The 5th IMF-Japan High-Level Tax Conference for Asian Countries

Regional Harmonization of Tax System

Tax Incentives and WTO rules

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April 21, 2014

Outline

- Overview of Tax Incentives for Investments In Asian Countries
- Tax Incentives Contingent on Exports
- WTO Rules that Affect Tax Incentives

Overview of Tax Incentives for Investments in Asian Countries

- Tax Holidays (THs)
  - Mostly targeted at “pioneer” industries, but some countries have a long list of pioneer industries
  - Some THs are contingent on exports
  - Period: 3 to 15 years
- Reduced CIT rates
  - After TH, or in lieu of TH
- Investment tax allowance
- Regional Headquarters
- Export processing zones
  - Mostly, import duties and VAT are exempted
  - Some countries also provide THs

Overview of Tax Incentives for Investments in Asian Countries (cont.)

- Transparency
  - Only few countries in the region publish the amount of revenue foregone relating to tax incentives for investments
  - Tax expenditure budget could be an effective measure to control and further streamline tax incentives
- Mechanism to design and approve tax incentives
  - In most countries, investment promotion ministry/agencies
  - In a few countries, MOF/Revenue Department has a veto

Benefits and Costs of Tax Incentives

Arguments <u>in favor</u> of tax incentives

- Can generate positive externalities
- Can convey positive signals to foreign investors
- Can compensate for inadequate tax system (but why not fix it?)
- Can compensate for other negative externalities and bottlenecks (but why not fix these too?)

Benefits and Costs of Tax Incentives

Arguments <u>against</u> tax incentives

- Create inefficiencies in the economy
- Generate revenue losses; tax expenditures in some OECD countries can exceed 5% of GDP
- Adverse impact on revenue administration
- Usually outside Parliamentary scrutiny
- Evidence shows that infrastructure, rule of law, the quality of labor matter more for MNEs
- Impacts negatively on horizontal equity of the tax system – introduces significant differences in tax treatment of similar businesses
- Studies show that tax incentives mostly attract footloose investments and not do not impact aggregate investment and growth

Tax Incentives Contingent on Exports

Examples

1. A company engaged in manufacturing is eligible for allowance for increased exports that is tax exemption of 10% or 15% of the value of increased exports
2. A company that exports more than 70% of its production is eligible for CIT holidays
3. A company located in a designated economic zone, which aims to promote exports but has no minimum export requirements, is eligible for CIT holidays
4. A company located in an export processing zone is eligible for exemption of import duties and VAT for its import

WTO Rules that Affect Tax Incentives

- Agreement on Subsidies and Countervailing Measures (ASCM)

  Article 3: "…. the following subsidies, within the meaning of Article 1 [(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)], shall be prohibited:

  (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I"

  => **Tax incentives contingent on exports could be regarded as "export subsidies"**

  - Tax incentives contingent on use of domestic products

- National Treatment Principle in GATT Article 3

WTO Rules-Compliant Tax Incentives?

- WTO does not make a decision unless a member brings a case to the Panel
  - Having tax incentives similar to neighboring countries does not necessarily mean WTO rule compliant
- A "gray" export-contingent tax incentive brings in juridical uncertainty that may deter investment
  - Need to minimize risks for export enterprises to have tax incentives cancelled unexpectedly
- UN's Least Developed Countries and ASCM Annex VII(b) countries are exempt from prohibition of export subsidies

Benefits (?) of WTO Rules

- Tax policy departments (TPDs) could use WTO rules as leverage to streamline tax incentives
  - Even investment promotion agencies (IPAs) cannot resist WTO rules
  - TPDs need to be involved in designing tax incentives
- Complying with WTO rules could set a base for regional harmonization of tax incentives