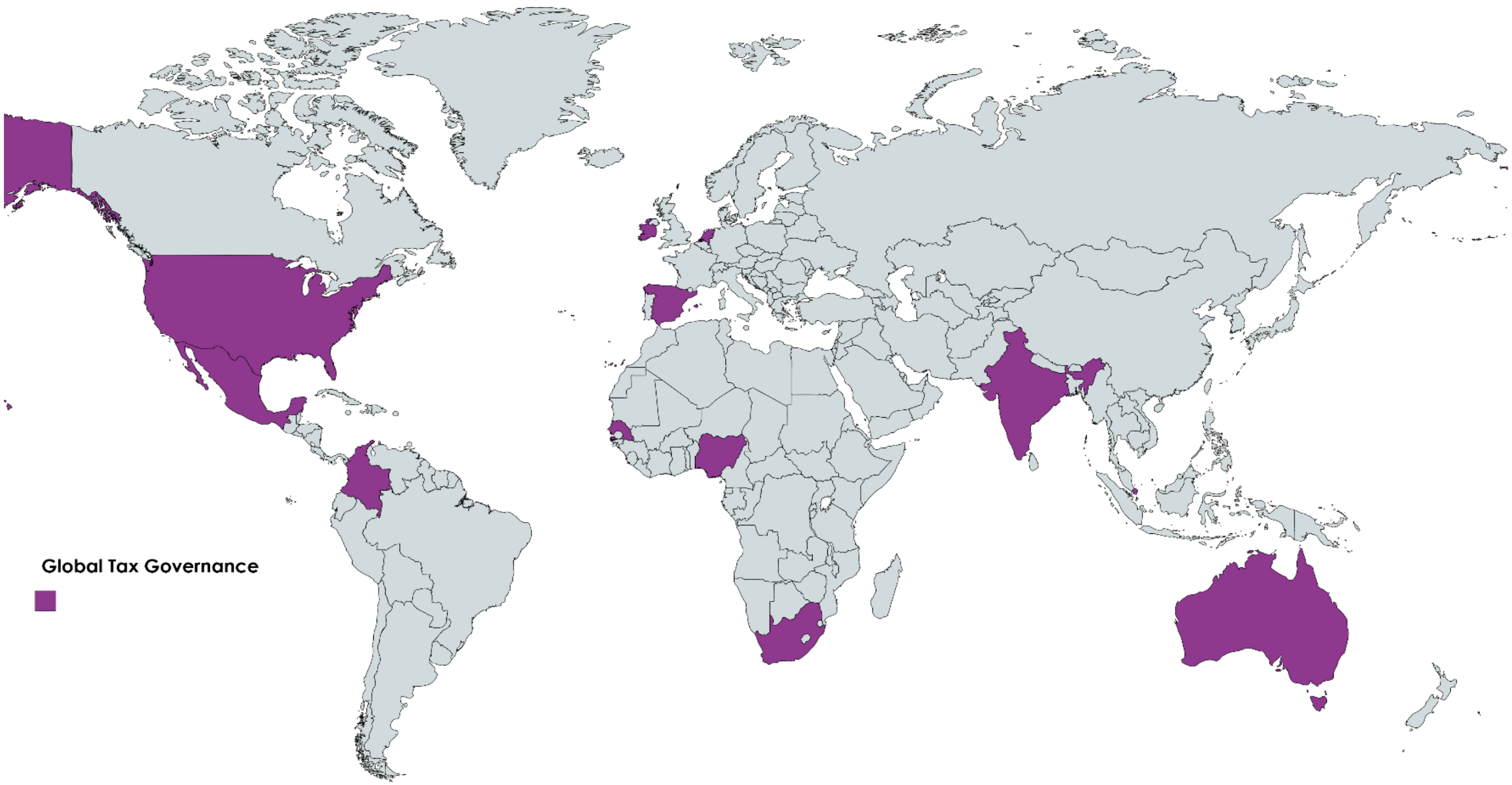
State Aid Investigations

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

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 and EU Code of Conduct

- 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). EU List of Non-cooperative Jurisdictions

1998 Report Harmful Tax Competition – 2018 BEPS IF Progress Report

- Questions
  - ❑ What type of incentives after BEPS?
  - ❑ Same approach OECD BEPS and EU Code of Conduct Group?
  - ❑ 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.

KEY FACTORS OECD –BEPS Action 5	APPLICABILITY TO TAX INCENTIVES
• No or low effective tax rates on income from geographically mobile financial and other service activities. • The regime is ring-fenced from the domestic economy. • The regime lacks transparency • No effective EOI with respect to the regime. • The regime fails to require substantial activities (**included 2018 Report as key factor**)	• Yes. Low or reduced tax rate. Comparison with rates within the country. • Yes, if tax incentive only for certain areas or certain type of investors. • Yes, if tax incentive is discretionary, or no clear evaluation on why the tax incentive is granted, or not information publicly available on the incentives. • To some extent, if information referring to the tax incentives needs to be exchanged amount countries. • The reason to invest in the country is not only the tax incentive and the lack of substantial activities (e.g. mailbox companies)
OTHER FACTORS	
• An artificial definition of the tax base. • Failure to adhere to international transfer pricing principles. • Foreign source income exempt from residence country taxation. • Negotiable tax rate or tax base. • Existence of secrecy provisions. **Removed in the 2018 Report** • *Access to a wide network of tax treaties.* • *The regime is promoted as a tax minimisation vehicle.*	▪ To some extent linked to transparency above (e.g. in case of discretionary tax incentives, or the existence of secrecy provisions). ▪ No clear how the tax incentive can be evaluated regarding an artificial definition of the tax base, or transfer pricing. ▪ ▪ Exemption of foreign source income from residence country taxation can be also regarded as incentive, but its consequences will need to be further evaluated.

EU Criteria	OECD Factor	Applicable to tax incentives
advantages are accorded only to non-residents or in respect of transactions carried out with non-residents	Key factor	Yes
advantages are ring-fenced from the domestic market, so they do not affect the national tax base	Key factor.	Yes
advantages are granted even without any real economic activity and substantial economic presence within the third country offering such tax advantages	Key factor. Main reference to substantial activities.	Yes
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	Other (non-key) factor and more specifically referring to international transfer principles without referring to the OECD rules.	Not clear the link between OECD principles, profit allocation and tax incentives, unless that the tax incentives provides for a more specific/favourable profit allocation method (e.g. sixth method in Latin American countries)
the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.	Key factor	Yes, especially if there are discretionary tax incentives granted by the government or law maker.

3.3 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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