



# International tax policy

**Tashkent state university of economics**

*Lecture 3*



## Basic Investment Incentives: Capital Allowances as a starting point

- ⦿ Allow the cost of capital assets to be written off against a business's taxable profits.
- ⦿ Take place of depreciation charged in commercial accounts. (Commercial depreciation is not allowed for tax in UK.)
- ⦿ Specially increased allowances referred to as first year allowances (FYAs). Also called enhanced capital allowances.
- ⦿ FYAs allow a greater proportion of the cost of an investment to qualify for tax relief against a business's profits of the period during which the investment is made. They can bring forward the time tax relief is available for capital spending.

## Starting Point for Reform in the UK : Incentives to invest under standard CT rules

- ◎ Prior to 1984 reform the incentives to invest in UK were very different from now
- ◎ Large negative METRs where investment was debt financed
- ◎ Capital Allowances in UK now:
  - 20% year on a reducing balance basis for general spending on plant and machinery
  - 10% a year on long life assets (> 25 years)

## Industry Specific Schemes

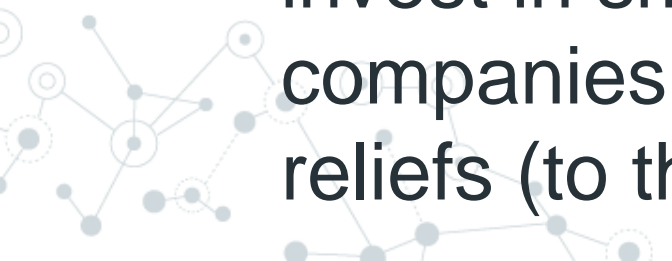
- ◎ Rare in UK (partly due to EU state aid rules)
- ◎ Only current example is film tax relief for low budget “British” films
- ◎ Support for film industry has been plagued by the use of tax incentives for avoidance schemes
- ◎ Cost in tax revenue out of all proportion to any benefit because of avoidance
- ◎ Constant changing of rules to limit

## Industry Specific Schemes: Films and Forests

- ◎ Avoidance by individuals via purchase and leaseback of film masters.
- ◎ Avoidance via re-labelling of television shows to get relief
- ◎ At one point it didn't even matter if film was even ever shown as tax break made underlying profitability of film irrelevant
- ◎ Film tax credit story not unique
- ◎ Tax incentive for forestry created similar problems



## Encouraging Entrepreneurial Activity and Enterprise

- ◎ Started in 1983 with Business Expansion Scheme.
  - ◎ Enterprise Initiative Scheme introduced in 1994 to replace BES
  - ◎ Venture Capital Scheme introduced in 1995
  - ◎ All designed to encourage individuals to invest in small unlisted trading companies in return for various tax reliefs (to the investors)
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## More Detailed History

- ◎ **Business Expansion Scheme.** Introduced in 1983 as a tax effective inducement to encourage investment in companies not quoted on the stock exchange. The scheme ended 31.12.93 and was replaced by the Enterprise Investment Scheme.
- ◎ **Enterprise Investment Scheme.** Introduced by the November 1993 budget as a replacement for the BES scheme which ended 31/12/93. Investors can invest up to £100,000 each year and get 20% tax relief; an additional 20% is available if the venture fails.
- ◎ **Venture Capital Trust.** A special type of investment trust on the Stock Exchange designed to provide start up or expansion capital for unquoted companies
- ◎ See handouts for details of where and how policy failed to live up to expectations

## Policy Lessons

- ◎ Policy rationale, support for risky investment, seemed sensible but:
- ◎ Investors and advisers used schemes in a way not foreseen or intended, e.g. by universities as a way of getting cheap finance for student accommodation
- ◎ Once policy introduced, constant fixes needed and original policy rationale lost, e.g. allowing extension to investment in private renting in 1988. Fixes to stop avoidance still needed despite redesign and renaming of original scheme.
- ◎ **Intentions of policy makers may be unrelated to actual outcome of policy intervention if users behaviour ignored!**

## Policy Lessons and questions: Framework Conditions

- ◎ Industry specific support via tax (and subsidies) tightly constrained by EU state aid rules in UK.
- ◎ Can/should other countries develop similar institutional constraints on central government and provincial level?
- ◎ Strong economic rationale desirable for departing from general CT rules

◎ What objectives meet above test? R&D yes... Culture (films) Not really .....

“strategic industries” better to target

- ⊙ Collect evidence about taxpayer behaviour before introduction of any tax incentive.
- ⊙ Plan to evaluate tax incentives from outset.
- ⊙ Be aware that some policies won't work - it is better to be prepared to abolish these than keep tinkering with them for face saving reasons.
- ⊙ Tax incentives often go hand in hand with enhanced avoidance opportunities. Need to be able to spot and counter these if you go down this road.