

Managing Editors:  
Madalina Cotrut and Kennedy Munyi

# Tax Incentives in the BEPS Era

IBFD Tax Research Series  
Volume 3



# Tax Incentives in the BEPS Era

## Why this book?

Recent tax developments aimed at mitigating the possibilities of base erosion and profit shifting are expected to increase the importance and popularity of tax incentives. This is due to the fact that states will want to remain competitive on the international stage and multinational enterprises will look for other opportunities to minimize their tax liabilities. This book seeks to answer the following essential questions, from both a practical and an academic perspective:

- Will tax incentives be the 21st century tool for tax planning structures?
- Will states need to introduce more tax incentives in the future in order to be more competitive?
- What are the effects of the anti-abuse measures adopted by the EU Member States and recommended by the OECD on tax incentives?
- What are the challenges of securing the use of tax incentives?
- What new tax policy challenges will tax incentives bring about?

This book answers these questions by analysing selected tax incentives that are commonly promoted by both developed and developing states, particularly those tax incentives that are of relevance to corporate income taxation. This analysis is performed with the objective of presenting the expected new role of tax incentives in the changing international tax arena, assessing whether – and, if so, which – tax incentives can be used or will be prone to abuse for tax planning purposes and examining the impact of the measures developed and/or adopted by the OECD and the European Union on tax incentives. *Tax Incentives in the BEPS Era* is essential reading for anyone working with tax incentives, tax planning tools and anti-abuse measures in their activities, including tax advisers, tax lawyers, tax administrators and tax policy makers.

This book is part of the IBFD Tax Research Series.

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## Foreword

It is my pleasure to write the Foreword to this latest volume in the IBFD Tax Research Series.

Over the past few years, the subject of tax incentives has received sustained focus. One of the main reasons for this has been the OECD Base Erosion and Profit Shifting (BEPS) Project. Even beyond that, there has been much debate surrounding the place of tax incentives, whether in the design of sustainable tax policy, in attracting sustainable investment or in fostering effective tax administration.

Generally, as far as tax policy is concerned, different considerations come into play for every country designing its own tax incentive framework. Even so, some things remain uniform. For example, one might often see a marked difference between the approaches taken by developing countries and developed countries. Indeed, while every country has its own policy that is imperative for introducing certain types of tax incentives, one often finds a correlation between a particular type of incentive and the level of development of the country implementing it. This book offers an analysis of the more prevalent tax incentives, particularly in light of the stated policy goals of the implementing jurisdictions. Not only does it analyse these incentives in detail, but also provides an overarching view of their overall place in any particular tax policy framework.

Long before the OECD BEPS Project, the link between tax incentives and tax avoidance was a troubling one for legislators worldwide. Thanks to the OECD BEPS Project, there is now a great appetite for a coordinated approach to this issue. This book also addresses the problems brought up by the OECD BEPS Project, as well as analyses potential solutions from the perspectives of both domestic and supranational law systems.

This book is the third volume in the IBFD Tax Research Series. As is characteristic of the series, it is written and edited in its entirety by in-house staff of IBFD.

The IBFD Tax Research Series was launched in 2013. Through this medium, IBFD offers technical analysis of the pertinent international tax issues of our time. In today's highly frenetic post-BEPS climate, there is a compelling need for clear, thoughtful analysis – not just of the law as it now stands, but also of possible changes to come. As one of the leading research centres in the field of international tax, IBFD has a clear duty to contribute its expertise. This series offers an avenue to fulfil that mission.

Belema R. Obuoforibo CTA ATT (Fellow)

Director, IBFD Knowledge Centre

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## Introduction

Recent tax developments aimed at mitigating the possibilities of base erosion and profit shifting are expected to increase the importance and popularity of tax incentives. This is due to the fact that states will want to remain competitive on the international stage and multinational enterprises will look for other opportunities to minimize their tax liabilities.

The purpose of this book is to analyse selected tax incentives that are commonly promoted by both developed and developing states, particularly those tax incentives that are of relevance to corporate income taxation. This analysis is made with a view to presenting the expected new role of tax incentives in the changing international tax arena, assessing if and what tax incentives are used or are prone to abuse for tax planning purposes, and examining the impact of the measures developed and/or adopted by the OECD and the EU on tax incentives.

Part One of the book introduces the reader to tax incentives by providing both the definition of the term “tax incentive” and outlining the types, purposes and characteristics of tax incentives that are examined in the book (see chapter 1). This chapter also provides a survey of the tax incentives granted in 2017 by 207 countries discussing their trends in the world.

Part Two analyses selected tax incentives affected by the BEPS developments, such as tax holidays (see chapter 2), capital investment incentives (see chapter 3), reduced tax rates incentives (see chapter 4) and Special Economic Zones (see chapter 5). The analysis is done from two perspectives: whether tax incentives may unintentionally be cancelled by measures adopted by EU Member States and proposed by OECD; and whether the tax incentives used abusively may be countered by different measures promoted by these BEPS developments.

The third part of the book focuses on the challenges raised in securing the use of tax incentives. The authors analyse the impact of tax treaties on tax incentives (see chapter 6), the challenges raised by state aid investigations when it comes to taxation, specifically when tax incentives are introduced by EU Member States disregarding the state aid rules (see chapter 7) and the possible difference between tax rulings and tax incentives (see chapter 8).

The final two chapters take a look at tax incentives from a tax policy design perspective. Chapter 9 analyses the effectiveness of the tax incentives. Tax

competition is one of the main drivers of tax incentives. Chapter 10 looks at who really is the winner in the process.

This book brings out the complexities of the tax incentives, their exposure to be used in tax planning structures and assesses the impact of the anti-abuse measures that the states are transposing in their legislations further to the work done at EU and OECD levels. The book mainly considers the measures proposed and adopted as of 1 May 2017.

We hope that Volume 3 of the IBFD Tax Research Series will stimulate further discussion and be of use to practitioners, students and policymakers.

Madalina Cotrut and Kennedy Munyandi  
Managing Editors



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## Introduction to Tax Incentives in the BEPS Era

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### 1.1. Introduction

There are many types of tax incentives granted all over the world. However, in this book, the authors only focus on the most common tax incentives related to direct taxation that are expected to be affected by the OECD Base Erosion and Profit Shifting (BEPS) Project. These are tax holidays, reduced tax rates, capital investment incentives and special economic zones (SEZs).

This chapter provides a survey of these tax incentives in 207 countries.<sup>1</sup> The countries surveyed were grouped into five regions, i.e. Africa, Asia-Pacific, Europe, Latin America and the Caribbean and the Middle East. Additionally, EU Member States and OECD member countries were scrutinized to see which tax incentives are implemented by them. The survey was made with the view to assess which tax incentives from the categories are still used by the countries surveyed and in which regions they are prevalent.

The survey proved relevant in an international context in which many measures are taken to prevent base erosion of the source (host) countries, taking into account the work done internationally at the OECD and EU levels. As a consequence, in the BEPS era, countries are expected to introduce more tax incentives, either to stay competitive or become more competitive.

This chapter begins by providing a definition of tax incentives in general and, for clarity purposes, also provides definitions of the selected tax incentives that form the core purpose of this book. The authors also analyse the characteristics of the tax incentives with the view to present their advantages and disadvantages. Finally, an analysis of the results of the survey of the selected tax incentives is made, highlighting their trends in the world.

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1. The countries that are included in the Tax Research Platform of IBFD were considered for the purposes of this survey.

## 1.2. What are tax incentives?

There is no consensus on the definition of the term “tax incentive”. In this respect, several examples were selected by the authors from the various definitions that scholars have provided:

- “Special provisions that allow for exclusions, credits, preferential tax rates or deferral of tax liability”;<sup>2</sup>
- “Tax incentives can be defined in terms of their effect on reducing the effective tax burden for a specific project”;<sup>3</sup>
- “Any incentives that reduce the tax burden of enterprises to induce them to invest in particular projects or sectors. They are exceptions to the general tax regime”;<sup>4</sup>
- “All measures that provide for a more favourable tax treatment of certain activities or sectors compared to what is granted to the general industry”;<sup>5</sup> and
- “Departures from the benchmark system that are granted only to those investors or investments that satisfy prescribed conditions”.<sup>6</sup>

In a nutshell, it can be said that, in general terms, tax incentives depart from a general and neutral tax system. They can be implemented in different forms, resulting in a favourable tax treatment or a reduced combined overall tax burden for the investor.

To understand which types of tax incentives were considered in the survey, specific definitions of the tax incentives are given. These specific definitions are also used in chapters 2-5 of the book.

“Tax holidays” mainly take the form of tax exemptions for a defined period with the objective of attracting foreign direct investment (FDI) and/or sustaining economic growth. Tax holidays may be granted in or outside the context of an SEZ.<sup>7</sup>

“Capital investment incentives” can take the form of financial incentives (i.e. cash grants, loans at below-market interest rates, loan guarantees or

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2. E. Zolt, *Tax incentives: Protecting the Tax Base*, in *Selected Topics in Protecting the Tax Base of Developing Countries*, Draft paper No. 3, p. 5 (2014).

3. *Id.*, at 5.

4. UNCTAD, *Tax Incentives and Foreign Direct Investment: A Global Survey*, ASIT Advisory Studies No. 16, p. 12 (UN 2000).

5. A. Klemm, *Causes, Benefits, and Risks of Business Tax Incentives*, 17 *International Tax and Public Finance* 3, p. 3 (2010).

6. A. Easson & E. Zolt, *Tax Incentives*, p. 15 (World Bank Institute 2002).

7. *See* ch. 2 of this book.

rebates), but they are most often tax-based inducements that aim to reduce the cost of investments in capital assets and the expenditure on research and development (R&D) in certain specific economic sectors or strategic pioneering industries. Among the incentives commonly made available by governments are investment allowances (such as tax depreciation, accelerated depreciation and enhanced deductions), front-end incentives (such as R&D tax credits) and back-end incentives (such as intellectual property (IP) box regimes). Capital investment incentives in principle relate to active investments rather than portfolio investments, whereby they are usually made exclusively available to foreign investors to boost domestic economic developments.<sup>8</sup>

“Reduced tax rates” are referred to as incentives granting a lower tax rate, than the applicable general tax rate, to specific types of companies, sectors, regions or income sources. If a country grants a low tax rate to all companies, that low tax rate does not qualify as a reduced tax rate incentive, but is rather a low general corporate income tax rate regime.<sup>9</sup>

“Special economic zone” is one of numerous terms referring to the same subject, i.e. a separate zone with economic development on the agenda, including tax incentives and customs alleviations, and usually a clear intention to attract FDI. Other common alternative terms include “economic and development zones”, “enterprise zones”, “free economic zones”, “free zones”, “tax-free zones”, “export processing zones” and “industrial development zones”.<sup>10</sup>

### 1.3. Purposes of the selected tax incentives

Countries may grant tax incentives to encourage investments in new companies, promote a country as a choice for investment funds or promote businesses in designated priority economic sectors and regions. On the other hand, tax incentives should not be used to compensate for deficiencies in the design of a tax system or an inadequate physical, financial, legal or institutional infrastructure.<sup>11</sup> Also, countries should not justify the granting of tax incentives as a protection against the tax incentives granted by the neighbouring countries, but they should stick to their tax policy purposes.

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8. See ch. 3 of this book.

9. See ch. 4 of this book.

10. See ch. 5 of this book.

11. E. Zolt, *supra* n. 2, at 6.

Upon scrutinizing the tax incentives specifically discussed in Part Two of this book, it can be seen that tax holidays are tied to the host country's policy considerations. Some examples include the following:

- if the host country wants to promote information and communication technology, it may grant tax holidays to companies that will enhance the dissemination of such specialist knowledge;
- if the host country aims to reduce unemployment, it may grant tax holidays to companies on the condition that they employ a specified number of nationals;
- if the host country wants to explore a new industry or products or expand an existing industry, tax holidays are granted to newly-established enterprises;
- tax incentives may be granted if the host country wants to develop a particular region of the economy; and
- if the host country wants to develop specific sectors/industries or activities, it will grant tax holidays to activities in R&D, information and communication technology, manufacturing, etc.<sup>12</sup>

With regard to reduced tax rate incentives, it can be seen that they are granted to specific types of companies (e.g. venture capital companies), activities (e.g. fund management and treasury services centres), sectors of the economy (e.g. shipping and agriculture), income sources (e.g. dividends paid to a foreign parent company) or particular geographical regions.<sup>13</sup>

As regards capital investment incentives it can be seen that they are commonly offered to encourage foreign established businesses to relocate to, hire within and/or invest in a certain country, to further develop a particular area or region or promote certain sectors of industry or activities that are considered crucial for the development of a country (such as R&D), and thereby promote the transfer of technology.<sup>14</sup>

Finally, SEZs are intended to develop the economy of the host country, provide employment and stimulate an improved standard of technology by granting tax incentives to enterprises.<sup>15</sup>

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12. See ch. 2 of this book.

13. See ch. 4 of this book.

14. See ch. 3 of this book.

15. See ch. 5 of this book.

## 1.4. Characteristics of the selected tax incentives

The specific features and characteristics of tax incentives may vary from country to country. Nonetheless, the selected tax incentives share general characteristics:

- Entitlement: In order to enjoy the tax benefits, investors should comply with strict requirements and eligibility criteria established by the country granting the tax incentive, specifically the conditions that the investor should fulfil with regard to the requirements set up by the legislator or government based on their objectives and policy considerations. Such eligibility criteria are, for example, (i) the size of the investor or investment (only available for large investors/investments or new investors/investments); (ii) specific sectors (e.g. the mining industry and R&D); or (iii) specific regions. This characteristic is found in all of the tax incentives surveyed. For example, in the case of tax holidays, the investor is required to (i) invest a specific amount of capital; (ii) be a foreigner; (iii) incorporate a new company in the host country; and (iv) perform particular activities. In the case of reduced tax rates, the investor should perform specific activities (e.g. fund management and treasury services) or incorporate companies as required by the favourable regime implemented by the country (e.g. to incorporate venture capital companies).
- Sunset clauses: Tax incentives are usually granted for a limited period. A country's decision on the specific length of time depends on the type of incentive and the type of investment being targeted. Tax holidays fulfil this criterion. In some jurisdictions, the existence of SEZs is also limited in time (e.g. in Kazakhstan).
- Broad in scope with regard to taxes covered: Tax incentives may cover all or just part of the taxes in the host country, depending on the type of tax incentive. For example, tax holidays and SEZs may offer full or partial exemption from host country taxes, such as corporate income tax, capital gains tax, withholding tax, payroll tax, property tax, indirect tax (such as VAT and import duties) and other government levies. Nevertheless, it should be kept in mind that all tax incentives described in this book focus mainly on corporate income tax.
- Interrelated: Different types of tax incentives may be implemented by countries. Implementing reduced tax rates does not mean that capital investment allowances can no longer be implemented in that country.

Depending on the tax policy objectives, countries may implement different types of tax incentives, with some exceptions.

- **Provided in the law:** Tax incentives are provided by the legal framework applicable in the country. In principle, tax incentives should be implemented in tax law. This is specific to developed countries. However, in developing countries, tax incentives are implemented in general investment laws or specific industry legislation (e.g. mining, oil and gas legislation) or through concessions with the host country government, and eventually in tax law.
- **Tax expenditure:** Tax incentives are seen as an element of the corporate income tax system that generates a country's tax expenditure. All tax incentives scrutinized in this chapter determine an expense for the countries implementing them. However, this cost could be counterbalanced with more targeted tax incentives that actually achieve their purposes, as is the case with Malaysia, Singapore, South Korea and Thailand.<sup>16</sup>

These characteristics play an important role in assessing the advantages and disadvantages of using tax incentives, either by the countries or by the investors.

Table 1.1. provides a better overview of the advantages and disadvantages of the selected tax incentives.

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16. See ch. 10 of this book.



Table 1.1. Advantages and disadvantages of the selected tax incentives<sup>17</sup>

| Tax incentive     | Advantages   | Disadvantages  |
|-------------------|--|--|
| Tax holidays      | <ul style="list-style-type: none"> <li>– develop a remote area of the host country;</li> <li>– beneficial for short-term companies that make profit in the first years and not for long-term companies that are more important for the country;</li> <li>– offer full or partial exemption from host country taxes, in particular corporate income tax;</li> <li>– investors may be relieved of certain compliance obligations, e.g. filing tax returns; and</li> <li>– tax planning opportunities for investors.</li> </ul> | <ul style="list-style-type: none"> <li>– if the activity is not profitable, there is a loss of revenue for the host country;</li> <li>– more typical for developing countries and provided in different laws (not only in tax law);</li> <li>– the regulatory authority granting the tax holiday should liaise with the tax authority for proper monitoring and evaluation of the tax incentive;</li> <li>– the investor should fulfil certain criteria to use this tax incentive, e.g. investing a specified amount of capital;</li> <li>– provided for a limited period;</li> <li>– the company benefitting from the tax holiday may not be eligible for other tax incentives in some countries; and</li> <li>– prone to abuse.</li> </ul> |
| Reduced tax rates | <ul style="list-style-type: none"> <li>– offer full or partial exemption from host country taxes, in particular corporate income tax;</li> <li>– provided for an unlimited period; and</li> <li>– tax planning opportunities for investors.</li> </ul>   | <ul style="list-style-type: none"> <li>– scrutinized by OECD and EU State aid rules;</li> <li>– may be provided in different laws (not only in tax law);</li> <li>– the regulatory authority granting the reduced tax rate incentive should liaise with the tax authority for proper monitoring and evaluation of the tax incentive;</li> <li>– the investor should fulfil certain criteria to use this tax incentive, e.g. investing a specified amount of capital; and</li> <li>– prone to abuse.</li> </ul>   |

17. Table 1.1. is made based on the advantages and disadvantages of the selected tax incentives discussed in the relevant chapters of the book.

| Tax incentive                 | Advantages   | Disadvantages  |
|-------------------------------|--|--|
| Capital investment allowances | <ul style="list-style-type: none"> <li>– provided for an unlimited period;</li> <li>– stimulate acquisitions of equipment and R&amp;D; and</li> <li>– tax planning opportunities for investors.</li> </ul> | <ul style="list-style-type: none"> <li>– may be provided in different laws (not only in tax law);</li> <li>– the regulatory authority granting the capital investment allowances should liaise with the tax authority for proper monitoring and evaluation of the tax incentive; and</li> <li>– prone to abuse.</li> </ul> |
| SEZs                          | <ul style="list-style-type: none"> <li>– stimulate active business operations; and</li> <li>– low compliance for investors.</li> </ul>   | <ul style="list-style-type: none"> <li>– do not stimulate passive asset holding;</li> <li>– certain conditions are required to be fulfilled by the investor;</li> <li>– tax authorities may not have supervision over the investors; and</li> <li>– may be provided for a limited period.</li> </ul>                       |

## **1.5. Analysis of the survey’s results**

This section provides an overview<sup>18</sup> of the tax incentives that are used by 207 countries in the world. The countries surveyed were grouped into five regions, i.e. Africa, Asia-Pacific, Europe, Latin America and the Caribbean and the Middle East. Additionally, EU Member States and OECD member countries were scrutinized to see the types of the tax incentives implemented by them.

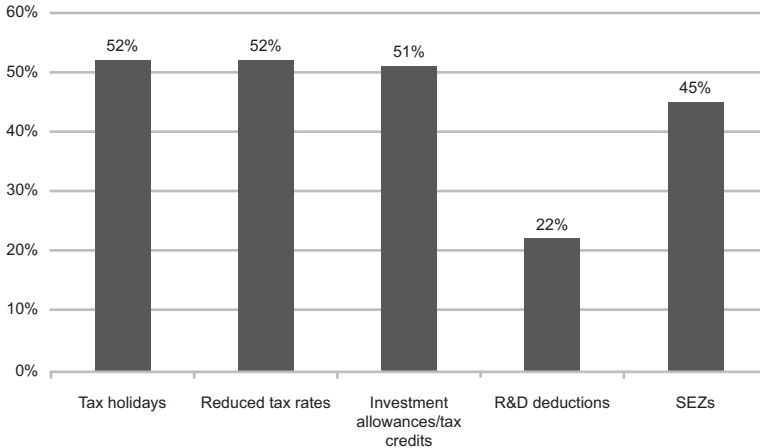
The survey was conducted with the view to assess which tax incentives were still used by the countries surveyed in 2017 and in which regions they were prevalent.

A compilation of the results from the regions was made with the view to give an overview of the prevalence of the tax incentives in the world. From the selected tax incentives, in 2017, tax holidays and reduced tax rates were the most used tax incentives in the world. Of the 207 countries surveyed, 108 used these tax incentives. In second place, investment allowance and tax credits were used by 106 countries. In third place, SEZs were used by

18. Information available on the IBFD Tax Research Platform was used. For almost all of the countries surveyed, the information available was accurate as of 1 January 2017.

93 countries. R&D deductions were implemented by 47 countries. For a better overview of the percentages and hierarchy of the most used selected tax incentives in the world, *see* Figure 1.1. To see which countries implemented the selected tax incentives and were considered in the calculation of the percentages, *see* the annexes at the end of the chapter.<sup>19</sup>

Figure 1.1. Use of selected tax incentives in the world



With regard to the prevalence of the selected tax incentives in each region, it can be seen that of the 47 countries surveyed in the Asia-Pacific region, tax holidays were most used. Tax holidays were implemented by 30 of these countries. Investment allowances and tax credits were also popular in this region, being implemented by 29 of the countries. For a better overview of the percentages and the hierarchy of the selected tax incentives in this region, *see* Figure 1.2. To see which countries implemented the selected tax incentives, *see* Annex 1.2.

19. From the OECD member countries, only Australia, Canada and the United States were considered. Egypt was considered only for Africa and not for the Middle East.



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