BIAC THE VOICE OF BUSINESS AT THE OECD

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BIAC Response to Consultation on Options for Low-Income Countries' Effective and Efficient Use of Tax Incentives for Investment

INTRODUCTION

BIAC believes that tax incentives can be effective instruments to stimulate long term investment and economic growth, but only when used as part of a well-conceived and well-implemented strategy to achieve a predictable, efficient and stable tax regime. In order to be effective, tax incentives require clear pre-established objectives. They should be based in law, transparent and efficiently managed. There is no 'one-size-fits-all' framework to determine which tax incentives will work, and which will not. Instead, the objective of a tax incentive and the decision to use them must be based on a broad economic assessment by the relevant country, including, for example, its financial, social or environmental requirements.

Where a country concludes that a tax incentive is ineffective, care must be taken to manage its removal. Rapid or unpredictable changes to local fiscal policies will often have a negative impact on a country's investment climate, and should therefore be avoided. Changes should be predictable and country actions should respect relevant agreements with taxpayers. Business thrives in politically stable and safe environments, where the rule of law prevails, and all forms of property can be effectively protected.

In addition to our comments set out below, we have also attached a 2013 BIAC submission to the OECD (relating to its "*Work on Tax and Incentives in Developing Nations*"), together with comments on the International Monetary Fund's questionnaire relating to the OECD's consultation document.

DETAILED COMMENTS

1. Predictable, efficient and stable tax regimes are the best incentives to stimulate long-term investment. Options for the effective and efficient use of tax incentives should be developed to help Low Income Countries ("LICs") to achieve predictability, efficiency and ultimate stability in their tax regimes.

2. To achieve predictability and manage expectations, it is important to help LICs focus on and clearly define "tax incentives"[1]. The OECD describes them as "*special tax provisions granted to qualified investment projects or firms providing favorable deviation from the general tax code*". A long-term view should be taken when determining whether a favourable deviation exists. It is important not to judge over the short-term or even on a single year basis

[1] Page 5 of the Options paper.

3. BIAC strongly supports the requirements of rule of law, transparency and efficient administration as criteria for efficient tax incentives. These criteria are amongst the ones mentioned in BIAC's previous comments on the subject[2].

4. It is also important to take a broader view of these criteria. In certain sectors, tax rules may be determined per decree, agreements or regulations[3]. Whether or not sufficient oversight and transparency are available in these cases will depend on the general legislative process in the country. Oversight can be made available through parliamentary processes, or through other means, e.g. the Extractive Industries Transparency Initiative for particular sectors.

5. To review, design or implement tax incentives, policy makers should be urged to look beyond tax. BIAC supports the Report's assessment that investment tax incentives should be viewed as part of broader policy design. If objectives for tax incentives are not clearly defined up-front, their effectiveness cannot be assessed. The potential loss of tax revenue through the use of tax incentives should be considered on the basis of the full project, including other risk compensation and economic benefits to the broader economy. For example, tax incentives may increase economic growth and development to attract first investors in the absence of a local market or local skills that are still being developed. The risk of these developments not occurring needs to be considered in the trade-off[4].

6. Before introducing and/or reviewing tax incentives, there should be a consideration as to whether tax incentives are the most appropriate instrument to meet a stated policy objective. Whilst the OECD's options paper considers some recommendations on what tax instruments are most appropriate, LICs should first consider whether they would like to deliver investment incentives through tax differentiation in the first place (before selecting which tax instrument to choose). This requires that various parts of a government collaborate, consult and agree on how to stimulate the economy and/or investment to ensure appropriate and transparent choices are made.

7. Individual countries have the right and the obligation to shape their local tax policy. If countries decide to grant tax incentives, they should be open to all meeting pre-set requirements and should not be allocated arbitrarily. Tax incentives should not, and cannot, compensate for an otherwise poor tax structure, but can be a highly effective complement to well-conceived tax design.

8. BIAC believes that best practice exchange and practical guidance development will help LICs determine what is needed (e.g. in terms of policy development and coordination) when assessing the cost/benefit of investment incentives, and what place tax incentives can have in attracting investment. In reality, most businesses will not make an investment just because a tax incentive improves the economics or pushes negative economics to a positive outcome. Rather, a range of other factors are considered.

[2] See Annex II.
[3] Page 21 of the Options paper.
[4] The benefits generated by tax incentives would also be expected to go beyond future tax revenue from the project in question.

9. Global businesses look at tax as a part of the whole package to determine whether to invest or not in a particular country. Competitive tax regimes will improve the likelihood of investment, if other factors are also aligned with a group's objectives. This will be the same for all types of incentives that apply to all sectors. Depending on the comparative state of the other factors, (profit) tax may be an equally relevant factor for resource-related industries as for mobile businesses[5]. For example, if a profit tax system does not allow for an equal sharing of the investment risk, profit tax incentives may help to compensate in case of high-risk investments. What is required is that a LIC form a view of the investment risk and how it can be shared in the country.

10. The multitude of factors and risks that exist underscore that there is no "one-size-fits-all" approach to tax incentives. Tax incentives that work in one country may not be effective in another and vice versa, i.e., if an incentive does not work in one economy or sector, it does not mean that the same will be ineffective elsewhere.

11. One of the investment risks will always be instability. Stability is, therefore, a key feature of a well-designed and competitive tax system. For most businesses, stable rules are necessary to achieve the economic results that were anticipated when the investment was made, e.g. in order to maintain the necessary level of production, or to obtain the necessary maintenance and expansion funds. The risk of instability will be factored into the overall cost of the investment. The bigger the investment, the more relevant it will be. There is sufficient evidence in developed and developing countries that instability of the tax regime has a negative impact on a country's investment pipeline.

12. Stability clauses serve their purpose in many jurisdictions, not least in LICs. Generalizing statements that deny the importance of stability –particularly for multi-billion dollar long-term investments– are unhelpful, and should be avoided[6].

13. Stability clauses should be assessed against other criteria, and rather than condemning the practice altogether, it would be helpful to provide guidance or establish a benchmark as to where stability clauses are and are not appropriate. For example, clauses that fall foul of the rule of law, are not transparent, and cannot be administered effectively would fall short of this benchmark.

14. Predictability and stability can in any case be enhanced through flexible tax instruments. Examples of flexibility include:

- Tax incentives that are time limited;
- Tax incentives that depend on the achievement of certain goals; and
- Tax rate differentiation dependent on quoted prices or published/international indices

These choices allow for predictability of tax revenues for budgeting (with taxpayer and tax authorities) whilst considering external changes.

[5] Page 10 and 17 of the Options paper.

[6] Pages 26/29 – that tax stability clauses create unfair advantages to old investment and can create significant distortions.

15. Tax stability clauses can also help avoid unilateral and/or arbitrary tax changes. Whilst BIAC understands that there could be situations where opaque or ill-considered tax arrangements should be reconsidered, this should never be done at short notice, contravening the arrangements or retroactively. Such changes will generally have a more negative effect on future revenues and Foreign Direct Investment.

16. The tools for the assessment of tax incentives should be easy, clear and simple in their application. Possibilities to make the tools more pragmatic and simple should be carefully analyzed before publication. Approaches like the World Bank questionnaire[7] to assess incentives based on clear criteria seem helpful.

[7] Page 30 *et seq*. of the Background document.

ANNEX

ANNEX I

RESPONSE TO IMF QUESTIONS ON PAPER ON TAX INCENTIVES

1. ***In your view, how effective are (different types of) tax incentives to boost investment? Which side benefits do these investments generate, e.g. through productivity spillovers to the rest of the economy? Do new investments/jobs displace existing ones?***

Tax incentives that are properly conceived and implemented can generate positive economic effects, e.g. realization of a greater number of investment projects, increased employment, and greater economic spillovers (boosting individual's revenues and promoting consumer demand).

Tax differentiation (e.g., between taxation in various sectors, between taxation in various areas of a country) should not always be considered a tax incentive. The overall risk-reward situation should be considered when developing tax policy, especially for extractive industries where the underlying economic profile of different investments may warrant tax differentiation to ensure optimal extraction for a country.

Government support for new technology development is also a well-accepted economic policy. To be effective for innovation, support should be focused and predictable, phasing out on a known timetable and directed at technology development, as opposed to ameliorating the cost to end-users. Incentives should not restrict technology options (technology neutral) but reward innovation that delivers cost-effective and sustainable solutions.

However, tax incentives are not always effective in generating a long term positive impact. The initial objective for granting the tax incentive may not have been clear or transparent (e.g., tax relief that is given on an arbitrary basis). Tax legislation, policies and regulations seem to the greatest positive impact when coordinated and considered in view of sustainable policy requirements to avoid overlapping incentives, and working in complementary fashion with other government policy initiatives.

Tax incentives are often conditional on certain legal requirements that limit the extent to which jurisdictions can intervene in the profitability of local enterprises. For example, EU member state governments cannot grant tax incentives that are generally financed but benefit only certain activities/sectors given State Aid regulations.

New jobs can displace existing ones. However, this may be a valid objective of a government to achieve higher income levels for their population, or more efficient investments to generate economic growth, for example. Job displacement is more likely to occur in a tight labour market in the first place and may therefore be less of an issue in LICs.

2. ***What is the fiscal revenue cost of tax incentives in your view/experience? How important are indirect fiscal effects?***

No particular approach can determine the actual fiscal revenue cost of tax incentives. Often tax incentives are granted to attract additional investment. In such cases, it is difficult to determine the base case (i.e., what would have been the fiscal revenue generated if a tax incentive had not been granted).

It is more relevant to understand what a government's objectives are for considering tax incentives, and how much they would be worth (to that government). This should be considered not just from a narrow point of view, but taking into account the net fiscal cost in general (i.e. overall government budget, rather than corporate tax revenues). Such an assessment would equally be an appropriate basis to determine whether incentives are required (where the model needs to be adjusted to be competitive in a sustainable way) and what would be the best instrument to achieve the government objectives (i.e. which type of incentive would be best?).

Governments (especially those of oil/gas producing countries or with other significant extractive industries) should have their own economic models considering cost/benefits beyond the corporate tax take. These models can be used to benchmark the implications of various instruments to improve the investment climate. Advisory firms or international organisations can assist in verifying. Such approximations could work on the basis of overall rate of return hurdles, which could also help with shorter term investments.

In any case, conditions to obtain incentives should be based in law, transparent and effectively managed.

3. *What is a good design of tax incentives for investment in terms of cost effectiveness (effect per $ spend)—i.e. the type of relief offered, the way in which they are targeted, the way they are phased out?*

There are no "one-size-fits-all" tax incentives. One and the same incentive may or may not be efficient depending on the sphere of application (type of activity, state of economy, region, etc.). The objectives of the incentives may only be achieved over the long-term, whereas the cost may be felt immediately. Economic effectiveness can only be measured separately for each incentive, but should consider policy and the broader economic impact over a long term perspective.

Good design of investment incentives is very important. They should be focused – and not affect existing investments or production.

Addressing inefficiency requires:

- Clear and upfront identification of the objective for the incentives to determine its scope;
- An economic feasibility study in proposals for new incentives (where possible).
- Transparent and upfront identification of markers to be achieved;
- A system of monitoring and efficiency evaluation.
- Clarifications to a precise validity period (the need for and options to implement a 'phase-out' of the incentive should be considered upfront.)

Investment incentives should be:

- Easy to understand;
- Easily administered; and
- Coordinated (with overall policies, between government departments and with other incentives).

Most importantly, investment incentives cannot compensate for an otherwise poor tax structure nor can they compensate for an unfavourable investment climate (e.g. significant administrative barriers to private investment, limiting competition, no independent legal system, failing property rights protection, etc.)

4. ***Do you have views on how tax incentives should be governed and which practices should always be avoided? How can transparency of tax incentives be ensured?***

Tax incentives should be consistent with the country's economic policy. The governance and policy design of tax incentives should, therefore, be aligned with other government departments. This should help avoid inconsistencies between government policies as well as avoid overlap. In case of multi-tiered country structures (e.g. with local governments having fiscal powers), coordination should exist between various tiers of government. This should also avoid overuse, which could undermine general tax compliance.

Tax incentives should not affect existing investment/production -neither negatively nor positively.

Tax incentives should not be provided arbitrarily. The conditions for qualifying should be clearly defined and open to all meeting these criteria. They should be based on clear objectives identified upfront that should be achieved with these incentives. This information should be covered by the rule of law. The legislative process should be structurally sound and transparent. This may not always require a full parliamentary process, certainly if this cannot be passed timely and efficiently but should always include sufficient checks and balances.

5. ***What obstacles for reform of tax incentives are often encountered? What can be done to overcome such obstacles to enable improvements in effectiveness and efficiency? Which successful examples illustrate that this is feasible?***

Obstacles to reform can be internal (within the control of policymakers) and external (outside the control of policymakers). Periods of significant (international) economic or social unrest may form external obstacles to tax incentive reform. Political instability or fragmented government may equally form obstacles to tax incentive reform.

The biggest risk regarding tax incentive reform in LICs is the instability risk created by the reform. Risk of instability will feature greatly in the assessment of the competitiveness of a tax regime as well as of the overall investment climate. There are numerous examples of the instability/unpredictability of a tax regime having a negative impact on the investment pipeline for a country. Especially if a country is looking to attract large extractive or infrastructure projects, investments will not necessarily return once a new regime is in place. The risk of instability has had an impact on the economic modelling done by investors when deciding where to invest and may have caused the capital to be invested in another region/country.

To limit this risk, any reform to tax incentives should consider a number of basic aspects:

- As for all tax law changes, changes to rules applicable to tax incentives should not apply retroactively;
- Grandfathering conditions for existing investments should be considered.
- Tax incentive related legislation should be clearly targeted to specific situations;
- Clear and reasonable transition rules should be available, especially for long-running projects;
- Ill-considered and unilateral changes should be avoided. It is relevant to engage timely and effectively with the taxpayer when considering tax incentive reform. Preferably a clear timeline and end date for review should be made available.

6. ***Do you have views on the costs and benefits of tax competition in the use of tax incentives? When and where is regional tax coordination desirable to address the spillovers from tax competition? Which regional initiatives are successful and in what manner?***

Tax incentives should be considered in view of the overall policy environment in a country and in order to be effective, should be linked to clearly defined policy objectives.

Countries have different economies and different policy objectives for their development. Countries should be able to set tax policies and allocate tax incentives that allow them to realise their objectives. Regional coordination may not be helpful without similar objectives and economies.

Tax incentives cannot compensate for an overall unfavourable investment climate; if granted in such a situation, they will likely be inefficient in attracting sustainable investment.

7. ***Which tools for analysis should governments in low-income countries use to inform policy makers about effectiveness and efficiency of tax incentives?***

In order to assess the effectiveness and efficiency of tax incentives, it is important to clarify the objectives of having the tax incentives in the first place. Once the objectives have been clarified, it is important to determine whether they have been realized and at what overall net economic cost. The analysis should not restrict itself to tax costs and tax revenues but consider the broader economic impacts.

LICs should be supported to allow expert surveys to be drafted to analyse the effectiveness of tax incentives. There are many options: questionnaires, individual expert reports on groups of incentives, creation of committees developing a common opinion on certain incentives, etc. In any approach, evaluation of incentive efficiency should include:

- An iIncentives inventory. It is important for LICs to ensure its various departments cooperate to ensure overviews of incentives can be made available;
- Incentives classification (types, targets, type of tax, etc.);

- Efficiency evaluation with involvement of experts. When there are differences regarding efficiency evaluation of a certain incentive, a harmonization procedure is needed to develop a common opinion.

This evaluation can be conducted using the growth rate of (target) economic indicators, and open book economics could be considered.

8. ***To make progress in more effective and efficient design and governance of tax incentives, what is the role of various stakeholders?***

Governments should coordinate efforts and information to:

- Have a clear and long-term view on policy objectives for investment;
- Ensure an overview of incentives (not just tax incentives) granted;
- Ensure economic modelling, using information already available within different departments.

LICs should have expert support in developing their economic modelling, including potential costs and revenues to meet their policy objectives.

In case tax incentive reforms are considered, multilateral engagement will be required with taxpayers to ensure awareness, consider alternatives and test impact assessments.

Organising support and multilateral engagement could be supported with best practice exchange on a regional or international basis. BIAC would be happy to participate in such engagements.

ANNEX II

Paris, 1 March 2013

BIAC Response to OECD Work on Tax and Incentives in Developing Nations

Dear Ben,

We met on the 14th November 2012 to discuss the various initiatives that the OECD is currently working on in relation to tax and developing nations. One of those initiatives is the OECD's work on tax incentives.

Following the meeting, you provided a copy of the OECD's "**Draft Principles to Enhance the Transparency and Governance of Tax Incentives for Investment in Developing Counties**" (the "Document). This document predominantly focusses on principles that the OECD recommends should be adopted by developing countries when creating and implementing tax incentives. You requested that BIAC consider providing comments on this.

During the meeting, you asked if BIAC could consider this topic more generally and how business can contribute. You specifically suggested that our members might provide input in the following areas:

- The development of a set of practices for business to follow when operating in developing nations (that offer tax incentives);
- Who business should communicate with in government when discussing applications for tax incentives; and
- Best practices on how incentives should developed and what types of incentives work well?

The following note reflects initial input from BIAC Members received after circulating your draft note on this issue. We would welcome a more formal discussion between the OECD and business on this important topic, both in relation to tax incentives in developing and developed nations. Through a more formal process, we would be better placed to canvas opinions more widely and to provide more constructive input.

Principles for developing nations

We agree that business should operate based on the principle, not only of maximizing shareholder value, but also of positively contributing to the economies of their host nations. BIAC encourages investing for the long term and responsible behaviour in relation to the law in general terms, including tax incentives.

BIAC endorses the establishment of principles to be adopted in this regard. However, there may be benefit from considering this in the context of OECD member states as well as developed non-OECD members and developing nations. Several times throughout the Document, the challenges posed by costs and difficulties in gathering data and measuring incentives are identified. In this regard, principles proposed for developing nations can only be meaningful if they reflect realistic examples set by their developed counterparts.

Developed nations may have a longer history of establishing tax incentives and may also have more effective governance frameworks and legal procedures to ensure that the development and implementation of incentives is well managed. However, developed countries do not have a strong track record of measuring the impact of tax incentives or gathering detailed information on their on-going use.

The development and adoption of a set of robust principles for developed and developing nations may be the only place to begin this important discussion.

1. ***Make public a statement of all tax incentives for investment and their objectives within a governing framework.***

BIAC agrees that a transparent and public policy statement on tax incentives and their objectives would be helpful. Business would also be happy to see very clear guidance published on the requirements to qualify for incentives, including, for example, the period of time where the incentive can apply and the administrative processes that must be followed. Such information should be updated regularly.

With respect to establishing appropriate objectives, BIAC has two initial comments:

Establishing the most appropriate objective: Establishing the most appropriate objective of a given tax incentive for investment will largely depend on the facts and circumstances surrounding the economic position of the host country. However, many BIAC members believe that developing nations should focus their tax incentives to encourage jobs growth, training and up-skilling the local population, including support where appropriate for significant investments that will contribute in these areas.

Objectives and measurement: The measurement of the effectiveness of a tax incentive can only be achieved where adequate ground work is performed to determine an appropriate goal and a framework. Without this initial groundwork, that even many developed nations find hard to undertake, controlling for variables and accurately identifying the most relevant data to understand the impact of an initiative will be a significant challenge.

BIAC recommends that the OECD assists developing nations by providing guidance on developing appropriate objectives and how to measure the impact of those objectives.

BIAC also suggests that OECD members/developed countries should take the lead to review and evaluate the effectiveness of their own incentive mechanisms. Most developed nations do not undertake post incentive reviews. Some governments do collect data on the cost of incentives but do not attempt to measure the benefit. This is likely going to be a difficult area to make significant progress due to constrained resources, the practical difficulties of measuring benefits (controlling for other variables) and the political barriers.

High quality work is required when incentives are being developed to establish a framework through which the incentive can be assessed and measured. Independent reviews will be required as governments may be less willing to publish negative information about their own tax policies. This is perhaps an area where business, civil society and governments can work together.

2. *Provide tax incentives for investment through tax laws only.*

While there may be policy disagreements as to the relative merits of tax incentives, BIAC believes that if countries offer tax incentives, those incentives should be legislated as part of the tax law, rather than operating on an ad-hoc basis.

3. *Consolidate all tax incentives for investment under the authority of one government body, where possible.*

Centralising the management of incentives does appear to be a reasonable proposal in principle. If as suggested above, all tax incentives are part of the tax law, then the administration of those tax incentives would be centralised in practice through the tax authority. However, BIAC has two comments in this respect; Firstly, centralizing the management of incentives may, in some ways, have the opposite impact than is desired. Having centralized statutory incentives could result in a rigidity of application that does not achieve the stated objective. Having some flexibility in application and negotiation through a regionalized or departmentalized structure may provide the additional flexibility that is required to really target the type of investment that will most likely achieve the stated goal.

Secondly, if incentives are managed on a centralized or diversified basis, in both cases a robust governance framework would be needed to ensure effective and responsible implementation. The structure in both cases would be different and guidance would be required in this respect.

In terms of governance, we suggest that a review board comprising representatives from academia, civil society and business could be charged with reviewing the net impact of the tax incentives in contributing to economic development and the future expansion of the tax base.

We also note that there is a lack of examples from the developed world where investment tax incentives are administered through only one centralized body.

4. *Ensure tax incentives for investment are ratified through the law making body or parliament.*

BIAC agrees that the ratification of tax incentives through the relevant law making body provides transparency to other stakeholders, perhaps most importantly the public. Through the embodiment of tax incentives in law, tax payers will be able to make investment decisions with more confidence. Such an approach should also reduce the potential for more ad hoc behaviour and informal tax incentives.

As we have indicated in section 2, incentives should be clearly legislated in the tax law, rather than operating on an ad-hoc basis.

Business is also best placed to make investment decisions where the law clearly indicates how tax incentives may be changed, or removed over time, and to what extent any existing grants of tax incentives would be grandfathered if the law is changed.

5. *Administer tax incentives for investment in a transparent manner.*

BIAC supports the idea of disclosure of incentives granted to tax-payers in their statutory tax returns. This would provide full transparency and an audit trail to governments to assist in the measurement of the impact of incentives and for the tax auditors in the planning and execution of tax audits. Clear guidance would be required to agree exactly what type of information would be appropriate to disclose on a broader basis. This would need careful consideration to take into account, for example:

- What the intended objectives of the incentive are and whether information disclosed by tax-payers would be useful in measurement;
- Whether imposing certain public disclosure requirements on tax payers could potentially allow access to their broader corporate strategy;
- Whether the information can be interpreted accurately by key stakeholders and is useful on a stand-alone basis; and
- Who is required to sign-off on the accuracy of such disclosures?

BIAC believes that business will generally be open and transparent in their approach to discussions on tax incentives during general tax audits. Governments may look to incorporate a random review of tax incentives in their tax audit strategy. In this regard, BIAC supports frameworks through which tax-payer risk profiles are established over time – with cooperative and compliant tax payers falling down the risk spectrum, and as such, being subject to fewer audits or enquiries.

6. Calculate the amount of revenue forgone attributable to tax incentives for investment and publicly release a statement of tax expenditures.

Business is concerned with possible effects of principle 6. This principle suggests that the primary factor that should be considered when assessing the implementation of a tax incentive should be (corporate tax) revenue forgone. If this is the case, clear guidance would need to be established with respect to how the quantum of revenue forgone should be calculated. We would assume that the proposed basis of calculation would be a simple assessment of the taxes generated through the application of the tax incentive vs. the tax revenues that would have been generated based on the same financial results and business circumstances without the application of the relevant incentive.

It is likely that such a calculation would not take into account the potential impact of the tax incentive on the behavior of a business. This would obviously stretch along a continuum from either not choosing to invest at all to re-structuring its investment in a different way which may be assumed to have a less stark, but still potentially significant, impact on tax revenues.

Approaching assessment in an overly simplistic way ignores the fundamental economic reason for the tax incentive, and would, presumably more often than not, result in a situation where the tax incentive is proved to be very costly to the host nation.

A more effective way to measure the effectiveness of tax incentives would be to establish a framework for assessment when each incentive is designed and launched. Such an approach would take into account the expected cost of implementing and administering the incentive, the target revenue generated and the intended outcome of the incentive (for example, measured in job creation, employment taxes raised in a specific sector or other economic factors relevant to the target industry). Such an approach, although requiring more investment at the development stage, would provide for a much more effective and accurate assessment of the incentive. We understand that the OECD is currently undertaking work to explore the possibility of using a standardized dynamic scoring tool to assist developing nations in assessing the impact of tax policy changes. Although a significant challenge, BIAC welcomes this ambitious initiative.

We also reiterate that in most cases, the development of specific geographic or technological areas, job creation, training and up-skilling the local population may be the most appropriate objectives and the quantum of revenue forgone must be assessed relative to the positive achievements of the incentive.

7. ***Carry out periodic review of the continuance of existing tax incentives by assessing the extent to which they meet the stated objectives.***

Business agrees that incentives developed for a specific purpose should not necessarily continue into perpetuity. However, clearer guidance would be needed on the removal of incentives when they are deemed to have achieved their goal.

Business will be most willing to commit to investments where political and legal stability are most likely. In this respect, it would be beneficial to clearly set out the process through which each tax incentive would be phased out. Business would propose that, on choosing to make an investment decision, the relevant tax incentive should be agreed to by the government for a minimum period of time subject to covenants (covering business behaviour and structure/size/scope of investment) and/or grandfathering rules. Only with meaningful commitments can business make the most effective investment decisions.

As noted in relation to principle 6, there must be a clear framework developed for each incentive to determine how its effectiveness should be measured. Only in this way can sensible decisions be made by the relevant governmental bodies. The relevant factors may include more than just the corporate tax revenues forgone.

8. ***Highlight the largest beneficiaries of tax incentives for investment by specific tax provision in a regular statement of tax expenditures, where possible.***

Very clear guidance will be the key to the successful implementation of principle 8. To determine whether a particular group of companies benefits disproportionately from tax incentives, it must first be well understood what a tax incentive is seeking to achieve. For example, if a particular country is seeking to develop its service (research and development) sector, it may be reasonable for the advanced scientific research institutions to receive a relatively large share of the incentive.

The language of the proposed principle may be interpreted that companies receiving the most significant corporate tax benefit should perhaps, at face value, be scrutinized more closely as taking advantage of the tax system. However, without taking into account the broadest range of information (e.g. relative numbers of jobs created/investments made etc.) it is difficult to draw conclusions.

Without first understanding exactly what a tax incentive is setting out to achieve, and how individual tax incentives should be measured, it will be very difficult to assess their fairness and effectiveness. Another difficulty in measuring and comparing is that different incentives may be implemented to drive different behaviours in different industries, in this respect, comparing apples with oranges would be a risk. Sometimes a tax incentive is implemented to compensate for the inadequacy of the underlying general corporate tax law, for example, where there is no minerals tax law that addresses some of the tax policy and design issues that are peculiar to the natural resources sector. In cases such as these, the development of a minerals tax law may be a more sustainable alternative to tax incentives.

It may be more effective to measure whether a particular incentive has achieved its stated objective and the relative distribution of incentives as a secondary factor. Of course, targeting incentives at the most appropriate segments of industry and designing well-functioning incentives (that can be measured) are important foundation stones.

The OECD could look to the work that has been done for the Extractive Industries Transparency Initiative (EITE) when considering the design of any disclosures and practicality of implementation.

9. ***Collect data systematically to underpin the statement of tax expenditures for investment and to monitor the overall effects and effectiveness of individual tax incentives.***

With respect to principle 9, BIAC would once again reiterate that developed countries must lead by example where data collection and incentive measurement is concerned. This is an area where even developed nations have a poor track record of devoting resources to gathering data and measuring the effectiveness of incentives.

Principles 9 and 6 should be considered side by side to ensure that reporting requirements are fair and can be effectively used for governments to make investment decisions. BIAC would welcome additional guidance in this area.

10. ***Enhance regional cooperation to avoid harmful tax competition.***

BIAC agrees that greater discussion within groups such as ATAF could be helpful in avoiding wasteful tax expenditure. Increased dialogue between such organizations should be encouraged by the OECD.

Regional common markets or free trade zones can also contribute to mitigating tax competition through incentives, certain free trade zones, noting Mercosur as an example, have adopted guidance under which incentives are developed. If incentives are seen to contravene the guidance, they must be adjusted. Promoting participation in such trade zones may facilitate the development of broader principles through which tax incentives can be developed and managed,

Business practices

There are likely a range of very basic principles that business would sign up to in relation to how they use and work with tax incentives. This may include principles such as the following:

1. While many businesses will already be subject to anti-corruption legislation such as the US Foreign Corrupt Practices Act and the UK Bribery Act, other businesses could undertake not to pay bribes or similar monies for the purposes of obtaining tax incentives;
2. With the exception of large investments that may be transformative for economic development and where the general tax law is insufficiently developed, not to seek individual or bespoke tax incentives that are not provided for in domestic law; and
3. Only to take advantage of transparent tax incentives, publically published and endorsed by the host nation legislation.

In return, business will be looking for politically stable and safe nations where the rule of law prevails and intellectual property can be effectively protected. BIAC would welcome more formal engagement with the OECD to develop these principles further.

Sincerely,

Will Morris

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