



Fiscal Affairs Department

Session V: TAX INCENTIVES

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FISCAL AFFAIRS DEPARTMENT
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Outline

- ▶ Pros and Cons of tax incentives
- ▶ Incentives: effective or ineffective?
- ▶ Are there good incentives?
- ▶ Tax planning through incentives
- ▶ Transparency and good governance matters!
- ▶ Tax cooperation and coordination?

Tax incentives: pros and cons

“To be, or not to be – that is the question...”



Can correct market failures

Positive spillovers

Additional investment

Aggressive tax planning

Economic distortions

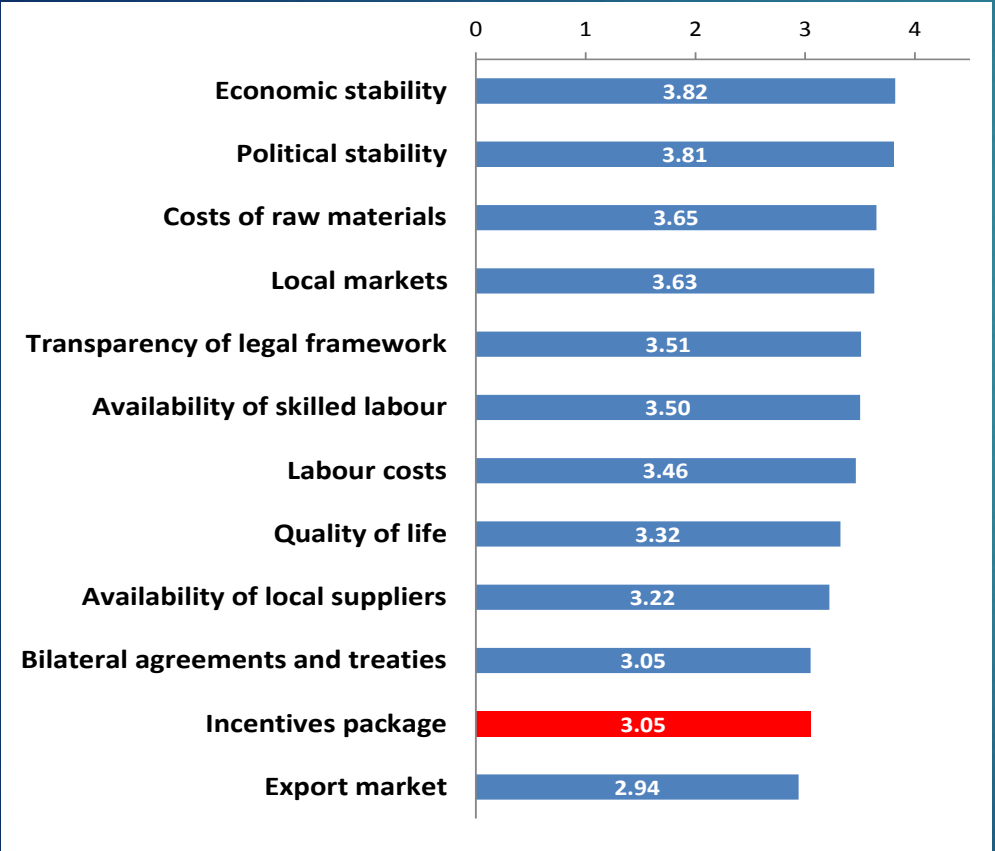
Revenue foregone



Tax incentives: do they matter to investors?

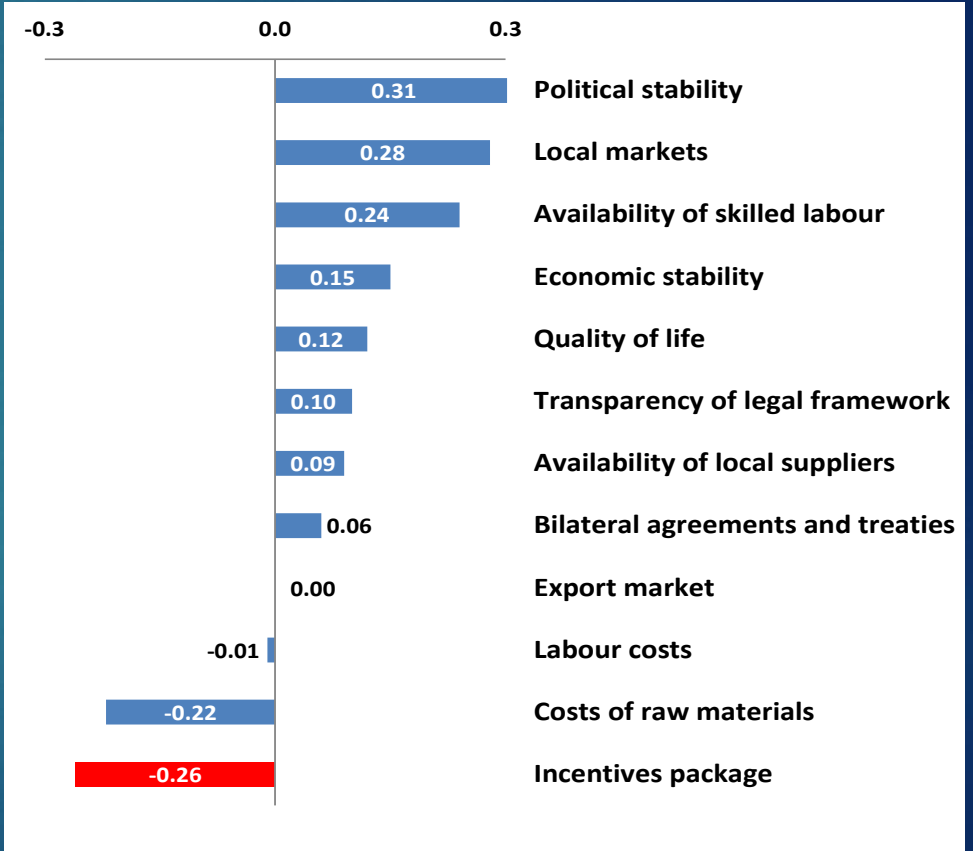
Are tax incentives important for investors?

Ranking of importance of investment location factors



Business survey of 7,000 companies

Change of importance of location factors over a period of 3 years

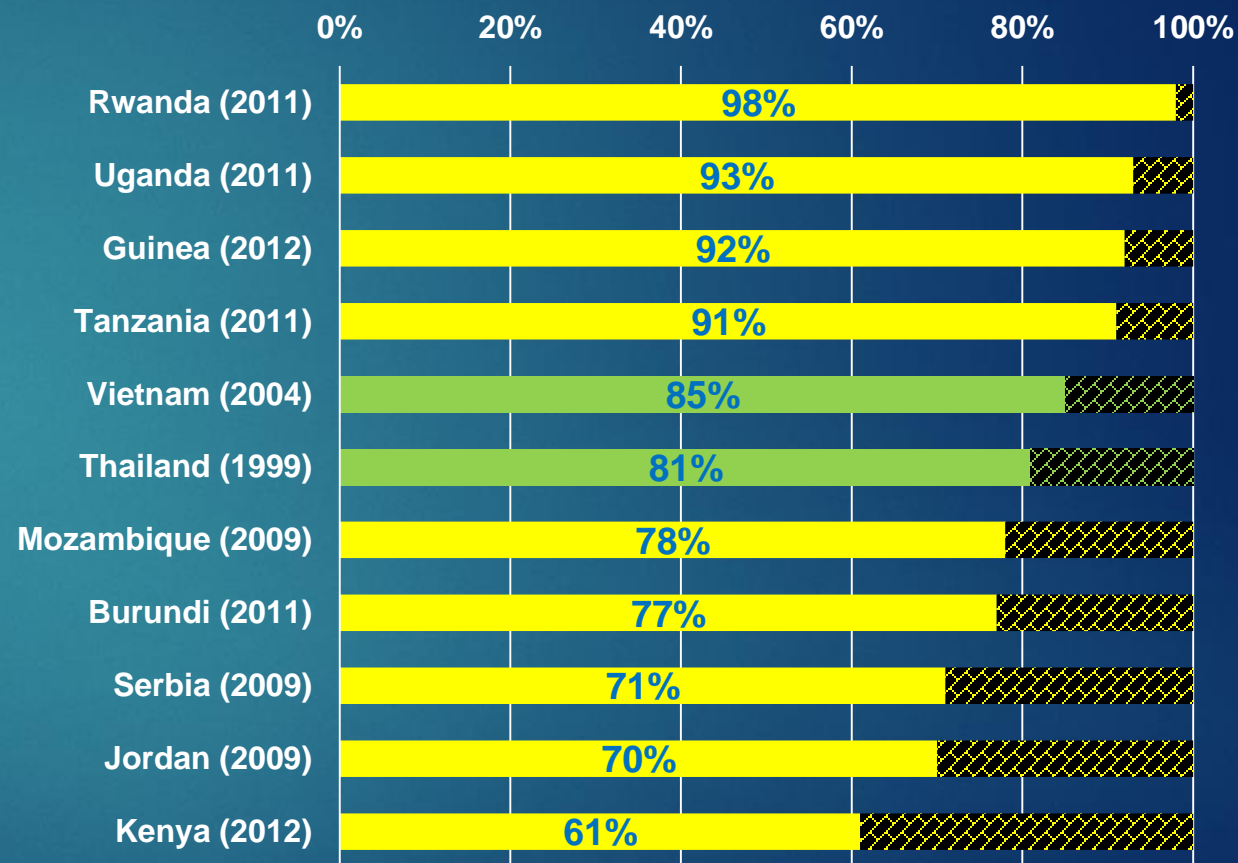


Source: UNIDO, Africa Investor Report 2011



Investor motivation surveys

- ▶ Question: Would have invested even if Incentives were not provided?
- ▶ Redundancy ratios?
- ▶ Risking revenue for little benefit



Tax incentives in ASEAN: “race to the bottom”?

ASEAN: tax incentives

Tax Holidays



Preferential Rates



Accelerated Depreciation /Investment Allowances



SEZ/Export Zones



Exemptions from Indirect Taxes



Exemptions from WHT

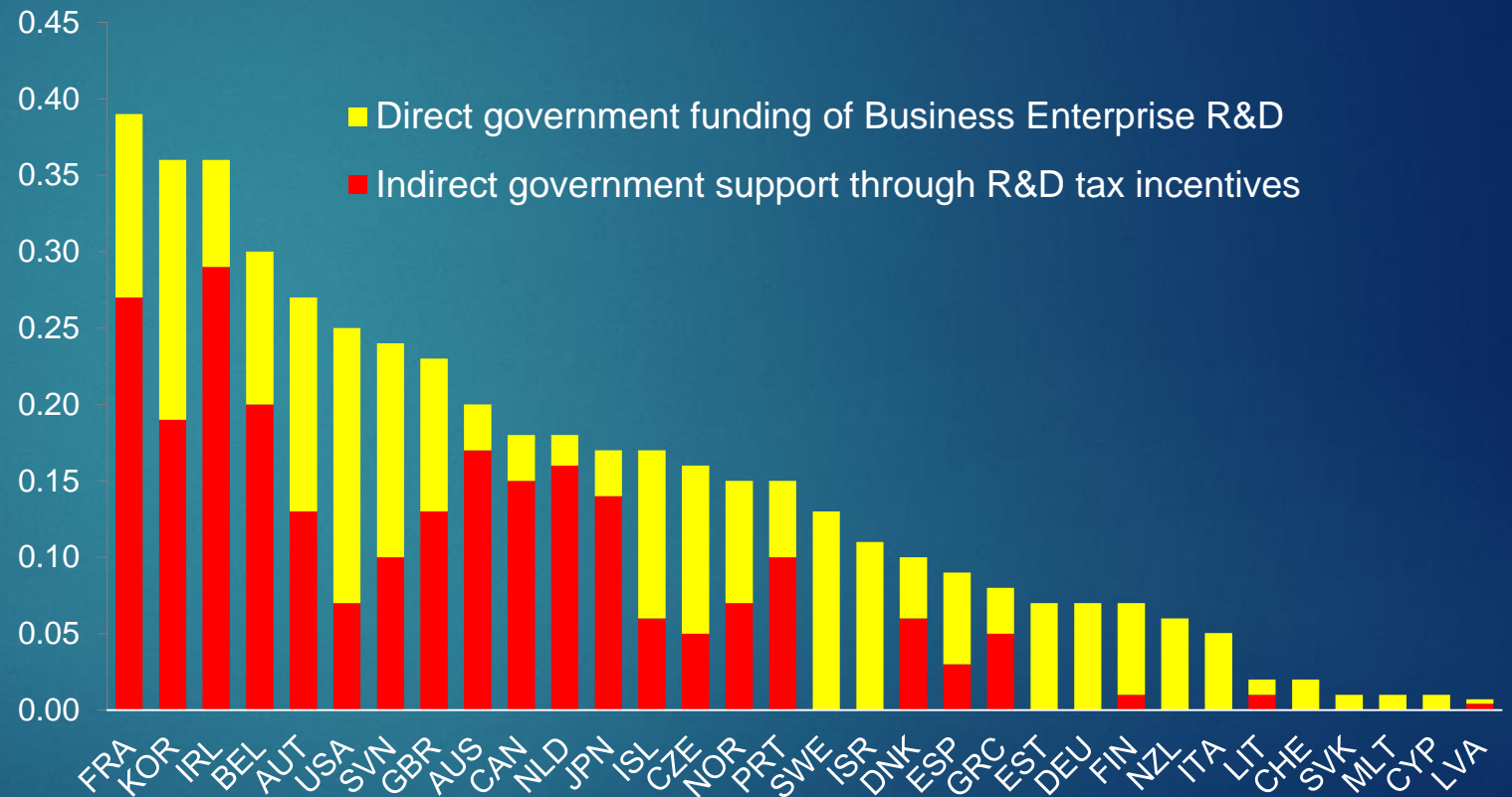


Are there “good” incentives?

R&D tax incentives play an important role

- ▶ Fiscal support for R&D of 0.4 percent of GDP per year would raise GDP by 5 percent
- ▶ Effective design of R&D incentives is critical

Direct Government Funding of business R&D and R&D tax incentives, 2014 (Percent of GDP)



Source: OECD

Effective design of R&D incentives is critical

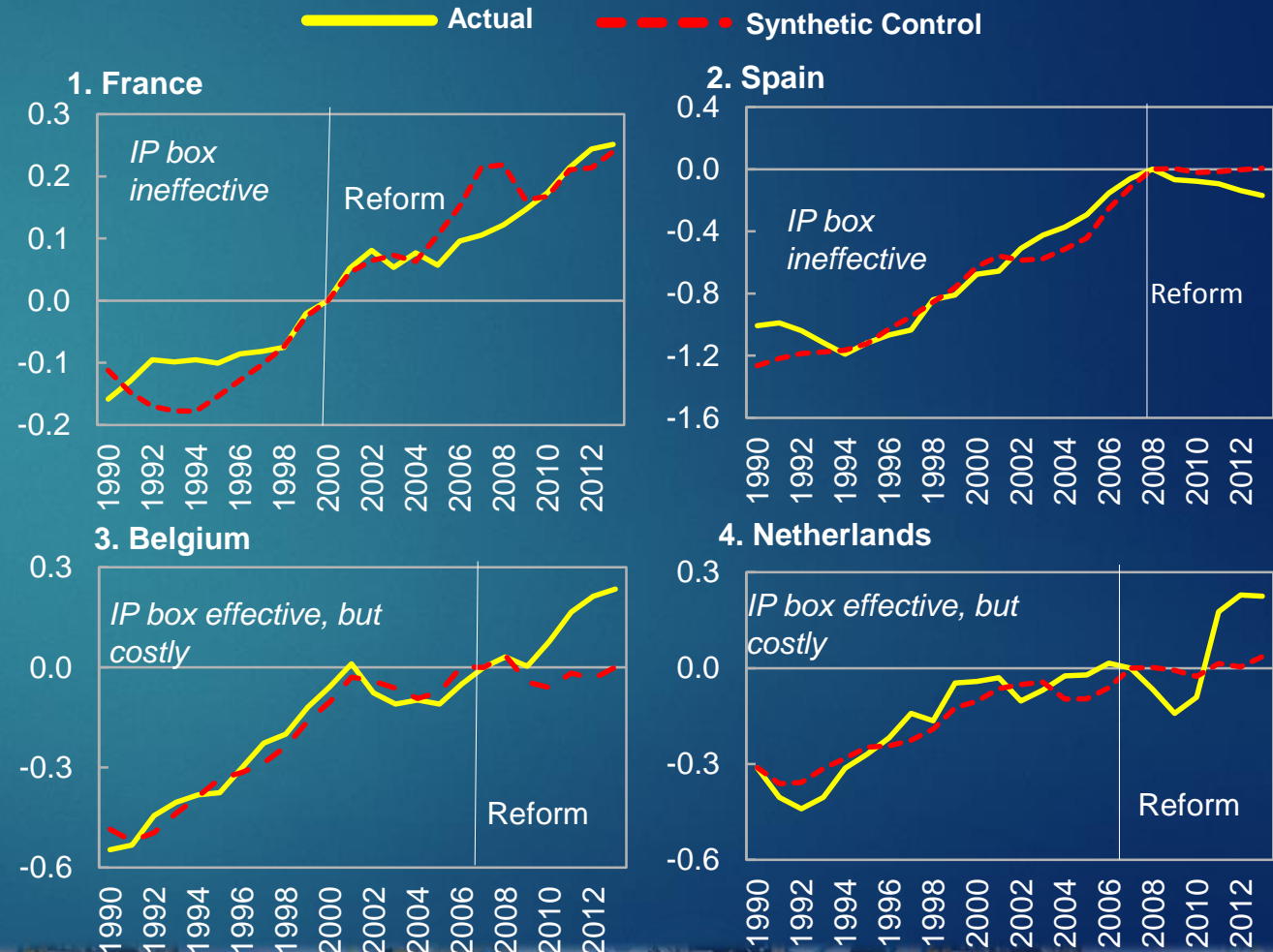
	Tax exemptions	Rate reductions	Super-deductions / Allowances	Tax credits
China	VAT exemption/ zero-rating for R&D centers	15% rate for high and new technology enterprises	150% super-deduction	
Japan				Volume base: 8%-12% Incremental: 5%-30%
Korea				Incremental: 40%-50% Volume-based: 2% - 25%
Malaysia	Income tax exemption – 5 to 10 years		50%- 100% investment allowance 200% super-deduction	
Myanmar			Up to 200% super-deduction	
Singapore			Up to 400% super-deduction	
Thailand	High-technology: CIT exemption for up to 8 years	33%-50% rate reduction for qualified		

Note: Included are only ASEAN (+3) countries with R&D tax incentives. Source: Country legislations

...but “Patent Boxes” should be avoided

- ▶ **Ineffective** – no effect at all in two countries
 - ▶ Only effective where tax relief is large and link with R&D strong
- ▶ **Inefficient** – as relief depends on income, not R&D
- ▶ **Negative international spillovers** – focus is on attracting mobile IP income (aggressive tax competition)

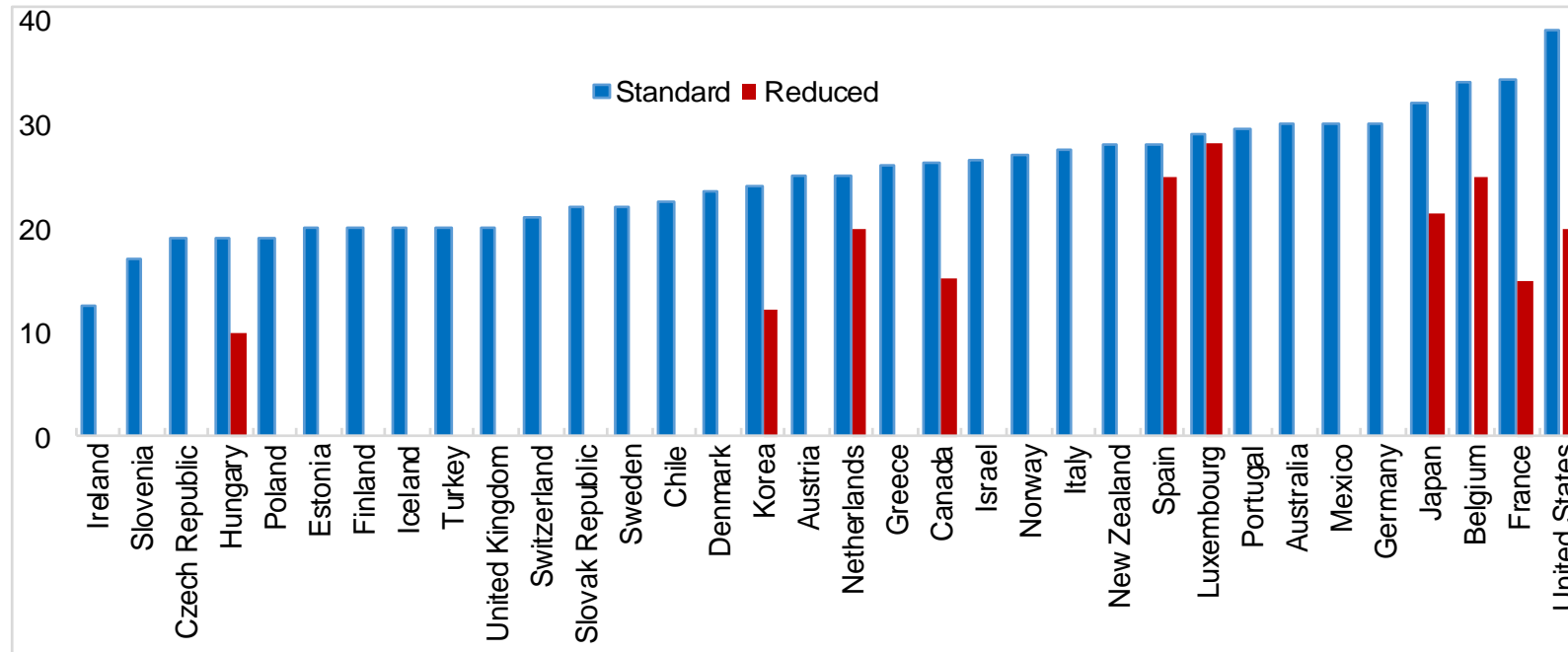
Synthetic Control Estimation Results: Intellectual Property Box and Private R&D (Log of real R&D spending)



Targeting small business...

Reduced rates common, but poorly targeted

Reduced CIT rates for small firms are used in 10 OECD countries



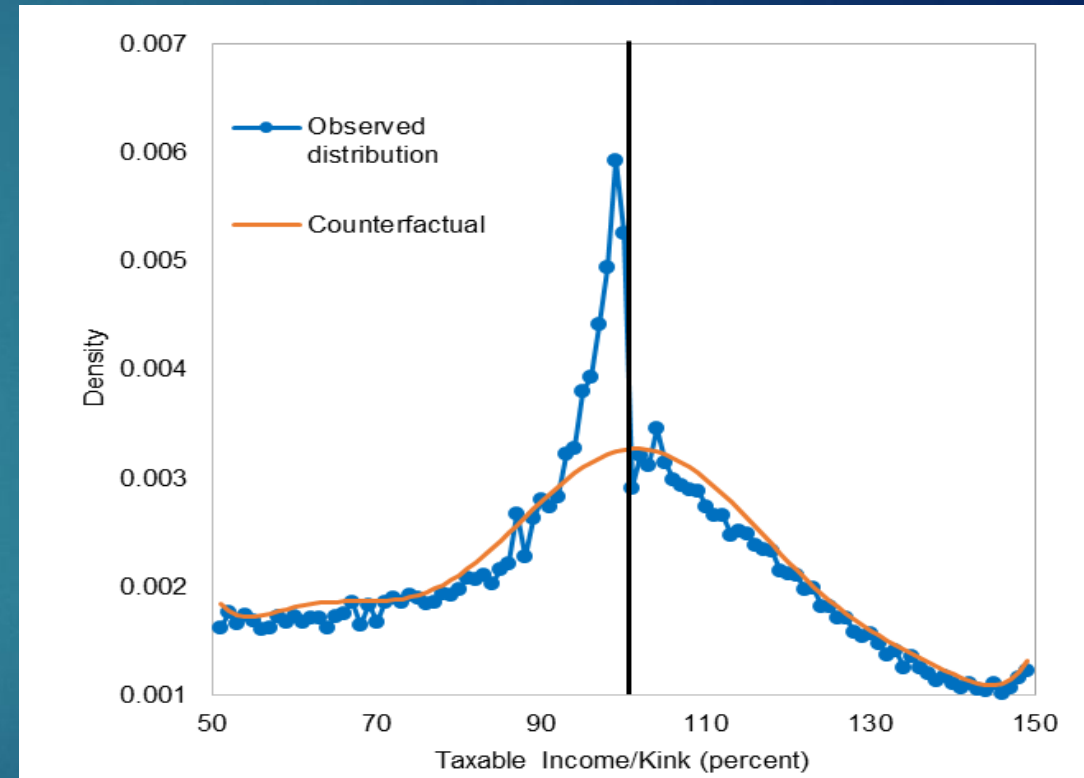
Source: OECD Tax Database

Note: Central and sub-central statutory CIT rate, including surcharges

Beware the ‘small business trap’...

- ▶ The trouble with incentives favoring small firms...
 - ▶ Most small firms are not new or innovative
 - ▶ ‘Small-business-trap’: bunching at kinks and notches
- ▶ Stronger case to favor new firms
 - ▶ But can be hard to implement

Bunching at a Kink – Evidence for Costa Rica 2006–13
(Density of taxpayers along the income distribution)



Source: Brockmeyer and Hernandez (2016).

Note: The kink refers to the income level at the exemption threshold for self-employed taxpayers for the years 2006-13. 100 on the horizontal axis denotes that taxable income is precisely equal to the threshold. The tax rate above the threshold is 10 percent.

Aggressive tax planning

Tax avoidance through incentives, examples

- ▶ “Old for New”, or the Aladdin Lamp
- ▶ Tax planning for targeted tax incentives
 - ▶ SME targeting: “two for one”
 - ▶ R&D targeting: mis-characterization of activities
- ▶ “Churning” of qualifying assets
 - ▶ E.g. Bolivia’s “tourist cows”
- ▶ Transfer pricing and thin capitalization between related parties subject to different rates

Benefit? At what cost?

Cost-benefit analysis



Direct impact & revenue

Indirect impact & revenue

Positive spillovers

Revenue foregone

“Tax planning”

Administration/Compliance



*...But transparency and good governance
are keys!*

Transparency and governance issues

- ▶ Case study: ...one of the ASEAN countries
 - ▶ Around 18 Investment Promotion Agencies (IPAs)
 - ▶ Around 180 special laws that provide tax incentives
 - ▶ Policy formulation, incentives administration and oversight are lodged together among IPAs



Provide through tax laws only
Consolidate under one authority
Reduce discretionary power
Administer transparently



...Should we talk?



Establishing a level playing field in ASEAN

- ▶ Regional cooperation and agreements can
 - ▶ help fight excessive incentives, protect tax bases
 - ▶ provide a comprehensive ASEAN-wide mechanism to address the tax competition
- ▶ Framework for harmonizing tax incentives:
 - ▶ assist understanding the extent of divergences of tax incentives policies and practices
 - ▶ serve as platform for dialogue on tax incentives-related policies

Thank you!