



International tax policy

Tashkent state university of economics

Lecture 2



Tax incentives for FDI



The dangers of special incentives

- low or zero additionality (they would come anyway)
- winners curse (officials bid too much for FDI)
- me too (or how to complicate your tax code with sectoral special measures such as film production incentives)
- more abusive tax shelters(“tax forests” and film tax credits again)
- governance and corruption issues: especially in LDCS
- re- labelling of domestic investment to get incentives (e.g. Chinese investment round tripped through Hong Kong)
- revenue effects

Alternative views of the "classical" corporate tax system

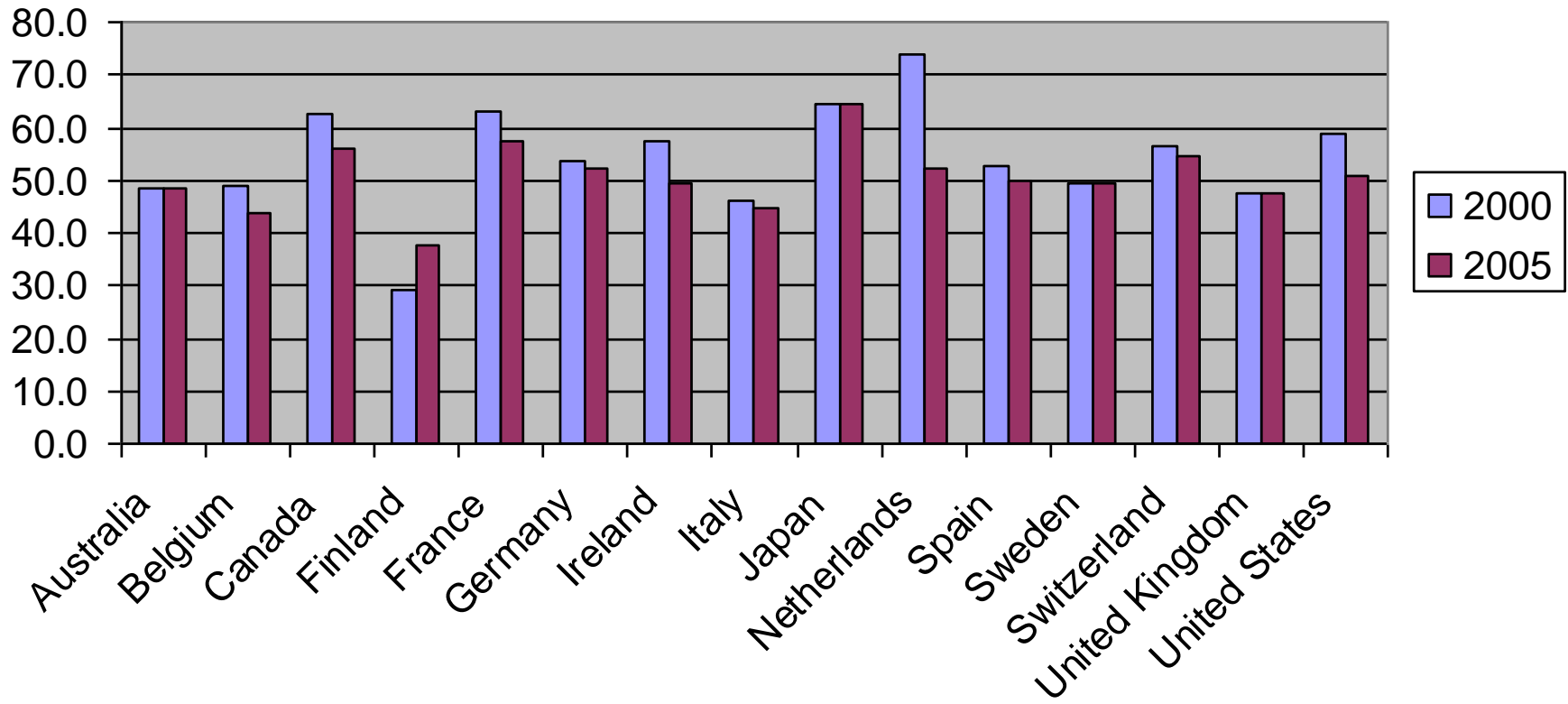
Theory	Influence of nontax factors on corporate financing decisions	Marginal Source of Finance	Marginal use of profits	cost of corporate capital ^a	Effect of dividend tax relief
"old" view ^b	Important	New equity important	Dividend payments	high above market interest rate	significant stimulus to corporate investment
Neutrality view ^c	unimportant	debt	financial investment in capital market	equal to market interest rate	no stimulus to investment
"New" view ^d	unimportant	retained earnings	dividend payments	slightly above market interest rate	windfall gains to existing shareholders; no investment stimulus
	unimportant	at time of establishment: new equity; after establishment retained earnings	reinvestment in real capital	starting very high above market interest rate, but falling over time	significant stimulus to the establishment and growth of new corporations
"Nucleus" theory of the firm ^e	unimportant	retained earnings	dividend payments	slightly above market interest rate	windfall gains to existing shareholders; no investment stimulus

Changes in the Taxation of Dividend Income (2000-2005)

Country	Reform Year	Pre-Reform System	Post-Reform System
United States	2003	Classical	Reduced PIT rate
Germany	2001	Full imputation	Partial inclusion
Finland	2005	Full imputation	Partial inclusion
Italy	2004	Full imputation	Partial inclusion
France	2001	Full imputation	Partial inclusion
Portugal	2002	Reduced PIT rate	Partial inclusion
Slovak Republic	2003	Classical	Personal tax exemption
Turkey	2003	Partial imputation	Partial inclusion

Taxation of Dividend Income

Top personal plus corporate tax rate on dividends




Administering Taxes

- ◎ Relatively cheap to collect for revenue authority because large amounts collected from few taxpayers
- ◎ In UK biggest 20 groups account for about 20% of yield
- ◎ CT as withholding tax for individuals
- ◎ Even if CT is undesirable per se argument is that it is needed as backstop to labour income taxation
- ◎ Ongoing war against avoidance and arms race - pages per finance bill seems ever increasing (in UK at least)




What influences revenues?

- ◎ Tax rate
 - ◎ Depreciation and investment allowances
 - ◎ Special exemptions and allowances
 - ◎ Effectiveness of tax administration
 - ◎ Share of gross profits in GDP
 - ◎ Ratio of debt to equity financing
 - ◎ Share of profits that are subject to **corporate** rather than personal income tax
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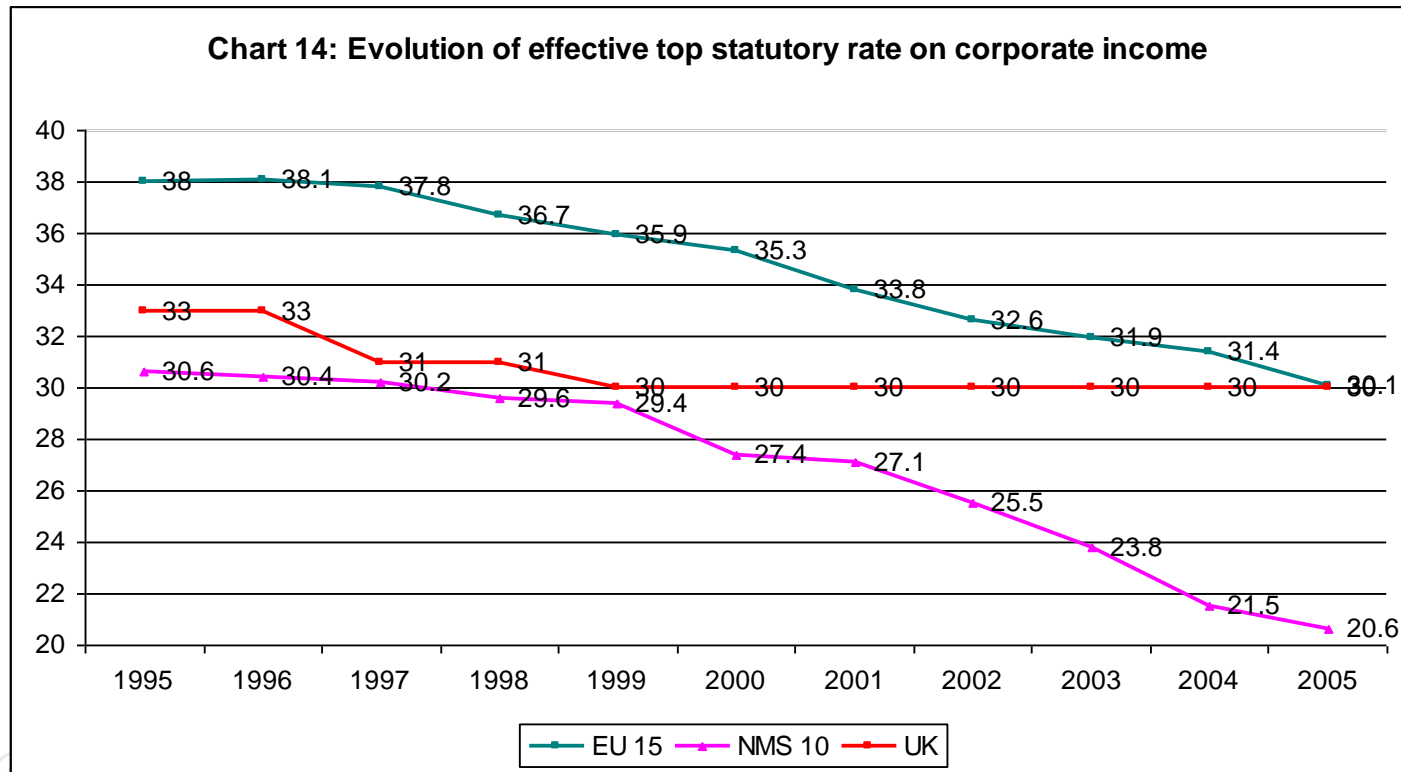


The tax base: Key Decisions

System requires rules on:

- ◎ Income streaming? (in a schedular system like UK)
 - ◎ Loss carry forward/carry back
 - ◎ Tax deductibility
 - ◎ Group relief
 - ◎ Rollover relief for capital gains and indexing
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Revenue neutral reform- rate reductions still funded by base broadening?



Fundamental Reform of Corporate Tax

- ◎ Many countries see problems with the preferential treatment of debt as compared to equity
 - Distortion of financing decisions
 - Opportunities for international tax planning
- ◎ Examples of country reforms that reduce the preferential treatment
 - Estonia with a 100% tax relief on re-invested profits (similarities to a cash-flow tax)
 - Belgium has introduced an Allowance for Corporate Equity
 - Germany is considering limiting interest deductions



Policy Constraints: A summary of Wider Considerations

Economic Theory:

Incidence in open economy
Effect on investment and economic growth
Tax rates across different types of assets

Political


Distribution
Comprehension of tax incidence

International

Tax shifting in the presence of credit regimes
Treaties
Unfair Tax Competition

Administrative

Corporate income tax as a backstop to labour income taxes
Collection Efficiencies



Summary of international trends

- ◎ Statutory corporate tax rates have been falling across the OECD but revenues have been relatively stable
- ◎ The EU has seen a recent fall in statutory rates and fall of revenues, but some of the revenue falls are due to the slowing of economic growth
- ◎ Countries have moved away from full imputation and reduced shareholder relief, but overall tax rates on dividends have generally fallen
- ◎ Some countries are introducing more fundamental corporate tax reforms