UNITED NATIONS WORKSHOP ON

TAX INCENTIVES AND

BASE PROTECTION

[redacted]ew York
[redacted] April 2015

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

TAX INCENTIVES: PROTECTING THE TAX BASE

Eric M. Zolt, UCLA School of Law

2

Overview of Presentation

- Introduction to tax incentives
- [redacted]f tax incentives
- [redacted] tax incentives
- [redacted]rative considerations
- [redacted]ems in developed countries on [redacted]effectives of tax incentives in [redacted]s
- [redacted] project change the tax [redacted]ncentives?

3

Introduction to Tax Incentives

- What are tax incentives?
- [redacted]ernment play in encouraging
- [redacted]s and costs of using tax
- [redacted]e decisions where to invest?
- [redacted] desirability of tax incentives?

4

Definition of Tax Incentives

- “Revenue losses attributable to provisions of the [redacted]h allow special exclusion, [redacted]on from gross income or which [redacted], preferential rates of tax or a [redacted]” (Congressional Budget Act of [redacted]ef which is not part of the [redacted]the tax in question but has been [redacted]x code for some extraneous [redacted]

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%

[redacted]

Country	Response	What types of tax incentives does your country use or has used in the past?													
		1.1 a Tax Holidays [Currently Used]	1.1b Tax Holidays [Used in the past]	1.1c Reduced Tax Rates [Currently Used]	1.1d Reduced Tax Rates [Used in the past]	1.1e Investment Allowances [Currently Used]	1.1f Investment Allowances [Used in the past]	1.1g VAT Exemptions/reductions [Currently Used]	1.1h VAT Exemptions/reductions [Used in the past]	1.1i Research and Development Tax Incentives [Currently Used]	1.1j Research and Development Tax Incentives [Used in the past]	1.1k Special Economic Zones [Currently Used]	1.1l Special Economic Zones [Used in the past]	1.1m Payroll Tax Holidays [Currently Used]	1.1n Payroll Tax Holidays [Used in the past]
Brasil	e79 reef* 3555m4112 14iur														

More purported benefits

- Symbolic
  - Signal foreign investors that country is an "investor-

[redacted] adequate tax systems

[redacted] rating loss and depreciation

[redacted] ner externalities

[redacted] resolution procedures, etc.

9

Costs of Tax Incentives

- Erosion of tax base
  - Investments that would have taken place even without tax

[redacted] ncentives to other activities or other types of
[redacted] kages)

[redacted] immobile tax bases (labor)
[redacted] ocation

[redacted] ease tax burden on non-qualifying activities
[redacted] rent seeking activities

[redacted] investors
[redacted] te opportunities for corruption
[redacted] bottom)

10

Estimates of Direct Costs of Tax Incentives

- Tax expenditure budgeting

[redacted]ating the costs of a particular tax

[redacted]ber of taxpayers covered by the

[redacted]ue, compliance and enforcement

[redacted]data requirement

[redacted]ehavioral assumptions

11

What Has Changed in Recent Years?

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

[redacted]more generous than in past years
[redacted]better targeted and better designed
[redacted]ization and greater capital mobility
[redacted]decrease, the significance of taxes in
[redacted]s increase
[redacted]ed
[redacted]ational structure, production and
[redacted], and types of products being
[redacted]old
[redacted]kets, custom unions and free-trade
[redacted]

12

Political Economy of Tax Incentives

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

[redacted]mething to improve economic growth—tax [redacted]easy to adopt and costs are less [redacted]nomic elite seeking to minimize tax liability) [redacted]nment agencies seeking to maximize the [redacted]ents without major concern for tax revenue)

Design Considerations for Tax Incentives

- Eligibility criteria

[redacted]

15

Administrative Considerations

- Which agency makes decisions?

[redacted]

Benefits and Cost of Targeting Tax Incentives

- Benefits

[redacted]rces on most desirable
[redacted]ce costs)
[redacted]to those investments most likely
[redacted]den
[redacted]

Different Types of Investors

- In designing tax incentives, important to think [redacted]es of investors and their [redacted]es
  - [redacted]stic
  - [redacted]ting in your country
  - [redacted]" of investment
  - [redacted]nt (mining, manufacturing, [redacted]ervices)
  - [redacted]al investment
  - [redacted]n

19

Tesla "Gigafactory"– the Process

- Announce plans to build facilities to manufacture [redacted]" batteries at a cost of $5 billion
- [redacted]opment officials from 7 states to [redacted]
- [redacted] put together a proposal as to what [redacted]provide (tax breaks, free land, [redacted]ments, and cash) and to complete [redacted]naire (90 questions)
- [redacted]tes as "Gigafactory Location [redacted]

20

Specific Design Considerations (Tax holidays)

- ➢ [redacted] start date
- [redacted]–from which taxes
- [redacted]g requirements
- [redacted]ecapture provisions
- [redacted]epreciation provisions
- [redacted]t operating loss provisions

Determination of Start Date

- ➢ Alternatives
- [redacted]proved
- [redacted]ness” or “begin production”
- [redacted] profitable (current tax period)
- [redacted] profitable (cumulative basis)

Scope of Holiday

- Eligible taxes

[redacted]es

[redacted]axes

[redacted] duties and export taxes)

[redacted]preferential treatment)

25

Filing & Reporting Requirements

- Reporting requirements

[redacted]rms for firms operating under tax

[redacted]n required

[redacted]ation (to monitor compliance with [redacted]ays)

[redacted]n (to allow estimation of costs of [redacted]ons)

[redacted]sactions (to assist in identifying

[redacted]

- Do tax holiday provisions or regulations:
  - [redacted]on treatment during holiday
  - [redacted]f depreciation or "minimum" [redacted]ation
  - [redacted]tion of property acquired during [redacted]er holiday period is over
  - [redacted]ure of depreciation upon [redacted]perty

27

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.

[redacted] with related entities (sales, services, loans,
[redacted]ntracts).
[redacted]tments (lack of recapture rules).
[redacted]ome (or defer deductions) at the end of a
[redacted]r depreciation, tax credit, or other purposes.
[redacted]credits -- fictitious employees and phony
[redacted]nto domestic economy.
[redacted]tives and Enterprise zones – divert
[redacted]gion or zone.
[redacted]fying activities into qualifying activities.

31

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

[redacted]ts

32

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

[redacted]

Tax Incentive Review Project

1. Compile list of existing tax incentives in your country;

[redacted]ing and granting tax incentives among
[redacted]cies;
[redacted]irements for taxpayers receiving tax
[redacted]nt efforts to monitor compliance, and
[redacted]ompliance;
[redacted]fforts to evaluate effectiveness of tax
[redacted]evaluating the effectiveness of existing
[redacted]evaluating the costs and benefits of new
[redacted]

Impact of Other Countries' Tax Regimes on Effectiveness of Tax Incentives

- Globalization and increased mobility of capital and
[redacted]longer able to design tax rules
[redacted]r tax regimes of countries of
[redacted](tax sparing arrangements)
[redacted]r the tax regimes of other
[redacted]egion
[redacted]nvestors
[redacted]s for foreign investment
[redacted]ustomers (particularly trade
[redacted]

Revenue Transfer from Developing Countries to Developed Countries

- Simple model: foreign investor invest directly in a [redacted]her through a branch or through a [redacted] immediately repatriates any [redacted] of foreign investor [redacted]axed on their world-wide income [redacted]allowed a credit for foreign income [redacted]regate tax liability unchanged [redacted]veloping country but increased tax [redacted]ely transfers tax revenues from [redacted]h countries (UNCTAD 2000)

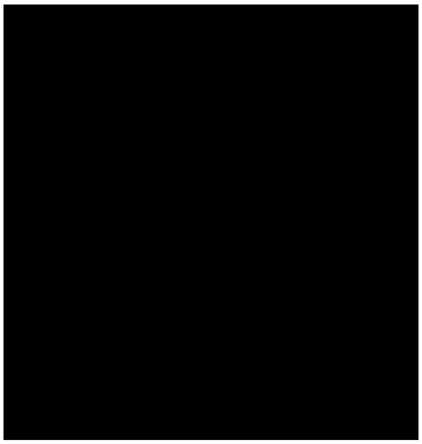
37

Revenue Transfer Argument Likely Overstated

- Many developed countries tax residents under a [redacted]h [redacted]provide for no “current [redacted] from foreign operations until [redacted]ed [redacted]rations can structure activities [redacted]ility [redacted]ties [redacted]angements

38

Continuum of Types of International



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

- [redacted]e US eliminate deferral of active [redacted]idiaries and impose a “minimum” [redacted]ncome