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Tax Incentives and Foreign Direct Investment

A Global Survey



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Foreword

Foreign direct investment (FDI) is increasingly being recognized as an important factor in the economic development of countries. Besides bringing capital, it facilitates the transfer of technology, organizational and managerial practices and skills as well as access to international markets. More and more countries are striving to create a favourable and enabling climate to attract FDI as a policy priority. In addition to reducing the restrictions on the entry of FDI, they are actively liberalizing their FDI regimes.

While the efficacy of incentives as a determinant for attracting FDI is often questioned, countries have increasingly resorted to such measures in recent years. In particular, they have been offering tax incentives, to influence the location decisions of investors. This study contains a survey of tax incentive regimes in over 45 countries from all regions of the world. Nearly all countries surveyed offer incentives that target specific sectors. Regional incentives aimed at assisting the economic development of rural or underdeveloped areas are also prevalent in nearly 70 per cent of the countries surveyed.

In terms of the types of fiscal incentives granted, there is clearly an increasing trend towards offering full or partial tax holidays or tax rate reductions for specific types of activities. Nearly 85 per cent of the countries surveyed offer such incentives. Another trend is the increasing prevalence of accelerated allowances, generally for investment in plant, machinery or industrial buildings, or a combination of allowances for investment in training, research and development or similar types of activities. Such allowances have the effect of enhancing the capacity of the community and the business environment. This type of incentive also tends to be much less costly than an outright tax holiday. The survey shows that some 60 per cent of the countries reviewed were granting allowances of this nature.

Consistent with the aim of increasing foreign currency earnings, there is also a clear trend towards the development of export incentives. More than 90 per cent of the countries surveyed offered some form of incentive of this type. Typically, export incentives apply to almost all taxes, whereas with other kinds of incentives, the trend is towards a more selective exemption or partial exemption.

The analysis also throws light on other issues related to the use of incentives, such as design considerations, the importance of proper administration of incentives and home country measures that increase the efficacy of tax incentives offered in host developing countries. Policy makers will find the study a useful tool in the design, implementation and administration of incentives.

Rubens Ricupero

Secretary-General of UNCTAD

Geneva, July 2000

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Contents

Foreword.....	3
Part 1 OVERVIEW	9
TAX INCENTIVES: ISSUES AND TRENDS	11
A. OBJECTIVES OF TAX INCENTIVES	12
Regional Investment	12
Sectoral Investment	13
Performance enhancement	13
Transfer of technology	13
B. ISSUES RELATING TO TAX INCENTIVES	14
Institutional issues	14
“Infant industry” issues.....	15
C. CLASSIFICATION OF TAX INCENTIVES	19
Reduced corporate income tax rate	19
Loss carry forwards	19
Tax holidays	19
Investment allowances	20
Investment tax credits.....	21
Reduced taxes on dividends and interest paid abroad	21
Preferential treatment of long-term capital gains	21
Deductions for qualifying expenses	22
Zero or reduced tariffs	22
Employment-based deductions	22
Tax credits for value addition	22
Tax reductions/credits for foreign hard currency earnings.....	22
D. DESIGN AND ADMINISTRATION OF INCENTIVES	23
Main considerations	23
Federal-state overlap.....	24
Other administrative issues	24
E. HOME COUNTRY MEASURES AND TAX TREATIES	28
Avoidance of double taxation	28
International commitments	30
Part 2 THE SURVEY.....	33
A.AFRICA	35
A Brief Summary	37
1. Angola	40
2. Cameroon	41
3. Côte d'Ivoire.....	43
4. Egypt	45
5. Ghana	47
6. Malawi	49
7. Mauritius	50
8. Morocco.....	52
9. Namibia	54
10. Nigeria.....	56
11. South Africa	59
12. Uganda	61
13. Zambia	63
14. Zimbabwe	65
B.ASIA AND THE PACIFIC.....	67
A Brief Summary	69
1. Australia	73
2. China.....	76
3. Cyprus	79
4. Hong Kong, China	81

5. India	83
6. Indonesia	86
7. Israel	88
8. Lebanon	92
9. Malaysia	94
10. Pakistan	97
11. The Philippines	99
12. Saudi Arabia	101
13. Singapore	103
14. Taiwan, Province of China	106
15. Thailand	108
16. Turkey	110
17. Vietnam	113
C. EUROPE AND ECONOMIES IN TRANSITION	117
A Brief Summary	119
1. Bulgaria	122
2. Hungary	123
3. Ireland	126
4. Kazakhstan	129
5. Lithuania	130
6. Malta	132
7. Poland	134
8. The Russian Federation	137
9. Slovenia	138
10. Uzbekistan	140
D. LATIN AMERICA	143
A Brief Summary	145
1. Belize	147
2. Brazil	149
3. Chile	152
4. Colombia	155
5. Costa Rica	157
6. Ecuador	159
7. Guatemala	162
8. Guyana	164
9. Panama	165
10. Peru	169
11. Uruguay	173
12. Venezuela	175
Abbreviations	177

BOXES

Box 1: The Changing role of incentives: industrialization of Singapore.....	16
Box 2: Avoidance of double taxation.....	29 30
Box 3: Tax sparing and foreign direct investment in developing countries	30 31
Box 4: Multilateral agreements.....	31 32

TABLES

Table 1: Governmental objectives and tax incentives use offered	17
Table 2: Sample of tax incentives in Ireland	18
Table 3: Main categories of tax incentives.....	20
Table 4: Two-year tax holiday and alternative commencement rules.....	26
Table 5: Alternative loss-carry forward rules.....	27
Table 6: Overall numbers of DTTs signed per region.....	29
Table 7: Synopsis of types of incentives: Africa.....	37
Table 8: Tax treaties signed per country/territory: Africa.....	37
Table 9: Synopsis of types of incentives: Asia and the Pacific	69
Table 10: Tax treaties signed per country/territory: Asia and the Pacific	69
Table 11: Synopsis of types of incentives: Europe and economies in transition	119
Table 12: Tax treaties signed per country/territory: Europe and economies in transition	119
Table 13: Synopsis of types of incentives: Latin America	145
Table 14: Tax treaties signed per country/territory: Latin America.....	145

Part 1

OVERVIEW

Tax incentives: issues and trends

Over the past two decades, most Governments have been actively promoting their countries as investment locations to attract scarce private capital and associated technology and managerial skills in order to help achieve their development goals. They have increasingly adopted measures to facilitate the entry of foreign direct investment (FDI). Examples of such measures include liberalizing the laws and regulations for the admission and establishment of foreign investment projects; providing guarantees for repatriation of investment and profits; and establishing mechanisms for the settlement of investment disputes. Tax incentives are also part of these promotional efforts.

The role of incentives in promoting FDI has been the subject of many studies, but their relative advantages and disadvantages have never been clearly established. There have been some spectacular successes as well as notable failures in their role as facilitators of FDI. As a factor in attracting FDI, incentives are secondary to more fundamental determinants, such as market size, access to raw materials and availability of skilled labour. Investors generally tend to adopt a two-stage process when evaluating countries as investment locations. In the first stage, they screen countries based on their fundamental determinants. Only those countries that pass these criteria go on to the next stage of evaluation where tax rates, grants and other incentives may become important. Thus, it is generally recognized that investment incentives have only moderate importance in attracting FDI.¹

In some cases, and with some types of investment, however, their impact may be more pronounced. For some foreign investors, such as footloose, export-oriented investors, tax incentives can be a major factor in their investment location decision. Also, among countries with similarly attractive features the importance of tax incentives may be more pronounced. In addition, Governments can quickly and easily change the range and extent of the tax incentives they offer. However, changing other factors that influence the foreign investment location decision may be more difficult and time consuming, or even outside government control entirely. For these reasons, investment experts, particularly from investment promotion agencies, view incentives as an important policy variable in their strategies to attract FDI for economic development.²

Basically, FDI incentives may be defined as any measurable advantages accorded to specific enterprises or categories of enterprises by (or at the direction of) a Government, in order to encourage them to behave in a certain manner. They include measures specifically designed either to increase the rate of return of a particular FDI undertaking, or to reduce (or redistribute) its costs or risks. They do not include broader non-discriminatory policies, such as infrastructure, the general legal regime for FDI, the general regulatory and fiscal regime for business operations, free repatriation of profits or national treatment. While these policies certainly bear on the locational decision of transnational corporations (TNCs), they are not FDI incentives *per se*.³

Most countries, irrespective of their stage of development, employ a wide variety of incentives to realize their investment objectives. Developed countries, however, more

¹ See, generally, UNCTAD-DTCI. *Incentives and Foreign Direct Investment*. Geneva and New York: United Nations Publications, E.96.II.A.6, 1996; OECD. *Investment Incentives and disincentives: Effects on International Direct Investment*. Paris: OECD, 1989; Anwar Shah, ed. *Fiscal Incentives for Investment and Innovation*, New York: Oxford University Press, 1995.

² Agreed Conclusions of the UNCTAD Expert Meeting on Investment Promotion and Suggested Measures to Further Development Objectives, TD/B/COM.2/EM.2/L.1, p.2.

³ UNCTAD-DTCI, *op. cit.*, 1996: 3.

frequently employ financial incentives such as grants, subsidized loans or loan guarantees. It is generally recognized that financial incentives are a direct drain on the government budget, and as such, they are not generally offered by developing countries to foreign investors. Instead, these countries tend to use fiscal incentives that do not require upfront use of government funds.

Tax incentives, the subject of this survey, can be defined as any incentives that reduce the tax burden of enterprises in order to induce them to invest in particular projects or sectors. They are exceptions to the general tax regime. Tax incentives would include, for example, reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market for import substituting investment projects.

Because tax incentives are intended to encourage investment in certain sectors or geographic areas, they are rarely provided without conditions attached. Very often countries design special incentive regimes that detail the tax benefits as well as the key restrictions. For instance, these regimes may require that a facility be established in a certain region(s), have a certain turnover, require the transfer of technology from abroad or employ a certain number of individuals. For example, China offers foreign-invested firms a tax refund of 40 per cent on profits that are reinvested to increase the capital of the firm or launch another firm. The profits must be reinvested for at least five years. If the reinvested amounts are withdrawn within five years, the firm has to pay the taxes. India, similarly, offers a tax exemption on profits of firms engaged in tourism or travel, provided their earnings are received in convertible foreign currency.

The current survey finds that reductions in the standard rates of corporate income tax and tax holidays are the most widely used fiscal incentives. These are followed by exemptions from import duties on capital equipment, raw materials and semi-finished components, duty drawbacks, accelerated depreciation, specific deductions from gross earnings for income-tax purposes, investment and reinvestment allowances and deductions from social security contributions.

A. Objectives of tax incentives

Regional Investment

Countries often employ a mix of incentives to channel investment for development of a particular area or region. Regional development objectives include support for rural development, building industrial centres away from major cities and reducing environmental hazards, over-urbanization and concentration of population. Angola, Brazil, Ecuador, Ghana, India, Pakistan and Thailand are some of the countries that use such incentives. In Egypt, incentive schemes for the reclamation and cultivation of barren and desert land also fall in this category. Some of those incentives integrate regional development and sector-specific objectives. For instance, Egypt's tax exemption schemes for poultry and animal husbandry have a longer exemption period if they contribute to decentralization and are set up in new industrial zones and new urban communities. Such exemption schemes are common in other developing countries as well. Colombia, for example, has a special incentives regime for the Rio Paez region, in the south of the country. Tax incentives include a 10-year tax holiday from profits tax, income tax, remittance tax and customs duties, and tax reduction for shareholders. Nigeria also has a regional incentives system that gives allowances ranging from 100 per cent to 5 per cent to companies that establish operations in rural areas where there are no facilities such as electricity, tarred roads, telephones and water supply.

Sectoral Investment

Countries employ tax incentives in order to promote sectors of industry or activities considered crucial for development. These may be targeted at mining and industrial parks, export-led activities, the film industry and businesses with new technologies. Singapore, for example, provides exemption from income tax for 5 years to pioneer companies involved in industries that are not adequately developed in the country. Costa Rica has special incentives for tourism applicable to hotel services, air and water transportation of tourists, travel agencies and car rentals. In Pakistan, hi-tech industries, which include power tools, information technology and solar energy utilization, benefit from a wide range of fiscal incentives.

The majority of tax incentives granted by developing countries relate to investment in manufacture, exploration and extraction of mineral reserves, promotion of export and, increasingly, the tourism and leisure sectors. Developing countries generally do not attract headquarters of companies and service activities and therefore few countries have incentives aimed at the service sectors. Some exceptions are Malaysia, Singapore and the Philippines, which employ incentives — primarily reduced corporate tax rates — to attract headquarters of companies.

Performance enhancement

As noted earlier, incentives can be targeted at many types of activities, such as export promotion, employment/skills training, domestic value added and headquarters location. Free trade zones (FTZs) typically cover incentives for export-oriented manufacturing. Panama, for example, has an export processing zone regime to promote the export of goods that are manufactured, assembled or processed in Panama. Qualifying enterprises in the zone are exempt from direct and indirect income taxes, import duties and value added taxes. Ghana taxes companies engaged in the export of non-traditional products at a reduced rate of 8 per cent instead of the standard 35 per cent.

Transfer of technology

An important objective of using incentives to attract investment to developing countries is the transfer of technology. Certain types of tax incentives are designed specifically for this purpose. Some countries, such as Singapore and Malaysia, have introduced a specific set of incentives directed towards research and development (R&D) activities and technology projects (pioneer industries). They include tax-exempt technology development funds and tax credit for expenditures on R&D, and for upgrading human resources related to R&D. In particular, deduction is allowed for certain types of expenditure, and income tax exemption is offered for a period of time, while machinery, equipment and raw materials are exempt from import duty and sales tax. For import of technology, tax incentives provided may take the form of deductions allowed for transfer costs of patent rights and import fees, exemption of income from consulting and the granting of tax privileges to R&D projects. Similarly, cooperation and partnership agreements among firms for R&D are often exempt under competition laws, particularly in developed countries such as the United States and member States of the European Union.⁴ By different competition regulation exemptions, it is possible to grant increasing legal certainty to technology holders and licensees willing to invest in new projects using new technologies within a country.

⁴ See UNCTAD. *World Investment Report*, 1997: 205-208.

B. Issues relating to tax incentives

Institutional issues

The offer of incentives can be justified on the grounds of the positive externalities, or spillovers resulting from an investment, such as the diffusion of new knowledge (technology), upgrading of the skills of the workforce or investment in R&D. In these cases, the investor does not capture the full value of the investment for the economy. For example, the investor may train workers or impart managerial or marketing skills, where the benefit to society far outweighs the benefit to the investor. Employees receiving such training may then leave the project and work elsewhere in the country. Without corrective public measures, such activities would operate below their optimum levels. Some experts have argued, on this basis alone, for allowing tax incentives on investment in equipment, which, they find, have strong growth effects.⁵ Furthermore, individual investments can lead to additional investments by the same investor or associated investment by other TNCs.⁶

The fundamental premise in offering incentives to FDI is that foreign investment creates more value for the host country than for the foreign investor. FDI involves more than the flow of capital. It also involves the internal utilization of intangible assets such as technology and managerial expertise that are specific to a given firm. Thus, a major effect of FDI can be the transfer of technology, managerial expertise, skills and other intangible assets from one country to another. If these intangibles are completely internalized, the rate of return will fully capture the net benefits of an investment, and incentives are not justified. To the extent that these intangibles create major beneficial effects for other sectors of the host economy that are not internalized by the transnationals, incentives may be justified. This conclusion raises an important question in designing an incentives system: how responsive is foreign investment to incentives? A simplistic case that can be considered is where the only value for the host country of an investment project is the tax revenues that accrue to the Government. For a tax incentive to be beneficial to the host country, the decrease in government revenues resulting from the incentive would have to be more than offset by the increase in tax revenues resulting from increased foreign investment flows.

Governments also use incentives based on another rationale: institutional failure. When there is institutional failure, the value of the project for the investor (the return to the investor) differs from its value for the economy.⁷ There can be many causes of institutional failure, some “natural”, and some caused by government policies. Among natural causes are externalities due to a spillover effect; for example, the introduction of technology (whereby the return to the investor is less than the return to the economy), pollution and congestion caused by the project (in which the cost to the economy is greater than the cost to the investor), and social costs and benefits, in which the return to the investor differs from the cost to the economy.

In addressing institutional failure, the “first best” solution for the Government is to remove the failure. For example, if the Government sets the minimum wage above the market wage (and there is consequent unemployment), the resource cost of labour is greater

⁵ DeLong J.B and Summers L.H. Equipment Investment and Economic Growth. *Quarterly Journal of Economics*, 1991, vol.106: 445-450.

⁶ UNCTAD, *op.cit.*

⁷ Institutional failure is a wider classification than “market failure.” Market is viewed as one of the several institutions that allocate goods, services and factors of production in an economy. Governments are also institutions that influence resource allocation. As institutions allocating resources, Governments can fail too, just as markets do. According to this school of thought, Government policies such as setting tariffs, blocking industry entry, government monopoly ownership and regulation of prices may fail to produce optimum allocation of resources.

for the investor than it is for the economy. Hence investment in labour-intensive projects will remain below its optimal level. The “first best” solution is to reduce the minimum wage. Doing so, however, may not be possible politically. The “second best” solution is for the Government to reduce the cost of labour to the investor via a direct subsidy to labour or by allowing the investor to deduct labour costs for tax purposes. Doing so, however, may place Governments in developing countries in the peculiar position of subsidizing labour in low-wage countries. The more usual response by developing country Governments is to extend tax holidays to investors in labour-intensive projects (i.e. they subsidize *capital* in trying to increase *labour* absorption).

Similarly, tariffs and non-tariff barriers to trade are a cost to the investor (by increasing the cost of capital equipment and inputs), but not to the country. They raise the cost of production and inhibit export-oriented production. The “first best” solution would be to remove these trade barriers. Doing so on a general basis, however, would remove protection for domestic (local and foreign) producers and reduce government revenues. Governments can also selectively employ the incentives of tariff reduction for export-oriented producers.

When the value of tax incentives to the investor exceeds the benefits accruing to the economy, they become a windfall for the investor. However, calculating how far investors should be compensated is not simple and straightforward. This lack of certainty may lead a Government to grant overly generous incentives, for example, in order to attract high-tech projects, particularly in “hot” industries, such as computer components, biotechnology and telecommunications.

“Infant industry” issues

The rationale for incentives may be argued on the basis of correcting for the failure of markets to reflect the gains that can accrue over time from declining unit costs and learning by doing. Over time, as unit costs decline with increased output, a country could acquire a comparative advantage in an expanding industry. This is the classic infant industry argument for protection.

Thus, temporary incentives may be justified on the grounds of protecting and promoting “infant industries”. To be effective, incentives should be directed to small and growing firms. Start-up firms are often short of funds because of their inability to borrow from capital markets. Also, such firms are in a non-taxpaying situation in the initial years. The types of incentives employed will determine their effectiveness. For example, reduced tax rates or tax holidays may not produce the required results. Measures such as investment tax credits that provide upfront funding might be more effective.

Tax incentives may be targeted at investment in regions that are disadvantaged due to their remoteness from major urban centres. Operating in a remote area may entail significantly higher transportation and communications costs in accessing materials used in production, and in delivering end products to markets. These higher costs place the location at a competitive disadvantage relative to other possible sites. Moreover, firms may find it difficult to encourage skilled labour to relocate and work in remote areas that do not offer the services and conveniences available in other centres. Workers may demand higher wages to compensate for this, which again implies higher costs for prospective investors.

Tax incentives may be provided in such cases to compensate investors for these additional business costs. Again in this situation, the “first best” solution would be for Government to develop the infrastructure so as to reduce these costs. As a second best solution, the Government could compensate the investor for the cost of constructing shared infrastructure and in training workers in the region. To the extent that these incentives attract

new investments, and/or forestall the outmigration of capital and labour from these regions, they may contribute to improving income distribution through subsidizing employment via investment initiatives, rather than through direct income supplementing programmes.

Box 1: The Changing role of incentives: industrialization of Singapore

Singapore is a small island nation with 3 million people living in an area of about 600 sq. km. Except for a seaport located strategically along an international trade route, it has neither natural resources nor a large market. Despite these constraints, the Singapore economy has grown in the past four decades at an enviable rate.

Job creation in the 1960s

When Singapore became independent in 1965, the major economic problem was mass unemployment. Entrepôt trading activities could not create enough jobs. The solution was rapid industrialization of the economy, with the participation of foreign investors in manufacturing and financial services. An Economic Development Board was formed to manage the industrialization programme. In 1967, the Economic Expansion Incentives Act (EEIA) was introduced in order to give tax incentives to manufacturers in pioneer industries and to promote export. A prudent development policy, which provides a wide range of incentives to foreign and local investors, is credited with the transformation of the economy. In the late 1960s, the annual growth rate averaged 9 per cent, and by 1970, the unemployment rate had been reduced to 6 per cent.

Upgrading technology in the 1970s

The industrialization programme was successful in attracting many TNCs, especially in the electronics industry. The strategic location of Singapore also attracted foreign investment in the ship-repairing industry. By the mid-1970s, unemployment was no longer a problem. In fact, the increased demand for skilled workers resulted in a labour shortage. Consequently, the Government embarked on a massive training programme to upgrade the skills of workers and to increase the supply of technicians and engineers. Consequently, enrolment at the polytechnics and universities increased.

Focus on high-tech policy in the 1980s

In line with the strategy to restructure the economy, the EEIA was amended in 1979. In the early 1980s, owing to an acute labour shortage, the main objective was to encourage diversification into high-tech industries and the upgrading of skills. In 1984, further amendments were made to the EEIA to provide benefits covering knowledge-skills, computer-related industries and R&D activities.

Knowledge-intensive industries in the 1990s

A strategic Economic Plan (SEP) was formulated to chart economic policies for the 1990s and beyond with a continuing focus on high-tech knowledge-intensive industries. In 1991, the National Technology Plan set out the core philosophy and major incentives for technology development in Singapore. It emphasized the promotion of relevant R&D activities in key technology areas. A National Science and Technology Board was set up that supports R&D activities through such schemes as the Research Incentive Scheme for Companies, R&D Assistance Scheme, Manpower Development Assistance Scheme, Patent Application Fund and the Innovator's Assistance Scheme.

Source: Tan Chwee Huat, National University of Singapore.

Although intended to redress institutional failure, incentives have the potential to introduce distortions in the economy by their impact on the economic and tax environment. They can influence fiscal and monetary policies, but at the same time, can create a requirement for effective management and administration of the incentives.

Advocates of tax incentives point to their extensive use in some high-growth Asian economies as positive evidence of their effectiveness. However, it has been suggested that

this positive association probably has less to do with the nature of the incentives themselves than with the characteristics of the countries where they are used, such as the quality of the civil servants and the efficiency of public bureaucracy. Such characteristics tend to minimize the political-economy costs of providing the incentives.⁸

Assessing the relative advantages and disadvantages of tax incentives is a complicated and controversial issue. The main difficulty in assessing their benefits is in determining if incremental investment is indeed the result of incentives. As noted earlier, it is generally recognized that incentives are not the prime determinant of investment decisions. If investment is in fact the result of incentives, difficulties arise in quantifying the positive effects, such as technology transfer or creation of employment, and possible negative effects, such as economic distortions or potential for corruption. Nonetheless, in spite of these problems, assessment of incentives is a useful, even necessary, exercise. If nothing else, this assessment may place bounds on the extent of the incentives offered. For example, one developing country recently rejected an investment project for which incentives

Table 1: Governmental objectives and tax incentives use offered

Objectives	Rationale	Incentives offered
Performance enhancement: Export promotion	Economies of scale in exporting, country image building, differences between the actual exchange rate and the equilibrium exchange rate	Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process exemption from export duties; preferential treatment of income from exports, income tax reduction for foreign exchange earnings tax credits for domestic sales in return for export performance duty drawbacks, tax credits for duties paid on imported materials income tax credits on net local content in exports; deduction of overseas expenditure and capital allowance for export industries income tax reduction or credits for net value added.
Technology transfer	Spillover effects, risk aversion	Accelerated depreciation on machinery; income tax reduction/tax holiday; investment and reinvestment allowances; allowances for skills training; reduction in tax for royalties/dividends.
Performance enhancement: Employment/training	Imperfections in the labour market, such as a high minimum wage; spillover effects.	Tax holidays; allowances for job training expenses; deductions based on total number of employees; reduction in social security payments.
Performance enhancement: Domestic value addition	Problems of supplier development, spillover effects to downstream industries	Tax holidays; reduction from standard rate of income tax; loss carry forward and carry back for income tax purpose deductions in income tax based on marketing and promotion; reductions in income tax based on total sales.
Sectoral investment	Spillover effects, industrial strategy and policy, national security	Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process; accelerated depreciation on machinery; income tax reduction/tax holiday; investment and reinvestment allowances; allowances for skills training; loss carry forward and carry back for income tax purpose; preferential treatment of capital gains.
Regional incentives	Shared infrastructure; equity considerations	Same as above.

Source: UNCTAD

(grants and low interest rate loans) totalled over 30 percent of the investment capital in the project. Tax incentives in another developing country in 1999 included: (i) a 9 percent basic tax; (ii) tax holidays of up to eight years from the date of first profitability; (iii) accelerated depreciation and a five-year loss carry-forward provision; and (iv) zero taxes on reinvested profits. The Government is currently reviewing these generous tax incentives.

⁸ Tanzi V. and Partha S. The Role of Taxation in the Development of East Asian Economies. In: Ito T. and Krueger A.O., eds. *The Political Economy of Tax Reform*, 1992.

In developing an incentives system, Governments need to clearly list and analyse the market imperfections and the extent of the imperfections that the incentives are designed to reduce or eliminate. The costs of granting incentives can then be compared to the benefits of removing or reducing the imperfections.

Periodic review of the incentives regime by Governments offers a potential double benefit. On the one hand, it can help Governments prevent revenue leakage by eliminating excessive incentives or unnecessary tax breaks to investors. On the other hand, it can help them update incentives packages to provide real value to investors that will attract more investment. There are many ways to assess the relative advantages of tax incentives in order to determine whether use or continued use is warranted. One simple way is for developing countries to list the objectives such incentives are designed to achieve and compare them with any revenue loss or other unintended results associated with their employment (see the sample list produced for Ireland in table 2).

Table 2: Sample of tax incentives in Ireland

Tax measures	Still in use?	Advantages	Disadvantages
10 per cent corporation tax for manufacturing and certain services	Yes (Until 31 December 2002)	Attractive for mobile investors. Has a dynamic effect in stimulating the economy.	Discriminates against other businesses. Zero or negligible tax rate could result in tax haven status, which would be undesirable.
12.5 per cent corporation tax for all businesses	Starting on 1 January 2003	Same as above.	Potential tax revenue foregone.
Export sales relief	No	Incentivized businesses which operated internationally. Encouraged Ireland to look outward for new markets.	Discriminated against non-export companies. Infringed EU and WTO rules.
Incremental export sales relief	No	Incentivized businesses to increase their level of international sales as the relief only applied to incremental business.	Discriminated against non-export companies. Would have infringed EU and WTO rules.
Accelerated capital allowances:			
?? Buildings	Yes, on a limited basis for some buildings	Rapid tax deductions up to 100 per cent (in some cases) in year 1 of capital expenditure.	Tax revenues lost to the State in immediate period.
?? Plant and machinery	No	Facilitated investment in new equipment and buildings. Facilitated development of industrial parks, buildings, etc.	Could result in excessive investment (e.g. unutilized buildings).
Tax-based leasing	Yes, but limited	Provision of finance at lower rates when market interest rates were high.	Tax foregone to exchequer where tax payers (banks) used capital allowances on leased assets to shelter profit taxable at high rates.
Section 84 loans: Loans where interest payments deemed to be dividends in hands of banks and thereafter not taxable under domestic law	Limited, and due to expire in 2001	Provision of finance at lower rates when market interest rates were high.	Tax revenue for the exchequer foregone.
International Financial Services Centre (Dublin)	Yes	Generated highly skilled financial services industry.	Limited duration because of need for EU approval.
?? 10 per cent corporation tax	Stand alone but no new licences can be issued	Centralized location due to property incentives only attaching to one area.	
?? Accelerated capital allowances linked to Urban Renewal Programme			

Tax measures	Still in use?	Advantages	Disadvantages
Shannon Airport	No (ended in 1999)	Encouraged the development of a regional airport and airport town	
?? 10 per cent corporation tax for certain activities at Shannon Free Airport			
Location based incentives	Yes	Encourages the rejuvenation and development of certain areas socially, culturally, industrially and aesthetically.	Tax revenue foregone in the immediate term.
?? Schemes of accelerated capital allowances for certain areas:			
/// Urban renewal			
/// Rural renewal			
/// Regional airport Development			
Source: Ryan R., IDA, Ireland			

C. Classification of tax incentives

Reduced corporate income tax rate

Governments may set a lower corporate income tax rate as an exception to the general tax regime in order to attract FDI into specific sectors or regions. Hong Kong (China), Indonesia, Ireland, the Lao People's Democratic Republic, Cambodia and Estonia are a few countries that use this type of incentive. It may be targeted at the income of foreign investors who meet specified criteria, or it may be applied for attracting additional FDI. Malaysia did this in the mid-1980s when investment inflows were below expectations.

Loss carry forwards

Governments that employ a low corporate profit tax rate often use two other mechanisms to lower the effective tax rate. One such mechanism is to allow investors to carry losses forward (or backward) for a specified number of years (usually three to five years) for tax accounting purposes. Usually, only a fixed ratio of the loss with an upper limit is allowed to be carried forward (or backward). This measure is particularly valued by investors whose projects are expected to run losses in the first few years as they try to increase production and penetrate markets. Accelerated depreciation (discussed below) also allows investors to reduce their tax burdens in the years immediately following investment when cash flow is important to pay off debt. Taken together, a low tax rate accompanied by loss carry forwards for tax purposes and accelerated depreciation is considered to be a major element in an effective tax system and one that is highly attractive to foreign investors.

Tax holidays

Tax holidays are a common form of tax incentives used by developing countries and countries with economies in transition to attract FDI. Under a tax holiday, qualifying "newly-established firms" are exempt from paying corporate income tax for a specified time period (e.g. five years). The provisions may exempt firms from other tax liabilities as well. Tax holidays eliminate tax on net revenues from investment projects over the holiday period, which, depending on the case considered, tends to encourage investment. At the same time, tax holidays deny firms certain tax deductions over the holiday period or indefinitely (e.g. depreciation costs and interest expense), tending to offset at least in part any stimulative effect.

Table 3: Main categories of tax incentives

Category	Specifications
Profit/income-based	Reduction of the standard corporate income tax rate; tax holidays, loss carry forward or carry back to be written off against profits earned later (or earlier)
Capital investment-based	Accelerated depreciation; investment and reinvestment allowance
Labour-based	Reduction in social security contributions; deductions from taxable earnings based on the number of employees or on other labour-related expenditure
Sales-based	Income-tax reductions based on total sales
Value added-based	Income tax reductions or credits based on the net local content of outputs, granting income-tax credits based on net value earned
Based on other particular expenses	Income-tax deduction based on, for example, expenditures relating to marketing and promotional activities
Import-based	Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process
Export-based	a) Output-related (e.g. exemptions from export duties; preferential tax treatment for income from exports; income tax reduction for special foreign exchange-earning activities or from manufacturing exports; tax credits on domestic sales in return for export performance) b) Input-related (e.g. duty drawbacks; tax credits for duties paid on imported materials or supplies; income-tax credits on net local content of exports; deductions of overseas expenditures and capital allowance for export industries)
<i>Source: UNCTAD</i>	

Tax holidays are viewed as a simple incentive with a relatively low compliance burden (e.g. no need to calculate income tax over the holiday period). This aspect tends to make this form of incentive attractive, particularly in countries that are just establishing a corporate tax system. Provisions may impose certain tax-related obligations (e.g. withholding personal tax from wages or filing income tax returns). For long-term investment projects, investors will often be required to keep records of capital expenditures and other items before and during the holiday period in order to be able to comply with the tax system following the tax holiday.

Investment allowances

Investment allowances are deductions from taxable income based on some percentage of new investment (depreciation). They tend to lower the effective price of acquiring capital. Both investment allowances and investment tax credits are given as a specified percentage of qualifying investment expenditures. Because they are deducted against the tax base, however, their value to the investing firm depends, among other things, on the value of the corporate income tax rate applicable to the tax base — the higher (lower) the tax rate, the higher (lower) is the amount of tax relief on a given amount of investment allowance claimed. In contrast, variations in the corporate tax rate do not affect the value of investment tax credits.

Under an investment allowance, firms are provided with faster or more generous write-offs for qualifying capital costs. Two types of investment allowances can be distinguished. With *accelerated depreciation*, firms are allowed to write off capital costs in a shorter time period than is dictated by the capital's useful economic life, which generally is the accounting basis for depreciating capital costs. While this treatment does not alter the total amount of capital cost to be depreciated, it increases the present value of the claims by shifting them forward closer to the time of the investment. The present value of claims is

obviously the greatest when the full cost of the capital asset can be deducted in the year the expenditure is made. With an *enhanced deduction*, firms are allowed to claim deductions for the cost of qualifying capital that are a multiple of the actual cost (i.e. one-and-half times or twice the price).

Depending on whether investment allowances must be claimed in the year they were earned or not, their value to a firm will differ. In most countries, unused depreciable capital costs can be carried forward — in some cases indefinitely — to offset future tax liabilities. Where the deductions must be claimed in the year earned, the tax treatment of losses becomes critically important. As is often the case during the early stages of an investment project involving high capital expenditure, deductions provide benefit only if they can be carried forward to offset future tax liabilities.

Investment tax credits

Investment tax credits may be flat or incremental. A *flat investment tax credit* is earned as a fixed percentage of investment expenditures incurred in a year on qualifying (targeted) capital. In contrast, an *incremental investment tax credit* is earned as a fixed percentage of qualifying investment expenditures in a year in excess of some base that is typically a moving-average base (e.g. the average investment expenditure by the taxpayer over the previous three years). The intent behind the incremental tax credit is to improve the targeting of the relief to incremental expenditures that would not have occurred in the absence of the tax relief.⁹

In some countries, investment tax credits may only be claimed in the year they are earned. Typically, however, unused credits may be carried forward for a limited number of years to offset future tax liabilities. As in the case of investment allowances, they are meaningful to firms only if they can be carried forward or backward. Another option is to make unused credits refundable (i.e. allow their value to be claimed in cash in the year earned). This can considerably increase the attractiveness of the incentive. However, it entails significantly higher revenue cost for the Government and a risk of abuse.

Investment tax credits may interact with the depreciation system. In many countries, the depreciable capital base of a given investment must be reduced in respect of investment tax credits and other forms of government assistance related to that investment. This practice recognizes that the cost to the firm of acquiring the capital is reduced by such relief, and is adopted to avoid unintended overlap of investment subsidy.

Reduced taxes on dividends and interest paid abroad

Governments generally levy taxes on dividends remitted abroad by foreign investors. These taxes may be reduced in order to attract foreign investment. Typically these taxes are about 10 per cent. Leaving aside the tax-shifting phenomenon analysed in section E below, the lower the dividend tax, the greater the tax incentive. On the other hand, the lower the dividend tax, the lower the penalty for remitting dividends, and the lower the incentive to reinvest profits.

Preferential treatment of long-term capital gains

Many countries accord preferential tax treatment for appreciation in value of capital (assets) held by enterprises if the capital (or assets) is held over a fixed period of time

⁹ Clark W. S., *The Design and Assessment of Corporate Tax Incentives for Foreign Direct Investment. A paper submitted at the UNCTAD Ad Hoc Expert Meeting on Tax Incentives, 8-9 July 1999*: 18.

(usually six months to a year). Long-term capital gains (capital retained for longer than the minimum period) are usually taxed at half the rate of short-term capital gains (capital retained for less than the minimum period). Short-term capital gains are usually taxed as ordinary income. Preferential tax treatment of long-term capital gains is intended to encourage investors to retain funds for longer periods.

Deductions for qualifying expenses

Some countries try to encourage certain types of behaviour by investors through the tax system. They allow more than full deduction for tax purposes of qualifying expenses. For example, they may allow double deduction of training expenses, R&D expenses, or export marketing expenses. As referred to in section A, this type of incentive may be considered in association with measures to encourage transfer of technology.

Zero or reduced tariffs

Governments can grant two types of tariff incentives. On the one hand, they can reduce or eliminate tariffs on imported capital equipment and spare parts for qualifying investment projects. This has the effect of reducing the cost of investment. On the other hand, they can increase tariffs on the final products of the investor in order to protect the domestic market from import competition.

Tariff protection has been quite a common form of investment incentive in many countries. Its use, however, has decreased over the decades as developing countries have lowered their tariffs following agreements under the WTO and under various regional trade arrangements. Also, many developing countries have come to the conclusion that investment stimulated through tariff protection often leads to an inefficient, high-cost, distorted industrial structure.

Employment-based deductions

In many countries government-mandated social security contributions can be a burden to enterprises, especially new ones. To encourage investment in specific sectors or geographic areas, Governments may reduce social security contributions or provide tax credits or allowances based on the number of employees hired. Bulgaria, on the other hand, offers tax incentives to further its social goal of providing employment to persons with disabilities.

Tax credits for value addition

In order to promote domestic capacity building and discourage export of raw commodities, Governments may provide tax credits or allowances for value addition in processing or for the net local content of outputs (defined as the value of sales less depreciation of capital equipment, and the value of imported raw material and supplies).

Tax reductions/credits for foreign hard currency earnings

One of the reasons many developing countries encourage export is in order to earn much needed foreign hard currency. Not only export processing, but also many industries in the services sector (e.g. tourism and hotels) are provided tax reductions or credits based on earnings of such hard currency.

D. Design and administration of incentives

Main considerations

The legal instruments granting tax incentives are drafted carefully so that they achieve policy objectives with a minimum leakage of tax revenue. They are expressed as precisely as possible so as to avoid the need for frequent corrections or changes. It is believed that frequent changes could contribute to the perception that the tax system is complex and difficult to comply with. Apart from the tax incentives regime, stability and predictability of the tax system are major factors influencing firms when they commit to long-term investment.

The four broad steps involved in incentives policies are: (i) designing incentives; (ii) granting incentives; (iii) implementation; and (iv) follow-up of compliance by firms that have benefited from the incentive measures. In this respect, incentives imply financial as well as administrative costs.

Generally, targeted tax incentives should be designed with the clear purpose of attaining increased investment in the field intended. Otherwise, unintended results may ensue in addition to revenue loss. For example, in Lebanon, tax incentives were offered to encourage building construction after the civil war. However, no incentives were offered to developers of destroyed or damaged property. This lack of clear purpose led to an oversupply of new buildings and resulted in lack of liquidity in the market, while damaged buildings continued to remain neglected.¹⁰

When tax incentives are employed to correct cyclical recessions, there is generally a significant time lag between the offer of incentives and investment. This arises from many factors: (i) inability to recognize a recession; (ii) the time taken to draft necessary legislation; and (iii) the time lag between an investment decision and its implementation. An added risk is that, once incentives are offered, pressures are often exerted to extend temporary measures and to make them a permanent part of the tax system. Governments may consider other more effective cost-neutral measures to combat cyclical recessions.

While tax incentives are enunciated in the tax code, quite often their administration is carried out by different government agencies. For example, tax deductions or allowances on employee training may be administered by the labour department, duty exemptions by the customs department and income and profit tax exemptions by the revenue department. Such diversity of agencies dealing with tax incentives tends to increase the inconvenience of doing business. It is generally recognized that investors prefer to deal with one Government agency and that they like to be able to determine from the start the total package of incentives available.

All other things being equal, the more transparent the incentives system, the more easy it is to administer and the easier it is for investors to understand. In more concrete terms, for regional incentives, for example, it is better to list the provinces/states in which these incentives will be granted than to refer vaguely to "less developed regions". If the rationale for an incentive is to increase labour absorption, then it may be preferable to target incentives at specified labour-intensive industry sectors (e.g. footwear, garments, and handicrafts), rather than simply referring to "labour intensive" projects. The general reference would raise the question of how "labour intensive" is defined and operationalized. Similarly, for the sake of clarity and transparency, it may be better to specify the high-tech industries

¹⁰ Abou Nasr W. Tax Incentives in Lebanon. A paper submitted at the UNCTAD Ad Hoc Meeting on Tax Incentives, 8-9 July 1999.

that qualify for incentives rather than simply stating “high-technology projects”, as the latter would give rise to the question of what constitutes high-technology.

Federal-state overlap

In a federal system of government, the federal (central) Government as well as the state (provincial) governments may offer tax incentives. Quite often, there is no coordination between these entities concerning the total package of tax benefits that investors finally receive. On the contrary, competition among state (provincial) governments to attract investment in their respective territories often results in windfall benefits for investors. For example, when a Mercedes-Benz car plant was installed in Tuscaloosa, Alabama in the United States, the state of Alabama ended up spending \$250 million, compared with an investment of \$300 million by the company. The sum was spent as financial incentives for site development, infrastructure and job training, among others. The company had considered locations in the states of Georgia, Nebraska, North Carolina, South Carolina and Tennessee before selecting Alabama.¹¹

More recently, competition among provincial governments in Brazil to attract Ford Motor Company to establish an automobile assembly plant not only pitted the state governments of Rio Grande do Sul and Bahia against each other, but also drew the Government of Argentina into the fray. Originally the state of Rio Grande do Sul was thought to be the beneficiary of the investment. As a result of negotiations with the state and federal governments, the assembly plant was finally located in the state of Bahia. Ford was able to negotiate a number of benefits, including import tax exemption for machinery and equipment, a 90 per cent reduction in import tax on tyres and other components, exemption from tax on industrialized products and exemption of tax on net income generated by the plant. In addition, the federal government-owned bank agreed to finance the undertaking under favoured terms and conditions. The state of Bahia agreed to grant an unspecified reduction in state VAT, land for the plant free of charge, and an additional US\$ 100 million in low-cost credit.¹²

Argentina felt that the liberal tax breaks offered by the states in Brazil, coupled with the devaluation of the real in 1999, were effectively pulling enterprises away from its territory. In its turn, Argentina has recently offered liberal tax incentives, infrastructure subsidies and other benefits to Volkswagen to entice it to install a factory for the manufacture of gearboxes.¹³

Other administrative issues

A related issue involved in the design and administration of an incentives system is the discretionary power of officials granting the incentives. Administrative discretion can be reduced if the enabling legislation clearly defines the incentives package and the criteria under which incentives may be granted. This reduces the opportunity for inappropriate administrative behaviour. Leaving some discretion to officials, however, has the advantage of increasing their flexibility to adjust incentives to specific situations, as in the case of a large TNC in the detergents industry, which approached the Government of a developing country concerning investment in a major project. Although the detergents industry was not on the list of promoted industries, the Government wanted the project. It was, therefore placed in the

¹¹ UNCTAD-DITC, *op. cit.*, 1996, based on a table on p. 30.

¹² Gomes G. M. A Short Note on State Level tax Incentives in Brazil. A paper submitted at the Expert Meeting on Tax Incentives, 8-9 July 1999.

¹³ *South-North Development Monitor*, No. 4629, 20 March 2000: 9.

awkward position of having to justify incentives on the basis that the project introduced a product or process new to the country.

The incentives regime in another developing country went to the other extreme by developing a very transparent, but complex system. Industries were divided into four groups: tourism/hotels, food processing, manufacturing, and agriculture/crops. For each of these broad sectors, it developed a matrix of activities and characteristics and awarded points for performance-based criteria. In manufacturing, for example, points were awarded to a project based on the amount of the investment (larger investments gained more points), employment, export intensity, domestic value added percentage, use of local resources, training and hiring, location, employment of women and employment of the disabled. The Government granted tax holidays based on the number of points achieved. The system proved to be so complex that the organization with the mandate to determine the incentives to be granted was paralysed and incentives were only granted if “higher authorities” mandated them.

More often than not, follow-up of the firms benefiting from the incentives is neglected. If investors are required to fulfil certain conditions as part of granting incentives, such as import of certain types of machinery, creation of jobs or completion of the project within a certain time frame, it is imperative that following the grant of incentives monitoring of the investment project be undertaken. The capacity to monitor is particularly weak in some developing countries. For example, the central bank of a developing country generated two sets of statistics on FDI: one for the balance of payments and one based on a survey of foreign investors. For 1998, these two data sets differed by a factor of almost 10. Without effective monitoring, Governments cannot ascertain the magnitude of actual investment inflows (they simply have statistics on investment approvals), industry composition, home country of investors, or the characteristics and performance of foreign investment projects. All this information is vital to Governments as it provides input to enable them to direct and control foreign investment, to formulate investment policies and strategies, and to target foreign investment projects by industry, characteristic and home country for promotion. This lack of monitoring capability has also led to a situation in which foreign investors in host countries with weak monitoring systems promise anything Governments demand in order to obtain investment licenses and incentives – and then configure the investment project in whatever manner best suits their interests.

Even relatively simple tax incentives such as tax holidays should be designed with due consideration to the type of investment they are targeted to attract. It is generally recognized that tax holidays alone may not be effective in attracting beneficial, long-term investment. They are considered to be attractive to firms that make profits in the early years of operation, such as firms in trade or short-term construction. Assembly-type manufacturers may also take advantage of tax holidays in ways not intended by the host country, as is highlighted in the example of a manufacturer of computer microprocessors, which enjoyed an eight-year tax holiday in an Asian developing country. At the end of the tax holiday, the manufacturer simply packed up and set up a new operation in a neighbouring country, which offered a new tax holiday.¹⁴ Some of these drawbacks can be addressed through the proper design of tax holidays.

¹⁴ Clark W. S., op. cit. : 59.

Table 4: Two-year tax holiday and alternative commencement rules

Investment 100											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Revenue	15	25	30	40	50	50	50	50	50	50	410
Start-up costs	50	30	10	0	0	0	0	0	0	0	90
Depreciation	10	10	10	10	10	10	10	10	10	10	100
Profit	-45	-15	10	30	40	40	40	40	40	40	220
Net cumulative Profit	-45	-60	-50	-20	20	60	100	140	180	220	-
Holiday begins first year of production											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total PV Tax
Taxable income	0	0	10	30	40	40	40	40	40	40	280 73
Holiday begins first year of profit											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total PV Tax
Taxable income	0	0	0	0	40	40	40	40	40	40	240 59
Holiday begins 1st year of net cumulative profit											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total PV Tax
Taxable income	0	0	0	0	0	0	40	40	40	40	160 36

Examples assume 10-year straight-line depreciation for tax purpose, no loss-carry forward provisions. Present value (pv) calculations use a discount rate of 10 per cent, and assume a corporate tax rate of 50 per cent.

Source: Clark W. S.

Several options are possible for determining the commencement of a tax holiday, including the year the investment license is granted, the first year of production, the first year of profit, and the first year of net cumulative profit. The choice can have a significant bearing on the attractiveness of the holiday and on its cost to the Government in terms of reduced tax revenues, as illustrated in Table 4. In terms of convenience of administration, and the least revenue leakage for the Government, commencement of tax holidays from the first year of production is preferable. However, from investors' standpoint, a tax holiday starting from the year when the enterprise first makes cumulative profit is preferable because of the lower present value (PV) on which the taxes are paid. The relief ultimately provided depends on the starting period of the holiday, the tax treatment of depreciable expenses, and the tax treatment of losses incurred during the holiday.

If losses incurred during a holiday are not deductible in the post-holiday period, a tax holiday may *increase* the tax burden for the investor. This outcome is particularly relevant for projects with significant start-up costs in the initial production years (e.g. workforce training costs, advertising and other costs of establishing in the local market). For such firms, loss carry forward provisions may provide a greater stimulus than a tax holiday with restrictive loss carry forward rules.

Table 5: Alternative loss-carry forward rules

Investment 100											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
Net revenue	-35	-5	20	40	50	50	50	50	50	50	320
Depreciation	10	10	10	10	10	10	10	10	10	10	100
Profit	-45	-15	10	30	40	40	40	40	40	40	220

No loss-carry forward											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total PV ^a
Taxable income	0	0	10	30	40	40	40	40	40	40	280 73

Two-year loss-carry forward											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total PV ^a
Unused 2 nd prior year loss	0	0	45	15	0	0	0	0	0	0	-
Unused 1 st prior year loss	0	45	15	0	0	0	0	0	0	0	-
Prior year losses used	0	0	10	15	0	0	0	0	0	0	25
Taxable income	0	0	0	15	40	40	40	40	40	40	255 65

Five-year loss-carry forward											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total PV ^a
Unused 5 th prior year loss	0	0	0	0	0	0	0	0	0	0	-
Unused 4 th prior year loss	0	0	0	0	5	0	0	0	0	0	-
Unused 3 rd prior year loss	0	0	0	35	15	0	0	0	0	0	-
Unused 2 nd prior year loss	0	0	45	15	0	0	0	0	0	0	-
Unused 1 st prior year loss	0	45	15	0	0	0	0	0	0	0	-
Prior year losses used	0	0	10	30	20	0	0	0	0	0	60
Taxable income	0	0	0	0	20	40	40	40	40	40	220 53

Examples assume same project specifics as in Table 4, and 10 year straight-line depreciation. Present value calculations use a discount rate of 10 per cent, and assume a corporate tax rate of 50 per cent.

Source: Clark, W. S.

The use of tax holidays, as opposed to a reduced tax rate, has one major disadvantage: it discriminates against investment in the future when the tax holiday is over. A reduced tax rate applies to income generated by investments made over the life of the investment project (assuming the reduction in tax is not temporary). A tax holiday, on the other hand, only applies to income generated over the tax holiday period. Hence a reduced tax rate tends to encourage investment over time to maintain capital equipment and to increase production capacity compared with a tax holiday. Put another way, tax holidays discriminate against sequential investment. This can be a major deficiency of tax holidays in attracting continuing investment. To overcome this, some countries have resorted to granting additional tax holidays if significant additional capital investments are undertaken. However, this is a cumbersome method.

If the reduced tax rate is available only temporarily (e.g. five years), the amount of relief available under the incentives programme will critically depend on tax depreciation and loss-carry forward provisions. Tax relief will be higher where firms are able to carry depreciation expenses and losses forward to the post-incentive period when the normal (higher) corporate tax rate is restored.

A longer period of low tax rates may produce a windfall gain for certain (if not most) qualifying investment projects. That is to say, a longer period would result in qualifying firms benefiting from a reduced rate of tax on “old” capital already installed in the host country. This can be contrasted with incentive measures tied to investment expenditures rather than to income from investment expenditures, as under a preferential tax incentives scheme.

Stability of the incentives regime may help avoid unnecessary revenue leakage for Governments. For example, the law on offshore corporations in Lebanon was introduced in 1983 as a means of attracting foreign capital to Lebanon by offering tax breaks and ease of repatriating revenues. Offshore companies are liable to pay a fixed yearly amount, and pay no other fees or taxes. In 1983, the fee was set at 10,000 Lebanese pounds (equivalent to US\$ 3,000). In 1994 this rate was increased to 1,000,000 Lebanese pounds. However, this amount was equivalent to only US\$ 650 at the then prevailing exchange rate. The fees currently levied by the Government on this type of operation do not even cover the administrative costs to the Government such as tax inspections or tax return processing. Such revenue leakage could have been avoided if the fee had been charged as a percentage of profit or turnover.¹⁵

Often, as an aftermath of offering tax incentives, Governments may be forced to introduce tax base protection measures to stop the leakage of revenues from tax planning and tax evasion techniques of firms. These rules can be very complex and cumbersome. Compliance costs increase, which is in itself a disincentive to investors. Above all, a simplified tax system is beneficial for Governments as well as investors.

E. Home country measures and tax treaties

Avoidance of double taxation

In order to assess the full tax treatment of FDI, it is necessary to look into the way home countries tax the income generated in host countries. Where an investor is subject to tax under a residence-based principle, the introduction of a tax incentive such as a tax holiday reduces or eliminates tax credit in the host country. It has the effect of increasing the tax revenues in the home country dollar for dollar. For an investor, the total tax burden remains unchanged, negating the benefits of tax incentives. Tax incentives simply result in the transfer of tax revenues from the host country treasury to the home country treasury.

Double taxation treaties (DTTs) deal with tax treatment of the income generated abroad in the context of avoiding international double taxation (see box 2). The home country can, through a method known as “tax sparing”, allow tax credits as if the host country were fully taxing the income, thus enabling the investor to retain the benefits of tax incentives (see box 3). Most OECD countries, with some exceptions, have granted tax sparing in their negotiations of double taxation treaties with developing countries (see table 6). Developed countries have granted tax sparing with the aim of promoting industrial, commercial or technological development of host countries¹⁶. Some countries have granted tax sparing as a bargaining chip in treaty negotiations, in order to obtain a lower withholding tax rate on dividends, interest and royalties for their investors.¹⁷

However, home countries are increasingly questioning the wisdom of granting tax sparing. It is argued that it may offer a windfall gain to the investor with no impact on net

¹⁵ Abou Nasr W. *op. cit.*

¹⁶ UNCTAD. *World Investment Report*, 1998:81

¹⁷ Clark W. S. *op. cit.*: 55.

additional investment. Moreover, it may have the unintended effect of encouraging investors to repatriate profits rather than to reinvest them in the host country where they would further promote economic development. Foreign firms may use transfer-pricing techniques to artificially inflate the amount of profit attributable to the host country and deflate profits in the home country through inter-affiliate payment structures. Such techniques are hard to detect and prevent.¹⁸

Table 6: Overall numbers of DTTs signed per region

Region	Total DTTs	Countries per region
Africa	207	12
Asia and the Pacific	631	17
Europe and economies in transition	360	10
Latin America	89	10
Total number of DTTs	1287	49
Source: UNCTAD		

Another unintended effect of these methods is what is known as “treaty shopping” by investors. They could avoid, seemingly legally, higher taxes in a country where they want to invest, by funnelling their investment through another country with which the targeted country has a tax treaty with favourable provisions. A recent example is the row over investors’ *bona fides* raised by tax authorities in India.¹⁹

It should be noted that the main feature of the method is that the investor’s country of residence treats the foreign tax within certain statutory limitations, as if it were a tax paid to itself. In a tax treaty, each of the contracting parties levies income taxes, but the country of residence permits income taxes paid to the source country to be deducted from its own income taxes, with certain exceptions.

The tax treaty usually indicates which taxes qualify for the credit. This has been developed to help the host country whereby the country of residence grants a tax credit calculated at a higher rate than the tax rate currently applied in the source country. Another feature found in recent treaties is the reciprocal extension of tax sparing credit. It appears that the adoption of this method tends to be limited in scope (list of incentives) and time as a means of improving the tax climate for attracting investors.

A recent study²⁰ suggests that tax sparing under tax treaties may be effective in stimulating FDI into developing countries. Comparing Japanese and United States outward investment, the study finds that Japanese firms are more likely to invest in countries with which Japan has tax agreements with tax sparing credits. The study also suggests that host countries tend to extend larger tax benefits to firms belonging to home countries which allow tax sparing credits (box 3)

Box 2: Avoidance of double taxation

¹⁸ UNCTAD. *World Investment Report*, 1998, Box III.10.

¹⁹ India is one of a handful of countries which imposes capital gains tax (CGT) on foreign investors, and it is as high as 30 per cent. Under the 1983 tax treaty with Mauritius, investors from Mauritius are exempt from CGT. The fact that Mauritius has a low tax regime that does not include CGT led many investors to channel investments to India through Mauritius in order to escape CGT altogether. As a result, the tax authorities in Bombay issued an “assessment order” charging an estimated 12 institutional investors of not being *bona fide* investors from Mauritius entitled to exemption from CGT. However, adverse reaction in the stock market and fear that those investors would withdraw funds from India prompted the authorities to withdraw the order. See *Financial Times*, April 5, 2000: 4; *Financial Times*, April 8/9, 2000: 11.

²⁰ Hines J.R. “Tax Sparing” and Direct Investment in Developing Countries, Working Paper 6728, National Bureau of Economic Research, Cambridge, MA. 1988.

In cross-border investment, both home and host countries may tax income from foreign affiliates. Overlapping assertions of jurisdiction result in international double taxation, a phenomenon generally deemed not conducive to business transactions in general and FDI in particular.

There are two main principles based on which countries assert jurisdiction to tax the income of firms (or individuals). The first is based on the source of income or the site of economic activity (known as the “territorial principle”); the second is based on the residence (or fiscal domicile) of the tax payer.

Under the *residence principle*, a country taxes the worldwide income of firms residing within its territorial jurisdiction. Criteria used to determine residence vary: for corporation head offices, for example, place of management or place of incorporation are used. Under the *source principle*, a country taxes all income earned from sources within its territorial jurisdiction.

Nearly all countries apply some combination of these two jurisdictional principles. Some Latin American countries, however, have traditionally taxed solely on the basis of the source principle. Firms incorporated in the United States, irrespective of the location of their head offices or places of management and control, are taxed on their worldwide income. Foreign corporations doing business in the United States are generally taxed solely on income earned from activities within the country.

The principal way Governments tackle the problem of double taxation is through the negotiation of double taxation treaties (DTTs). These treaties allow either for exemption of income generated in a host country or for credit for taxes paid. The essential feature of the exemption method is that the investor's country of residence exempts from taxation certain items of income from foreign sources. Exemption is mainly granted in respect of active income; passive income such as interest, royalties or dividends is generally taxed, with a credit being given for foreign taxes. Under the credit method, the country of residence permits income taxes paid to the source country to be deducted from its own income taxes, with certain exceptions.

A variant of this method, called “tax sparing” has been included in DTTs concluded with developing countries by most of the major home countries including Canada, France, Germany, Japan and the United Kingdom. The United States is a notable exception, which steadfastly refuses to grant tax sparing credits.

Source: UNCTAD. World Investment Report, 1998, pp.79-88

International commitments

Apart from home country measures and bilateral commitments such as DTTs, there are a number of multilateral commitments within the framework of WTO agreements that impose disciplines in the area of incentives. It should be noted that, on the one hand, the obligations imposed by WTO have a bearing on government policies on incentives and, on the other, national development objectives and those dictated by regional integration processes may have their own priorities.

How national/regional policy objectives are balanced with multilateral commitments/obligations is yet another issue for a host country Government to explore while it formulates its incentives policies (see box 4).

Box 3: Tax sparing and foreign direct investment in developing countries

Tax sparing is the practice of adjusting home country taxation of foreign investment income to permit investors to receive the full benefits of host country tax reductions. It is thus designed to promote the effectiveness of local tax incentives for foreign investment. Most high-income capital exporting countries grant tax sparing for FDI in developing countries.

Developing countries are often willing to offer foreign investors significant fiscal incentives in order to encourage FDI and thereby stimulate local economic growth. Popular incentives include lengthy tax holidays, expensing or other generous tax treatment of new investment expenditures and other tax reductions as well as providing roads, worker training, and other public inputs at below market prices. Tax incentives have the ability to stimulate foreign investment effectively and efficiently. Home country tax systems may, however, reduce — or, in some cases, completely remove — incentives created by host-country tax abatements through corresponding increases in home country tax burdens.

In reaction to this possibility, many Governments provide tax sparing credits for investments in developing countries. Specifically, tax sparing often takes the form of allowing firms to claim foreign tax credits against home-country tax liabilities for taxes that would have been paid to foreign Governments in the absence of special abatements on income from investments in certain developing countries. Since foreign tax credits are then based on tax obligations calculated without regard to taxes actually paid, any special tax breaks offered by host country Governments enhance the after-tax profitability of foreign investors and are not simply offset by higher home country taxes.

The volume of Japanese FDI located in countries with which Japan has tax sparing agreements is 1.4 to 2.4 times larger than it would have been otherwise. In addition, Japanese firms are subject to 23 per cent lower tax rates than are their United States counterparts in countries with which Japan has tax sparing agreements. Similar patterns appear when tax sparing agreements with the United Kingdom are used as instruments for Japanese tax sparing agreements. This evidence suggests that tax sparing influences the level and location of FDI and the willingness of foreign Governments to offer tax concessions.

A comparison of Japanese and United States investment patterns reveals that, while Japan permits its firms to claim tax sparing credits for investments in certain developing countries, the United States does not. It follows that, to the extent that tax sparing is effective, Japanese firms will exhibit greater willingness than United States firms to invest in developing countries. In addition, Japanese firms are more likely than are United States firms to receive special tax breaks from countries with which Japan has tax sparing agreements, and they locate a much higher proportion of their foreign investment in countries with which Japan has tax sparing agreements than do United States firms. All other things being equal, tax sparing agreements are associated with 140 per cent to 240 per cent higher FDI levels and 23 per cent lower tax rates on FDI.

Source: Hines J.R, Jr.

Box 4: Multilateral agreements

Among the WTO Agreements, mention should be made of the following:

Agreement on Trade-Related Investment Measures (TRIMs) prohibits the application of any trade-related investment measure that is inconsistent with Articles III (national treatment of imported goods) and XI (prohibition of quantitative restrictions on imports or exports) of the GATT. An Illustrative List annexed to the Agreement contains examples of measures that are inconsistent with GATT Articles III.4 and XI.1. These concern essentially local-content requirements, trade-balancing requirements and measures that have the effect of restricting exports. The TRIMs Agreement prohibits these types of measures not only if they result from mandatory legal requirements but also if they are applied as conditions of obtaining an advantage. The Agreement contains transition provisions under which Member States have been allowed to maintain notified TRIMs during a period of five years in the case of developing country Members and seven years in the case of least developed country Members.

The Agreement on Subsidies and Countervailing Measures (ASCM) prohibits subsidies that are contingent, in law or in fact, upon export performance and those that are contingent upon the use of domestic over imported goods by covering "government revenue that is otherwise due, is foregone or not collected (e.g. fiscal incentives such as tax credits)". The Agreement establishes another category of actionable subsidies that have adverse effects on the interest of other Members when they cause injury to the domestic industry of another Member, nullify or impair the benefits accruing to another Member or cause serious prejudice to the interest of another Member. The Agreement also identifies non-actionable subsidies with a certain limit, including assistance to R&D activities by firms of not more than 75 per cent of the costs of industrial research or 50 per cent of the costs of pre-competitive development activity, if such assistance is limited exclusively to costs of personnel, instruments, equipment, buildings and consultancy services.

The ASCM contains provisions for special and differential treatment for developing countries through exceptions and transition periods for different categories of developing countries with respect to the disciplines on prohibited and actionable subsidies.

Source: UNCTAD

Part 2

THE SURVEY

A. Africa

A Brief Summary

Countries in the region have put in place an array of tax incentives to promote regional development. They offer such incentives as income tax exemption or reduced rate of taxes, investment allowance and remission from customs duty for equipment and goods destined for production in designated remote areas. Manufacturing, plantation, timber, horticulture and tourism are encouraged wherever possible by offering reduced tax rate and exemption from duty and VAT. Exploration and extraction of minerals is given priority, and is governed by a special tax regime which allows for recoupment of expenses related to mining activities. Another salient feature is the promotion of export of non-traditional goods, as the African economy is heavily dependent on exports of primary commodities. Wherever special economic zones or free trade areas are present, they offer liberal exemption from profit tax, customs duty and VAT. Corporate taxes generally range between 35 and 40 per cent of taxable income. Most countries have withholding taxes for dividend, interest and royalty payment.

Table 7: Synopsis of types of incentives: Africa

Country	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	Duty/VAT exemption/reduction	R & D Allowance	Deduction for qualified expenses
Angola	?			?		
Cameroon	?		?	?		?
Côte d'Ivoire	?			?		
Egypt	?			?		
Ghana	?	?		?		
Malawi	?	?	?			?
Mauritius	?	?	?			
Morocco	?	?	?	?		
Namibia	?		?	?		?
Nigeria	?		?	?	?	
South Africa	?		?			
Uganda	?		?	?	?	?
Zambia	?		?	?		?
Zimbabwe	?		?	?		?

Table 8: Tax treaties signed per country/territory: Africa

	Cameroon	Côte d'Ivoire	Egypt	Ghana	Malawi	Morocco	Mauritius	Nigeria	South Africa	Uganda	Zambia	Zimbabwe
TOTAL WORLD	4	9	34	5	8	18	30	11	49	6	19	14
Developed Countries	3	8	18	5	7	15	8	7	26	4	13	8
Western Europe	2	7	15	5	7	13	8	6	20	4	11	7
European Union	2	5	12	5	5	11	7	5	17	3	9	5
Austria			1						1			
Denmark			1	1	1	1	1	1	1	1	1	
Finland			1			1			1		1	
France	1	1	1	1	1	1	1	1	1		1	1
Germany		1	2			1	1		2		1	1
Ireland									2		1	
Italy		1	1			1	1		1		1	
Netherlands			1		1	1		1	2		1	1

	Cameroon	Côte d'Ivoire	Egypt	Ghana	Malawi	Morocco	Mauritius	Nigeria	South Africa	Uganda	Zambia	Zimbabwe
Spain						1						
Sweden			2		1	1	1		3		1	1
United Kingdom	1	1	1	3	1	1	1	1	2	2	1	1
Belgium		1	1			1		1	1			
Luxembourg						1	1					
Other Western Europe		2	3		2	2	1	1	3	1	2	2
Malta			1						1			
Norway		1	1		1	1	1	1	1	1	1	1
Switzerland		1	1		1	1			1		1	1
North America	1	1	2			2		1	3		1	1
Canada	1	1	1			1		1	1		1	1
United States			1			1			2			
Other Developed Countries			1						3		1	
Australia									1			
Israel									1			
Japan			1						1		1	
New Zealand												
Developing Countries	1	1	11		1	2	21	1	19	2	5	3
Africa	1	1	2		1	2	9		14	2	4	2
North Africa	1	1	2			2			1			
Algeria						1						
Sudan			1									
Tunisia	1	1	1			1			1			
Other Africa					1		9		13	2	4	2
Botswana							1		1			
Kenya											1	
Lesotho							1		2			
Madagascar							1					
Malawi									1			
Mauritius									2			1
Mozambique							1					
Namibia							1		1			
Seychelles									1			
South Africa					1		2			1	1	1
Swaziland							1		1			
Uganda									1		1	
Zambia									1	1		
Zimbabwe							1		1			
Tanzania, United Republic of									1		1	
Asia and the Pacific			9				12	1	5		1	1
West Asia			3				2					
Cyprus			1									
Iraq			1									
Kuwait							1					
Oman							1					
Turkey			1									
Central Asia			2									
Armenia			1									
Uzbekistan			1									

	Cameroon	Côte d'Ivoire	Egypt	Ghana	Malawi	Morocco	Mauritius	Nigeria	South Africa	Uganda	Zambia	Zimbabwe
South, East and South-East Asia			4				10	1	5		1	1
China			1				1		1			
India			1				1				1	
Indonesia			1				2					
Malaysia							1					1
Nepal							1					
Pakistan							1	1				
Singapore							1					
Sri Lanka							1					
Taiwan Province of China									2			
Thailand							1		1			
Korea, Republic of			1						1			
Central and Eastern Europe			5			1	1	3	4		1	3
Albania												
Bulgaria												1
Czech Republic			1					1				
Hungary			1						1			
Poland			1						1		1	1
Romania			1			1		1	1			
Russian Federation							1					
Slovakia								1	1			
Yugoslavia (former)												1
Macedonia, the Former Yugoslav Republic of			1									

1. Angola

(a) Regional Incentives

Special incentives are offered under tax regulations for projects located in rural areas that are considered to aid the development of such regions.

Angolan law allows several exemptions or reductions for industries and services, including possible exemption of the industrial profit tax for a period of between 5 and 10 years, for new industries producing goods that the local industries do not produce, or introducing new technologies of importance to the national economy. Those incentives are also available to new industries and to commercial activities that establish themselves in regions considered to be of interest for the national economy. Tax exemption is also granted for the acquisition of land and buildings for the installations of new industries or for the improvement of existing industries.

A customs tax exemption exists for imported equipment, goods and raw materials used by an industrial company.

(b) Sectoral Incentives

Tax exemption (profit tax) is offered to companies establishing hotels and similar facilities as long as they meet the standards set for the tourism industry.

A tax reduction (profit tax) of 20 per cent is offered to companies engaging exclusively in agriculture, timber or cattle.

(c) Export Incentives and Free Trade Zones

For companies exporting goods, consumption tax (similar to VAT) exemption is possible, and if these companies have already paid the consumption tax, it will be refunded. Such exporting companies are entitled to a tax reduction (profit tax) if they export more than 59 per cent of their production.

(d) Statutory Tax Rate

The full national corporation tax rate in Angola is 50 per cent. This rate is the combination of a flat rate corporation tax of 40 per cent and a 10 per cent surcharge on taxable income over 210 million new kwanzas. There is no additional local tax, but there are withholding taxes at the rate of 10 per cent on dividends, 15 per cent on interest and 10 per cent on royalties.

2. Cameroon

(a) Regional Incentives

An investment allowance equivalent to 50 per cent of the cost of utilities and transportation is granted to an enterprise established in a non-urban area.

Enterprises that make payments to other enterprises located in a member country of the Central African Customs and Economic Union (UDEAC) for the use of patents, trademarks, designs or models during their period of validity can deduct such payments for company tax purposes. However, payments made to enterprises located outside the UDEAC that participate in either the management or the capital of the enterprise making the payment cannot be deducted for company tax purposes and are treated for tax purposes as a distribution of profits by the paying enterprise.

Capital gains arising from a merger of companies other than those made from the sale of shares or debentures are exempt from company tax, provided the company taking over has its registered office in Cameroon or another UDEAC member country.

(b) Sectoral Incentives

Value Added Tax (VAT) is payable by individuals, corporate bodies, councils and State enterprises that carry out, whether occasionally or regularly, profit-seeking economic activity on an independent basis. Certain sectors of the economy are, however, exempt from VAT. Transactions exempt from VAT include:

- ?? Sale of products from extractive activities;
- ?? Interest on external loans;
- ?? Interest on deposits made by persons who are not in the business of placing deposits to earn interest;
- ?? Gaming and recreational activities;
- ?? The lease of undeveloped land and unfurnished premises by persons who are not professionals;
- ?? Export operations;
- ?? Specified international traffic;
- ?? Activities of approved non-profit making organizations of a social, cultural, religious, educational, recreational or philanthropic nature consistent with the objectives of the organization in question;
- ?? Specified essential goods, water and electricity up to a specified volume/quantity.
- ?? Composition, printing and sale of newspapers and periodicals, except advertising transactions;
- ?? Tuition and boarding fees collected by schools and colleges;
- ?? Medical tests, consultations, health care, hospitalization, medical and biological analyses; and
- ?? Subject to reciprocal treatment, all goods and services intended for the official use of foreign diplomatic missions, internal organizations, diplomats and members of their families and technical and administrative personnel of foreign and diplomatic missions and members of their families.

(c) Export Incentives and Free Trade Zones

All enterprises regularly established in Cameroon that export part or all of their industrial products are granted an export allowance equal to 5 per cent of the FOB value of the exports to be deducted for company tax purposes.

Industrial free trade zone incentives are available to enterprises engaged exclusively in export. These include exemption from taxes, duties or levies for the first 10 years with the exception of the payment of company tax at the reduced rate of 15 per cent of taxable income after deducting the following allowances:

- ?? 25 per cent of total salary and wages paid to Cameroon nationals during the fiscal year;
- ?? 25 per cent of capital expenditure made in the fiscal year.

(d) Other Incentives

Other incentives include import duty concessions, exemption from export duties, tax reductions, and holidays. Additional tax incentives include the carry forward of depreciation indefinitely and losses for four years as well as tax reduction on capital gains reinvested.

(e) Tax incentives legislation highlights

- ?? Investment Code Law 90.007 of 8 November 1990, Ruling of 24 January 1994;
- ?? Temporary Reductions of Taxes GTC Part 1, Ch. III, Articles 139-142;
- ?? Tax benefits for New Enterprises and Enterprises in Difficulty Law 89-001 of 1 July 1989;
- ?? Tax on the Granting of Credit Decree 73/28 of 30 August 1973, as amended by Finance Law 1986-87.

(f) Statutory Tax Rate

The national corporate tax rate is 35 per cent. An additional 10 per cent surcharge is in effect, which makes the rate of corporate tax imposed 38.50 per cent. Oil companies are taxed at 57.5 per cent, or 48.6475 per cent depending on whether they opt for an after tax or a before tax share of "*rente minière*" (mineral rent), and oil pipeline transportation enterprises are taxed at a reduced rate of 5 per cent.

There is a minimum tax payable of 1 per cent of turnover plus a 10 per cent local surcharge. Residents and non-residents with undertakings or establishments in Cameroon may elect to pay tax at 15 per cent of turnover in lieu of corporate tax at 38.5 per cent on profits arising from drilling, exploration and assistance projects carried out for oil companies.

Withholding tax on dividends is 25 per cent and on royalties it is 15 per cent. The withholding tax on interest is 15 per cent plus a local surcharge of 10 per cent, giving an effective rate of 16.5 per cent. Withholding tax on interest paid to non-resident lenders has been suspended.

3. Côte d'Ivoire

(a) Regional incentives

There are no specific regional incentives. However, the Investment Code provides a longer exemption period (eight years) when the investment site is located outside the region of the economic capital, Abidjan.

(b) Sectoral incentives

Tax incentives are granted under the Mining Code and the Petroleum Code for enterprises involved in mining and petroleum activities. These codes provide exemption from VAT and additional tax on imports and purchases to companies involved in exploration or production of oil/gas or minerals. The tax exemption applies to transactions or purchases directly and exclusively assigned to petroleum or mining activities. The Code also provides specific rules concerning calculation of corporate income for tax purposes. Exemption of VAT and additional tax on imports and purchases accorded to oil/gas companies are extended to their subcontractors providing petroleum-specific services.

Enterprises involved in mining operations are exempt of employer tax on payroll during the exploration period. They are also granted a five-year exemption from corporate income tax. The starting year of this exemption is the fiscal year of the effective start of production.

(c) Export incentives and free trade zones

Exemption from VAT is allowed on exported products or services.

(d) Other Incentives

Certain tax incentives are available to all qualifying enterprises in Côte d'Ivoire. Enterprises may apply for a reduction in the tax on industrial and commercial profits (Corporate Income Tax.) For the reduction to be granted, the amount invested in Côte d'Ivoire should be at least ten million CFA francs for an investment period not exceeding three years. Côte d'Ivoire also offers a favourable accelerated depreciation regime.

In addition to these incentives, which are available under the General Tax Code (Article 84), the new Investment Code adopted in 1995, repealing the Investment Code of 1984 allows incentives through two different schemes:

?? Declaration Scheme (régime de déclaration)

?? Agreement Scheme (régime d'agrément à l'investissement)

These incentives include exemptions from corporate income tax, professional tax, land tax, and general import taxes. Incentives may be granted for five or eight years depending on the location of the investment.

(e) Tax incentives legislation highlights

?? Article 84 of the Tax Code (Code General des Impôts);

?? Petroleum Code (Code Petrolier) Law No 96-669 of August 29 1996;

- ?? Mining Code (Code Minier) Law No 95-553 of 18 July 1995;
- ?? Investments Code (Code des Investissements) Law No 95-620 of 3 August 1995.

(f) Statutory tax rate

The national rate of corporation tax is 25 per cent. There are no local taxes. The rate of withholding tax on dividends is 10 per cent, and it applies to dividends paid out of taxed profits. Where dividends are paid out of exempt profits, the rate is 18 per cent. The rate of withholding tax on interest is 18 per cent. Interest paid by Côte d'Ivoire banks or stockbrokers is taxed at 16.5 per cent while interest paid by foreign financial institutions on loans of at least 3 years to buy plant and machinery are taxed at 9 per cent. Interest on certificates of deposit (*bons de caisse*) issued by banks and financial institutions is taxed at 25 per cent, and issued by other kinds of enterprises at 18 per cent.

There is no withholding tax on interest paid on:

- ?? Commercial current accounts between related companies;
- ?? Loans from banks resident in the Côte d'Ivoire; or
- ?? Loans made from borrowed funds, the interest on which is subject to withholding tax.

The notional rate of withholding tax on royalties is 25 per cent. However, a 20 per cent reduction is applied, making an effective rate of 20 per cent. Payments made in return for the granting of rights in industrial property (patents, trademarks, know-how) will be regarded as royalties paid under a lease of industrial property, and as such, are subject to a special rate of tax of 2.5 per cent.

4. Egypt

(a) Regional incentives

Law No. 8 adopts a geographically and activity based investment incentive structure. The following tax incentives are granted to inland projects under the law:

- ?? A basic five-year tax holiday is awarded for priority sectors in the Old Valley, including: infrastructure, manufacturing, venture capital projects, financial leasing, software, tourism, livestock, fish and poultry, refrigerated transportation services for agricultural produce, foodstuffs, marine transportation, oil sector support services, hospital and medical centres offering 10 per cent of their overall capacity free of charge, and aviation projects. There is a 10-year tax holiday for projects in new industrial zones, urban communities, and remote areas and those implemented through the Social Fund for Development. Projects in the New Valley are entitled to a tax holiday of 20 years.
- ?? Imported capital assets, construction materials, and components required to establish an approved project are subject to import duty at a low flat rate of 5 per cent of the cost, insurance and freight value. Approved projects are eligible for paying duty on a deferred basis or by instalments.

Under Law No. 59, a company that locates in a new town and whose activities are confined to that location is eligible for the following tax incentives:

- ?? Profits are exempt from corporate income tax for 10 years, starting from the first fiscal year following the year in which production commenced. Furthermore, under Law No. 8, the profits of projects established in the New Valley are exempt from corporate income tax for 20 years;
- ?? Imported machinery and equipment and construction materials required to establish factories or similar premises are subject to import duty at the low flat rate of 5 per cent;
- ?? Returns on bonds, finance deeds and income from similar securities issued for public subscription are exempt from tax on revenue of movable capital;
- ?? A percentage of the paid-up capital to be determined in accordance with Central Bank rules shall be exempt from tax on projects of stock companies; and
- ?? A five-year residence is granted to founders of joint stock and limited liability companies and partners in a partnership of established companies and institutions.

(b) Sectoral incentives

A number of other tax incentives are available apart from those granted under Law No. 8 and Law No. 59. For example,

- ?? New industrial (manufacturing) companies with more than 50 employees are exempt from corporate income tax for five years, starting from the first fiscal year following the commencement of production;
- ?? Enterprises in the hotel ownership and management business are exempt from corporate income tax and all other taxes for five years, starting from the commencement of activities. Local authorities may not levy any taxes or duties on such enterprises without the approval of the Ministry of Tourism;
- ?? Companies formed in 1981 or thereafter to reclaim and cultivate barren land are exempt from corporate income tax for the first 10 years after the land becomes productive;
- ?? Cattle- and poultry-raising companies and fisheries incorporated after 1978 are exempt from corporate income tax for five years, starting from the commencement of business;

- ?? Bookkeeping companies are exempt from corporate income tax without any time limit;
- ?? Tourism projects, and their extensions, that are located in a remote area are exempt from corporate income tax for 10 years, starting from the commencement of activities.

(c) Export incentives and free trade zones

The following tax incentives are available to free zone projects under Law No. 8:

- ?? No tax is levied on free zone projects or on dividends paid out of the profits of such projects. This exemption has no time limit. Such projects are subject to a 1 per cent annual duty on the added value of goods entering or leaving the zone for the account of the project (excluding transit goods). A project whose main activities do not involve the entry or departure of goods from the zone is subject instead to a 1 per cent fee on the its annual turnover.
- ?? No customs duties are levied on goods entering free zones from abroad or from other free zones, including capital equipment and transportation equipment necessary for production activity within the free zone.

(d) Statutory tax rate

Corporation tax rates depend on the type of income. Foreign dividend, interest or royalty income is taxed at 32 per cent. Profits from export and industrial operations of companies is taxed at 32 per cent. The income of oil exploration and production companies is taxed at the rate of 40.55 per cent. All other companies are taxed at 40 per cent. In addition, a development duty is charged at a rate of 2 per cent on taxable income in excess of 18,000 Egyptian pounds.

No withholding tax is charged on dividends. Interest and royalties are subject to a withholding tax of 32 per cent. Under domestic law there is no withholding tax rate on interest on savings and deposit accounts in banks and post offices, and on interest on public sector bonds and debentures.

5. Ghana

(a) Regional Incentives

A location incentive in the form of a rebate is granted to manufacturing companies located outside Accra and Tema. In other regional capitals, a rebate of 25 per cent of tax liability is granted, and in all other places a rebate of 50 per cent of tax liability is granted.

(b) Sectoral Incentives

Incentives are granted to enterprises engaged in agriculture, hotel activities, manufacturing, construction, import and export activities, and other activities detailed in the Ghana Investment Code and the Income Tax Act. Whereas the corporate income tax rate is 35 per cent, companies in the hotel industry are taxed at 25 per cent.

The tax rate on income derived by banks from loans granted to any farming enterprise is 20 per cent. The rate of tax on rural or community banks after their period of tax exemption (that is, the first 10 years of their commencing operation) is 8 per cent.

(c) Export incentives and free trade zones

Non-traditional export companies are taxed at a reduced rate of 8 per cent. Non-traditional exports are those other than cocoa, coffee beans, timber and logs, electricity, and unprocessed gold or any other mineral in its natural state.

Free zone developers and enterprises that are granted licenses under the Free Zones Act are exempted from the payment of income tax on profits for the first 10 years from the date of commencement of operation. The income tax rate after the 10-year period is limited to a maximum of 8 per cent. Enterprises in free zones are exempted from the payment of direct and indirect duties and levies on all imports of items used in the manufacture of goods for export from free zones.

(d) Other incentives

The income accruing to a company engaged in the construction for sale or rental of residential premises during the first five years following the commencement of operations of the company is exempt from tax.

The rental income from any residential or commercial premises is also exempt from tax for first five years following completion of the construction of such premises.

(e) Tax incentives legislation highlights

- ?? Income Tax Decree SMCD 5 as amended;
- ?? Free Zones Act 1995, Art. 504;
- ?? Income Tax (Amendment) Act 1998, Art. 551.

(f) Statutory tax rate

The national rate of corporation tax is 35 per cent. There are no local taxes. The rate of withholding tax on dividends is 10 per cent and the rate of withholding tax on interest is 10 per cent except in the case of interest paid on government bonds and bonds of a registered cooperative society or a statutory corporation which is exempt from tax. The rate of withholding tax on management or technical service fees is 15 per cent.

6. Malawi

(a) Sectoral incentives

New corporate investors investing in excess of US\$10 million are given the option of paying a corporate tax at the rate of 15 per cent or taking a 10-year tax holiday. For those investing less than US\$10 million but more than US\$5 million, the options are corporate tax at the rate of 15 per cent or a 5-year tax holiday. Manufacturing companies can deduct operating expenses incurred up to 24 months before the start of operations. Indefinite losses carry forward for tax allowances. There is no duty on import of raw materials.

Qualifying expenditures for new and old buildings and machinery are given a 40 per cent and 20 per cent investment allowance respectively. Training costs are given a 50 per cent allowance.

Horticultural producers are allowed duty-free import of equipment and raw materials.

(b) Export incentives and free trade zones

Incentives for establishing export manufacturing operations include an export tax allowance equal to 12 per cent of export revenue and a transport tax allowance equal to 25 per cent of international transport costs for non-traditional exports. No duties are levied on the import of capital equipment, raw materials and packaging materials. Traditional exports are tobacco, tea, coffee and sugar.

(c) Other incentives

In addition to the normal capital allowances, qualifying training costs are allowed at 150 per cent of actual amounts expended.

(d) Tax incentives legislation highlights

All incentives are provided under the Taxation Act.

(e) Statutory tax rate

The rate of national corporate tax is 38 per cent and there are no local corporate taxes.

There is no withholding tax on dividends; on interest and royalties the rate is 15 per cent.

7. Mauritius

(a) Regional incentives

Companies holding a regional development certificate issued under the Development Incentives Act are classified as tax incentives companies and their income is taxed at a rate of 15 per cent.

(b) Sectoral incentives

The Government has introduced a number of incentive regimes that are designed to encourage both overseas and local investors to establish manufacturing and service industries in Mauritius. Qualification for these incentives is determined under the Industrial Expansion Act of 1993, which covers the Hotel Management Incentive Scheme, Pioneer Status Scheme and Health Development Certificate for Polyclinics. A key feature is that such companies qualify for the reduced tax rate of 15 per cent as incentive companies. Other qualifying sectors include:

- ?? Companies engaged in the agro-based industry approved by the Minister of Agriculture and Natural Resources;
- ?? Companies deriving at least 75 per cent of their gross income from agriculture, other than sugar cane cultivation, but including fishery and livestock;
- ?? Companies whose main activity is to provide lease financing, subject to approval by the Minister;
- ?? Companies deriving at least 75 per cent of their gross income from the construction of buildings, roads and bridges; and
- ?? Companies engaged in tourism activities that hold a certificate issued by the Minister in charge of tourism and leisure.

Following the Finance Act of 1998, offshore corporations incorporated on or after 1 July 1998 will be taxed at the rate of 15 per cent. A foreign tax credit is available where documentary evidence of the foreign tax credit can be presented to the local tax office in Mauritius. Otherwise the foreign tax credit is presumed to be 90 per cent of the local tax (i.e. a minimum effective tax of 1.73 per cent).

(c) Export incentives and free trade zones

Export incentive schemes include the Export Service Zone Scheme and the Export Processing Zone Scheme under the Industrial Development Zone Act of 1993. Companies qualifying under these regimes are entitled to the 15 per cent reduced tax rate as incentive companies.

To integrate local manufacturing enterprises with export enterprises, all approved local manufacturing enterprises enjoy a uniform corporate income tax rate of 15 per cent from 1 July 1996.

Free port companies are not classified as tax incentive companies and the income derived within the free port zone by such companies is exempt. Income derived from any activity outside the free port zone is taxed at the rate of 35 per cent. Expatriates employed by free port companies benefit from a tax credit of 50 per cent (e.g. the tax is attributable on their emoluments).

(d) Other incentives

Tax incentive company status is also accorded to companies registered with the Small and Medium Industries Development Organization.

Zero rating for VAT will be extended to specified locally manufactured goods. Magazines and other periodicals are exempted from VAT.

(e) Tax incentives legislation highlights

- ?? Industrial Expansion Act, 1993;
- ?? Export Service Zones Act, 1981;
- ?? Development Incentives Act;
- ?? Hotel Management (Incentives) Act, 1982;
- ?? Health Development Certificate Act, 1992;
- ?? Mauritius Offshore Business Activities Act, 1992.

(f) Statutory tax rate

The standard corporate tax rate is 35 per cent and there are no local corporate taxes. There is no withholding tax on dividends or royalties, and no specific withholding tax on interest. However, income is subject to ordinary corporate tax and is collected by assessment as part of corporate income. Interest paid to a non-resident by any bank in Mauritius or by a corporation approved by the Minister as an offshore company is exempt from tax.

8. Morocco

(a) Regional incentives

Companies set up in the Western Sahara region are exempt from income tax.

(b) Sectoral incentives

Agriculture is exempt from income tax until 2010. There are practically no restrictions on the sectors in which foreigners can invest, except in agriculture.

Incentives are offered to develop certain priority sectors such as banking, manufacture, real estate and trade. They include reduced import duties, exemption from an import tax levy, exemption from patent tax during the first five years of operation, exemption from urban tax for the first five years of operation and exemption from VAT for equipment, material and tools.

Other incentives available include exemption from National Solidarity Contribution, exemption from tax for creating an annual investment reserve. Machinery and equipment are allowed depreciation on a sliding scale. Losses may be carried forward for a period of four years. Exemption from VAT is accorded for equipment related to fishing and agriculture.

(c) Export incentives and free trade zones

Firms engaged in export are exempt from corporate tax for the first five years and taxed at 50 per cent of the regular rate for the next five years. Goods for export are exempted from VAT.

The free trade zone in Tangiers is open to both Moroccan and foreign companies. Goods may be imported duty free to the zone. The companies are exempt from other taxes as well. The only requirement is that all local workers be paid directly in foreign hard currency, which they are obliged to convert to local currency at the Moroccan banks operating in the zone.

(d) Other incentives

Special incentives are available for companies installing environmental protection equipment using renewable energy sources and otherwise complying with environmental protection laws.

(e) Tax incentives legislation highlights

?? Investment Charter (Law No. 18/95) of 1995;
?? Corporate Tax Law (1996).

(f) Statutory Tax Rate

The corporate tax rate is 35 per cent. Companies subject to corporate tax must pay a levy, called the National Solidarity Contribution (PSN), at the rate of 10 per cent of the corporate tax. When corporate tax is exempt, PSN is 25 per cent of the presumed corporate tax.

A business tax or patent is levied on individuals and enterprises carrying out business in Morocco. The tax is based on the rental value of business premises and on a fixed amount based on the size and nature of the business.

Domestic corporations (irrespective of the extent of foreign ownership, a corporation incorporated in Morocco is considered to be a domestic corporation) are also subject to a minimum tax regardless of whether they make profits or losses. This tax is based on turnover and income (e.g. from interest, subsidies or bonuses) and is levied at the rate of 5 per cent of income. However, companies are exempt from paying this turnover tax during the first three years of operation.

Dividends paid to non-resident shareholders are subject to 15 per cent withholding tax while those paid to corporate shareholders from taxable entities incorporated in Morocco are not taxable. This does not apply to foreign investment income. Interest paid to residents is taxed at 36 per cent. Interest paid to non-residents is subject to a 10 per cent withholding tax. Royalties and management fees paid to residents are taxed at 36 per cent, while those paid to non-residents are subject to a 10 per cent withholding tax.

9. Namibia

(a) Export incentives and free trade zones

Manufacturing incentives

Incentives for registered manufacturers include a deduction, limited to taxable income from manufacturing, of 50 per cent of manufacturing income (that is, gross manufacturing income, less exemptions) for five years, spread over nine years (higher deductions can be negotiated); an accelerated allowance with respect to buildings for manufacturing; and an additional allowance of 25 per cent related to employment and approved training costs for employees directly engaged in manufacturing operations. An additional tax allowance with respect to certain export marketing expenditures is granted. This allowance is calculated at 25 per cent, 50 per cent or 75 per cent of the export marketing expenditure, depending on the level of export turnover.

Export-promotion incentives

The export-promotion incentive provides for the exemption of 80 per cent of taxable income resulting from the export of manufactured goods from tax (excluding manufactured fish or meat products). Goods are not required to be manufactured locally.

Export processing zones (EPZs)

The objectives and purposes of EPZs are to attract, promote or increase the manufacture of goods for export; to create or increase industrial employment, export earnings, and industrial investments; and to encourage technology transfer and the development of management and labour skills.

Enterprises in EPZs qualify for total relief from general sales tax, additional sales levy, customs duties, excise duties, stamp taxes on specified instruments, transfer duty, and income tax. In addition, the Export Processing Zones Act provides that foreign currency may be acquired and used without restriction.

Goods removed from an EPZ into Namibia are deemed to be imported into Namibia, and such transactions are subject to customs duties, additional sales levy and general sales tax. Goods removed from Namibia into an EPZ are deemed to be goods exported from Namibia.

(b) Other incentives

Generous tax allowances are granted for the construction of buildings and the acquisition of capital equipment.

(c) Tax incentives legislation highlights

Tax incentives are contained in the Income Tax Act of 1981.

(d) Statutory tax rate

The standard national rate of corporate tax of 35 per cent applies to companies for years of assessment commencing on or after 1 January 1995. There are no local corporate taxes. The rate of withholding tax on dividends is 10 per cent. Dividends distributed by a cooperative, insurance company, public utility company or a company deriving income from mining or natural oil are exempt from withholding tax. There is no withholding tax on interest. The withholding tax rate for royalties is 10.50 per cent for years of assessment commencing on or after 1 January 1995.

10. Nigeria

(a) Regional incentives

Accelerated capital allowances are granted on the basis of the cost of qualified capital expenditure to investors that establish operations in rural areas where facilities such as electricity, tarred roads, telephones and water supply are not available.

Rural Investment Allowances are granted at the following rates when the locations of investment are 20 km or more from the availability of the following facilities:

?? Electricity	50 per cent
?? Telephone	15 per cent
?? Water	5 per cent
?? All facilities	100 per cent

(b) Sectoral incentives

Tax holidays are available for pioneer products and companies granted licenses for such products. The holiday period covers an initial period of three years, renewable for an additional two years. A new company going into mining of solid materials is exempted from tax for the first three years of operation.

A company that engages wholly in the fabrication of spare parts, equipment and tools for local consumption or for export is granted a 25 per cent Investment Tax Credit on the cost of fixed assets.

A company engaged in marketing and distribution of natural gas for commercial purposes, a power plant, a liquefied natural gas production company, a gas to liquid plant, a fertilizer plant, or a company engaged in laying transmission and distribution pipe lines (downstream operations) is granted:

- ?? A three-year tax-free period, renewable for an additional two years;
- ?? Accelerated capital allowances at the rate of 90 per cent of plant and machinery after the tax-holiday period;
- ?? Tax-free dividends, if investment is in imported capital or in plant and machinery with a value of not less than 30 per cent of equity share capital of the company; and
- ?? VAT exemption for plant and machinery purchased for gas utilization.

Companies engaged in exploration of petroleum in deep offshore areas (water depths over 200 metres) and inland basin areas are granted a concessionary profits tax at the rate of 50 per cent of chargeable profits for the duration of the production-sharing contracts (PSCs) instead of the normal rate, 85 per cent. Royalties for deep offshore PSCs are graduated from 12 per cent to 0 per cent depending on water depth, while inland-basin PSCs are charged a flat rate royalty of 10 per cent.

A manufacturing company is granted a 15 per cent investment tax credit on the cost of replacement of obsolete plant and machinery in addition to accelerated capital allowances.

Losses incurred by agricultural trade and businesses are carried forward indefinitely, whereas others are restricted to four years. Tractors, ploughs and other agricultural implements are exempt from VAT.

Bank interest on loans to agricultural trade, gas utilization projects, fabrication of local equipment and tools, and working capital for cottage industry companies established under the Family Economic Advancement Programme are tax free.

Companies engaged in research and development activities for commercialization are granted a 20 per cent investment tax credit on qualifying capital expenditure. There is no restriction on the total claimable capital allowances in respect of manufacturing and agricultural trades and businesses; other businesses are restricted 66.66 per cent of assessable profit. Manufacturers are allowed 25 per cent duty drawback.

(c) Export incentives and free trade zones

Tax exemptions are available for export products. Exports are zero-rated. Costs of buildings, plants and machinery of a manufacturing company are granted in full as tax relief. Profits or gains of a company that is 100 per cent export-oriented are tax exempt for the first three years. This applies if the company is new, exports 75 per cent of its turnover, and repatriates it to Nigeria. Old plant and machinery of the company, if any, must be less than 25 per cent of total cost of plant and machinery.

Plant and machinery imported for use in an EPZ is subject to the VAT drawback scheme. Profits of a company in respect of exported goods used to buy raw materials, plants, equipment and spare parts are tax exempt.

Duties on imports of goods for export businesses are allowed as credits under a duty drawback scheme.

(d) Other incentives

Research and development expenses are tax deductible, and the expense can also be capitalized if desired. Self-assessing companies which pay taxes promptly are granted a 1 per cent tax bonus. Companies with at least 25 per cent imported equity capital are exempt from minimum tax levy, a tax paid by companies that make a loss.

(e) Tax incentives legislation highlights

- ?? Companies Income Tax Act, CAP 60 LFN, 1990;
- ?? Capital Gains Tax Act, CAP 42 LFN, 1990;
- ?? Industrial Development (Income Tax Relief) Act, CAP 279 LFN;
- ?? Petroleum Profit Tax Act, CAP 354 LFN;
- ?? Value Added Tax Decree 104, 1993;
- ?? Personal Income Tax Decree 102, 1993.
- ?? Deep Offshore and Inland basin Production Sharing Contract Decree No. 9, 1999.

(f) Statutory tax rate

The national corporate tax rate is 30 per cent, and there are no local taxes.

Dividends paid are subject to 10 per cent withholding tax, except in the following cases, where they are exempt:

- ?? The company enjoys pioneer status or manufactures a pioneer product.
- ?? The company is a manufacturing exporter that exports 50 per cent of its annual turnover.
- ?? The shareholder pays for equity participation in a company in foreign currency or with assets brought into Nigeria between 1 January 1987 and 31 December 1992, and provided the shareholder owns at least 10 per cent of the share capital of the payer company. This exemption is granted for a period of three years, but is extended to five years for dividends paid out of profits arising from specified operations such as agricultural, petrochemical or liquefied natural gas industries.

The standard rate of withholding tax on interest is 10 per cent. There is no tax on interest earned on savings accounts of up to 50,000 naira and foreign currency bank deposit accounts of non-residents opened on or after 1 January 1990.

Foreign currency loans in excess of 150,000 naira, agricultural loans, loans (taken after 1 April 1990) which are used for manufacturing goods for export may be subject to concessionary rates or zero rates, depending on the duration of the loan.

The rate of withholding tax on royalties is 15 per cent. Payments for services provided in construction and related services industries and contracts for supplies are subject to a 5 per cent withholding tax creditable against the final tax liability. The rate is 10 per cent for management and technical service fees paid to corporate entities, and 5 per cent if paid to non-corporate entities.

11. South Africa

(a) Sectoral incentives

A tax holiday scheme is available for any newly formed company commencing new manufacturing activities that qualify under the law. To qualify under this scheme, the law requires:

- ?? An investment exceeding 3 million rand in plant, machinery, land and buildings;
- ?? The entity must commence with new manufacturing activities and must not have started the manufacturing process prior to applying for the tax holiday scheme;
- ?? The company may take over assets from a connected party, provided that the company makes an equal investment into new and unused assets.
- ?? The criteria for eligibility include the following components:
 - Spatial component:* The company should set up its new manufacturing activities in an area that qualifies as an eligible area.
 - Industry component:* The Department of Trade and Industry has set guidelines that outline which industries qualify for tax holiday approval.
 - Human resource component:* To qualify under this component, the total salaries and wages bill should exceed 55 per cent of the total value added.

Each of the three criteria outlined above that the company meets, entitles it to a two-year tax holiday, with a maximum tax holiday of six years according to the following conditions:

- ?? Companies could apply for tax holiday status up to 30 September 1999.
- ?? The six-year tax holiday must be used within 10 years of approval.
- ?? The tax holiday status will come into effect in the year that the company earns a taxable income.
- ?? The tax holiday must be used in consecutive years (i.e. once the company starts receiving the benefit, it cannot skip years if it subsequently makes losses).

In addition, South Africa offers accelerated depreciation for certain sectors such as farming (50 per cent, 30 per cent, 20 per cent over three years) and manufacturing (33 per cent for new and unused machinery brought into use before September 30, 1999).

A textiles, clothing and footwear programme provides for the duty-free import of products based on the attainment of certain export levels. This Duty Credit Certification Scheme for the clothing and textile industry has been extended to March 2000. The scheme allows companies to use 30 per cent of the value of their exports to import textiles.

(b) Export incentives and free trade zones

Rebates from various customs and excise duties for exporters are available, as is zero rating for VAT on export of goods and services.

(c) Tax incentives legislation highlights

Income Tax Act, Sections 12, 13 & 37H.

(d) Statutory tax rate

The national rate of corporate tax is 30 per cent. A rate of 40 per cent applies to income earned in South Africa by a branch of a company, which has its place of effective management outside South Africa. This rate applies in respect of years of assessment ending on or after 1 April 1996.

Under domestic law, dividends are exempt from income tax and withholding tax. However, all dividends declared are subject to Secondary Tax on Companies (STC) which is payable by the company declaring the dividend. The STC, introduced in March 1993, is a tax levied on dividends declared by a company, but it is a tax on the company and not on the shareholder. Liability is assessed on the net dividend distribution (i.e. dividends distributed, less dividends accrued in the relevant dividend cycle). STC is determined independently of corporate tax liability, and thus a company with tax losses, which declares a dividend, is still liable to STC.

Certain payments of cash or other assets by a company to or for the benefit of its shareholders may be construed as a deemed dividend, and as such, will be liable to STC.

The current rate of STC is 12.5 per cent and is applicable to dividends declared after 14 March 1996. Dividends declared between 1993 and 1996 are taxed at a rate of 25 per cent.

Companies which have South African branches but which are effectively managed outside of South Africa are not subject to STC.

Interest accruing to a non-resident after 15 March 1988 is not subject to withholding tax. Interest accruing on or after 3 June 1992 is also exempt from income tax if the person earning the interest is:

- ?? A person who is ordinarily resident outside South Africa (subject to certain limitations); or
- ?? A company that is managed and controlled outside South Africa, and with effect from 13 March 1996, not conducting business inside South Africa.

The rate of withholding tax on royalties is 12 per cent.

12. Uganda

(a) Regional incentives

Firms located outside Kampala, Entebbe, Namanve, Jinja and Nyeru are entitled to an initial capital allowance on plant and machinery of 75 per cent while those located in these areas are entitled to an initial capital allowance of 50 per cent.

(b) Sectoral incentives

Incentives are available for domestic as well as foreign investors, provided they qualify in terms of investment amount. However, foreign investors engaged in certain activities (listed under the Investment Code), such as wholesale and retail commerce, public relations and food processing intended solely for the domestic market, are not eligible for incentives. An investor may obtain a certificate of incentives from the Uganda Investment Authority.

A holder of a certificate of incentives is entitled to exemption from corporate tax for a period of three years if the value of investment is US\$ 300,000 or less. If the investment amount is over US\$ 300,000, the exemption will be for a period of five years. An additional year of exemption is granted if the investment is in one of the priority areas listed in the Investment Code.

Start-up costs are amortized over a period of four years, at 25 per cent a year. In addition, costs incurred for training, R&D and mineral exploration are 100 per cent deductible.

Plants, machinery and construction materials are exempted from import duty and sales tax. An investor holding an investment license and his or her expatriate staff may import one motor vehicle each for personal use and personal and household effects free of duty and sales tax.

Capital goods used for business are allowed annual depreciation at varying rates, the maximum rate being 45 per cent for computer equipment. Buildings and hotels are allowed 5 per cent of annual depreciation. Losses can be carried forward indefinitely.

(c) Export incentives

In addition to the above incentives, firms involved in export can avail of a duty drawback facility.

(d) Tax incentives legislation highlights

?? The Investment Code (1991);
?? Income Tax Act (1997).

(e) Statutory tax rate

The corporate tax is 30 per cent.

Dividends paid to non-residents are subject to 15 per cent withholding tax. Interest paid to non-residents is subject to a 10 per cent withholding tax, while the withholding tax on royalties and management fees is 15 per cent.

Small enterprises are subject to a minimum tax based on turnover (if less than 50 million Uganda shillings, equivalent to US\$ 37,000), unless they elect to file regular tax returns. The tax is 1 per cent of turnover with no allowance or deductions.

13. Zambia

(a) Regional incentives

Income from rural enterprises is taxed at a rate reduced by one seventh of the tax that would otherwise have been charged.

Micro and small enterprises are entitled to various incentives under the Small Enterprises Development Act of 1996. Enterprises registered under the Act are entitled to exemption from income tax for the first three years if they operate in an urban area and the first five years if they operate in a rural area. They may operate a manufacturing enterprise for the first five years without a manufacturing license and are exempt from paying taxes for the same period. A micro enterprise is defined as one with a turnover of less than 20 million Zambian kwacha per annum; a small enterprise must have a turnover of less than 80 million Zambian kwacha

(b) Sectoral incentives

Income from farming is taxed at the rate of 15 per cent. Capital allowances are available at an enhanced rate of 50 per cent on implements, machinery and plants used exclusively for farming, manufacturing or tourism.

Activities that can be written off in full against revenue in the year that it is incurred include: tourism or expenditure on land for the purposes of farming, stumping and clearing, for the prevention of soil erosion, for sinking boreholes or wells, for aerial and geophysical surveys, and for water conservation, as well as for farm buildings and other structures.

An investor that incurs capital expenditure on the growing of tea plants, coffee trees, banana plants, citrus fruit trees, or other similar plants or trees is entitled to a development allowance of 10 per cent of the expenditure. This allowance is in addition to the normal capital allowances available.

Capital expenditure in relation to mining operations can be deducted against revenue in the tax year in which it is incurred, and qualifies if it constitutes expenditure on:

- ?? building works, railway lines or mining equipment;
- ?? shaft sinking, including expenditure on sumps, pumps, chambers, stations, ore bins and other accessories to a shaft.
- ?? the purchase or payment of a premium for the use of any patent, design, trademark, process or other expenditure of a similar nature;
- ?? preliminary surveys, boreholes, development or management incurred prior to the commencement of production or during any period of non-production ; and/or
- ?? interest payable on any loan for mining or prospecting purposes (the deductibility of interest is restricted by reference to the debt-to-equity ratio of the company).

Under the Mines and Minerals Act of 1995, holders of a mining right are entitled to exemption from customs and excise duties on the importation of all machinery and equipment (including specialized motor vehicles) required for any of the activities conducted or to be conducted, in pursuance of the right or otherwise for the purposes of their investment in mining or prospecting. This exemption applies strictly to a holder of a mining right under the Act.

(c) Export incentives and free trade zones

Income from the export of non-traditional goods (all goods except for copper, lead, zinc and cobalt) is taxed at the rate of 15 per cent.

(d) Tax incentives legislation highlights

?? Small Enterprises Development Act of 1996;
?? Mines and Minerals Act of 1995.

(e) Statutory tax rate

The rate of corporate tax is 35 per cent and the rate of withholding tax on dividends, interest and royalties is 15 per cent.

14. Zimbabwe

(a) Regional incentives

Various regions have been declared “growth point areas.” The incentives for developing industrial and commercial businesses are:

- ?? Generous allowances for capital expenditure on commercial buildings (25 per cent of cost over four years);
- ?? 15 per cent investment allowance (non-recoupable) in addition to the usual capital expenditure allowances; and
- ?? Reduced rates of tax for: (i) new manufacturing companies at 10 per cent; and (ii) new infrastructure contractors (roads, bridges, etc.) for the first five years of operation at 15 per cent.

(b) Sectoral incentives

The following special incentives are offered to mining operations and industrial parks:

- ?? Mining: generally the State offers a variety of tax breaks and refunds for the year when capital expenditures are incurred, specifically, “special mining leases”.
- ?? Industrial park developers: reduced tax rates on income from the lease of premises to manufacturers — tax exempt for the first five years, and thereafter, taxed at the rate of 15 per cent along with various tax holidays.

(c) Export incentives and free trade zones

Special incentives are available to export-oriented manufactures. New companies whose exports represent a minimum of 40 per cent of output, are taxed at a reduced rate of 25 per cent for the first five years. Other companies whose exports represent a minimum of 50 per cent of output, the tax rate is reduced to 27 per cent.

For EPZs the following incentives are offered (either for stand-alone enterprises, or preferably, for export parks):

- ?? Tax exemption for the first five years, and 15 per cent tax thereafter;
- ?? Customs duty exemptions;
- ?? Exemption from all withholding taxes;
- ?? Exemption for employees from tax on fringe benefits; and
- ?? Double deduction for export market promotional expenditures is allowed.

(d) Other incentives

It is possible to enter into contracts with the State for “build, own, operate, or transfer” (BOOT) projects (e.g. bridges or railway lines). Tax rates are reduced as follows:

- ?? first five years at 0 per cent;
- ?? next five years at 15 per cent; and
- ?? thereafter the usual rate applies at 35 per cent.

(e) Tax incentives legislation highlights

?? Finance Act (Ch. 23.04);
?? Sales Tax Act (Ch. 23.08);
?? Income Tax Act (Ch. 23.06).

(f) Statutory tax rate

The standard rate of corporate tax is 37.5 per cent. However, companies and trusts are subject to a "drought surcharge" of 5 per cent of income tax payable for the year of assessment beginning 1 April 1996, making the effective rate of tax 39.38 per cent. Non-resident companies are liable to an additional Branch Profits Tax of 15 per cent of 56 per cent of taxable income (an additional 8.4 per cent), giving an overall rate of 45.9 per cent.

The standard rate of withholding tax on dividends is 20 per cent. However, with effect from 1 January 1994, a withholding tax of 15 per cent is levied on dividends paid by companies listed on the Zimbabwe Stock Exchange. The rate of withholding tax on interest is 10 per cent. The rate of withholding tax on royalties is 20 per cent, except for royalties in respect of minerals that are subject to corporate tax.

B. Asia and the Pacific

A Brief Summary

Almost all economies in the region extend tax incentives in order to promote regional development. They offer such incentives as tax holidays, income tax exemption or reduced rate of taxes, investment allowance and customs duty exemptions for equipment and goods destined for production in designated remote areas. Some countries offer additional incentives, depending on the amount of investment or the number of jobs created in these areas. Priority, hi-tech, and pioneer industries (industries that are not sufficiently developed in the country) are given similar tax breaks. A few countries offer a reduced tax rate or other exemptions to attract headquarters of operations to these countries. Research and development expenses are generally given 100 per cent (in some cases 200 per cent) deductions. Export is promoted either through tax and duty exemptions or by establishing special economic zones which are governed by special tax regimes. Corporate taxes hover around 30 per cent of taxable income. Most countries have withholding taxes for dividend, interest and royalty payment.

Table 9: Synopsis of types of incentives: Asia and the Pacific

Country	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	Duty/VAT exemption/reduction	R & D allowance	Deduction for qualified expenses
Australia		?	?	?	?	?
China	?	?	?	?	?	
Cyprus	?	?	?	?		
Hong Kong, China	?	?			?	?
India	?	?	?		?	?
Indonesia	?			?		
Israel	?	?	?		?	?
Lebanon	?			?		
Malaysia	?	?	?		?	?
Pakistan	?		?	?		
Philippines	?		?	?	?	?
Saudi Arabia	?			?		
Singapore	?	?	?		?	?
Taiwan, Province of China	?		?		?	
Thailand	?			?	?	?
Turkey	?		?	?		
Viet Nam	?	?		?		

Table 10: Tax treaties signed per country/territory: Asia and the Pacific

	Australia	China	Cyprus	Hong Kong, China	India	Indonesia	Israel	Lebanon	Malaysia	Pakistan	Philippines	Saudi Arabia	Singapore	Taiwan Province of China	Thailand	Turkey	Viet Nam
TOTAL WORLD	44	67	29	2	78	48	36	11	51	52	33	8	47	14	45	40	26
Developed Countries	22	28	14	1	36	25	21	4	22	25	22	4	23	4	23	16	13
Western Europe	16	19	11		25	17	18	4	15	21	16	4	16	1	16	11	10
European Union	13	15	9		21	15	17	2	12	16	13	4	12	1	14	10	8
Austria	1	1	1		1	1	1		1	1	1				1	1	

	Australia	China	Cyprus	Hong Kong, China	India	Indonesia	Israel	Lebanon	Malaysia	Pakistan	Philippines	Saudi Arabia	Singapore	Taiwan Province of China	Thailand	Turkey	Viet Nam
Denmark	1	1	1		1	1	1		1	2	2		1		2	1	1
Finland	2	1			2	1	2		1	1	1		1		1	1	
France	1	2	1		2	1	2	1	1	2	1	1	1		1	1	1
Germany	1	1	1		2	2	1		1	2	1		1		1	1	1
Greece			1		1		1										
Ireland	1		1				1		1	1							
Italy	1	1	1		2	1	2		1	1	1	1	1		1	1	
Netherlands	1	1			1	1	2		1	1	1	1	1		1	1	2
Portugal		1			1								1				
Spain	1	1			1	1	1				1				1		
Sweden	1	1	1		3	1	1		1	1	2		1	1	2	1	1
United Kingdom	1	2	1		3	2	1	1	2	3	1	1	2		1	1	1
Belgium	1	1			1	2	1		1	1	1		1		1	1	
Luxembourg		1				1							1		1		1
Other Western Europe	3	4	2		4	2	1	2	3	5	3		4		2	1	2
Iceland		1															
Malta	1	1	1		1			1	1	1							
Norway	1	1	1		2	1	1		1	1	2		3		1	1	1
Switzerland	1	1			1	1		1	1	3	1		1		1		1
North America	3	3	3	1	5	4	2		2	3	2		2	1	2	3	1
Canada	1	1	1		2	2	1		1	1	1		1		1		1
United States	2	2	2	1	3	2	1		1	2	1		1	1	1	3	
Other Developed Countries	3	6			6	4	1		5	1	4		5	2	5	2	2
Australia		1			1	2			2		1		1	1	1		1
Israel		1			1						1		1		1	1	
Japan	1	3			2	1	1		2	1	1		2		2	1	1
New Zealand	2	1			2	1			1		1		1	1	1		
Developing Countries	18	24	6	1	33	17	10	6	22	23	9	4	19	9	17	14	10
Africa	1	4	1		7	5	1	1	4	4			1	4	2	3	1
North Africa		1	1		2	2		1	1	2						3	1
Algeria																1	1
Egypt		1	1		1	1										1	
Libyan Arab Jamahiriya					1					1							
Sudan									1								
Tunisia						1		1		1						1	
Other Africa	1	3			5	3	1		3	2			1	4	2		
Gambia														1			
Kenya					1												
Mauritius		1			1	2			1	1			1		1		
Mozambique																	
Namibia									1								
Nigeria										1							
Senegal														1			
Seychelles		1				1											
Sierra Leone					1												
South Africa	1	1					1							2	1		

	Australia	China	Cyprus	Hong Kong, China	India	Indonesia	Israel	Lebanon	Malaysia	Pakistan	Philippines	Saudi Arabia	Singapore	Taiwan Province of China	Thailand	Turkey	Viet Nam
Zambia					1												
Zimbabwe									1								
Tanzania, United Republic of					1												
Latin America and the Caribbean	1	1			2	1	2				1		1	1			
LATIN AMERICA	1	1			1	1	1				1		1	1			
Argentina	1																
Brazil		1			1						1						
Mexico							1						1				
Paraguay														1			
Venezuela						1											
THE CARIBBEAN					1		1										
Jamaica							1										
Trinidad and Tobago					1												
Asia and the Pacific	16	19	5	1	24	11	7	5	18	19	8	4	17	4	15	11	9
West Asia		4	2		8	1	1	3	3	7		1	2		1	3	
Bahrain																	
Cyprus		1			1										1		
Iran, Islamic Republic of								1		1							
Iraq																	
Jordan					1				1	1						1	
Kuwait		1	1						1								
Lebanon										1							
Oman					1					1							
Qatar					1					1							
Saudi Arabia					1	1							1			1	
Syrian Arab Republic			1		1			1									
Turkey		1			1		1		1	1		1					
United Arab Emirates		1			1			1		1			1			1	
Yemen																	
Central Asia		2			2	1		1		4					1	2	1
Armenia		1						1									
Azerbaijan										1							
Georgia																	
Kazakhstan										1						1	
Kyrgyzstan																	
Turkmenistan					1					1							
Uzbekistan		1			1	1				1					1	1	1
South, East and South-East Asia	13	12	3	1	14	9	6	1	13	8	8	3	14	4	13	6	8
Afghanistan					1												
Bangladesh		1			1				1	1			1		1		
Brunei Darussalam																	
China	1		1	1	1		1		1	1	1		1		1	1	1
Hong Kong, China		1															
India	1	1	1			1	1		1		1	1	2		1	1	1
Indonesia	2				1				1	1	1	1	1	1	1		

	Australia	China	Cyprus	Hong Kong, China	India	Indonesia	Israel	Lebanon	Malaysia	Pakistan	Philippines	Saudi Arabia	Singapore	Taiwan Province of China	Thailand	Turkey	Viet Nam
Lao People's Democratic Republic		1															
Macau																	
Malaysia	2	1			1	1					1		1		1	1	1
Maldives																	
Mongolia		1			1				1							1	1
Myanmar									1				1				
Nepal					1										1		
Pakistan		1				1		1			1		1		1	1	
Philippines	1	1			1	1	1		1	1			1		1		
Singapore	1	1			2	1	1		1	1	1	1		1	1		1
Sri Lanka	1				1	1			2	1			1		1		
Taiwan Province of China	1					1							1		1		1
Thailand	1	1	1		1	1	1		1	1	1		1	1			1
Viet Nam	1	1			1				1				1	1	1		
Korea, Democratic People's Republic of							1										
Korea, Republic of	1	1			1	1			1	1	1		1		1	1	1
Pacific	3	1							2				1				
British Solomon Islands																	
Fiji	1								1								
Guam																	
Kiribati	1																
Papua New Guinea	1	1							1				1				
Central and Eastern Europe	4	15	9		9	6	5	1	7	4	2		5	1	5	10	3
Albania									1							1	
Belarus		1			1												
Bulgaria		1	1		1	1											
Croatia		1														1	
Czech Republic	1	1	1		2	1	1		1				1		1	1	1
Estonia		1											1				
Hungary	1	1	1		1	1	1		1	1	1				1	1	1
Latvia		1											1			1	
Lithuania		1											1				
Poland	1	1	1		1	1	1		1	1	1		1		1	1	1
Romania		1	1		1	1			1	2					1	2	
Russian Federation			2		1	1	1	1	1						1	1	
Slovakia	1	1	1		1		1										
Slovenia		1															
Yugoslavia (former)		2	1						1								
Macedonia, the Former Yugoslav Republic of		1												1		1	

1. Australia

(a) Regional incentives

State and territory governments provide incentives to assist businesses situated overseas, in other states, or in urban areas to relocate to specified zones. Rules vary from state to state, but the incentives generally take the form of subsidies as well as reductions in payroll taxes, land tax and stamp duty.

(b) Sectoral incentives

Banking incentives

Certain profits of an offshore banking unit established by a resident financial institution authorized to deal in foreign exchange are taxed at the effective rate of 10 per cent. Income (excluding capital gains) from eight types of offshore banking activities conducted in Australia is eligible. Interest paid to a non-resident lender by an offshore banking unit generally is not subject to withholding tax.

Film industry incentives

A resident taxpayer who invests in a qualifying Australian film is granted a 100 per cent tax deduction for capital expenditure incurred in producing or contributing to the production of the film if, as a consequence, the investor becomes the first owner of the copyright. Losses generated by the tax deduction may be carried forward and must be set off solely against income from qualifying Australian films.

Mining and petroleum incentives

Taxpayers carrying out prescribed mining or petroleum operations may obtain an immediate write-off of expenditure incurred on exploration or prospecting for minerals or petroleum. The deduction is available against income of any category, and not only mining or petroleum income. Deductions are also available for particular capital expenditure incurred in the course of mining and quarrying operations over either a period specified in the legislation or the life of the mine.

Primary production incentives

Taxpayers who engage in the cultivation of land, forestry or horticulture, in fishing operations, or in the sale of livestock and their products may qualify for the following tax concessions as primary producers:

- ?? Income averaging over five years so that taxpayers are not disadvantaged when tax is levied at progressive rates on income that fluctuates from year to year. This provision applies to individuals and trustees only;
- ?? Deductions over 10 years for telephone line costs;
- ?? Immediate deductions for expenditure on soil conservation or measures to prevent land degradation in the year in which it is incurred;
- ?? Deductions over three years for capital expenditure on water conservation and distribution systems; and

?? Deductions over 25 years for capital expenditure on timber access roads and timber mill buildings, and a special deduction for timber depletion when the consideration for the land purchased by the taxpayer includes a price for standing timber.

Other schemes apply to primary producers, including the Income Equalization Deposits (IED) Scheme, under which non-corporate primary producers may reduce fluctuations in their income by making deposits with the Department of Primary Industries and Energy that are tax deductible in the year of deposit and are taxable in the year of withdrawal.

Taxable interest is payable on 100 per cent of the deposit if it qualifies as a farm management bond, or 61 per cent of the deposit in other cases. Withdrawal of farm management bonds is subject to conditions such as financial hardship caused by a fall in commodity prices, drought or fire.

(c) Export incentives and free trade zones

Bonded warehouse facilities are available, subject to a license being granted by the Australian Customs Service. There is no time limit for removing the bonded goods. In addition, import credit schemes are offered to exports of Australian manufactured items in the textile, clothing and footwear (TCF) industries and to passenger motor vehicle (PMV) components. Duty drawback and duty-free imports for goods to be further manufactured in Australia and re-exported are also available. The state and territory governments also offer tax incentives to attract new industry and can assist in the research and development (R&D) of new products.

(d) Other incentives

Among other tax incentives that Australia offers are special incentives for R&D in the form of tax deductions of up to 125 per cent of eligible R&D expenditure in determining taxable income. In addition, other tax incentives are available to attract regional headquarters operations to Australia (e.g. certain deductions and exemptions from withholding tax).

(e) Tax incentives legislation highlights

The Australian income tax system is implemented by a number of separate Acts of Parliament. The Income Tax Assessment Act (ITAA), first passed in 1936 and amended in every subsequent year, is the principal act dealing with income tax. Research and development incentives fall under Section 73B ITAA. Film industry incentives fall under Section 124ZAN, 80AAA, 26AG and 51(1) ITAA.

(f) Statutory tax rate

The standard rate of national corporate tax is 36 per cent and there are no local taxes, which will be reduced to 34 per cent for fiscal year 2000.

Dividend withholding tax is 30 per cent and applies to an unfranked dividend or to the unfranked part of a dividend which is partly franked. Dividend withholding tax has been abolished on franked dividends paid by Australian resident companies to non-resident shareholders.

The Australian imputation system is based on the concept of a company's franking account. Broadly, it is the state of the franking account, either in surplus (franking credits in excess of franking debits) or in deficit (excess franking debits), that determines the extent to which a company can pay a franked dividend without incurring a penalty for overfranking. Ordinarily, corporate income tax payments will give rise to most of the company's franking credits. Another source of franking credits is franked dividends received by the company from other resident companies. Most of a company's franking debits arise out of the payment of a franked dividend by the company.

An exemption from withholding tax applies to non-resident shareholders in respect of the unfranked portion of certain dividends received from an Australian resident company which are funded from foreign source dividends received by the company on or after 1 July 1994. The types of foreign source dividends that qualify are as follows:

- ?? Dividends that are exempt from Australian income tax. These are dividends received from companies in listed countries where the relevant shareholding is at least 10 per cent; and
- ?? Dividends received in respect of shareholdings of at least 10 per cent in foreign companies, where the Australian company's recipients are deemed to have paid the underlying tax under the foreign tax credit provisions.

In order for this exemption to apply, the Australian dividend paying company must make a foreign dividend account declaration (FDA).

The FDA is a notional account which will quantify, on any given day, the amount of distributable profits that can be paid as withholding tax-free dividends. Basically, the FDA will be credited with amounts of qualifying dividends paid on or after 1 July 1994 and debited for expenditure relating to the qualifying dividends and for the part of the dividends, if any, on which Australian tax is payable. The FDA will also be debited when a dividend to which the new exemption applies is paid.

Withholding tax at 10 per cent is payable on interest. Interest paid to the Government or central bank from the investment of official reserves is exempt from tax.

Under Australia's domestic law, certain types of interest are exempt. For example, interest paid to non-residents by offshore banking units (OBUs) on deposits made by, or borrowings from, non-residents is exempt from withholding tax on interest, provided that the deposits or borrowings are on-lent to non-residents or other OBUs. However, an OBU that applies funds obtained with the benefit of the exemption in a way unintended by the legislation will be liable for income tax at punitive rates. Other exemptions include interest on certain debentures and government loans.

The rate of withholding tax on royalties is 30 per cent.

2. China

(a) Regional incentives

Special incentives are granted for investment in Shantou, Shenzhen, and Zhuhai in Guangdong province; in Xiamen in Fujian province; and on the island of Hainan. These areas are known as special economic zones (SEZs). The rate of income tax levied on production-oriented foreign investment enterprises (FIEs) in SEZs is 15 per cent. An FIE is defined as a Chinese-foreign equity joint venture, a Chinese foreign cooperative joint venture, or a wholly foreign-owned enterprise established in China.

Similar reduced rates are granted for foreign investments in economic and technological development zones (ETDZs), which include the following coastal cities: Beihai, Beijing, Dalian, Fuzhou, Guangzhou, Lianyungang, Nantong, Ningbo, Qingdao, Qinhuangdao, Shanghai, Tianjin, Wenzhou, Yantai, and Zhanjiang. Other regions are following the successful models of the SEZs and ETDZs. For example, the Pudong new development area, adjacent to the city of Shanghai, was approved in 1990 to offer incentives to foreign investors, and six free trade zones have been established, one each in Dalian, Guangzhou, Shanghai, and Tianjin and two in Shenzhen. Areas throughout China are being designated as high- or new-technology development zones. Zones similar to the ETDZs are to be created in the mid-western regions.

(b) Sectoral incentives

Foreign investment enterprises scheduled to operate for at least 10 years, and engaged in production-oriented activities, are entitled to an exemption from income tax for two years, starting with the first profit-making year. This is followed by a 50 per cent reduction of the usual income tax rate (30 per cent, 15 per cent, or 24 per cent) over the subsequent three years. However, the State Council is authorized to issue separate exemption and reduction regulations for FIEs engaged in the exploitation of resources such as petroleum, natural gas and rare or precious metals.

Foreign investment enterprises engaged in agriculture, forestry, or animal husbandry, or located in a remote undeveloped area may, with the approval of the State Council, be allowed a 15 - 30 per cent reduction in the usual income tax rate for a further 10 years after the expiration of the initial tax exemption and reduction period described above.

Those FIEs that the Ministry of Foreign Trade and Economic Cooperation has certified to be technologically advanced enterprises may be granted a 50 per cent reduction of the usual income tax rate in the three years following the expiration of the initial tax exemption and reduction period, provided they remain technologically advanced. A technologically advanced enterprise must possess technologically advanced production techniques and equipment, and these techniques and equipment must either be in short supply in China or the enterprise must develop new products, products that replace existing domestic products, or products that will expand exports or serve as import substitutes.

If foreign investment exceeds US\$ 5 million, an FIE that is established in an SEZ, that is engaged in a service industry, and that has a scheduled term of operation of at least 10 years may, on approval by the tax authorities of the SEZ, be granted an exemption from income tax in its first profit making year, followed by a 50 per cent reduction of the usual income tax rate in the next two years.

A Chinese-foreign equity joint venture with a scheduled term of operation of at least 10 years, that is confirmed as a high- or new-technology enterprise and that is established in a high- and new-technology development zone may, on approval by the local tax authorities, be granted an exemption from income tax for two years, starting with the first profit-making year.

Subject to conditions, tax exemption and reduction periods are also available to Chinese-foreign equity joint ventures engaged in harbour and wharf construction, and to foreign bank branches and Chinese-foreign joint venture banks set up in SEZs, FIEs established in the Pudong new development area and engaged in construction projects, and FIEs engaged in infrastructure projects or agricultural development in the Hainan SEZ.

(c) Export incentives and free trade zones

Export-oriented enterprises (FIEs that produce goods mainly for export and balance their foreign exchange revenue and expenditure or that earn a foreign exchange surplus) may also be entitled to further tax reductions after the expiration of the initial tax exemption and reduction period. In any year in which the FIE exports at least 70 per cent of its total output, it may be granted a 50 per cent reduction of the usual income tax rate. If, however, the FIE is established in a SEZ or ETDZ in which the rate is already 15 per cent, it will pay tax at 10 per cent instead of at 7.5 per cent.

Free trade zones are entitled to the following advantages:

- ?? Goods imported into the zone from abroad are exempt from customs duty. However, if the goods are subsequently transferred to another part of China that is not a free trade zone, customs duty will be levied; and
- ?? Products manufactured in a free trade zone are exempt from customs duty when sold inside the free trade zone or shipped outside China.

(d) Other incentives

A foreign investor that directly reinvests its share of profits derived from a FIE may obtain a refund of 40 per cent of the tax already paid by the FIE on the reinvested amount, subject to the approval of the tax authorities. To obtain the refund, the foreign investor must either use its share of the profits (before the profits have been distributed) to increase the capital of the FIE or use the profits (after distribution) as capital to establish another FIE. The profits must be reinvested for at least five years. If the reinvested amounts are withdrawn within five years, the foreign investor must repay the tax refunded. A 100 per cent tax refund is granted to foreign investors if profits are reinvested in an export-oriented enterprise or a technologically advanced enterprise.

(e) Tax incentives legislation highlights

Income tax law of the People's Republic of China for enterprises with foreign investment and foreign enterprises, Articles 7 to 10.

Detailed rules for implementation of FEIT Law, Articles 69, 73, 75, and 80-82.

(f) Statutory tax rate

The standard income tax rate applicable to enterprises with foreign investment in China is 30 per cent. The local governments and municipalities levy a 3 per cent tax on net taxable income in all areas other than the SEZs. This may be waived or reduced at the discretion of the local governments. The effective corporate tax rate is therefore 33 per cent (30 per cent income tax plus 3 per cent municipal tax).

In principle, withholding tax at the rate of 20 per cent is levied on dividend income received by foreign companies, enterprises and other economic organizations that do not have permanent establishments or sites in China. However, dividends received from FIEs are exempt from tax on that income which is not effectively connected with a permanent establishment.

Withholding tax on interest is 20 per cent. Interest payments made to international finance organizations on loans granted to the Government of China or China's state banks, and on interest payments made to foreign banks on loans granted at a preferential interest rate (as defined) to China's state banks may be exempt from tax.

The rate of withholding tax on royalties is 20 per cent. Royalties paid for the use of technology that is held to be advanced, or provided on preferential terms, may be exempt from tax. The rate is reduced to 10 per cent on royalties paid for the use of certain proprietary technology for specific important development areas and paid by foreign investment enterprises located in specified investment zones.

3. Cyprus

(a) Sectoral Incentives

Cyprus offers complete exemption from tax for shipowners operating Cypriot-registered ships. Profits derived from the operation of an auxiliary tourist building or project are exempt from tax for a period of 10 years. Companies listed on the Cyprus Stock Exchange are subject to tax at 50 per cent of the normal tax rates. Manufacturing companies are entitled to investment allowances for machinery used directly in the production process.

(b) Export incentives and free trade zones

A reduction of 50 per cent of the tax charged on profits from exports is applicable. The industrial free zone of Larnaca and bonded factories and warehouses are customs-free zones. Foreign employees of companies established in the industrial free zone of Larnaca are liable for income tax at 50 per cent of normal tax rates.

An international business entity is a company, partnership or branch of an overseas company registered in Cyprus, wholly owned by foreigners, and deriving its income outside Cyprus. The main advantages offered to these entities are that international business companies pay corporation tax at only 4.25 per cent, international business partnerships are tax exempt, and international business branches pay tax at only 4.25 per cent when they are managed and controlled in Cyprus, and no tax when they are not. In addition, there are no taxes on dividends paid. International business companies are considered for tax purposes as resident in Cyprus.

The employees of international business entities pay tax at 50 per cent of the normal tax rates if they render their services in Cyprus. If services are rendered abroad, the employees are exempt from tax if they are paid through Cyprus; otherwise they pay tax at one tenth of the normal tax rates.

(c) Other Incentives

Certain types of income are exempt from tax in order to attract the inflow of foreign funds (e.g. interest on foreign capital deposits, salary received for services offered abroad and foreign investment income).

Other types of income are exempt and certain deductions are allowed (e.g. dividends paid by listed companies of up to £1,200 per annum, interest on listed debentures of up to £600 per annum and 30 per cent of the cost of acquisition of first issue shares) in order to encourage new entries on the Cyprus Stock Exchange.

(d) Tax incentives legislation highlights

All the incentives are provided for under the income tax law except for the tax exemption applicable to shipowners of Cypriot registered ships which is provided for under the Merchant Shipping Law.

(e) *Statutory tax rate*

The corporate tax rates are as follows:

0 – 40,000 Cyprus pounds	20 per cent
Over 40,000 Cyprus pounds	25 per cent

A 10 per cent tax is chargeable on profits not subject to the main charge because they are covered by losses brought forward, investment allowances for capital expenditure and certain incentive deductions available to mining enterprises.

In addition to corporate tax, there is a special defence contribution payable at 4 per cent, from 1 August 1998, making the effective tax rate 29 per cent.

Under domestic law, a withholding tax of 20 per cent is levied at source on dividends (this requirement does not apply to offshore companies). Dividends are also subject to a 4 per cent defence contribution deduction, making the effective rate 24 per cent. Corporate non-resident shareholders can claim relief from or refund of this withholding tax by filing an application with the tax authorities. Under domestic law, there is no withholding tax in Cyprus on dividend payments made by offshore companies. A 29 per cent withholding tax is charged — 25 per cent withholding tax on interest (for taxable income over 40,000 Cyprus pounds) and a 4 per cent defence contribution. A flat rate of withholding tax at 10 per cent is applicable on royalties. Royalties are also subject to the 4 per cent defence contribution, making the effective rate 14 per cent. Withholding tax may be reduced or eliminated by tax treaty provisions.

4. Hong Kong, China

(a) Regional incentives

None.

(b) Sectoral incentives

Certain offshore funds managed in Hong Kong, China are exempt from profits tax.

(c) Export incentives and free trade zones

None, but income derived from a source outside Hong Kong, China is not liable to taxation.

(d) Other incentives

Expenditure on scientific research, or payments to an approved research institution of either a revenue or capital nature (excluding payments for land or buildings), are eligible for a 100 per cent deduction if they are related to the taxable trade or business of the taxpayer. Scientific research is considered related to the trade or business of the taxpayer if it may lead to, or facilitate an extension or improvement in, technical efficiency of the trade or business. Medical research that will benefit workers employed in the tax payer's trade or business is also considered related to the trade or business of the taxpayer.

Income from approved debt instruments is taxed at 50 per cent of the normal profits tax rates. Debt instruments must have a maturity of more than five years, a value of at least 500,000 Hong Kong dollars and an acceptable rating.

(e) Tax incentives legislation highlights

The Basic Law acts as a separate constitution for the territory.

Under the Basic Law (Art. 18) the tax incentive legislation highlights are:

- ?? the laws previously in force in Hong Kong as stipulated in Art. 8 of the Basic Law;
- ?? laws enacted by the Hong Kong special administrative region (SAR) of China; and
- ?? laws enacted by the National People's Congress of the People's Republic of China or its Standing Committee that relate to defence or foreign affairs.

(f) Statutory tax rate

The basic national corporate tax rate is 16 per cent. Dividends and interest are not subject to withholding tax in Hong Kong, whether paid to residents or non-residents.

Royalties for the use of intangibles in Hong Kong, China paid to an unassociated non-resident are deemed to be taxable in Hong Kong. The amount deemed taxable is 10 per cent of the gross amount of the royalties paid. The effective withholding rate is therefore 1.6 per cent. Royalties for the use of intangibles in Hong Kong SAR paid to an associated non-resident are deemed to be taxable in Hong Kong SAR. The amount deemed taxable is 100

per cent of the gross royalty income if a person carrying on a trade, profession or business in Hong Kong SAR at any time wholly or partly owned the intellectual property in respect of which the royalties are paid. The effective withholding tax rate in such a case is therefore 16 per cent.

5. India

(a) Regional Incentives

An industrial undertaking set up in a specified underdeveloped state or union territory or in a specified industrially underdeveloped district, and which commenced manufacturing or production before 31 March 1995, is eligible for a 30 per cent tax exemption on its profits for the 10 years beginning with the year in which manufacturing or production takes place. Similar benefits are available to small-scale industrial undertakings that began manufacturing or producing articles or operating cold storage plants before 31 March 2000.

An industrial undertaking set up before March 2000 in a particular class of backward state specified in the Eighth Schedule of the Constitution backward areas stipulated by the central Government as Category A is eligible for 100 per cent tax exemption on its profits for the first five years and 30 per cent for the next five years. Similar benefits are available for an industrial undertaking set up in an industrially backward district stipulated by the central Government as Category B. The exemption for such undertakings is 100 per cent on profits for the first five years and 30 per cent for the next three years.

(b) Sectoral incentives

An industrial undertaking set up in any part of India for the generation of power, or its generation and distribution, before 31 March 2003, is eligible for 100 per cent tax exemption on its profits for the first five years and for 30 per cent for the next five years.

All the profits of an undertaking that begins commercial oil production in any part of India after 1 October 1998 are exempt from tax for the first seven years.

A specified enterprise that develops, maintains and operates new infrastructure facilities set up on or after 1 April 1995 is entitled to tax exemption of 100 per cent on profits for the first five years of operation and 30 per cent for the subsequent five years. Such facilities include roads, highways, bridges, airports, ports, rail systems, activities related to irrigation, sanitation or water supply or any other public facility of a similar nature notified in the Official Gazette. The exemption is available for any 10 consecutive years of the first 12 years of developing, maintaining and operating such infrastructure facilities. The limit for claiming the exemption increases from 10 consecutive years out of 20 years in the case of operating and maintaining a highway project.

An enterprise set up before 31 March 2000 and engaged in the business of providing basic or cellular telecommunications services, including radio paging, domestic satellite service or network and electronic data interchange services is entitled to 100 per cent tax exemption on profits for the first five years. The exemption is 30 per cent for the subsequent five years. A similar exemption is available for operating industrial parks set up and operating before 31 March 2002.

An approved company set up before 1 April 1999, and engaged in scientific and industrial R&D, is eligible for 100 per cent tax exemption on its profits for five years.

An approved undertaking engaged in developing and building housing projects that commenced development and construction on or after 1 October 1998, and completes them before 31 March 2001, are entitled to 100 per cent tax exemption on the profits.

An enterprise that begins operating a hotel before 31 March 2001 in a hilly or rural area, place of pilgrimage or other such place earmarked by the central Government for development of tourism infrastructure, is entitled to a 50 per cent exemption on profits for the first 10 years. And for a hotel which commences functioning before 31 March 2001 in any place other than metropolitan cities, the exemption is 30 per cent on profits for the first 10 years. In addition, 30 per cent tax exemption is available on profits for the first 10 years of an enterprise that begins operating ships before 31 March 1995.

(c) Export incentives and free trade zones

A complete tax holiday is provided to companies that are set up in FTZs for the first 10 years of operation. These FTZs are Kandla Free Trade Zone (KAFTZ), Gujarat; Santa Cruz Electronics Export Processing Zone (SEEPZ), Mumbai; Madras Export Processing Zone (MEPZ), Tamil Nadu; Cochin Export Processing Zone (CEPZ), Kerala; Noida Export Processing Zone (NEPZ), Uttar Pradesh; and Falta Export Processing Zone (FEPZ), West Bengal. Approved, newly established 100 per cent export-oriented industrial undertakings and units in electronic hardware and software technology parks are entitled to a similar tax holiday.

A domestic company or a resident non-corporate assessee engaged in the hotel or travel agency business can enjoy an exemption of 50 per cent on the profits derived from services provided to foreign tourists, plus any portion of the remaining profits that are transferred to a reserve account from the profit and loss account. Profit must be received in convertible foreign exchange.

A 50 per cent tax exemption is available on profits from projects such as construction of any building, road, dam, bridge, assembly or installation of any machinery or plant, or construction of any structure executed outside India. The said exemption should be credited to a Foreign Project Reserve Account and utilized for the purpose of business within the next five years, and not be used for distribution by way of dividends or profits. A similar tax exemption benefit is available on profits from housing projects awarded on the basis of a global tender and aided by the World Bank. The amount of tax exemption should be transferred to a Housing Projects Reserve Account and utilized for the purpose of business within five years.

A resident tax payer engaged in the export of manufactured goods or computer software is allowed a deduction from profits on the basis of the ratio of export turnover to total turnover. The proceeds must be received in convertible foreign exchange.

(d) Other incentives

A foreign institutional investor investing in shares and securities in India would be liable to tax at 10 per cent on its long-term capital gains and 30 per cent on short-term capital gains. The minimum period of holding in the case of equity shares would be more than one year to be considered long term, and three years in the case of other securities.

Dividends, interest or long-term capital gains of an infrastructure capital fund or infrastructure capital company that earns from investments made on or after 1 June 1998 in any enterprise engaged in the business of developing, maintaining and operating any infrastructure facility, and which has been approved by the central Government, is exempt from tax.

Dividends paid by domestic companies to their shareholders are exempt from tax. However, the domestic company would have to pay an additional tax —termed as “tax on distributed

profits" — which is computed at the rate of 10 per cent of the amounts distributed as dividends by the domestic company.

(e) *Tax incentives legislation highlights*

- ?? Income Tax Act, 1961;
- ?? Wealth Tax Act, 1957;
- ?? Gift Tax Act, 1958 (abolished from 1 October 1998);
- ?? Central Excise Act, 1944 (including Service Tax on specified services);
- ?? Customs Act, 1962;
- ?? Interest Tax Act, 1974;
- ?? Expenditure Tax Act, 1987.

(f) *Statutory tax rate*

The national corporate tax rate is 35 per cent and the tax rate for foreign companies is 48 per cent. The 1999/2000 budget announced a surcharge of 10 per cent, making the effective rate 38.5 per cent.

Dividends declared, distributed or paid after 1 June 1997 are not subject to withholding tax. However, companies making distributions are subject to a 10 per cent additional tax on the dividend amount. Dividends paid to a foreign company are subject to a withholding tax of 20 per cent.

Under domestic law, the withholding rates on interest paid to companies vary with the type of loan or security. The rate most likely to apply to foreign investors, in the absence of a free rupee market, is that applied to foreign currency loans:

Type of loan or security	Rate of withholding tax
?? On foreign currency loans, foreign currency Non-resident accounts, and foreign currency deposits with public limited companies	20 per cent
?? Bonds of an Indian company purchased with foreign currency	10 per cent
?? General rate	48 per cent

The rate of withholding tax on royalties is 20 per cent. This rate applies to agreements entered into after 31 May 1997 regarding royalties, as defined under domestic law and approved by the central Government, or where it is in accordance with the industrial policy in force. A 30 per cent rate applies to agreements concluded on or after 1 April 1976 as approved by the Central Government or where it is in accordance with the industrial policy in force. For approved agreements concluded before 1 April 1976, the rate is 50 per cent of the net amount after deduction for expenses. If an agreement has not been approved by the Indian Government, the rate is 55 per cent with effect from 1 April 1994, and 48 per cent from 1 April 1997.

6. Indonesia

(a) Regional Incentives

✍️ The basic tax incentive is a tax holiday for three years in Bali and Java, and for five years everywhere else.

In addition, a tax holiday for another year is granted in each of the following cases:

- ?? Where at least 2,000 people are employed;
- ?? Where cooperatives own at least 20 per cent of the project;
- ?? Where the value of the project, excluding land and buildings, is at least US\$ 200 million; and
- ?? Where the construction phase of the project is limited to five years. If the time taken is less, the time saved is added to the total tax holiday period.

Subject to tax office certification, companies granted a tax holiday are not required to make advance payments of corporate income tax on the importation of goods relating to the revenues covered by the tax holiday. In addition, those revenues are not subject to withholding taxes.

Losses incurred during the tax holiday period cannot be deducted from taxable profits derived after that period.

(b) Sectoral incentives

The Government recently introduced a new tax holiday regime. Tax holidays will be granted in respect of approved projects in certain industry sectors including textiles, selected chemicals and pharmaceuticals, iron and steel, and crude oil refining.

Tax holidays are granted for:

- ?? Projects approved by the investment coordinating board, BKPM (i.e. by the State Minister of Investment/Chairman of the BKPM); and
- ?? Projects approved by the Minister of Finance based on recommendations of the committee charged with the responsibility of reviewing applications for tax holidays.

It is expected that the process for dealing with applications for tax holidays under the new regime will be more transparent than under the previous regime. Companies that had submitted applications under the previous regime are required to re-apply.

(c) Export incentives and free trade zones

Bonded zones and industrial estates have been set up to encourage the processing of exports. Goods may be brought into bonded zones free of import duty for export elsewhere. Goods brought into an industrial estate are also subject to favourable regimes with respect to value-added tax and sales tax on luxury goods. Bonded zones exist on Batam Island and surrounding islands and in Jakarta. Industrial estates have been established on Batam Island and Bintan Island.

(d) Tax incentives legislation highlights

A majority of tax incentives are provided under the Income Tax Laws of 1984 and 1995. The tax-free zone on Batam Island was created by Presidential Decree 21 of 1978 and Government Regulation 22 of 1986.

Favourable regimes on Bintan Island were established by Presidential Instruction No. 4 of 1992 and Presidential Regulation 57 of 1992.

(e) Statutory tax rate

Corporate income tax is levied at 10 per cent on the first 25 million Indonesian rupiahs of taxable income, 15 per cent on the next 25 million rupiahs (i.e. the band from 25 million rupiahs to 50 million rupiahs), and 30 per cent on the band of taxable income in excess of 50 million rupiahs.

Non-resident companies having their permanent establishment in Indonesia are liable for an additional 20 per cent tax on the profits, after deducting corporate income tax. If the non-resident company is resident in any treaty country, the rate of the additional tax is reduced by the relevant treaty.

The rate of withholding tax on dividends, interest and royalties is 20 per cent.

7. Israel

(a) Regional incentives

Encouragement of capital investments

An enterprise owned by corporations (either incorporated in Israel or registered in Israel as foreign corporations) or other specified entities, may be eligible for approved enterprise status if the related investment programme meets specified capital, employment and other criteria. Such a status makes it eligible for a variety of tax incentives, some of which depend on the region in which the enterprise is located. In general, preference is given to industrial and tourism projects with potential to inject foreign currency into the economy, provide employment opportunities in defined areas of the country or assist the Government in attaining stated objectives.

An approved enterprise may be entitled to Government support in establishing or expanding its business in the form of investment grants at a percentage of the cost of the physical assets of the enterprise. The rate of the investment grants generally depends on the particular area where the enterprise is located. This financial support by the Government is coupled with significant tax incentives.

Taxable income of an approved project of a corporation, owned and controlled in excess of 49 per cent by non-residents who invested foreign currency in the corporation's equity, is subject to corporate income tax at rates between 10 and 20 per cent (compared to 36 per cent on other corporate income), depending on the proportion of foreign investment. These benefits are available for a period of 10 consecutive years, beginning with the first year that the approved project has taxable income. If a corporation's taxable income from an approved enterprise does not meet the above foreign ownership requirements, it is subject to corporate income tax at the rate of 25 per cent for a period of seven consecutive years. As of 1 January 1997, taxable income generated by the investment programme of an approved project in a development zone classified as zone A is fully tax-exempt during the first two years of the period of benefits.

Once begun, the period of benefits continues to run, even if the approved enterprise incurs losses in subsequent years. The tax benefits are available only for a maximum period of 12 years from the first year of operations of the approved enterprise or 14 years from the year in which the approval was granted, whichever comes first.

Dividends paid to shareholders from income earned by an approved enterprise during the period of tax benefits are subject to income tax of 15 per cent (compared to 25 per cent tax on dividends paid to individuals and foreign shareholders, and tax exemption on dividends paid to Israeli companies from other earnings).

In addition, investments in plant and equipment of an approved enterprise (net of investment grants) may be depreciated at rates higher than those usually allowed by the tax authorities during the first five years these assets are used. Depreciation of buildings is deductible to the extent of 400 per cent of the usual rates (not to exceed 20 per cent per year), while machinery and equipment may be depreciated at 200 per cent of the usual rates (250 per cent if there is significant physical damage to equipment due to operation in shifts or extremely difficult conditions).

Tax concessions for residents of certain regions

In order to encourage settlement in remote, sparsely populated regions of the country, various tax concessions and tax credits are granted to residents of those regions according to regulations.

(b) Sectoral incentives

Industrial companies

The Law for the Encouragement of Industry (Taxes), enacted in 1969, defines an industrial company as a corporation that derives at least 90 per cent of its gross income in a particular year from industrial or manufacturing activities or that owns a hotel which also meets other conditions stated in the law regarding the components of gross income. An industrial company is entitled to special benefits, including accelerated depreciation, certain deductions not allowable to other entities (such as amortization of acquired technology costs, patent costs and expenses related to a public offering of shares), and the filing of consolidated tax returns with other industrial companies in the group (a benefit not allowed to non-industrial entities).

Risk capital funds

During the 1990s, venture capital funds have done brisk business in the Israeli economy, which has experienced a metamorphosis with substantial reliance on the civilian high-tech sector. Foreign funds (incorporated abroad) which meet certain criteria, usually obtain upon application, a private ruling from the income tax authorities with regard to their tax position. The typical ruling allows a tax rate of 20 per cent on the revenue of the fund deriving from its Israeli investments. This reduced tax rate serves as a tax incentive for foreign risk capital funds to invest in Israel's flourishing high-tech industries.

Reorganization of intensive R&D companies

Regulations dealing with this subject were enacted in 1994. They contain provisions that differ in several respects from the conditions of the regular Mergers Law for tax deferral upon transfer of assets in exchange for shares. The regulations may prove useful to high-tech companies, especially in light of frequent ownership changes, which are common for such companies.

Deduction of R&D expenses

Expenses incurred in connection with an R&D project approved by the Government that is conducted by or on behalf of the owner of an enterprise to advance and develop that enterprise may be deducted in their entirety for tax purposes in the year in which they were paid, up to a ceiling (for investors who are not the owners of the enterprise) expressed as a percentage of taxable income (40 per cent in recent years). The project must be connected to industry, agriculture, transportation or energy. Participation of a third party in financing a R&D project, or R&D expenditures incurred by an entity which does not own an enterprise active in one of the fields mentioned above, in consideration for a reasonable share of the rights in the project, are allowed deduction on a limited basis only. R&D costs incurred to advance or develop an enterprise, other than described above, may be amortized over three years, beginning with the year in which each expense was originally incurred.

Residential dwellings for rental

Projects that meet the conditions specified by law are eligible for various tax concessions for an unlimited period. These include lower corporate income tax rates, accelerated depreciation of residential apartments, lower rates of capital gains tax on sales of property and tax at 15 per cent on dividends paid out of earnings and capital gains.

Deduction for holders of participation certificates in oil exploration partnerships

In order to encourage investors to invest in oil exploration partnerships, regulations allow such investors to deduct their share of the expenses incurred in the partnership for oil exploration operation from their taxable income.

Deduction from income of investors in Israeli movies

Investors in motion picture productions in Israel may deduct from their taxable income their share in the cost of production, incurred by a partnership in which they participate. The production must be approved by a public committee, and the cost of production must exceed US\$ 100,000. Income from advance sale of projection rights is considered to be income only 18 months after production has been completed, or when actually paid, whichever is earlier.

Tax benefits for “scientific employees”

A “Scientific Employee” is defined as an employee, eligible under a collective employment agreement in Israel for a sabbatical year, who was employed during that year in an approved project. Wage compensation of such an employee will be taxed at a maximum rate of 35 per cent during a period of up to 18 months (regular marginal tax rate for an individual is 50 per cent).

(c) Export incentives and free trade zones

Free Trade Zone Eilat

The Eilat region was declared a free trade zone in 1985. The law provides a number of specific tax concessions and other benefits, including:

- ?? Exemption from indirect taxation on imported goods purchased by tourists or outgoing Israelis in exchange for foreign currency;
- ?? Value added tax concessions and, in certain cases, exemptions;
- ?? Income tax credit of up to 10 per cent of an individual’s taxable income;
- ?? Grants to reduce employers’ costs for an amount equal to twice the tax credit from which the employees benefit.

Jordan Valley Free Zone

Pursuant to the Peace Agreement, which was signed between Jordan and Israel in 1994, the Jordan Gateway Project was established in 1996. The United States Government allowed the Governments of Jordan and Israel to create this region as a Qualifying Industrial Zone, whereby industries established in the Zone can have their produce enter the United States customs free. Goods imported into free zone areas are not subject to customs duties. Revenue from projects within free zone areas is exempt from income tax and there are no real estate or land taxes to be paid in the free zone.

Free ports

In addition to the port of Eilat, the ports of Haifa and Ashdod have been declared free ports. Special tax benefits and exemptions from indirect taxation are accorded to “authorized entrepreneurial enterprises” in free port zones. An enterprise is recognized as an “authorized entrepreneurial enterprise” if all of its production is intended for export. The benefits accorded to such enterprises are as follows:

- ?? Exemption from all taxes on income (with the exception of capital gains tax and land appreciation tax) for a period of seven years, starting from the first year of taxable earnings;
- ?? Taxes on income at the rate of only 30 per cent without any further time limit following termination of the seven-year period;
- ?? Taxation of dividends at the rate of 15 per cent;
- ?? Taxation on real capital gains adjusted for inflation;
- ?? Exemption from all taxes on capital gains from the sale by foreign residents of ownership rights in the enterprise that were acquired in foreign currency;
- ?? Exemption from property tax on real estate owned by the enterprise; and
- ?? An approved enterprise established in a free port is entitled, in addition to the above benefits, to grants and tax concessions under the Law for the Encouragement of Capital Investments for enterprises in a development zone classified as zone A.

(d) Tax incentives legislation highlights

- ?? The Law for the Encouragement of Capital Investments, 1959.
- ?? The Law for the Encouragement of Industry (taxes), 1969.

(e) Statutory tax rate

The national rate of corporate income tax is 36 per cent. Dividends, interest and royalties are subject to a 25 per cent withholding tax subject to the following exceptions and any treaty provisions. Under Israel's domestic law, dividends attributed to earnings from an approved enterprise are taxed at 15 per cent. This rate is applicable when a treaty does not reduce the tax rate below 15 per cent. Interest paid by the Government or on foreign currency deposits with banking institutions, if the depositor has neither business nor occupation in Israel, is exempt from tax.

8. Lebanon

(a) Regional incentives

A 10-year exemption from income tax is granted to industrial companies established after 1980 in specific areas, provided these companies produce goods that were not produced in Lebanon at the beginning of 1980. In areas designated as "industrial zones", 75 per cent of a company's tax liabilities may be exempted. In order to take advantage of this regulation, investments should consist of capital expenditures designed to increase the company's staff and other employees.

(b) Sectoral Incentives

Farms (provided they do not display farm products in sales outlets or sell products after processing), shipping and transport companies (subject to certain restrictions) are exempted from income tax.

Real estate development companies are granted income tax exemptions of 50 percent on profits derived from the construction or subdivision of buildings into housing units and sale to third parties.

Machinery, equipment, spare parts and building material imported for the setting up of new industrial firms, and equipment and raw material imported for the agricultural sector are subject to only 2 per cent customs duty.

Imported hotel equipment is exempt from certain duties provided that the operating period is for at least 10 years. Imported buses for tourism agencies are also exempt from customs duties.

(c) Export incentives and free trade zones

Offshore companies are exempt from income tax. Dividends distributed by offshore companies are exempt from capital gains tax.

Companies established in free trade zones are exempt from customs duties and are not subject to corporate taxes for 10 years. In addition, foreign employees employed in them are exempt from personal income tax.

(d) Other incentives

Companies using operating profits to finance certain capital investment are allowed income tax exemption up to 50 per cent for a period of up to four years, provided that such exemption does not exceed the original investment made.

Holding companies are exempt from income tax and capital gains tax.

SOLIDERE (a Lebanese company established in 1994 for the development and reconstruction of Beirut Central District) is exempt from tax on profits during a period of 10

years. Dividends paid to shareholders, as well as capital gains arising from the exchange of shares, are also exempt from tax for 10 years.

(e) Statutory tax rate

Corporate tax rate is 15 per cent. Although tax rates are generally low, companies are subject to other charges that are relatively high. For example, normal security contributions are set at 38.5 per cent.

Capital gains resulting from the disposal of fixed assets or investments are taxed at a rate of 10 per cent. Distribution of profits, payment of interests and directors' fees are subject to a 10 per cent withholding tax.

Source: Basile A, Abou Nasr BKR and Thomé C (personal communication). Information is current as of 30 July 1999.

9. Malaysia

(a) Regional Incentives

Labuan Offshore Financial Centre

Labuan Island has been developed into an international offshore financial centre. The tax rate for offshore trading companies is 3 per cent of the profit per audited accounts or at the fixed sum of 20,000 ringgit. Offshore companies engaged in non-trading activities are exempt from tax.

Pioneer status companies

Companies enjoying pioneer status receive special tax benefits. Seventy percent (85 per cent for projects in the eastern corridor of Peninsular Malaysia, Sabah, and Sarawak) of statutory income is tax exempt. The balance is then taxed at the current corporate income tax rate. Pioneer status is accorded to a company that is engaged in a promoted activity or produces a promoted product. Small-scale companies can also be accorded pioneer status upon application. A small-scale company is a resident company incorporated in Malaysia under the Companies Act 1965 whose shareholders' funds do not exceed 500,000 ringgit, and of which at least 70 per cent of the equity shareholding is held by Malaysian citizens. As an alternative to applying for pioneer status, a company may be eligible for an investment tax allowance.

Investment tax allowance

An investment tax allowance (ITA) of 60 per cent (80 per cent in the eastern corridor of Peninsular Malaysia, Sabah, and Sarawak) is available to approved companies for qualifying capital expenditures incurred within five years of the date of approval of the allowance. The ITA can be set off against 70 per cent (85 per cent in the eastern corridor of Peninsular Malaysia, in Sabah, and in Sarawak) of statutory income in the year of assessment. The rate is 100 per cent of qualifying capital expenditure for an activity or a product of national and strategic importance. Similarly, the rate is 100 per cent for a contract R&D company or a technical or vocational training company. A company conducting in-house research is eligible for an ITA of 50 per cent. For a high-tech company the rate is 60 per cent, and for a company located in a promoted area, it is 80 per cent. Any unused portion of the ITA can be carried forward to future years for deduction.

(b) Sectoral incentives

Incentives for approved operational headquarters

Companies that set up operational headquarters in Malaysia enjoy a concessionary 10 per cent tax rate for 5-10 years on income arising from the provision of qualifying services to their offices or related companies outside Malaysia.

Incentives for approved service projects

Approved service projects (ASPs) are projects related to transportation, communications, utilities, or any other sub-sector approved by the Minister of Finance. The main tax incentive available to an ASP is either an income tax exemption of 70-100 per cent of statutory income

for 5-10 years or an investment allowance equivalent to 60-100 per cent of qualifying capital expenditure incurred within five years from the date of approval as an ASP. The investment allowance can be set off against 70-100 per cent of the statutory income.

Foreign fund management incentive

Foreign fund management companies are subject to a reduced rate of 10 per cent on their chargeable income derived from providing fund management services to foreign investors. This chargeable income, after the deduction of the 10 per cent tax, forms the exempt account of the company from which tax-free dividends can be declared on a two-tier basis.

Tax scheme for venture capital companies

A venture capital company (VCC) is a company incorporated in Malaysia that holds shares in a venture company (VC). A VC is involved in high-risk ventures and new technology that would promote or enhance the economic or technological development of Malaysia. An exemption from income tax applies to gains that accrue to a VCC from the disposal of the shares (within three years from the date of listing) and dividends distributed out of those gains.

(c) Export incentives and free trade zones

A double deduction is granted for approved export promotion expenses in computing taxable income. Companies resident in Malaysia can claim a double deduction for all qualifying outlays and expenses incurred primarily in creating or increasing a demand for exports of goods or agricultural produce manufactured, produced, assembled, processed, packed, graded or sorted in Malaysia. This double deduction also extends to the entire services sector. A pioneer company is not given a deduction under this incentive during the tax relief period. However, the deductions that would have been allowed had the company not had pioneer status may be accumulated, and the aggregate amount will be allowed as a deduction in its first assessment period as a post-pioneer business expense.

Other incentives available under the Promotion of Investment Act, 1986 (POIA) are hotel incentives, an industrial adjustment allowance, an infrastructure allowance, an export allowance, an abatement of export income, and an abatement of adjusted income.

(d) Other incentives

All existing companies engaged in manufacturing or agricultural activities that do not enjoy any form of capital expenditure incentive under the POIA are eligible for a reinvestment allowance (RA) amounting to 60 per cent of qualifying capital expenditures incurred on plant, machinery, and industrial buildings for expansion, modernization or diversification. Like the ITA, the RA is available for setoff against 70 per cent of statutory income. Any unabsorbed RA may be carried forward for setoff in future years until it is fully used. Qualifying projects in promoted areas in the eastern corridor of Peninsular Malaysia, Sabah, and Sarawak are not subject to the 70 per cent ceiling and may set off the RA against 100 per cent of statutory income.

(e) Tax incentives legislation highlights

- ?? Promotion of Investments Act, 1986;
- ?? Income Tax Act of 1967.

(f) Statutory tax rate

The national rate of corporate tax is 28 per cent, and the income tax rate for petroleum operations is 38 per cent.

There is no withholding tax on dividends payments made by a Labuan-based company carrying on an offshore business activity. Dividend distributions from income arising from sources outside Malaysia by a resident company (other than a company carrying on the business of banking, insurance, shipping and air transport) are exempt from tax. When a resident company pays a dividend, it is deemed to have deducted tax at the corporate income tax rate payable on the profits from which the dividend is derived. However, tax deemed to have been deducted from dividends does not have to be paid unless it exceeds corporate income tax payable by the company on its profits.

The rate of withholding tax on interest is 15 per cent. Under domestic law, interest paid on "approved loans" for financing development projects is exempt from tax. An "approved loan" is defined as any long-term loan or credit made by a non-resident to:

- ?? The Malaysian Government, a Malaysian state government, or another person (when the loan or credit is guaranteed by the Malaysian Government or a state government);
- ?? A local authority or statutory body;
- ?? A person other than one specified in (a) or (b) when the amount of the loan or credit exceeds 250 million ringgit. The loan or credit concerned must have been approved by the Minister of Finance and the agreement giving it effect must have been executed in Malaysia. An agreement executed abroad qualified if it was executed with the prior approval of the Minister. However, approval for such loans was discontinued after 25 October 1996.

Interest paid to a non-resident by commercial or merchant banks operating in Malaysia is exempt from tax. Interest payments made by a Labuan-based company carrying on an offshore business activity are also exempt from tax.

The rate of withholding tax on royalties is 10 per cent. Royalty payments made by a Labuan-based company carrying on an offshore business activity are exempt from tax.

10. Pakistan

(a) Regional Incentives

A five year tax holiday is available for investment projects in rural areas. To be eligible, the firm must be new – ie, not formed through a division or reconstitution of existing business. Industries in rural areas receive total exemption from customs duties, surcharges and sales taxes on imported machinery.

(b) Sectoral incentives

Agricultural income is exempt from income tax.

Profits derived from computer training schemes, manufacture of solar equipment, fruit processing and stuffed toys are granted a 5-year tax exemption. There are no tariffs on the import of plant, machinery and equipment for hi-tech industries which include power tools, metallurgical industry, information technology and solar technology. Priority industries (engineering/capital goods, chemicals and other products) and agro-based industries are allowed 10 per cent tariff concession.

The first-year allowance for plant, machinery and equipment is 90 per cent for hi-tech industries and 75 per cent for priority industries and agro-based industries. This allowance can be set off against statutory income in the year of assessment. Any unused portion can be carried over to subsequent years until it is completely used up.

A reinvestment allowance is granted at the rate of 50 per cent of the cost of plant, machinery and equipment for improving technology or diversifying a product line. For the infrastructure, services and agriculture sectors, the reinvestment allowance is 40 per cent.

(c) Export incentives

Companies engaged in export enjoy a concessional tax rate of 0.5, 0.75 and 1.0 per cent of export proceeds depending on the value added of exported goods. Plant, machinery and equipment and raw materials used for the manufacture of goods destined for export are zero-rated for tariff purpose.

(d) Other incentives

Housing programmes for the poor and needy enjoy special incentives such as: (i) no duties on the import of construction machinery, pre-cast plants and other items; (ii) a presumptive income tax at 1 per cent of the sales price for builders and developers; (3) no capital value tax; and (4) no wealth tax for five years on the value of houses or apartments.

(e) Tax incentives legislation highlights

?? Finance Act, 1999.

?? Income Tax Ordinance, 1979.

?? Pakistan Customs Act, 1969.

(f) Statutory tax rate

For fiscal year 2000, the income tax rate for banking companies is 55 per cent, for public companies, (except banking) 30 per cent and for others, 35 per cent. The withholding tax on dividends and technical services fees is 15 per cent. Interest paid to foreign lenders is treated as normal income and treated accordingly.

11. The Philippines

(a) Regional Incentives

Tax incentives are granted to enterprises located in less developed areas or special economic zones, and those establishing regional headquarters and regional warehouses in the Philippines.

The Board of Investments (BOI) uses the incentives package of Executive Order 226 to encourage registered enterprises to locate in less developed regions of the country. Registered pioneer firms enjoy six-year income tax holidays, and non-pioneer firms, four years. Registered projects locating in less developed areas enjoy six years income tax holiday, regardless of status (pioneer or non-pioneer) or type of project (new or expansion), as well as additional deductions from taxable income equivalent to expenses incurred in the development of necessary and major infrastructure facilities. This privilege is not granted to projects engaged in mining, forestry and processing of minerals and forestry products, as they would naturally locate in such areas to be near the source of their raw materials. An additional deduction for labour expense equivalent to 100 per cent of the wages of the labour force is also allowed for registered enterprises locating in less developed areas and meeting a prescribed capital-to-labour ratio. This incentive, however, cannot be used simultaneously with the income tax holiday.

Firms located outside the national capital region, and registered on or before 31 December 1994, were allowed to avail of VAT and duty exemption on imported capital equipment until 31 December 1999. If these firms purchase capital equipment domestically, they may avail of a tax credit equivalent to the VAT and duties that would have been paid had the equipment been imported. They are also allowed a credit for taxes and duties paid on raw materials used in the manufacture of export products. In addition, they enjoy an exemption from VAT and duties on imported spare parts, and an exemption from wharfage dues and other fees.

The Board of Investments of the Autonomous Region of Mindanao — comprising 14 regions in Southern Mindanao — can grant registration and administer incentives to a range of firms including: export traders, service exporters, and those engaged in support activities for exporters, food processing, pearl culture, wood-based shipbuilding, food production, sugar cane plantation and refineries, pharmaceuticals and tourism.

(b) Sectoral incentives

Special laws and international agreements provide special incentives to specific activities, such as exploration of mineral resources using modern technology, mining, quarrying and processing of minerals, basic iron and/or steel making, seamless pipes production, industrial tree plantations, publication or construction. These laws offer participating companies preferential tariff rates from 0 to 5 per cent.

(c) Export incentives and free trade zones

Incentives are offered to firms registered with the Philippines Economic Zone Authority (PEZA), which replaced the Export Processing Zone Authority. Such firms are exempt from all national and local taxes. In lieu of paying taxes, they pay a final 5 per cent of their gross income as follows:

- ?? 3 per cent to the national Government.
- ?? 1 per cent to the local government units.
- ?? 1 per cent to the Special Development Fund.

Gross income for manufacturing and trading enterprises means gross sales less direct costs for salaries, wages or labour expense, production/service supervision salaries, cost of raw materials, intermediate goods, finished goods, supplies and fuels used in production, financing charges, rent and utility charges and depreciation. However the following are not deductible expenses: administrative salaries, corporate management salaries, marketing and sales salaries, interest and financial charges on working capital, loss on foreign exchange transactions, loss on disposal of assets, advertising, insurance, miscellaneous supplies and expenses, including entertainment expenses.

(d) Other incentives

Holders of Philippine inventors' patents enjoy exemption from customs duties and charges on their imports of machinery, equipment and spare parts, and from income tax, VAT and excise tax, resulting from the commercialization of their invented products.

Foreigners employed by regional or area headquarters of multinational corporations are subject to 15 per cent income tax on their gross income. Regional or area headquarters established in the Philippines by multinational corporations, which do not derive income in the Philippines, are not subject to income tax, local licenses, fees, dues or VAT. They also enjoy duty-free importation of training materials.

(e) Tax incentives legislation highlights

- ?? Omnibus Investments Code of 1987;
- ?? Executive Order No. 226.

(f) Statutory tax rate

The national rate of corporate tax is 32 per cent. A minimum income tax of 2 per cent applies to gross income unless the regular corporate income tax is greater.

The rate of dividend withholding tax is 32 per cent, but it is 15 per cent if:

- ?? The country of domicile of the non-resident recipient allows a tax sparing credit of 17 per cent for tax deemed to have been paid in the Philippines;
- ?? The Bureau of Internal Revenue in the Philippines rules that the 15 per cent rate applies even in some cases where the non-resident recipient's country of domicile has no treaty with the Philippines. Such rulings have been made with respect to the following: Bermuda, Cayman Islands, Hong Kong (China), New Hebrides, Panama, Switzerland and Vanuatu.

The rate of withholding tax on interest is 20 per cent. Non-resident foreign companies that derive interest income from the Philippines are liable for a 35 per cent tax on gross Philippine-sourced interest income. This rate is reduced to 20 per cent in the case of interest derived by non-resident companies from foreign loans contracted after 1 July 1986.

Royalties paid to non-resident foreign corporations are treated as part of gross income and treated accordingly.

12. Saudi Arabia

There are practically no restrictions on investment by foreigners, and corporations may even be 100 per cent foreign-owned. However, in practice, a foreign investor finds it easier to transact business with a local partner having 50 per cent or more of ownership. Incentives are also designed to promote local ownership.

(a) Sectoral incentives

The Saudi Arabian Ministry of Industry and Electricity allows foreign investment in the following areas:

- ?? Industrial development involving processing of raw material into semi- or fully-manufactured goods and packaging of manufactured goods;
- ?? Agricultural development, animal husbandry and fisheries;
- ?? Health care including building, operations and management of health care facilities;
- ?? Services development, such as tourism, technology, training, shipping, environmental protection and information technology; and
- ?? Contracting.

The following incentives are offered:

Industrial or agricultural undertakings with foreign participation are granted a tax holiday of 10 years on income tax. Other foreign invested undertakings are allowed a five-year tax holiday. Eligibility for a tax holiday requires a minimum of 25 per cent equity participation by a Saudi national. Machinery, equipment and spare parts and raw materials used in manufacture are exempted from customs duties.

(b) Export incentives and free trade zones

Saudi Arabia does not make special efforts to promote exports. However, exports are exempted from customs duties, port fees are reduced by 50 per cent and no fees are charged for storage for 10 days.

Saudi Arabia is a member of the Gulf Cooperation Council (GCC). As such, there are no import duties on goods traded among GCC members.

Quota and tariff protection are granted to products that are manufactured locally and which meet international quality standards. Tariff protection can be as high as 20 per cent and can be imposed for a maximum of five years.

(c) Tax incentives legislation highlights

- ?? Royal Decree No. M/4 (1979);
- ?? Ministerial Resolution No. 11/G/O (1990).

(d) Statutory Tax Rate

Corporate income tax ranges between 25 per cent and 45 per cent. Petroleum and hydrocarbon-related companies are governed by different tax regimes.

Dividends paid to non-residents are subject to a 15 per cent withholding tax. Management fees and royalties are subject to a 10 per cent withholding tax. Nationals of GCC countries are not liable to income tax. Instead, they are subject to *Zakat*, a religious wealth tax.

13. Singapore

(a) Sectoral Incentives

Investment Allowances

An incentive in the form of a tax investment allowance is available to companies that undertake manufacturing or construction operations, provide engineering or technical services, perform research and development work, operate projects that reduce drinking water consumption, or carry on any of the qualifying activities of a pioneer service company. Companies have to apply to the Economic Development Board (EDB) for this type of allowance. It is granted as a deduction from taxable income, in addition to the normal tax depreciation deductions available, of up to 100 per cent of capital expenditure on factory buildings (not land) and new equipment to be used in Singapore. The actual rate of the investment allowance is subject to negotiation, and the capital expenditure must be incurred within five years following the issue of an investment allowance certificate by the EDB. In the case of tourism projects, the period within which the capital expenditure must be incurred following the issue of the certificate is 3-5 years for expenditures between 20 million and 50 million Singapore dollars, 5-8 years for expenditures of between 50 million and 100 million Singapore dollars and up to 10 years for expenditures over 100 million Singapore dollars.

When an investment allowance is set off against a company's taxable income, an equivalent amount can be credited to an exempt income account. Dividends declared out of this exempt income account are tax-free for shareholder recipients. If the shareholder is a company, the exempt dividends received could in turn be passed on to its shareholders as tax-exempt dividends. Any investment allowance not fully set off against taxable income in a year of assessment can be carried forward until it is fully used.

Pioneer industries

Companies involved in an industrial activity that is not being carried out in Singapore on a scale adequate to the country's economic needs may apply for pioneer industry company status. An eligible company (called a pioneer company) is granted complete exemption from Singapore income tax for five years, and a period up to a maximum of 10 years may in some cases be negotiated.

At the end of their tax holiday periods, manufacturing and service companies operating under pioneer or pioneer service certificates qualify for the post-pioneer company incentive. This incentive is extended to other activities as the Ministry of Trade and Industry may decide. The income of a post-pioneer company derived from activities qualifying under the appropriate certificate during the tax-relief period is taxed at a reduced rate of not less than 10 percent; in practice, the rate normally charged is 15 percent. The relief period is determined by the Ministry, up to a maximum of 10 years.

Companies incurring capital expenditure of at least 10 million Singapore dollars on new productive assets for the manufacture of approved products, qualify for an expanding enterprise incentive. Companies undertaking qualifying pioneer service activities also qualify for this incentive if they intend to substantially increase the volume of that activity, but their investments in new productive assets need not be as high as 10 million Singapore dollars. Under this incentive, profits attributable to the new capital expenditure are exempt from tax for up to a maximum of 20 years.

International financial services

A reduced income tax rate of 10 per cent is offered for certain types of international financial services including: (i) international operational headquarters; (ii) finance and treasury centres; (iii) approved international commodity trading companies; (iv) approved international shipping enterprises; (v) approved oil trading; and (vi) offshore insurance risks.

Income derived from the following activities also qualifies for a 10 per cent concessional tax rate:

- ?? Prescribed activities of the Asian Currency Unit (ACU);
- ?? Prescribed activities of an approved fund manager;
- ?? Prescribed activities of an approved security company;
- ?? Offshore leasing of plant and machinery by a leasing company;
- ?? Transactions in specified commodity futures on any specific exchange or specified market with specific parties by a member of a prescribed commodity futures exchange;
- ?? Prescribed services provided by approved credit rating agencies; and
- ?? Trading in debt securities transactions during a specified period.

(b) Export incentives and free trade zones

Export services

An enterprise providing qualifying services outside Singapore to customers not resident or not having permanent establishments in Singapore may apply for approval as an export service company or firm. Under this incentive, 90 percent of qualifying export profit, after deducting related tax depreciation, is exempt from tax. The tax-exempt period is 10 years, extendible by the Ministry of Trade and Industry.

International trade incentive

A company exporting from Singapore more than 10 million Singapore dollars of qualifying manufactured goods or domestic produce or more than 20 million Singapore dollars of qualifying commodities may apply for the international trade incentive. Under this incentive, 50 percent of export profit is exempt from tax, usually for five years.

Warehousing and servicing incentives

A warehousing company that intends to incur fixed capital expenditure of 2 million Singapore dollars or more on facilities for the storage and distribution of manufactured goods for export, is eligible for exemption from tax on 50 percent of its qualifying export income. The duration should not exceed 10 years from the date of its approval as a warehousing operation or such later date to which the EDB may agree. Further extension of the tax relief period may be extended, but in aggregate, cannot exceed 20 years.

(c) Other incentives

Enterprises providing specified services can claim double tax deductions for expenditure incurred on R&D. In determining what expenditure is eligible for this benefit, the EDB takes into consideration the extent of expenditure on R&D activities, the level of expertise and qualifications of the researchers and the complexity of the research project in question.

(d) Tax incentives legislation highlights

- ?? The Economic Expansion Incentives (Relief from Income Tax) Act (Cap. 86), as amended;
- ?? The Income Tax Act (Cap. 134), as amended

(e) Statutory tax rate

The national rate of corporate tax is 26 per cent.

Singapore operates an imputation system, under which a resident company may distribute as dividends the amount of its after-tax profits (taxable at the corporate income tax rate) without a further tax charge. However, when dividends are distributed in excess of such profits they can be subject to further tax at the prevailing corporate income tax rate of 26 per cent, although this tax paid on the excess dividends may be carried forward for set-off against the company's future Singapore tax liabilities.

The withholding tax rate on interest is 15 per cent. However, there is no withholding tax on certain bank deposits placed in approved banks, and on interest on government-approved loans.

The rate of withholding tax on royalties is 15 per cent. The rate may be wholly or partly reduced if the use of the property is of economic benefit to Singapore and its use in Singapore is approved by the Government, provided that this reduced rate does not result in an increased tax liability in the recipient's country of residence. The rate is 26 per cent for royalties and rent for movable property derived from operations carried out in or from Singapore.

14. Taiwan, Province of China

(a) Regional incentives

If a company invests a specific amount or employs a specific number of employees in specified industries located in areas with scanty natural resources, or in less developed areas, it may credit 20 per cent of the total investment amount to offset its current year business tax. Unused tax credits can be carried forward for up to four years. The eligible geographical areas, the applicable industries, the amount of investment and the number of employees is prescribed by the Executive Yuan each year.

(b) Sectoral incentives

A depreciation period of two years is permitted for R&D, experimental, quality control, and energy saving equipment. Companies within specially designated industries can halve the government-set depreciation period for machinery installed for the purpose of either industrial restructuring or improving management and production methods.

Investors that retain for two years their investments in industries designated as important by the Government may deduct 20 per cent of those investments from their business income tax or personal income tax for the third year, subject to a limit of 50 per cent of the tax payable. Unused relief may be carried forward for four years with no 50 per cent limit in the last year. Alternatively, shareholders of important industries may, upon the approval of a shareholders' meeting, elect not to use the tax credits themselves, but instead, to exempt the company from corporate income tax for five consecutive years.

(c) Other incentives

An investment tax credit of 5-20 per cent is available for investment in automation equipment or technology, anti-pollution or recycling equipment or technology, research and development outlays, personnel training, establishment of international brand images, or equipment or technology for energy conservation or recycling water for industrial use. The investment tax credit can be applied to offset up to 50 per cent of the current year's business income tax. Unused credits can be carried forward for four years, with no 50 per cent limit in the last year.

With effect from 1 July 1999, the rate of business tax applicable to income generated by financial institutions is reduced from 5 per cent to 2 per cent.

(d) Tax incentives legislation highlights

?? The statute for industrial upgrading;

?? The statute for encouragement of private participation in transportation infrastructure projects.

(e) Statutory tax rate

There is no tax on taxable income up to NT\$50,000. Taxable income between NT\$50,000 and NT\$100,000 is taxable at the rate of 15 per cent of the total, but with a cap of 50 per cent

of the amount over NT\$50,000. The portion of taxable income over NT\$100,000 is taxed at the rate of 25 per cent. Profits earned by a company on or after 1 January 1998 are subject to an additional 10 per cent tax if they were not distributed in the following year.

The withholding tax rate on dividend income received by a profit-seeking enterprise without a permanent establishment in Taiwan is 25 per cent. Foreign shareholders — whether individuals or profit-seeking enterprises — of a company with foreign investment approved status, are subject to a 20 per cent dividend withholding tax rate. Remittance of branch profits is not subject to withholding tax. The dividend withholding tax rate for non-resident individuals is 35 per cent. However, a reduced rate of 20 per cent applies for approved foreign investments on the Taiwan Stock Exchange. Non-resident individuals investing in listed companies must be approved by the Taiwan Securities and Exchange Commission and their investment will be subject to the 20 per cent dividend withholding tax rate.

The withholding tax rate on interest and royalties is 20 per cent.

15. Thailand

(a) Regional Incentives

The Board of Investment (BOI) in Thailand is primarily responsible for granting tax incentives, over which it has discretionary authority. However, the BOI has provided an extensive list of industries to which it would, as a matter of practice, grant incentives. Projects that are granted incentives by the BOI are referred to as promoted projects.

The BOI has identified three promotional zones in Thailand as follows:

- ?? Zone 1: the six provinces surrounding Bangkok.
- ?? Zone 2: the 10 provinces surrounding Zone 1.
- ?? Zone 3: the remaining provinces in the north, north-east and far south of Thailand, as well as the Laem Chabang Industrial Estate. Zone 3 has been designated as an Investment Promotion Zone.

Broadly, to encourage projects in the less developed provinces, promoted projects located in Zone 1 receive the least generous tax privileges, while those in Zone 3 receive the most generous tax privileges. The incentives potentially available in each zone are noted below. The BOI also provides additional incentives for relocating factories into Zones 2 and 3.

Zone 1 incentives

- ?? A corporate income tax exemption for three years, provided the project exports not less than 80 per cent of its total sales and locates its factories in industrial estates or promoted industrial zones.
- ?? Exemption of import duty on machinery to be used in a new project, provided the project exports not less than 80 per cent of its total sales and locates its factories in industrial estates or promoted industrial zones.
- ?? Exemption of import duty on raw materials used in the export products for a period of one year provided 30 per cent of sales are exported.

Zone 2 incentives

- ?? A corporate tax exemption for 3 years, which may be extended to 7 years, provided the project locates its factories in industrial estates or promoted industrial zones.
- ?? A 50 per cent reduction in import duty on machinery to be used in the project.
- ?? Exemption from import duty on raw materials used in export products for a period of one year provided that 30 per cent of sales are exported.

Zone 3 incentives

- ?? A corporate tax exemption for 8 years, with a 50 per cent reduction in the corporate income tax for an additional period of 5 years.
- ?? Exemption from import duty on machinery to be used in the project.
- ?? Exemption from import duty on raw materials used in export products for a period of 5 years, provided 30 per cent of sales are exported.
- ?? A 75 per cent reduction in import duty on raw materials used in the production for domestic sales for a period of 5 years.
- ?? A double tax deduction for water, electricity and transport costs for 10 years from the date of the first sales.
- ?? An additional 25 per cent deduction for costs associated with developing certain infrastructure facilities connected with the project.

(b) Sectoral incentives

The BOI has identified certain priority projects in such areas as basic transportation systems, public utilities, environmental protection and/or restoration, technological development and basic industries. These projects would automatically be entitled to:

- ?? Corporate income tax exemption for eight years regardless of location.
- ?? A 50 per cent reduction in import duty on machinery in Zones 1 and 2.
- ?? Import duty exemption on machinery for projects in Zone 3.

(c) Export incentives and free trade zones

The BOI provides various export incentives as noted above. In addition to the BOI, the Industrial Estate Authority of Thailand provided further incentives in respect of projects located in EPZs. Export processing zones may be located in any of the BOI's promotion zones. The incentives available are as follows:

- ?? Exemption from import duty on machinery and other equipment.
- ?? Exemption from import duty on all raw materials.
- ?? Exemption from VAT, excise tax and other surcharges.

(d) Other incentives

In an attempt to support upgrading of production technology, product quality and the development of new products, the BOI grants incentives to promoted products that invest in R&D activities. Additional incentives include an extension of the corporate income tax holiday by three years.

The Revenue Code of Thailand also provides an exemption from corporate income tax equivalent to the expenses incurred in respect of R&D.

(e) Tax incentives legislation highlights

Source tax incentive legislation includes the Investment Promotion Law.

(f) Statutory tax rate

The national corporate tax rate is 30 per cent.

The withholding tax rate is 10 per cent on dividends and 15 per cent on royalties and interest subject to the provisions below. There is no withholding tax on interest paid to non-resident individuals or companies not carrying on business in Thailand on deposits or loans derived from operators of the Bangkok International Banking Facilities (BIBF) solely for the purpose of extending loans in a foreign country. A rate of 10 per cent applies to interest paid to non-resident individuals or companies not carrying on business in Thailand on deposits or loans derived from operators of the BIBF for extending loans in Thailand.

16. Turkey

(a) Regional incentives

As from 1 January 1999, Turkey provides investment allowances ranging from 40 per cent to 200 per cent for industrial investments exceeding US\$250 million, depending on location and type of investment.

Investors benefit from the investment allowances once they complete the correct documentation and obtain formal approval. Under the incentives regime, imported goods will be exempt from VAT and certain other taxes, duties and fees, as well as exemption from payments relating to energy support and loan assignment.

More generous incentives are given for investments made in regions with first or second degree priority (see table below for list of provinces and priority). These incentives include the following:

- ?? Developments that include housing for personnel under the investment allowance scheme are exempted from certain taxes;
- ?? Public lands may, in some cases, be transferred to the investor free of charge;
- ?? A cash repayment of the VAT paid is available for machines purchased or produced in Turkey, and additional payments may be applied for from the Fund of Encouragement of Investments; and
- ?? Industry loans are made available at preferential, low interest rates.

Degree of priority	Province
?? First degree	Adiyaman, Agri, Batman, Bayburt, Bingol, Bitlis, Diyarbakir, Gumushane, Hakkari, Kars, Mardin, Siirt, Sirnak, Tunceli and Van.
?? Second degree	Amasya, Artvinj, Cankiri, Corum, Elazig, Erzincan, Erzurum, Kastamonu, Kahramanmaras, Malayta, Sinop, Sivas, Sanliurfa, Tokat, Yozgat and Zonguldat.

(b) Sectoral incentives

Investments in the following sectors will qualify for incentives in developed regions: electricity production, those within the framework of Build-Operate-Transfer, R&D or design and modelling, environmental protection, yacht building and shipbuilding, education, health and tourism, the electronics industry and other sectors approved by the Undersecretariat of Treasury and Foreign Trade. In addition to the above, offshore banking is available in FTZs with a minimum US\$ 1 million paid in capital. Offshore banks can benefit from incentives just like other companies operating in FTZs. These incentives include transferability of earnings in these zones, exemption from income and corporate taxes, exemption from customs duty on imports of machinery and other incentives determined by the Council of Ministers.

Furthermore, investments requiring high technology, with high value added, renewals and quality enhancements are also considered in investment incentives.

(c) Export incentives and free trade zones

Investments in exports which reach a certain level of export sales volume will be exempted from all taxes, duties and fees related to loans extended for the completion of this investment.

In addition, exporters are exempt from VAT thus gaining a competitive advantage in international trade. They are allowed to either refund or credit the VAT they incurred during production of export goods.

Exporters are allowed to expense 0.05 per cent of their sales amount without any documentation.

Companies operating in the FTZs can benefit from such incentives as exemption from income and corporate taxes, exemption from VAT, a cheaper workforce due to regulations in the FTZs and exemption from customs duties and other duties when importing goods.

(d) Other incentives

One of the instruments that helps create a competitive edge for investors in Turkey is the Renewal Fund. It gives investors the opportunity to defer corporate tax for three years without any indexation.

Another instrument is the Financing Fund, which provides investors with the ability to defer corporate tax for one year. This applies only to earnings gained before 1 January 1999. And last but not the least important is the re-evaluation and cost increase incentive which protects companies from seeming to have huge, inflationary profits causing high tax payments.

(e) Tax incentives legislation highlights

- ?? Act on Encouragement of Foreign Capital;
- ?? Act on New Taxes for Economic Stabilization.

(f) Statutory tax rate

The corporate tax rate is 33 per cent, calculated as the sum of the basic rate of 30 per cent and 3 per cent fund contribution. The rest, 67 per cent of taxable profits are taxed at 16.5 per cent (15 per cent plus 1.5 per cent fund contribution). For publicly owned corporations, this tax is 5.5 per cent. Therefore, the effective tax rate for private corporations is 44.055 per cent.

The rate of withholding tax on interest is 16.5 per cent (15 per cent plus 1.5 per cent fund contribution).

The rate of withholding tax on dividends is 20 per cent increased by the 10 per cent fund surcharge, to 22 per cent. For public companies the dividend withholding tax rate is 11 per cent — 10 per cent withholding tax plus 10 per cent fund surcharge on the withholding tax.

The withholding tax rate of 25 per cent, increased by the fund surcharge of 10 per cent to 27.50 per cent, applies to amounts paid for the transfer or sale of a patent, trademark or

copyright. In all other cases the rate is 20 per cent, increased by the 10 per cent fund surcharge to 22 per cent. These rates may be reduced by tax treaty provisions.

17. Vietnam

(a) Regional Incentives

A 10 per cent rate applies for 15 years for projects such as:

- ?? Infrastructure projects established in a location where natural or socio-economic conditions are severe;
- ?? Projects in mountainous or remote areas;
- ?? Reforestation projects;
- ?? Special projects.

These projects are also entitled to income tax exemption for four years from the first profit-making year and a 50 per cent tax reduction for the subsequent four years. Reforestation and infrastructure projects in mountainous and remote areas and large projects may be entitled to an eight-year tax holiday from the first profitable year.

(b) Sectoral incentives

For projects that meet one of the following criteria, a 20 per cent rate applies for 10 years from the first year of operations:

- ?? At least 50 per cent of production is exported;
- ?? At least 500 workers are employed;
- ?? The project involves farming or the processing of agricultural, forestry, or marine products;
- ?? Advanced technology is used, or a research and development industry is involved; and/or
- ?? Substantial local raw materials are used in accordance with special conditions.

The above projects are also entitled to a profit tax exemption for one year from the date of profitable operation and a reduction of 50 per cent for the subsequent two years.

For projects involved in activities listed below, a 15 per cent rate applies for 12 years from the first year of operation:

- ?? Projects in which at least 80 per cent of production is exported;
- ?? Investments in metallurgy, basic chemicals, mechanical manufacturing, chemicals, petroleum, fertilizer, electronic component production, and automobile and motorbike component production;
- ?? The building and operating of infrastructure (e.g. bridges, roads, water supply, drainage, electricity or seaports);
- ?? Cultivation of perennials;
- ?? Investments (including hotel projects) in locations where natural or socio-economic conditions are severe;
- ?? Projects (including hotel projects) that will be transferred without compensation to Viet Nam on termination of the operation;
- ?? Any project that meets two of the criteria required for the 20 per cent tax rate to apply.

In certain circumstances, these projects are also entitled to income tax exemption for two years from the first profit-making year, and a 50 per cent tax reduction for the subsequent three years.

(c) Export incentives and free trade zones

Foreign enterprises investing in the EPZs, regardless of industry, are entitled to special tax incentives as follows:

- ?? An income tax rate of 10 per cent for manufacturing projects;
- ?? An income tax rate of 15 per cent for service projects;
- ?? Exemption from income tax for the first four profit-making years for manufacturing enterprises and a 50 per cent reduction in income tax for the subsequent four years;
- ?? Exemption from income tax for the first two profit-making years for services and a 50 per cent reduction of income tax for the subsequent four years;
- ?? A 5 per cent tax on remittance of profits abroad for all types of EPZ enterprises; and
- ?? Exemption from import and export duties for all kinds of machinery and equipment, raw materials and finished products imported to, or exported from, Viet Nam.

(d) Other incentives

Build-operate-transfer (BOT) projects, carried out by BOT companies are entitled to preferential tax treatment as follows:

- ?? Profit tax of 10 per cent;
- ?? Four-year tax holiday from the first profit-making year;
- ?? Profit tax reduction of 50 per cent for the subsequent four years; and
- ?? Repatriation tax of 5 per cent.

The most preferential turnover tax rate and possible exemption from, or reduction of, turnover tax is to be decided by the Prime Minister on a case-by-case basis. Effective 1 January 1999, a value-added tax law replaced the turnover tax law.

In accordance with Circular 2345/TT of the Minister of Science, Technology and Environment, new tax incentives are available for hi-tech companies. Hi-tech companies that meet the criteria listed below are entitled to an exemption from import tax on production materials for five years from commencement of production, a profit tax exemption for eight years, and a reduction of 50 per cent for the subsequent four years. The company should:

- ?? Be located in the EPZ, industrial zone or high-tech zone;
- ?? Have a product quality control system that meets the standard of ISO-9000;
- ?? Have an average value of technology equipment per head of at least US\$ 40,000;
- ?? Have annual revenue per capita of at least US\$ 70,000;
- ?? Have at least 40 per cent of staff with college, university degree or above, with practical training in overseas companies or institutes; and
- ?? Provide professional training to all staff with vocational training degrees and to workers.

(e) Tax incentives legislation highlights

- ?? Enterprise Investment Tax Law;
- ?? The Law on Foreign Investment, 1996;
- ?? Decree 29 on Promotion of Domestic Investment, 12 May 1995.

(f) Statutory tax rate

The universal income tax rate is 32 per cent; under the Enterprise Income Tax Law, the tax rate for domestic entities ranges from 25 to 50 per cent according to the type of industry.

?? The withholding tax on dividends varies from 5 to 7 per cent and 10 per cent depending on the amount of the investment made by the foreign firm, as follows:

?? Where the foreign investor has contributed capital amounting to more than US\$ 10 million, or where the foreign party invests 70 per cent of the equity, the rate is 5 per cent;

?? Where the foreign investor has contributed capital amounting to between US\$ 5 million and US\$ 10 million, or where foreign participation is between 50 and 70 per cent, the rate is 7 per cent;

?? In all other cases, the rate is 10 per cent.

There are no specific regulations concerning withholding tax on interest paid to foreign recipients. It is advisable for the paying company and the recipient to ensure that the State Committee for Cooperation and Investment deals with the matter of withholding tax when the original investment application is made.

A 10 per cent rate of withholding tax applies on royalties on the transfer of foreign technology under approved licensing contracts for a period of less than five years and a rate of 15 per cent applies where the period is five years or more.

C. Europe and economies in transition

A Brief Summary

Industrialized countries of western Europe generally offer more financial incentives than tax incentives. However, Ireland is an exemption, which offers reduced tax rates in order to promote manufacturing. Economies in transition generally have higher profit taxes and lesser choice of incentives. In these economies, investment in selected sectors are given such incentives as investment allowance or tax credits. Job creation, especially for disabled persons, is encouraged by giving tax exemptions or tax allowances, depending on salaries paid. Incentives are available more liberally in special economic zones through which export is promoted either through tax and duty exemptions or partial or full exemption of VAT.

Table 11: Synopsis of types of incentives: Europe and economies in transition

Country	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	Duty/VAT exemption/reduction	R & D Allowance	Deduction for qualified expenses
Bulgaria	?			?		
Hungary	?		?	?		
Ireland	?	?	?			
Kazakhstan	?			?		
Lithuania	?	?	?	?		
Malta	?		?		?	?
Poland	?		?			
Russia	?	?		?		
Slovenia			?	?		?
Uzbekistan	?	?	?	?		

Table 12: Tax treaties signed per country/territory: Europe and economies in transition

	Bulgaria	Hungary	Ireland	Kazakhstan	Lithuania	Malta	Poland	Russian Federation	Slovenia	Uzbekistan
TOTAL WORLD	34	53	47	21	26	37	63	53	8	18
Developed Countries	20	24	30	11	14	19	25	33	5	7
Western Europe	18	19	21	8	11	15	20	26	4	6
European Union	15	16	18	8	9	14	15	21	3	6
Austria	1	1	1			1	1	1	1	
Denmark	2	1	2		1	2	1	2		
Finland	1	1	2		1	1	1	2		1
France	1	1	1	1		1	1	1		1
Germany	1	1	1	1	1	1	1	2		1
Greece	1	1					1			
Ireland		1			1		1	1		
Italy	1	1	1	1	1	1	1	2		
Netherlands	1	1	1	1	2	1	1	2	1	1
Portugal	1	1	1				1			
Spain	1	1	1				1	1		
Sweden	1	2	2	1	1	2	1	2		
United Kingdom	1	1	3	2		2	1	3		1
Belgium	1	1	1	1	1	1	1	1	1	1
Luxembourg	1	1	1			1	1	1		
Other Western Europe	3	3	3		2	1	5	5	1	
Iceland					1		1	1		
Malta	1	1					1			
Norway	1	1	1		1	1	1	2		
Switzerland	1	1	2				2	2	1	
North America	1	2	5	3	3	3	2	5	1	1
Canada	1	1	2	1	1	1	1	2		1
Greenland										

	Bulgaria	Hungary	Ireland	Kazakhstan	Lithuania	Malta	Poland	Russian Federation	Slovenia	Uzbekistan
United States		1	3	2	2	2	1	3	1	
Other Developed Countries	1	3	4			1	3	2		
Australia		1	1			1	1			
Israel		1	1				1	1		
Japan	1	1	1				1	1		
New Zealand			1							
Developing Countries	9	18	8	5	3	11	24	14	1	10
Africa	2	2	3			3	5	1		1
North Africa	1	1				2	2			1
Algeria	1									
Egypt		1				1	1			1
Libyan Arab Jamahiriya						1				
Morocco										
Tunisia							1			
Other Africa	1	1	3			1	3	1		
Benin										
Côte d'Ivoire										
Gambia										
Ghana										
Kenya										
Malawi										
Mauritius								1		
Nigeria										
Senegal										
Seychelles										
Sierra Leone										
South Africa		1	2			1	1			
Uganda										
Zambia			1				1			
Zimbabwe	1						1			
Tanzania, United Republic of										
Latin America and the Caribbean		2	1				1			
LATIN AMERICA		2	1				1			
Argentina										
Belize										
Brazil		1								
Ecuador										
Falkland Islands										
Mexico			1							
Uruguay		1					1			
Venezuela										
THE CARIBBEAN										
Anguilla										
Antigua and Barbuda										
Barbados										
British Virgin Islands										
Dominica										
Grenada										
Jamaica										
Montserrat										
Netherlands Antilles										
Saint Kitts and Nevis										
Saint Lucia										
Saint Vincent and the Grenadines										
Trinidad and Tobago										
Asia and the Pacific	7	14	4	5	3	8	18	13	1	9
West Asia	1	3	1	2		3	4	4		1
Cyprus	1	1	1			1	1	2		
Iran, Islamic Republic of				1			1			
Kuwait		1								
Lebanon						1		1		
Saudi Arabia										

	Bulgaria	Hungary	Ireland	Kazakhstan	Lithuania	Malta	Poland	Russian Federation	Slovenia	Uzbekistan
Syrian Arab Republic						1				
Turkey		1		1			1	1		1
United Arab Emirates							1			
Yemen										
Central Asia	2	1		2	1		1	1		1
Armenia	1						1			1
Azerbaijan										
Kazakhstan	1	1			1					
Kyrgyzstan				1						
Turkmenistan				1				1		
South, East and South-East Asia	4	10	3	1	2	5	13	8	1	7
Bangladesh							1			
China	1	1			1	1	1		1	1
India	1	1				1	1	1		1
Indonesia	1	1					1	1		1
Macau							1	1		
Malaysia		1	1			1	1	1		
Mongolia		1						1		
Nepal										
Pakistan		1	1	1		1	1			1
Philippines		1					1			
Singapore					1		1			
Sri Lanka							1			
Thailand		1					1	1		1
Viet Nam		1					1			1
Korea, Democratic People's Republic of								1		
Korea, Republic of	1	1	1			1	1	1		1
Pacific										
British Solomon Islands										
Guam										
Kiribati										
Tuvalu										
Central and Eastern Europe	5	11	9	5	9	7	14	6	2	1
Albania		1					1			
Belarus					1					
Bulgaria		1		1		1	1			
Croatia		1				1	1			
Czech Republic	1	1	1		1	1	1	1	1	
Estonia			1	1	1		1			
Hungary	1		1	1		1	1	1		
Latvia			1		1		1			
Lithuania			1	1			1	2		
Poland	1	1	1		1	1		1	1	
Romania		1	1	1		1	1			1
Russian Federation		1	1		2		1			
Slovakia	1	1	1			1	1			
Slovenia							1			
Ukraine		1			1					
Yugoslavia (former)		1					2	1		
Macedonia, the Former Yugoslav Republic of										
Moldova, Republic of	1	1			1					

1. Bulgaria

(a) Regional incentives

Since 1 January 1998, tax incentives generally have become limited to companies that employ persons with disabilities or to companies located in areas with unemployment rates higher than the national average, which add to their workforce.

(b) Sectoral incentives

Agricultural producers may be relieved from corporate income tax for agriculture-related activities not involving processing, if the tax amount due is reinvested in the same agricultural activities.

(c) Export incentives and free trade zones

A number of FTZs have been established in Bulgaria where foreign entities and individuals may carry out permitted trading activities. Although transactions in a FTZ are carried out in convertible currency, employees must be paid in the national currency, the leva. Imported goods are exempt from customs duties and value-added tax in the FTZs, and goods exported from them to a country outside Bulgaria are exempt from customs duties.

(d) Tax incentives legislation highlights

?? Foreign Investment Law, 1997;

?? Corporate Income Tax Law, 1997.

(e) Statutory tax rate

Corporate tax rate in Bulgaria is graduated, with the maximum rate at 50 per cent.

Bulgaria levies a 15 per cent withholding tax on dividends, interest and royalties paid to non-residents. These rates may be reduced under a number of Bulgarian double taxation agreements.

2. Hungary

(a) Regional incentives

Firms located in an entrepreneurial zone or a region of high priority, and investing in the manufacture of goods, are entitled to a tax credit equal to 100 per cent of their 18 per cent corporate tax liability. The tax credit is calculated on the basis of the ratio of their income from the production of qualifying goods realized in the qualifying region to their total income. The 100 per cent tax credit is available within five years of making the investment. The 100 per cent tax credit applies only to the year during this five-year period in which sales revenues increase over the previous year, as follows:

- ?? By at least 1 per cent, in the case of an investment in an entrepreneurial zone.
- ?? By an amount equal to at least 5 per cent of the value of the investment for an investment in a region of high priority.

The tax credit can be claimed on the corporate tax liability only up to the year 2002. Investment in these regions may also give rise to accelerated depreciation and/or additional tax credits.

In a socially and economically underdeveloped region or in a county with high unemployment:

- ?? Investors are entitled to a tax credit equal to 100 per cent of their corporate tax liability for investments in the manufacture of goods made after 31 December 1996 either in a socially and economically underdeveloped region or in a county where the unemployment rate in December 1996 or 1997 exceeded 15 per cent. The goods should be worth at least 3 billion forint. This tax benefit can be used within 10 years of making the investment. It applies if income from sales revenues in one of those years increases by at least 5 per cent of the value of the investment over the previous year, and if the annual average number of employees increases by at least 100 from the second year of making the investment. Overfulfilment of the requirement in a given year can be taken into account in subsequent years.

- ?? This tax allowance may be claimed on the corporate tax liability only up to the year 2011.

Investors are entitled to a one-off tax credit equal to 6 per cent of their corporate tax liability for the year in which a machine, building or infrastructure project is put into operation in certain regions. To be eligible for this entitlement, their head offices or premises must be registered with the Court of Registration or the local government in (a) a region of high priority, or (b) in an entrepreneurial zone.

(b) Sectoral incentives

Investors are entitled to a tax credit equal to 100 per cent of their corporate tax liability if they made an investment, after December 1996, in the manufacture of goods worth at least 10 billion forint. This tax benefit can be used within 10 years of making the investment. It applies if income from sales revenues in one of those years increases by at least 5 per cent of the value of the investment as compared to the previous year and if the annual average number of employees increases by at least 500 from the second year. Overfulfilment of the requirement in a given year can be taken into account in subsequent years.

This tax allowance may be claimed on the corporate tax liability up to the year 2011. This tax incentive is available everywhere in Hungary provided the conditions required are met.

Investors are entitled to a tax credit equal to 50 per cent of their 18 per cent corporate tax liability if they made an investment, after 31 December 1995, worth at least 1 billion forint in the manufacturing of goods. This tax benefit can be used within five years of making the investment. It applies if sales revenues in one of those years increase by 5 per cent of the value of the investment over the previous year. Overfulfilment of the requirement in a given year can be taken into account in subsequent years.

(c) Export incentives and free trade zones

According to the general rules of the Hungarian Customs Law there are two types of free zones:

?? Free zones for industrial processing; and

?? Free zones for the purpose of storage.

Goods delivered to a customs free zone from outside the customs territory are free from import duties and taxes.

When a plant is established within a customs free zone for industrial processing, the means of production (e.g. equipment and furnishings) required for plant operation that are imported, are exempt from customs duty. Any auxiliary materials and fuels used in the course of production are also exempt from customs duty.

(d) Other tax incentives

Since the local authorities have the right to levy local taxes and to determine the rate of taxation within the framework of the Hungarian law, economic entities/companies can achieve more favourable tax incentives through negotiations with the local authority. In practice, the local authority can decrease the tax rate or exempt the company from local tax liability. The rate of the incentive depends on the type and size/rate of the investment and on other circumstances in the region (e.g. the unemployment rate or the existence of other investments).

(e) Statutory tax rate

The rate of corporate tax is 18 per cent. Effective from 1 January 1997, the supplemental tax of 23 per cent was abolished. However, any profits earned in 1995 and 1996 that are distributed later will be subject, with some exceptions, to the supplemental tax. When these dividends are paid abroad, the supplemental tax due on dividends under domestic law is limited to the withholding tax rate set forth for dividends in Hungary's double taxation agreements. When the full 23 per cent rate applies, the effective corporate tax rate is 33 per cent.

A Hungarian company, when distributing dividends, has to compute and withhold 20 per cent dividend tax from the gross dividend declared. However, the Hungarian distributing company need not withhold the dividend tax if the dividend is paid to a Hungarian company. When dividends are distributed to a foreign shareholder, the law states that the Hungarian company distributing the dividends must withhold the full 20 per cent dividend tax upon payment of the dividends even though a tax treaty provides for a lower withholding tax rate. Thereafter, the Hungarian distributing company can apply for reimbursement of the difference between 20

per cent and the treaty rate on behalf of the foreign shareholder. However, direct application of the treaty is possible provided that a number of official procedures are fulfilled prior to the payment of the dividend.

Interest paid to non-resident companies is charged as business income and is subject to tax at the effective rate of 18 per cent. The Hungarian payer must withhold the full 18 per cent withholding tax upon payment of the interest. The foreign recipient is entitled to apply for reimbursement of the difference between the 18 per cent rate and the treaty rate. However, direct application of the treaty is possible, provided that a number of official procedures are fulfilled prior to the payment of the income.

Interest paid by the Government, the National Bank of Hungary and other financial institutions is not subject to withholding tax. However, no exemption applies when a Hungarian financial institution pays interest on the basis of a commission.

The rate of withholding tax on royalties is 18 per cent, but it can be lower through treaties.

3. Ireland

(a) Regional incentives

Corporate and individual taxpayers alike can obtain special incentives designed to encourage investment in certain designated areas and streets. Relief is in general granted to an investor who incurs expenditure on the construction, conversion or refurbishment of certain premises. Relief is given either by way of a system of capital allowances (i.e. write-off against total income over a predetermined period) or by way of deduction against specified sources of income as that income arises.

An urban renewal scheme applies to 43 specified areas within towns and cities across the country. Under the scheme, the following forms of relief apply in respect of residential accommodation:

Owner Occupied:	5 per cent of the construction cost of a new house may be deducted from total income each year for 10 years
	10 per cent of the costs of refurbishment of an existing house may be deducted from total income each year for 10 years
Lessor:	Up to 100 per cent of the construction cost may be set against the first year of rental income

This relief is available during the period from 6 April 1999 to 31 December 2001

Apart from the general urban renewal relief referred to above, there are a number of areas/specific types of developments which qualify for specific allowances for specified periods. The following is a list of the different kinds of relief available and their expiry dates:

Type of incentive	Expiry date
1. Multi-storey car parks	31 December 2000 (in certain cases only)
2. Seaside resort areas	31 December 1999
3. Enterprise areas	31 December 1999
4. Custom house docks areas	31 December 1999
5. Temple Bar Area	31 December 1999 (in certain cases only)
6. Designated islands	31 December 1999
7. Third level institutions	31 December 2002
8. Private convalescent homes	N/A
9. Childcare services	N/A
10. Student accommodation	31 March 2003
11. Park and ride and related development	30 June 2002

Relief numbers 8 to 11 above were only introduced in the Finance Act of 1999. The private convalescent homes relief allows a capital expenditure write-off over a seven-year period. It was introduced to encourage investment by the private sector in this area, seen as important in light of the ageing population. Regarding the provision of relief for childcare services, the Government hopes that this will eliminate the supply/demand imbalance and result in affordable childcare being made available. Similarly, student accommodation relief is designed to increase the supply of affordable accommodation. The park and ride provisions are aimed at reducing the level of traffic congestion in the major cities. Such provisions have been successfully introduced in other European countries.

As already stated, relief is generally granted either by way of capital allowances or by way of deduction against rental income. Capital allowances are available for deduction against total income. Generally, the rate of capital allowances is 50 per cent allowance in the first year with the balance being available over the following 12 years, but there are differences for each type of incentive. In particular, the status of the claimant is important. An owner operator will generally be able to claim allowances at a faster rate than a lessor. In order to curb the practice of "selling" capital allowances to individuals to shelter their total income, a general restriction has been put in place in respect of passive investors. Thus allowances can only be set against non-rental income to the extent of 25,000 Irish pounds per annum. In some cases, allowances are entirely "ring-fenced" to rental income.

(b) Export incentives and free trade zones

A reduced rate of corporation tax applies to profits of manufacturing and certain service companies until the end of 2010. This reduced rate may be extended to qualifying Irish-based trading companies that export Irish manufactured goods.

For companies not qualifying for the above reduced rate, the following tax rates will apply to trading income:

Year	Rate
1999	28.0 per cent
2000	24.0 per cent
2001	20.0 per cent
2002	16.0 per cent
2003	12.5 per cent

Non-trading income (i.e. interest and rental income) does not qualify for the above mentioned rates. With effect from 1 January 2000 the rate that applies to such income is 25 per cent. Certain other activities, including mining and land dealing, are also subject to tax at 25 per cent.

Operations in the Shannon Free Airport Zone and the International Financial Service Centre (IFSC) qualify for the effective corporation tax rate of 10 per cent but only until 31 December 2005.

Tax exemption in certain circumstances is granted for patent royalties derived by companies from inventions devised in the State.

(c) Tax incentives legislation highlights

?? Taxes Act, 1997.

?? Taxes Consolidation Act, 1997.

?? Amended by Finance Acts, 1998 and 1999.

(d) Statutory tax rate

The standard corporation tax rate is 28 per cent. Withholding tax at the rate of 24 per cent is applicable to dividends and royalties for patents. No tax is withheld from interest on hire-purchase payments, on bank deposits held by resident companies and by non-residents, subject to the completion of certain formalities, or on payments between banks on current/nominal accounts. Where the interest is "short" interest (broadly, interest that is paid

on a debt which is not capable of exceeding one year), no withholding tax is required to be deducted, otherwise the rate is 24 per cent. Withholding tax rates may be reduced under double taxation treaties.

4. Kazakhstan

(a) Regional incentives

The same types of incentives offered under sectoral incentives are available for investment in assisting the transfer of government bodies from Almaty to the new capital in Astana.

(b) Sectoral Incentives

Incentives of up to 100 per cent tax relief for five years, and up to 50 per cent tax relief for another five years may be granted, after government screening, for a wide range of sectors, including infrastructure and processing industries classified as "high/new technology", "up-to-date and effective technology" or "high quality."

Infrastructure includes railways, highways, sea and river ports, bridges, thermal electric power stations, electricity transmission lines and telecommunications networks. Processing industries cover a wide range including: yarn, textiles, footwear, fur and leather, furniture, cardboard products, processing and storing of agricultural products, children's nutritional products, confectionery and non-alcoholic drinks and wines, output with new high-tech machinery, equipment and tools, all types of vehicles and other types of transportation equipment, industrial electrical engineering products and consumer electrical and electronic products, fertilizers, medicines, household chemical products, perfumes and cosmetics and extraction of ferrous and non-ferrous metals.

Partial or full customs duty exemption is also offered on equipment and raw materials needed for the investments in these sectors.

(c) Export incentives and free trade zones

Duty and VAT refund for export-oriented investment on imported raw materials and other inputs are available.

(d) Tax incentives legislation highlights

?? Law on Foreign Investment (1994, amended July 1997);

?? The Tax Code (1995);

?? The Law on State Support of Direct Investments (1997).

(e) Statutory tax rate

The statutory tax rate is 35%.

5. Lithuania

(a) Regional incentives

Local governments are allowed to grant tax incentives.

(b) Sectoral incentives

All companies involved in sales, production and services relating to agricultural products pay a 10 per cent tax on profits, provided these account for a minimum of 50 per cent of sales. Artists' unions (architects, artists, designers, photographers, composers, cinematographers, scientists, writers, crafters and journalists) and their enterprises and organizations that allocate no less than 29 per cent of their profits to meet the needs of these unions, pay corporate tax at a rate of 5 per cent. Profits of health care institutions are exempt from tax.

(c) Export incentives and free trade zones

Generally there are no export duties. Excise tax is not applied to commodities for export and to goods in transit through Lithuania. There is no VAT for exported goods and services.

Investments made in Lithuania's Free Economic Zone are offered incentives as follows:

- ?? For investments over US\$ 1 million, a corporate tax holiday for the first five years and a 50 per cent tax reduction for the following 10 years (an actual rate of 14.9 per cent);
- ?? For investments under US\$ 1 million, a corporate tax reduction of 80 per cent for the first five years (an actual tax rate of 5.8 per cent) and a 50 per cent tax reduction for the following 10 years (an actual tax rate of 14.5 per cent);
- ?? No customs duties;
- ?? No VAT, excise, road or real estate taxes;
- ?? Withholding tax exemptions for repatriated profits and dividends;
- ?? A 50 per cent discount on land leases; and
- ?? Special write-offs for investments and other expenses to acquire long-term assets and new technologies.

(d) Other Incentives

If an enterprise holds a foreign investment of over US\$ 2 million, it is relieved from corporation tax payments for three years, and for the next three years it pays only 50 per cent of the corporation tax due. This is not applicable in enterprises that are involved in retail and wholesale trade of gas and oil products.

Losses incurred by a company over a given tax year may be carried forward for not more than five years from the year when the loss is incurred. Profits reinvested or used for investments in fixed assets (equipment, machinery and buildings) are not taxed.

(e) Tax incentives legislation highlights

?? Law on State Enterprises;
?? Law on Stock Corporations;
?? Law on Small Enterprises; and
?? Law on Foreign Investment.

(f) Statutory tax rate

The national rate of corporate tax is 29 per cent. There is no withholding tax charged on dividends, interest or royalties.

6. Malta

(a) Regional incentives

The Industrial Development Act of 1998 provides for a number of incentives that apply only to companies located on the sister island of Gozo, in recognition of the additional cost of setting up and running an enterprise involved in manufacturing on that island. The primary incentive is the reimbursement of travel costs.

(b) Sectoral incentives

Under the Merchant Shipping Act of 1973, companies registered in Malta that own exempt ships are exempt from company tax on profits earned by those ships. Shareholders are exempt from tax on dividends paid out of the profits. An exempt ship is one registered under the Maltese flag weighing at least 1,000 tons.

Manufacturing companies may claim investment allowances for capital expenditure on new industrial buildings or structures and new plant and machinery of 15 per cent and 30 per cent, respectively. These replace the normal initial allowances. In the case of Maltese-owned companies, the rates are 16.5 per cent and 33 per cent, respectively.

Accelerated depreciation allowances for capital expenditure on new industrial buildings or structures and new plant or machinery are at 4 per cent and 25 per cent, respectively. These allowances replace the normal annual wear and tear allowances. The rates for Maltese-owned companies are 5 per cent and 33.33 per cent, respectively. This benefit is available only to manufacturing companies as defined in the Industrial Development Act.

(c) Export incentives and free trade zones

Companies licensed to operate in Malta's free port zone are exempt from company tax on profits for business carried on in the zone. Dividends, interest, and royalties paid by these companies are tax-free for non-resident recipients. Expatriate employees of these companies pay income tax at a top marginal rate that cannot exceed 30 per cent, and they do not have to make social security contributions.

A 10-year company tax holiday is available for manufacturing companies that export at least 95 per cent of their turnover. Manufacturing companies not eligible for the tax holiday are exempt from company tax on those additional profits generated by increased export sales.

(d) Other incentives

A reduction of the tax rate (normally 35 per cent) to 17.5 per cent is offered (15.75 per cent in the case of Maltese-owned manufacturing companies) on profits set aside by a company for the exclusive purpose of financing a project that requires no more than five years to be completed. This incentive requires the approval of the Malta Development Corporation.

Deductions amounting to 120 per cent of training and R&D costs and to 140 per cent of export promotion costs are allowed. The top marginal rate of income tax is limited to 30 per cent for expatriate employees of qualifying manufacturing companies, subject to a minimum tax of 1,000 Maltese liri per year.

(e) Tax incentives legislation highlights

?? The Industrial Development Act, 1998;
?? The Merchant Shipping Act, 1973.

(f) Statutory tax rate

The basic national rate of corporate tax is 35 per cent. No withholding tax is charged on dividends, interest or royalties.

7. Poland

(a) Sectoral incentives

Allowances of up to 30 per cent in 1999 and 25 per cent in 2000 for qualifying exports or businesses that implement new technologies.

(b) Export incentives and free trade zones

Seventeen Special Economic Zones (SEZ) have been created: (i) Mielec (1995); (ii) Katowice and Suwałki (1996); (iii) Łódź, Legnica, Wałbrzych, Częstochowa, Kamienna Góra, Kosztrzy-Słubice, Słupsk, Starachowice, Tarnobrzeg, Tczew, Warmia-Mazury, Zarnowiec (1997); and (iv) Kraków, Mazowsze (near Warsaw) (1998). Mazowsze SEZ has since been closed.

Companies planning to commence activity in the zones must obtain a permit from the zone authorities. The permit is granted for a specific time and provides the companies with a basis for benefiting from tax exemptions or tax preferences.

Economic enterprises entitled to income tax exemption, may be totally exempted for a period equal to half the period for which the zone has been established (but no more than 10 years). After that period they may be granted 50 per cent exemption.

Obtaining the permission, which entitles the entities to use the benefits of the zone, is possible when conditions prescribed for specific zones are satisfied. These conditions refer to the value of the planned investment (0.35 to 2 million euros) or the number of newly created jobs (40-100). An entity that operates within a zone is not allowed to conduct any economic activity outside the zone.

Enterprises that have no rights to such allowances are entitled to treat their investment expenditures connected directly with the economic activity conducted in the zone as revenue earning costs or to apply increased amortization rates. Such preferences may be utilized alternatively. In addition, entities operating the SEZs are exempt from local fees and taxes (i.e. tax on land and real estate).

(c) Other incentives

A general tax incentive is available for specific investment expenditures of certain companies registered in Poland, including: (i) acquisition of certain machinery and appliances (including the cost of their installation); (ii) acquisition of certain buildings and facilities, including industrial buildings, facilities and generators; and (iii) acquisition of certain enterprises, intangibles, and lease payments. The incentive takes two forms: accelerated depreciation and tax premium.

To benefit from the tax incentive the taxpayer has to meet certain requirements. In the year preceding the year in which the tax incentive is utilized, the taxpayer should have had a profitability ratio (taxable income to taxable revenue) not less than:

- ?? 2 per cent for firms engaged in the collection, purchase and segregation of wastes;
- ?? 4 per cent for firms engaged in such activities as agricultural processing, construction (including residential construction), the manufacture of construction materials and tourism.
- ?? 8 per cent for other types of economic activity not listed above.

Generally, taxpayers meeting profitability requirements, may deduct from their taxable income all or part of their investment expenditure and up to 10 per cent of their taxable income, only in the year in which the investment is made.

In some cases, however, the profitability requirements do not have to be met. These concern the following taxpayers:

- (i) Those who start economic activity in a tax year, and who, in the year before the initiation of the economic activity, incurred investment expenditures of not less than the equivalent of 2,000,000 euros. This expenditure can be deducted in the year of initiation of the economic activity and in the three subsequent years;
- (ii) Those who incur the expenditure on machinery and appliances which are connected with the introduction of licenses and patents;
- (iii) Those who incur investment expenditure on the purchase and installation of equipment necessary to implement a quality control system compatible with ISO series 9000. This needs to be confirmed with a relevant certificate.
- (iv) Those whose export sales are equal to 50 per cent of the total income earned, or in the tax year in which the right to the tax incentive is acquired, the total amount of export sales exceed 8,000,000 euros.
- (v) Those who generate profits from the sale of fishing products outside Polish territory.
- (vi) Those who incur expenditure on fixed assets related to the production of pharmaceuticals or medical equipment which meet the requirements for a concession to manufacture them.

Generally, the taxpayers specified in categories (ii) to (vi) above may deduct from their taxable base all or part of their investment expenditure, up to 30 per cent of their taxable base, only in the year in which the investment was made. From the year 2000, the rate will be decreased to 25 per cent. Effective 1/1/2000, investment allowances are discontinued. Only those investors who incurred defined expenses prior to this date may continue to benefit from investment allowance.

The taxpayers who are described in the first category above may deduct investment expenditures up to 10 per cent of their taxable base *in the year of initiation of the economic activity, and 10 per cent each year over the three subsequent years.*

The real benefit is a tax premium, which may be utilized by each taxpayer listed above. The tax premium entitles the company to claim an additional deduction from the taxable base in the tax year following the year in which the investment outlays were made. It equals half the investment outlays deducted in the previous tax year. However, the extra deduction currently may not exceed 10 per cent of the taxable base. The tax premium is a real tax benefit rather than an accelerated depreciation charge.

There are tax discounts available to achieve community, social welfare and cultural goals. For example, these are tax discounts based on the number of disabled persons employed by a company. An income tax credit of 5 per cent is available on the sale of textbooks and academic publications.

(d) Tax incentives legislation highlights

Corporation Tax Law, 1992 (amended 1997).

(e) Statutory tax rate

The national rate of corporate tax is 30 per cent in 2000, which will be reduced in stages to 22 per cent by 2004. A withholding tax of 20 per cent is charged on dividends, interest and royalties, which can be reduced under treaty provisions.

8. The Russian Federation

(a) Regional incentives

Some regional governments give tax holidays or reduced tax rates on their share of the profits tax, as seen below.

(b) Sectoral incentives

Contracts for production, printing and showing of Russian films are exempted from VAT. Also, profits reinvested in film production is exempted from tax.

(c) Export incentives and free trade zones

VAT exemptions are available for goods and services for export.

Russia Federation has set up over 20 Free Customs Zones to increase exports. In these zones, investors in theory can receive tax incentives. In practice, however, these regulations have not been implemented well and the zones have attracted little foreign investment. A new law on economic zones has been under consideration for several years but it has not been implemented.

(d) Other incentives

There is a two-year tax holiday for small businesses, defined as those with less than 250 employees. There is no VAT on imported fixed assets. Reduced duty rates are available on the importation of fixed assets.

Companies that employ 50 per cent or more disabled persons full-time enjoy a 50 per cent reduction in profit tax.

Foreign suppliers who produce similar goods in Russian Federation can apply for reduction in import duties if the investment is at least \$100 million, of which \$10 million is provided by the foreign partner.

(e) Tax incentives legislation highlights

?? Taxation of Legal Entities Registered According to Russian Legislation, RSFSR #2116-1.

?? Presidential Decree No. 73,1995.

?? Law No. 10-FZ, 1999.

(f) Statutory tax rate

The statutory tax rate is 30 per cent with tax revenues divided into federal (11 per cent) and local parts (19 per cent). Interest and dividend are taxed at 15 per cent, and can be reduced under bilateral tax treaties. Royalty, licensing and management fees are subject to a 20 per cent withholding tax. In addition, regions and cities impose a wide variety of taxes.

9. Slovenia

(a) *Export incentives and free trade zones*

Economic Zones

The law on economic zones, in force since 27 June 1998, determines performance of economic activities in these zones until 1 January 2010. There are two economic zones within Slovenia: Maribor and Koper.

Economic zones are part of the customs area of Slovenia and are governed by a special customs regime. An economic zone can be established by one or more domestic legal entities. Economic zones may be established near a port or airport for easy international trade in goods. Goods manufactured within the economic zones are exempt from customs duties provided they are not exported to the Slovenian markets and are not used otherwise than in accordance with the law. Domestic goods brought to the zone for the purpose of re-export are deemed to be exported once they enter the zone.

Within the economic zone, users can perform production, service activities and wholesale activities. Retail services may only be provided to other users within the zone for their use within the zone and for providing transportation to international carriers and their crew. Users in the economic zone may also perform banking and financial services, business related to property transactions, personal insurance and reinsurance but only in relation to performance of business activities within the economic zone.

(b) *Other incentives*

According to the law on tax on profits of legal entities, tax incentives are offered on the following conditions:

- ?? A tax allowance of 40 per cent of the amount invested in tangible fixed assets (except cars) and in intangible long-term assets, but not exceeding the amount of the tax base. If the taxable person sells or transfers tangible fixed assets or intangible long-term assets before three years after the year in which he/she used the tax incentive, the amount of the tax incentive used increases the base cost of the asset for the year when it was sold or transferred. Taxable entities that use this tax incentive may not distribute the profits for profit-sharing. If the taxable person distributes profits for profit-sharing within five years after the year that the tax incentive is granted, the tax base is increased in the current year by the amount of tax incentive used.
- ?? A taxable entity, which establishes reserves for investment in tangible fixed assets, intangible long-term assets and long-term investments into other entities in Slovenia, can use tax allowances in the amount of 10 per cent of the tax base.
- ?? For a taxable entity, in business for an indefinite period or for at least two years, that employs trainees or other workers, the tax base can be decreased by an amount equal to 30 per cent of the salaries paid to those employees, but at the most only for the first 12 months of their employment. A taxable entity that hires people with disabilities is eligible for an allowance amounting to 50 per cent of their paid salaries. A taxable entity that hires a person with 100 per cent disability or a deaf-mute person is eligible for 70 per cent of their paid salaries.

All three tax incentives together can decrease the tax base, up to the amount of the tax base. This means that on no account can the tax incentives offered to a taxable person decrease the tax base to such an extent as to lead to a tax loss.

(c) Tax incentives legislation highlights

- ?? Law on economic zones;
- ?? Law on tax on profits of legal entities.

(d) Statutory tax rate

The national rate of corporate tax is 25 per cent. No withholding tax is charged on interest or royalties. Dividends from a Slovenian company paid to another Slovenian company, which are taken from taxed profits, are exempt from withholding tax. Otherwise, the rate is 25 per cent for residents, and 15 per cent for non-residents, subject to treaty provisions.

10. Uzbekistan

Investors entitled to incentives are categorized as: foreign investors, exporters, newly established enterprises, enterprises employing privileged categories of workers and "other" categories. The law defines an entity with foreign investment (EFI) as one having more than 30% foreign equity participation. Different incentives apply to each category. For foreign companies that meet certain criteria, contributions to the reserve fund of up to 20 per cent of net profit before tax are tax exempt, if 60 per cent or more of revenues are from "own production." If foreign ownership is greater than 50 per cent and if the firm has a charter fund of more than US\$ 300,000, the tax rate on profits is 20 per cent; if it is more than US\$1 million, the tax rate on profits is 16 per cent.

(a) Sectoral incentives

A tax holiday for seven years and a 25 per cent tax rate thereafter are offered for investment in sectors promoted by the Government, under the Strategic Investment Plan. In addition, EFIs specialized in the production and processing of agricultural products (except grape and fruit/berry wines, and "strong drinks"), consumer goods and construction materials, medical equipment, machinery and equipment for agriculture and in the food industries are granted additional incentives. EFIs that invest in city passenger transportation (except taxis), repair, maintenance and construction of roads, the restoration of cultural objects for sightseeing, and the production of artificial limbs and provision of services for invalids and correction institutions are tax exempt.

(b) Export incentives and free trade zones

For firms carrying out export activities, expenditures on "qualifying investments" may be entitled to a reduced rate of tax on profits according to the proportion of revenue derived from their exports. For example, on exports that account for 30 per cent of total profits, the total profits are taxed at half the base rate. In addition, the portion of revenue derived from an increase in exports is exempt from profits tax. For export-oriented or import substituting EFIs, if more than 25 per cent of their goods are children's consumables, the firm is exempt from profits tax for a period of five years, and thereafter, taxed at half the normal rate. If the firm exports more than 30 per cent of its output, taxes are reduced to 50 per cent of the applicable rate. Inputs and capital equipment for export manufacture by EFIs are exempt from customs duties and VAT.

(c) Other incentives

Expenditure on "qualifying investments" may reduce taxable profits by the amount of the expenditure (in excess of annual depreciation). The term "qualifying investments" is defined broadly and includes any investment to develop the firm's own production base. However, aggregate tax relief for qualifying investment expenditure, together with expenditure on environmental protection, charitable donations and other minor deductions, may not reduce taxable profits by more than 50 per cent in a tax year.

Income derived from the use of intellectual property rights, either owned or received under license, is exempt from taxation for periods varying from one to five years depending on the type of intellectual property right. License fees received by the owner of intellectual property rights are also exempt for the same period of time.

If 75 per cent or more of the employees are from professional technical schools, the firm is tax exempt. Prorated tax incentives are also available for those employing invalids and war veterans.

(d) Statutory tax rate

The statutory tax rate is 33 per cent for firms that are not eligible for tax reduction of one type or another. For all new firms, except stock or commodity exchanges and trading firms, the tax rate in the first year is 25 per cent of the basic rate and in the second year it is 50 per cent of the basic rate. Other applicable taxes or levies are: (a) 1 per cent ecology tax on turnover; (b) social infrastructure tax of 6 per cent of after-tax profits; and (c) maintenance fee of 2 per cent of after-tax profits. Withholding tax on dividends and interest is 15 per cent and royalties, licensing, and management fees are taxed at the rate of 20 per cent.

D. Latin America

A Brief Summary

Regional development is encouraged in most countries through offering income tax exemption or reduced rates of taxes, investment allowance and customs duty exemptions for equipment and goods destined for production in designated remote areas. Depending on the location of countries, certain sectors, such as tourism, forestry, agriculture and farming, are promoted by giving similar tax incentives. A few countries offer tax stabilization agreements to companies which invest a high specified amount, or more. These agreements guarantee current taxes against future increases for a long period, usually 20 years. Mineral exploration and extracting is promoted by providing opportunity for quick redemption of investment costs. Free trade zones and special economic zones, which promote exports by offering exemption of taxes, duty and VAT, are common.

Table 13: Synopsis of types of incentives: Latin America

Country	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	Duty/VAT exemption/reduction	R & D allowance	Deduction for qualified expenses
Belize	?	?	?	?		
Brazil	?	?	?	?		?
Chile	?	?	?	?		
Colombia	?	?	?	?		
Costa Rica	?		?	?		
Ecuador	?	?	?	?		?
Guatemala	?		?	?		
Guyana	?		?			?
Panama	?		?	?	?	?
Peru	?	?	?	?		
Uruguay	?		?	?		
Venezuela	?		?	?		

Table 14: Tax treaties signed per country/territory: Latin America

	Belize	Brazil	Chile	Colombia	Ecuador	Guyana	Panama	Peru	Uruguay	Venezuela
TOTAL WORLD	5	28	4	2	8	3	5	3	5	21
Developed Countries	5	19	2	2	5	3	2	3	2	16
Western Europe	5	15			5	1	1	1	2	13
European Union	3	14			4	1	1	1	1	11
Austria		1								
Denmark	1	1								1
Finland		2								
France		1			1					1
Germany		1			1				1	2
Italy		1			1					1
Netherlands		1					1			1
Portugal		1								1
Spain		1			1					
Sweden	1	1						1		1
United Kingdom	1	1				1				2
Belgium		1								1
Luxembourg		1								

	Belize	Brazil	Chile	Colombia	Ecuador	Guyana	Panama	Peru	Uruguay	Venezuela
Other Western Europe	2	1			1				1	2
Norway	1	1								1
Switzerland	1				1				1	1
North America		3	2	2		2	1	2		3
Canada		1	1			1				
United States		2	1	2		1	1	2		3
Other Developed Countries		1								
Japan		1								
Developing Countries		6	2		2		3		1	4
Latin America and the Caribbean		2	2		2		3		1	3
LATIN AMERICA		2	2		2		1		1	1
Argentina		1	1							
Brazil					1					
Ecuador		1								
Mexico			1		1					1
Panama									1	
Uruguay							1			
Venezuela										
THE CARIBBEAN							2			2
Aruba							1			
Bahamas										
Barbados										1
Netherlands Antilles							1			
Asia and the Pacific		4								1
South, East and South-East Asia		4								1
China		1								
India		1								
Indonesia										1
Philippines		1								
Korea, Republic of		1								
Central and Eastern Europe		3			1				2	1
Albania										
Belarus										
Bulgaria										
Croatia										
Czech Republic		1								1
Estonia										
Hungary		1							1	
Poland									1	
Romania					1					
Slovakia		1								

1. Belize

(a) Regional Incentives

The Commercial Free Zone Act of 1994 established a commercial free zone (CFZ) at the Belize and Mexico border to attract foreign investment. The CFZ provides facilities for various activities, including manufacturing, processing, packaging, warehousing and distribution of goods and services. Several incentives are offered:

- ?? Exemption from import duties for all merchandise articles or other goods that enter the CFZ for commercial purposes;
- ?? Exemption from all duties and taxes for all fuel and goods, including building materials, furniture, equipment, supplies, and parts required for the proper functioning of a CFZ business;
- ?? Exemption from import or export quotas;
- ?? Exemption from consumption, excise and other taxes;
- ?? Exemption from income tax and any new corporate tax levied by the Government during the first five years of operation of a CFZ business. Reduced rates are levied thereafter;
- ?? Tax credits based on the number of Belizean workers employed on a continuing basis; and
- ?? Carry forward of net losses incurred during the first five years of operation for three years following the tax holiday.

(b) Sectoral incentives

The Mines and Minerals Act of 1988 covers all mining operations in Belize. The fiscal incentives package for mining allows investors quick recuperation of their investment. The package covers the corporate tax, a 3 per cent (Ex quarry/Ex mine) *ad valorem* on all industrial and constructive minerals and 5 per cent *ad valorem* on all precious and semi-precious metals. It also provides for losses to be carried forward for seven years, after which only that amount which reduces the profits in that year to one-half of its value is allowed. The Act also provides for exemption from payment of customs duty for mining equipment and supplies. The company operating under this Act is subject to a 15 per cent withholding tax, which, if reinvested, can be waived. Finally no tax holidays are granted as mining involves the exploitation of non-renewable assets.

(c) Export incentives and free trade zones

The Export Processing Zone (EPZ) programme is intended to attract local and foreign investment and to boost exports of non-traditional manufactured goods. The programme is also designed to facilitate technology transfer and high quality production, improve managerial and technical skills and generate employment opportunities. Incentives under the Export Processing Zone Act of 1990 and the Export Processing Zone Regulations of 1992 include:

- ?? Complete exemption from customs duties. Import duty exemption extends to capital equipment, spare parts and service vehicles used inside the EPZ;
- ?? Exemption from property and land taxes; excise sales and consumption taxes; and trade, turnover, foreign exchange and transfer taxes;
- ?? A guaranteed income tax holiday of 20 years, with a possible extension, and the option to deduct losses from profits following the tax holiday; and
- ?? No foreign exchange restrictions and import or export licensing requirements.

(d) Other incentives

Under the Fiscal Incentives Act of 1990, enterprises approved by the Government may be granted tax holidays or duty exemptions. The tax holiday is normally for five years from the date of commencement of production. However, the Minister of Economic Development may, upon later review, extend the tax holiday for a term not exceeding 10 years. In addition, companies that are engaged in such activities as agriculture, agro-industrial production or marine culture, and whose operations are strictly export-oriented and highly labour intensive, may receive a tax holiday for up to 25 years.

(e) Tax incentives legislation highlights

- ?? The Commercial Free Zone Act of 1994;
- ?? The Mines & Minerals Act of 1998;
- ?? The Export Processing Zone Act of 1991 and Export Processing Zone Regulations of 1992;
- ?? The Fiscal Incentives Act of 1990.

(f) Statutory tax rate

The national rate of corporate tax is 35 per cent. Interest, management fees and rental of equipment, plant and machinery paid to a non-resident are subject to a withholding tax of 25 per cent. Royalties, interest and dividends paid are not subject to any withholding tax.

2. Brazil

(a) Regional incentives

Regional incentives seek to encourage the economic and social development of certain areas of the country. Two autonomous federal agencies administer the regional incentives traditionally offered: the Superintendence for the Development of the Northeast (*Superintendência do Desenvolvimento do Nordeste* — SUDENE) and the Superintendence for the Development of the Amazon Region (*Superintendência do Desenvolvimento da Amazônia* — SUDAM). The north-eastern region, covering about 19 per cent of Brazil's territory, includes the states of Alagoas, Bahia, Ceará, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, and Sergipe, and parts of the states of Maranhão and Minas Gerais. The Amazon region, which occupies almost 60 per cent of the country, includes the northern states of Acre, Amapá, Amazonas, Pará, Rondônia, Roraima, and Tocantins; the northern portion of the state of Mato Grosso; and the western part of Maranhão.

Enterprises operating in the northeastern region for which the SUDENE is responsible are eligible for the following incentives:

- ?? A 37.5 per cent reduction in the income tax for enterprises established in the region, up to December 2003. This percentage is scheduled to be reduced to 25 per cent from January 2004 to December 2008, and to 12.5 per cent from January 2009 to December 2013;
- ?? For projects approved after January 1998, a 75 per cent reduction of the income taxes effective up to December 31, 2003. This percentage is scheduled to be reduced to 50 per cent from January 2004 to December 2008, and to 25 per cent from January 2009 to December 2013;
- ?? Partial exemption from state and municipal taxes; and
- ?? Exemption from duties on imported equipment.

Eligibility for these benefits depends on SUDENE's prior approval of a new project or the expansion of an already existing project. Any income derived from the project cannot be remitted abroad.

Approved enterprises operating in the Amazon region, for which the SUDAM is responsible, are offered similar incentives.

Numerous tax incentives and financing programmes are also available at the state level. Governors in all regions of the country, but most notably in the states of Paraná and Rio Grande do Sul (southern states), Bahia, Ceará, and Minas Gerais, are competing fiercely to attract business investment and generate employment in their states.

(b) Sectoral incentives

A number of tax incentives are based on Brazil's agro-industrial technology development programmes, which seek to increase industrial technology development. The incentives apply to projects previously approved by the Ministry of Science and Technology (*Ministerio da Ciencia e Tecnologi*s — MCT), and some of them are scheduled to be progressively reduced up to the tax year 2013. In general, they grant or allow:

- ?? Accelerated amortization of some intangibles;
- ?? Accelerated depreciation on domestically produced equipment;
- ?? Double deduction of technology development expenses, limited to 8 per cent of the basic income tax liability;
- ?? Reduction of up to 50 per cent of withholding taxes due on remittances of royalties and technical services fees; and
- ?? Increase in the deduction of royalty and transfer of technology expenses to 10 per cent of related gross sales.

(c) Export incentives and free trade zones

Manaus Free Trade Zone

A free trade zone has been established in and around the port of Manaus on the Amazon River, about 1,000 km (625 miles) from the Atlantic Ocean. The zone has become the principal assembly point for radios, television sets, videocassette recorders, motorcycles, and other goods that depend on imported parts. The constitution guarantees the existence of the Manaus free trade zone until 2013. The following incentives, intended to encourage occupation and development of the region, are offered to all companies located within the boundaries of the FTZ:

- ?? Suspension or reduction of import duties until the product leaves the zone or is used in the company's manufacturing process;
- ?? Federal excise tax waiver on imported products that remain in the FTZ and on products manufactured in the zone; and
- ?? Deemed state VAT credit on the purchase of products from other states in Brazil and refund of a percentage of the state VAT paid.

These exemptions, however, do not apply to imports of automobiles, weapons, jewellery, perfume, alcoholic beverages, and tobacco products. There is no time limit on storing goods duty-free in the FTZ. Companies incorporated in Brazil but owned by foreigners may be set up in the zone, but branches of foreign companies may not. The procedure for setting up in the FTZ is similar to the procedure for establishing projects under the SUDAM and the SUDENE. The responsible agency is the Superintendence of the Manaus Free Trade Zone (*Superintendência da Zona Franca de Manaus - SUFRAMA*).

Export Processing Zones

In 1988, the Government authorized the creation of export processing zones (EPZs) (or *zonas de processamento de exportação*). These EPZs are free export trade zones that may be created by states and municipalities in the areas covered by SUDENE and SUDAM to reduce regional differences and further Brazil's development. Companies established in these zones must be manufacturers of goods for export and they are committed to predefined minimum levels of local expenditure. By November 1996, 18 EPZ authorizations had been granted.

Imports and exports of companies operating in the EPZs are exempt from import duties, IPI, the social contribution on turnover, and the financial transactions tax; and warehouse space is available at concessionary rates. However, EPZ companies are subject to income tax, and depreciation of imported equipment cannot be claimed as a deductible expense.

There are no restrictions placed on either Brazilians or foreigners for acquiring control of an existing company located in an EPZ and thus obtaining benefits they provide. The initial duration of operations is 12 months, subject to renewal.

(d) Other incentives

Imports of equipment related to approved projects involving the introduction of new technologies are granted a reduction in import taxes.

(e) Tax incentives legislation highlights

The core of Brazilian Federal Tax Legislation, including the various incentives offered at federal level, is Decree 3.000 of 26 March 1999.

(f) Statutory Tax Rate

In addition to the statutory corporate income tax rate of 15 per cent, Brazil imposes a 12 per cent social contribution tax. For financial institutions, the social contribution tax rate is 18 per cent.

An additional surtax is imposed on legal entities and financial institutions. The rate is 10 per cent on income in excess of 240,000 real. The effective rate therefore varies with the chargeable profits. For legal entities, the maximum effective rate for 1997 was 33 per cent. For financial institutions, it was 43 per cent because of the greater burden related to the social contribution tax.

Dividends paid are not subject to withholding tax. Withholding tax on interest and royalties is 15 per cent although interest paid to the Government or its agency is exempt from tax.

3. Chile

(a) Regional incentives

Employees who earn income from activities performed in the First Region, located in the far north of Chile, or in the Eleventh Region, Twelfth Region, or Chiloé Province, which are located in the far south, may deduct a special allowance from that income for personal income tax purposes. Businesses operating in Tierra del Fuego or the Antarctic territories are also granted special tax incentives. Qualified taxpayers in Aysen, Magallanes and the province of Palena may claim tax credits for investing in fixed assets such as machinery and equipment and certain new or imported ships and aircraft. These credits are allowable until 31 December 2008, and unused credits may be carried over until 2030.

(b) Sectoral incentives

Companies that enter into a petroleum-operating contract with the Chilean Government pay either the normal corporate taxes or a 50 per cent substitute tax on the fees received. Reductions of up to 100 per cent of the normal corporate taxes or the substitute tax may be granted, however, depending on the degree of risk involved for the contractor. Taxes, duties, and levies on imports of machinery needed for the operations may be similarly reduced. Foreign non-resident subcontractors are liable for a flat 20 per cent tax on their gross fees, which can be reduced by up to 75 per cent.

Companies that enter into a contract with the Chilean Commission of Nuclear Energy (*Comisión Chilena de Energía Nuclear*) to explore, exploit or process radioactive substances may be granted tax treatment similar to that applicable to petroleum contractors.

(c) Export incentives and free trade zones

Export Incentives

The principal incentives for exports are as follows:

- ?? Exporters may carry out manufacturing process in private bonded warehouses without paying import duties on foreign raw materials or parts used in the process, provided that the finished products are exported within a specified period;
- ?? Exports are zero-rated for value-added tax purposes;
- ?? A drawback (refund) of charges affecting the cost of inputs is granted, equal to 10, 5 or 3 per cent of the value of non-traditional exports if the aggregate free-on-board value of such exports in any calendar year does not exceed US\$ 10,998,000, US\$ 16,497,000, or US\$ 19,796,400 respectively;
- ?? Exporters may obtain a reimbursement of customs duties paid on imports of raw materials, semi-manufactured products and parts incorporated into exports. If the drawback described above is also available, the exporter must choose between drawback and reimbursement. Reimbursement of duties is also available on products that are re-exported after only minor processes such as assembling, packaging, finishing, ironing and labelling; and
- ?? Exporters who import capital goods may defer payment of customs duties over 3-7 years. Also, the Treasury grants exporters purchasing new capital goods produced in Chile a loan equal to 73 per cent of customs duties in force. This loan must be repaid over 3-7 years. Both the deferred customs duties and the loan bear interest. Lastly, if sufficient

exports are made, both liabilities may be written off, provided exporters make use of this benefit before 1 January 2003; and provided the benefit applies only to instalments due up to 31 December 2005.

Free Trade Zones

Free trade zones have been established at the ports of Arica, Iquique, and Punta Arenas. The Arica zone is available only to the electronics, metal-mechanical (*metal-mecánica*) and chemical industries. Goods and raw materials imported into a FTZ can be assembled, finished, connected, manufactured, or transformed and then re-exported or sold to customers in another part of the country.

All operations within the FTZs are exempt from corporate income tax and value-added tax. Imports of foreign goods into the zones are exempt from import duties. Sales and transfers of merchandise from a FTZ to another area of the country normally generate import duty and value added tax liabilities. However, sales to some adjacent areas are subject only to a single 5.2 per cent tax, which increases or decreases in the same proportion that the average customs duty rate increases or decreases.

(d) Other Incentives

Investors who make their investment under Decree Law No. 600 of 1974 can ask for a guaranteed aggregate tax rate of 42 per cent to apply to profits from the investment for 10 years. If the investment amounts to US\$ 50 million or more, this guarantee can be extended to 20 years, and the continued application of various tax rules in their current form can be guaranteed for the same period. For example, the present right to carry forward losses indefinitely can be secured for at least 20 years even if the right of other taxpayers to carry forward losses is curtailed sooner by a change in the law.

A tax credit is available for the cost of training employees, subject to certain limitations.

(e) Tax incentives legislation highlights

Foreign Investment Code (DL 600)
Law No. 19606

(f) Statutory tax rate

The national corporate tax rate is 15 per cent.

Normally, dividends paid to non-residents are subject to a final withholding tax of 35 per cent. However, a credit is given for corporate income tax paid on the profits from which the dividends derive. The tax actually withheld is calculated by applying a rate of 35 per cent to the grossed-up dividend (the dividend plus a credit equal to 17.65 per cent of the dividend) and deducting the credit from the result. This calculation produces an effective withholding rate of 20 per cent on the grossed-up dividend, or 23.52 per cent on the dividend before grossing up.

Withholding tax on interest is 35 per cent. Registered loans from foreign or international banks or duly registered financial institutions, instalment payments of imports, time deposits with Chilean banks and duly authorized issues of bonds and debentures in foreign currency

are subject to a 4 per cent withholding tax. The withholding tax is only 4 per cent on interest payments made to foreign banks and financial institutions and on import instalments. Foreign loans, in general, are subject to a stamp tax of 0.1 per cent per month, or fraction thereof, between disbursement and maturity, with a maximum of 1.2 per cent.

Withholding tax of 30 per cent is charged on royalties. Theoretically, this rate may be increased to 80 per cent where the rights used are of little benefit to the Chilean economy. The withholding tax rate is 20 per cent for film royalties and for payments of technical assistance fees and engineering services, as well as for cinema and television royalties, and 15 per cent in respect of copyright payments.

4. Colombia

(a) *Regional incentives*

To help develop the area of Rio Paez, located in Colombia's southern region, the Government has created a tax haven that grants new companies incorporated in the region a 10-year holiday from income tax, remittance tax and customs duties. This exemption is also extended to shareholders.

In order to promote economic activity in the areas affected by the earthquake in January, 1999, companies in the Quindio department districts are being offered a tax exemption of 70 per cent over profits obtained from their economic activities. Other affected districts outside the Quindio department are offered an exemption of up to 30 per cent.

Additionally, companies generating new direct jobs in the affected area are entitled to a tax credit for the salaries and social benefits paid during 1999 and 2000. This tax credit however cannot exceed 50 per cent of the income tax due in the corresponding year.

(b) *Sectoral incentives*

Tax incentives are also provided for the mining industry, forestry and agriculture.

Investments in mining and petroleum exploitation can deduct the expenses incurred for beginning the exploitation. This includes investments in areas where exploitation is already taking place as well as areas where there is no production or which are unproductive.

Colombian Tax Law grants special treatments for investments related to agriculture and forestry. New forestry plantations are entitled to a 20 per cent tax credit calculated on the basis of the investment made, as certified by the proper authorities. Alternatively, they can obtain a tax-free forest incentive certificate valued at 50 per cent to 75 per cent of the costs, depending on the number of trees planted. New agricultural activities, along with related constructions, such as deep holes, irrigation systems and silos, are permitted special deductions not exceeding 10 per cent of the taxpayer's net income. Expenses beyond farms, construction and general repairs and conditioning are considered to be deductible expenses.

Companies that increase the number of jobs by more than 5 per cent over the previous year in order to maintain economic activity may take a tax credit equivalent to the value of salaries and social benefits paid during the year.

(c) *Export incentives and free trade zones*

Colombia has established FTZs for processing and reassembly of imported goods for re-export. These zones are considered as being outside the country's customs territory, even though they are within it geographically. This legal distinction permits goods imported into a zone to receive special treatment under customs, foreign exchange, foreign investment and trade, and tax regulations. For example, no customs duties or value added tax applies until the merchandise is transferred from the zone to Colombian territory for consumption. When FTZ users export products or services produced in the FTZ, they may be exempt from income and remittance taxes.

Free trade zones may deal with goods and services, or they may serve as industrial zones for technological services or for tourist services. They are located in Barranquilla, Bogotá, Buenaventura, Cartagena, Cúcuta, Palmaseca, Rionegro, Santa Marta and Urabá. The production and commercial use of goods for export, as well as services linked to international commerce, are allowed in these zones.

(d) Other incentives

The remittance tax applicable to turnkey projects performed by a branch of a foreign company is just 1 per cent of the total value of the project.

(e) Tax incentives legislation highlights

Law No. 218, 1995 (Ley Paez)

(f) Statutory tax rate

The basic corporate tax rate is 35 per cent.

The rate of withholding tax on dividends paid out of after-tax profits is 7 per cent for 1996 and subsequent years. The effective rate of withholding tax on interest and royalties is 39.55 per cent, made up of 35 per cent withholding tax and 7 per cent remittance tax.

5. Costa Rica

(a) Sectoral Incentives

Incentives granted to approved forest development projects include exemptions from property tax, tax on corporate assets during the pre-operating period, and income tax on net income arising from the products of plantations. Also, some tax incentives are granted for the sustainable management of existing forests. The Government protects companies against seizure of any land subject to forest development.

The following incentives are offered with a view to promoting tourism in Costa Rica:

- ?? *Hotel services.* Exemption from customs duties and any tax on supplies (excluding vehicles and fuel) required for the construction and operation of hotels, depreciation at accelerated rates, grant of business licenses, and exemption from property tax.
- ?? *National and international air transport of tourists.* Depreciation at accelerated rates, provision of fuel at competitive prices, and exemption from customs duties and any tax on supplies required for the operation of aeroplanes. For aquatic transport of tourists, exemption from customs duties and any tax on supplies required for the construction or enlargement of docking facilities, marinas, bathing resorts, and aquariums; depreciation at accelerated rates; and exemption from any tax (except for customs duties) on boat purchases.
- ?? *Travel agencies.* Exemption from any tax (except for customs duties) on imported vehicles with a minimum capacity of fifteen passengers.
- ?? *Car rental.* Vehicles imported for rental to tourists qualify for a 50 per cent customs duty and tax exemption.

(b) Export incentives and free trade zones

Enterprises established in the free zones are entitled to a 100 per cent exemption from income tax for the first eight years of operations and a 50 per cent exemption for the subsequent four years. In some areas, this exemption is 100 per cent during the first 12 years and 50 per cent for the next six years. Other benefits include the free use of the foreign currency generated abroad and exemption from import duties on imports of raw materials, machinery and equipment, as well as exemption from export duties, tax on corporate assets and net worth tax. These companies also enjoy exemption from value added tax and selective consumption tax on acquisitions of services and final goods. Finally, there is an exemption from any withholding tax on payments to non-residents.

The minimum fixed assets investment is US\$ 150,000, or its equivalent in local currency, for such companies to be established in an industrial park (the geographic area in which companies under the free trade regime operate, and strictly controlled by the customs authorities). Companies established outside an industrial park must invest US\$ 2,000,000 on fixed assets, among other requirements.

Service companies may now benefit from the incentives available in free zones. This enables companies to move headquarters of their Latin American operations to Costa Rica.

(c) *Other incentives*

Under a drawback system (*regimen de perfeccionamiento activo*) industries that import raw materials temporarily for processing and subsequent export as finished products are exempt from import duties on those raw materials, as well as on imports of machinery required for processing. They are also exempt from export duties, and there is no income tax exemption.

(d) *Tax incentives legislation highlights*

- ?? Free Zones Regime Law No 7210 (*ley de Regimen de Zonas Francas No 7210*), Chapter VII, Articles 20 and 21.
- ?? General Customs Law No 7557 (*ley General de Aduanas No 7557*), chapter VI, section 1, article 179.
- ?? Forest Law No 7575 (*ley Forestal No 7575*), Chapter II, Articles 22 and 23, and Chapter III, Articles 29 and 30.
- ?? Tourism Development Incentives Law No 6990 (*ley de Incentivos al Desarrollo Turistico No 6990*).

(e) *Statutory tax rate*

The national corporate tax rate of 30 per cent applies to companies with a gross income exceeding 20,475,000 Costa Rican colones. It is 10 per cent for companies with a gross income of less than 10,179,000 colones, and 20 per cent for companies with a gross income of between 10,179,000 and 20,475,000 colones.

The withholding tax rate on dividends and interest is 15 per cent, but can be reduced under treaty provisions. A 25 per cent withholding tax rate applies to royalties paid to non-resident taxpayers.

6. Ecuador

(a) Regional incentives

New agricultural companies that are established outside Quito and Guayaquil to process agricultural products pay 50 per cent of the normal income tax due. In addition, individuals engaged in agricultural, livestock, and forestry activities, either as owners or as tenants of the land, are taxed at the rate of 5 per cent of the estimated value of their land. Taxable income so determined is generally lower than it would be if it were calculated in accordance with the generally applicable rules.

(b) Sectoral incentives

Legal entities may deduct amounts that they invest in the creation or expansion of mining companies. The deduction does not, however, reduce the 15 per cent employee profit-sharing required by the Labour Code. Imports of machinery, laboratory equipment, work vehicles, and other supplies necessary for mining activities are subject to import duties at lower-than-normal rates and are exempt from value added tax. The sale of mineral substances is also exempt from value added tax.

Investors may deduct from their taxable income capital contributions made for forming or increasing the common stock of tourism companies. Tourism companies are generally eligible for an exemption from registration and stamp duties and transfer tax. In addition, certain projects may qualify for an income tax holiday of 5-10 years and other tax incentives.

Investors can deduct 100 per cent of fixed asset values that constitute new investments for increasing non-traditional exports or for forestry or reforestry activities. However, such reduction cannot exceed 50 per cent of the previous year's taxable income. Investments in environmental conservation projects are accorded similar treatment.

Certain goods, such as agricultural products, livestock, and fish, are not subject to value added tax as long as they are transferred in their natural state or serve as materials used for agricultural production or for the raising or feeding of livestock and fish. Also exempt from such tax are machinery, equipment, tools or spare parts used in agriculture or animal husbandry.

(c) Export incentives and free trade zones

The principal incentives for exports are:

- ?? Application of preferential customs tariffs on exports or total relief for exports to specific developed countries under the Generalized System of Preferences (GSP);
- ?? Partial or total exemption from customs duties and duty drawback for imports of raw materials used in the production or treatment of export products;
- ?? Reimbursement of value added tax paid for the purchase of raw materials and supplies used to manufacture export products, including agricultural and similar goods. Tax reimbursement is also available for products and goods sold internally but destined for export; and
- ?? Investment allowance for the purchase of fixed assets used for the export of non-traditional products.

Enterprises that establish processing or trading operations in the FTZs (in Esmeraldas, Montecristi, and Riobamba) or administer the zones on behalf of the National Council of Free Trade Zone Investments are exempt from income tax, value added tax, and municipal taxes for 20 years, with a possibility of extending the exemption. Imports into, and exports from, the FTZs are exempt from customs duties and taxes.

(d) *Other incentives*

Investments of more than US\$ 500,000 are eligible for a special regime, under which a stable income rate will be guaranteed for 20 years in the case of investments in new projects and 10 years in the case of investments in existing projects. Furthermore, free repatriation of business profits in a convertible currency and of proceeds from the liquidation of the investment is also guaranteed, provided that tax obligations have been met.

Goods entering the country for assembly in Ecuador are protected by a system of suspended duties and taxes, known as the *maquila system*. Enterprises authorized to undertake in-bond assembly operations may import raw materials and components on a temporary basis free of customs duties and taxes. However, these duties and taxes become payable at the time the imported items are re-exported in the form of finished products.

Important changes as from 1 January 1999:

Income tax in Ecuador has been suspended. Therefore any incentive related to income tax is also suspended. Replacing the income tax system is a new monetary circulation tax (*impuesto a la circulacion de capitales*), which imposes a 1 per cent charge on all monetary operations and transactions — whether in Ecuadorian currency, constant value units, or foreign currency — undertaken through institutions that form part of the national financial system (including offshore.).

(e) *Tax incentives legislation highlights*

- ?? *Ley de Regimen Tributario Interno*, 22 December 1989 (RO No 341);
- ?? *Ley Especial de Desarrollo Turistico*, 28 January 1997 (RO No 118);
- ?? *Ley de Regimen de Maquila*, 3 August 1991 (RO 493);
- ?? *Ley de Zonas Francas*, 19 February, 1991 (RO No 625);
- ?? *Ley de Minería*, 31 May, 1991 (RO No 695 S);
- ?? *Ley de Desarrollo Agrario*, 14 June 1994 (RO No 461);
- ?? *Ley Organica de Organica Aduanas*, 13 July 1998 (RO No 359);
- ?? *Ley de Promocion y Garantia de las Inversiones*, 19 December 1997 (RO No 219)

(f) *Statutory tax rate*

The basic corporate tax rate is 25 per cent, but a full credit for corporate income tax is available, effectively cancelling the potential withholding tax liability. The effective rate of tax on dividends is zero.

Interest paid to non-residents is generally subject to the non-resident income tax (NIT) of 33 per cent. Interest paid on loans issued by the federal Government and public sector institutions is exempt from withholding tax.

The rate of withholding tax on royalties is 33 per cent. Tax is withheld on 80 per cent of the fees paid to non-residents making the effective rate of tax 26.4 per cent (i.e. 80 per cent of 33 per cent).

7. Guatemala

(a) Sectoral incentives

Various incentives are offered to promote forestry, mining and tourism. Often, these incentives take the form of import duty exemptions, granted for an indefinite or limited period, on imports of raw materials and equipment necessary to carry out the project concerned. Investors in reforestation projects may be eligible for income tax credits over a period of 10 years under an old law. However, a new law eliminates this benefit for new projects. Owners of mining exploitation rights pay only a percentage of the royalties due to the Government. Profits from the construction of new buildings used in the tourism industry qualify for a 100 per cent income tax exemption in the first five years, followed by a 50 per cent exemption for the next five years.

(b) Export incentives and free trade zones

Various tax incentives have been created to encourage exports to countries outside the Central American Common Market (CACM). However, exports of coffee, fresh bananas, livestock, meat, sugar, unprocessed cotton, unrefined mineral oil and wood do not qualify. The incentives include a 10-year exemption from income tax on profits from qualifying exports and the temporary suspension of import duties on imports of raw materials, intermediate products, and equipment used in the production of the exports.

(c) Other incentives

Companies may deduct from taxable income up to 15 per cent of their total profits for the year in which they are reinvested in the acquisition of plant, machinery and equipment used directly in the production process and the generation of taxable income. This deduction is given in addition to depreciation. Reinvestment must normally take place within five months following the end of the year in which the deduction is claimed. The assets covered by this incentive should have an estimated useful life of more than four years; the deduction is withdrawn entirely or in part if the plant, machinery or equipment is disposed of within four years of acquisition. In addition, companies may deduct from taxable income up to 5 per cent of their total profits for the year if they are reinvested in an employee training programme.

(d) Tax incentives legislation highlights

- ?? Impuesto Sobre la Renta, Decreto 26-92.
- ?? Ley Forstal, Decreto 96-101.
- ?? Ley de Fomento y Desarrollo de la Actividad Corportadora y de Maquila, Decreto 29-89.
- ?? Ley de Zonas Frances, Decreto 65-81.
- ?? Ley de fomato Turistico nacional, Decreto 25-74.

(e) Statutory tax rate

The national rate of corporate tax is 30 per cent. There is a withholding tax of 12.50 per cent on dividend payments. A stamp tax of 3 per cent is also levied on documents supporting the payment of dividends. Withholding tax on interest is 20 per cent. Interest paid on foreign

loans granted by financial institutions is exempt from tax, provided the foreign currency is sold to a local bank. Interest paid on foreign loans to the state, municipalities and agencies thereof, is also exempt. Withholding tax on royalties is 30 per cent, but the withholding tax rate on film/tape royalties is 25 per cent. The tax base for its computation is 60 per cent of the gross payment, resulting in an effective rate of 15 per cent.

8. Guyana

(a) Regional incentives

Tax incentives are available in the Linden region.

(b) Sectoral incentives

Approved mortgage finance companies and building societies are exempt from corporate taxes. Petroleum and mining companies also qualify for tax exemptions in some circumstances. Companies involved in the development of real estate may deduct development costs over a 10-year period.

Guyana reintroduced tax holidays for high-risk industries in 1998. These are determined by the Government in certain regions.

(c) Export incentives and free trade zones

Subject to certain conditions, companies registered in Guyana may claim tax allowances for exports of manufactured, processed or agricultural products. As from 1997, the maximum allowance that can be claimed is 75 per cent of export profits when export sales exceed 61 per cent of total sales.

(d) Tax incentives legislation highlights

Income Tax Act, Sec. 33B.

(e) Statutory tax rate

The national rate of corporate tax is 45 per cent. Non-commercial companies are subject to a rate of 35 per cent. Withholding tax on dividends and interest is 15 per cent. Interest paid on approved loans, trade accounts and temporary bank loans is exempt from tax. Royalties are subject to withholding tax at 10 per cent.

9. Panama

(a) Sectoral incentives

Tourist activities

Tax incentives for investments in tourist activities apply to investments in the construction and rehabilitation of hotels, convention centres and tourist attraction facilities; in the transportation of passengers; and in the production in Panama of motion pictures and television series to be exhibited internationally. Principal incentives include:

- ?? Exemption from import duties and value added tax on equipment and materials used in construction or rehabilitation activities;
- ?? Exemption from real estate tax on new structures;
- ?? Accelerated depreciation for major construction projects; and
- ?? A special system for loss carry-forward.

Investments in areas designated as special tourist zones will be exempt from real estate tax, import duties on materials and equipment, value added tax and income tax till end-2015. Tax incentives for areas not designated special tourist zones are available till end-2005.

Incentive laws allow for the concession of islands and other government land for up to 20 years. The period can be increased to 40 years, depending on the project's potential labour and economic impact. To qualify for the incentives, investors must invest the required amount, which depends on the type of activity, and initiate construction or rehabilitation activities within six months of applying for them. Tourist activities must also begin within a specified time frame.

International maritime commerce

The income from international maritime commerce of merchant ships registered under Panamanian law is not subject to income tax in Panama even if the transportation contracts are executed there. The owner of a ship registered in a foreign country is not liable for tax on income from Panamanian sources, provided that the country in which the ship is registered grants reciprocal treatment for income earned in that country by ships of the Panamanian merchant marine. The exemption in Panama extends to a foreign individual or company deriving income from Panamanian sources through the operation of a foreign-registered ship, provided that the country of nationality of the individual or the country of incorporation grants reciprocal treatment for income earned by an individual of Panamanian nationality or a company incorporated in Panama.

Offshore companies

Panama imposes taxes according to the territoriality principle (that is, it does not tax foreign-sourced income). Investors can take advantage of this by establishing what Panama treats as offshore companies, namely, companies incorporated in Panama that do business outside Panama. Such companies are generally exempt from tax on the following activities:

- ?? Billing the sale of merchandise from an office established in Panama, provided that the goods concerned do not physically enter Panamanian territory or, if they do, are in transit to another country and under the control of the customs authorities.
- ?? Conducting from an office established in Panama transactions perfected, finalized or taking effect abroad. For example, income derived from international offshore activities

by a Panamanian-incorporated bank holding an international banking license is not subject to income tax.

- ?? Distributing dividends or shares of profit when such dividends or shares originate from income not produced on Panamanian territory.

Mining incentives

Incentives offered to mining concessions include the following:

- ?? A loss-carry forward regime allowing losses to be carried forward to any of the three years immediately following the year in which the loss arises, in addition to other carry-forward regimes established under other tax regulations;
- ?? A deduction for the depletion of mines, quarries and other natural resources;
- ?? An exemption from import and customs duties during the life of the concession for any equipment, supplies and materials necessary for mining operations, except for vehicles not productive in the mining activity;
- ?? An exploration and extraction rate based on the year of production, and royalty payments of 2 per cent for minerals and 4 per cent for precious minerals, based on gross production;
- ?? A total exemption from export taxes, including value added tax;
- ?? A deduction of exploration expenses and R&D expenses in the year in which they were incurred, or deferral of such expenses; and
- ?? A 20 per cent discount from income tax on any commercial mining production initiated by a company not later than 8 February 1998.

(b) Export incentives and free trade zones

Free zones

Panama has established a shipping and processing centre on the Atlantic Ocean, known as the Colon Free Zone, which caters to companies whose principal business activity is the re-exportation of merchandise from the centre. Companies operating in the Colon Free Zone are exempt from tax on their earnings from exports and re-exports.

Companies operating in a free zone for oil-related activities are subject to favourable tax treatment similar to the regime for companies operating in the Colon Free Zone. Any natural person or juridical entity may import any types of products derived from petroleum, subject to import duties between 0.08 and 0.63 balboas per gallon (beginning in 1998). Oil products sold in Panama are subject to a protection tariff of 14 per cent (in 1998) of the cost, insurance, and freight value; the tariff is decreased by 1 per cent each subsequent year until it reaches 5 per cent.

Companies located in free zones are exempt from a number of taxes, including commercial license tax and import duties. Exemption from tax on dividends is given when the dividends are derived from income earned in the zone.

Export processing zones

Companies operating in processing zones created for the exportation of goods that have been manufactured, assembled or subjected to processing are fully exempt from direct and indirect taxes, including income tax, import duties, commercial license tax and value added

tax. Such exemptions are not available to a non-resident company whose country of incorporation allows it to recognize a deduction or credit on any tax paid in Panama.

(c) Other incentives

Until 2000, under Law 28 of 1995, a tax credit is available on any direct investment in the following:

- ?? Technological research and development, genetic improvement and acquisition of advanced technology;
- ?? Infrastructure for the provision of electricity and water required for productive operations;
- ?? Infrastructure and equipment for transportation and communication in productive operations that result in a direct reduction of operating expenses;
- ?? Training of a plant's personnel required in productive operations; and
- ?? Production of new articles or expansion of the production capacity.

The credit can be for up to 25 per cent of the tax payer's income tax liability for each year until the credit is fully recaptured, provided that the taxpayer is not availing of incentives under other laws.

In addition, indirect investments, represented by bonds, shares and other securities, of entities effecting the above activities, qualify for income tax credit. Taxpayers that invest through financial leases are also eligible for the credit.

A number of other incentives are offered to manufacturing operations conducted in Panama under Law 3 of 1986. These include accelerated depreciation, exemption from import taxes on machinery and equipment, exemption from income tax on profits derived from exports for companies registered with the Official Registry of the National Industry for unregistered companies through 2002, and exemption from reinvestment of earnings on the sale of real estate.

The City of Knowledge (Decree Law 6 of 1998) is the creation of a special segregated area within the Panama Canal Zone specially dedicated to the establishment of universities and technical institutions from all over the world. Any institution set up within this area is 100 per cent tax-free from any taxes for 25 years, and foreigners who come to the City as professors, students, spouses or children have special migration status.

The Legal Stability of Investments Law (Law 54 of 1998) provides that investments of more than US\$ 2 million in two years on 14 specified activities (and others that can be included with approval by the Cabinet or the President) have a guaranteed tax regime for national and municipal taxes. The investor is guaranteed the same national tax regime for 10 years and the same municipal tax regime for five years that existed at the time of investment.

(d) Tax incentives legislation highlights

- ?? Decree Law 170 of 27 October 1993, articles 55-57;
- ?? Law 3 of 28 January 1988;
- ?? Law 4 of 14 June 1994;
- ?? Fiscal Code, articles 694;
- ?? Law 25 of 30 November 1992.

(e) *Statutory tax rate*

Companies registered on the Official Registry of the National Industry and profits derived from a "Contract with the Nation" are subject to tax at a rate of 30 per cent on income up to US\$ 500,000 and 34 per cent on the amount over US\$ 500,000.

If dividends are not distributed, or the total dividends distributed are less than 40 per cent of the net income, dividend tax must be prepaid on 40 per cent of net income after tax. Dividend tax is 10 per cent, and in the case of branches, a 10 per cent dividend tax should be paid at year-end.

A 10 per cent withholding tax must be withheld from dividend distributions to resident and non-resident shareholders, except where dividends are paid from income derived from foreign sources.

The basic rate of withholding tax on interest is 6 per cent. Interest paid on bonds and securities registered with the National Commission of Securities is subject to a final withholding tax of 5 per cent. Interest paid on savings accounts, term deposits, and government securities is tax exempt.

The withholding tax rate on royalty payments is calculated on 100 per cent of the gross amount at the normal corporate tax rate.

10. Peru

(a) Regional incentives

Manufacturing enterprises operating in the Frontier Zone are exempt from income tax and VAT, as well as other taxes (except municipal taxes). However, these exemptions are due to expire after 2000.

Enterprises established in the "Jungle Zone", as defined by the VAT law, and engaged in the import and selling of goods and services for use or consumption within the zone were exempt from this tax until December 31, 1999.

The Amazon Region Promotion Law covers departments (political divisions of Peru) not only in the "Jungle Zone", but also some in the coastal and sierra areas. This law exempts from VAT, as of 1 January 1999 and for a 50-year period, all enterprises established therein which are engaged in the selling of goods and services for use or consumption in the zones so indicated. It also exempts enterprises with construction contracts or for the first sale of buildings they themselves constructed. Imported goods destined for consumption in the Amazonia will be exempt from VAT from 31 December 2000.

This Law also provides for: exemption from income tax or decrease in the rate applicable to companies; reinvestment of profits free from income tax; special VAT fiscal credit; exemption from VAT and selective consumption tax for natural gas, oil and petroleum derivatives; exemption from the Extraordinary Solidarity Tax and Extraordinary Net Asset Tax; and a reduction of the self-appraisal value of real property for municipal tax purposes.

(b) Sectoral incentives

Reinvested profits of mining companies are not taxable, provided that the companies have reinvestment programmes.

Non-distributed profits of mining companies, up to 80 per cent of the annual net taxable income, are not subject to income tax, provided they are applied to the execution of new investment programmes that ensure an increase in the production levels of the mining units involved.

Certain agricultural enterprises are entitled to a reduced income tax rate (15 per cent instead of 30 per cent). Accelerated depreciation rates are offered for hydraulic infrastructure and irrigation works. Third-party reinvestment of profits in the development and irrigation of uncultivated lands is free from income tax for up to 20 per cent of the taxable income and small agricultural producers are exempt from income tax and VAT.

Imports of goods during the oil and gas exploration stage are not subject to import duties. A temporary exemption from customs duties may apply during the oil and gas production stage.

Private educational institutions that reinvest, wholly or partially, their reinvestible income in themselves or in other similar institutions, in infrastructure and teaching equipment, are entitled to a reinvestment tax credit equivalent to 30 per cent of the reinvested amount.

(c) Export incentives and free trade zones

The export promotion centre, CETICOS (*Centros de Exportacion Transformacion, Industria, Comercializacion y Servicios*), established in the northern (Paíta) and southern (Matarani, Ilo an tacna) zones in the country, provide incentives for companies engaged in repair, merchandise reconditioning, mixing, packaging, “*maquila*”, transformation, active perfecting, product and merchandise distribution and storage. The following benefits are offered:

- ?? Companies constituted or established before 31 December 2004, which annually export 92 per cent of the goods they produce, are exempt from income tax, VAT, Municipal Promotion Tax, Additional Municipal Promotion Tax, Selective Consumption Tax, Extraordinary Solidarity Tax and any other government or municipal taxes until 31 December 2012;
- ?? The merchandise entering the CETICOS is exempt from customs duties, VAT and other taxes, and may be re-exported;
- ?? Merchandise from the CETICOS entering the rest of the country is subject to customs duties and other corresponding import taxes;
- ?? Domestic merchandise and the rendering of services from the rest of the country into CETICOS are considered exports and are, therefore, subject to customs duties and VAT reimbursement (drawback) norms and the other laws or regulations related to exports; and
- ?? By means of the drawback, producer-exporter companies obtain, upon exporting the merchandise, a total or partial reimbursement of the customs duties applied on the import of raw materials, intermediate products, parts and pieces incorporated into, or consumed in, the production of the merchandise exported, for an amount equivalent to 5 per cent of the FOB value of the products exported.

Enterprises that export products qualify for a drawback benefit of value added tax.

A special regime for paying customs duties in instalments (payment in 14 semi-annual instalments) applies to companies that have entered into contracts with the Peruvian Government for the exploration, development and/or production of natural resources which require an investment period of more than four years. However, companies that have entered into contracts with the Peruvian Government (including those that have tax stability contracts under the General Mining Law) for the development and production of natural resources requiring an investment period of between two and four years are excluded in the exploration stage. The regime may be applied to imports of new capital and intermediate goods as well as to used capital goods entering the country under the customs duties temporary exemption regime.

(d) Other incentives

Enhanced VAT recovery system

The law provides for a general and an enhanced early recovery system for enterprises engaged in productive activities. Under the general system, which is applicable to all productive companies in a pre-operating stage, the VAT paid upon acquisition of capital goods is reimbursed through negotiable credit notes.

The enhanced system is restricted to companies that have entered into contracts with the Peruvian Government for the exploration, development and/or production of natural resources which requires an investment period of more than four years. It does not apply to companies that have entered into contracts with the Peruvian Government (including those

having tax stability contracts under the General Mining Law) for the development and production of natural resources which require an investment period of between two and four years in the exploration period.

Under this regime, the VAT paid on the acquisition of new capital goods as well as on the acquisition of intermediate goods and services and construction contracts can be recovered on a monthly basis through negotiable credit notes. Reimbursement is made in foreign currency when the company is entitled to keep accounting records in such currency.

Tax stability agreements

Peruvian and foreign investors and enterprises may conclude agreements with the Government that guarantee that the income tax rules applicable will remain stable, the tax treatment of assets acquired through finance leasing will stay consistent, employment rules will not vary, dividends will remain freely available and favourable rules for exports will continue to remain in force. The Government also guarantees stability of the free exchange market. In the event that it establishes different exchange rates, the government will guarantee that the rate most beneficial to the investor will apply. These agreements remain in force for 10 years.

In the case of mining enterprises, the guarantee covers all taxes. In the case of oil and gas exploration and production activities, carried on under license or service contracts, the Government guarantees that the exchange regulations and tax laws in force when the agreement was signed will remain unchanged during the term of the contract.

According to the Financial Leasing Law, for tax purposes the goods constitute the lessors' fixed assets and are depreciated over the period during which the contract is enforceable (for a minimum period of three years). The instalments paid by the lessee are a deductible expense for the lessee and represent income for the lessor. The residual value of the goods for their transfer at the expiration of the contract is accepted, while the market value norms do not apply.

(e) Tax incentives legislation highlights

- ?? The General Mining Code;
- ?? Agricultural Promotion Law;
- ?? Promotion of Investment in Education law;
- ?? Decree No. 842 granting tax exemptions for operations in Ilo Mataranti, Paita and Tacna.

(f) Statutory tax rate

The basic rate of national corporate tax is 30 per cent. A minimum income tax system applies, under which companies must make a minimum annual payment of income tax equal to 1.5 per cent of their total assets, excluding investments in other enterprises that are subject to income tax. The excess of this net worth tax paid over the income tax assessed for the same year may be carried over for one year.

There is no withholding tax on dividends. Dividends paid to non-residents (corporations and individuals) are subject to a withholding tax of 30 per cent. Withholding tax on interest is charged at 30 per cent. Withholding tax on royalties is charged at 10 per cent. Technical services rendered partly in Peru and partly abroad by non-resident companies are subject to a withholding tax at an effective rate of 12 per cent (i.e. 40 per cent of the gross income

charged at 30 per cent). As of 1 January 1997, royalty payments made to non-residents are subject to withholding tax at the rate of 30 per cent.

11. Uruguay

(a) Sectoral incentives

Industrial incentives

Various incentives are granted under the Industrial Promotion Law of 1974 (Law 14, 178/74) to projects formally declared to be of national interest. Applications for these benefits must be filed with the Ministry of Industry and Energy. The project should be one that aims to generate greater efficiency in production and marketing, to increase or diversify exports of manufactured goods, or to increase the role of tourism by expanding present facilities. Completion of the application procedures takes at least six months. Incentives include:

- ?? Exemption from import duties, consular fees, and unloading charges for imports of raw materials, spare parts, and fixed assets required for the project;
- ?? Relief from tax on industry and commerce; and
- ?? Exemption from tax on net worth for a given number of years determined for each applicant.

Investment holding corporations

Investment holding corporations (*sociedades anónimas financieras de inversión*) are corporations with special legal status, whose main activity is investment abroad in securities and titles to movable and immovable property. They are exempt from tax on industry and commerce, Uruguay's corporate income tax. The only tax they are liable for is an annual tax of 0.3 per cent on their shareholders' equity adjusted for tax purposes. If the corporation's total liabilities exceed twice the shareholders' equity, the taxable amount of shareholders' equity is increased by this excess. Funds held in trust on behalf of third parties must be included in total liabilities when determining whether this limit has been exceeded.

(b) Export incentives and free trade zones

Nine free zones are currently in operation in the country, eight of which are privately operated, and one is State operated. Goods and raw materials may be imported into the free zones without payment of customs duties. Businesses established in the free zones are wholly exempt from Uruguayan taxes, except social security contributions, provided that not less than 75 per cent of the workforce is Uruguayan. Free zone corporations, however, are still required to deduct withholding tax from dividends paid to their non-resident shareholders if the normal rules require withholding tax to be deducted.

(c) Other incentives

Investment promotion

Under the Investment Promotion Law of 1998 (Law 16, 906/98), the following incentives may be granted:

- ?? Exemption from tax on net worth and value added tax for qualifying movable goods purchased for use in production and for data processors;

- ?? Exemption from tax on net worth for qualifying intangible assets and for goods that represent a transfer of technology to Uruguay;
- ?? Reduction of the employer social security rate by three percentage points; and
- ?? Accelerated depreciation for qualifying tangible and intangible assets.

Additional incentives are offered to taxpayers investing 500 million Uruguayan pesos or more and to those investing in certain promoted activities.

Reinvestment of income

Income reinvested in machinery and equipment (including computer hardware) and in building and construction for the manufacturing or hotel industry is exempt from income tax subject to certain limits. The exempt income may not exceed 40 per cent of the capital expenditure on machinery and equipment or 20 per cent of the capital expenditure on buildings and constructions, nor may it exceed 40 per cent of total taxable income for the year before the exemption is taken into account.

(d) Tax incentives legislation highlights

- ?? Act 11.073 of 24 June 1948;
- ?? Industrial Promotion Act No 14.178 of 28 March 1974;
- ?? Act No 15.921 of 17 December 1987;
- ?? Investment Promotion Act No 16.906, effective 7 January 1998.

(e) Statutory tax rate

The national rate of corporate tax is 30 per cent. Dividends and royalties are subject to a withholding tax of 30 per cent. Dividends paid by a resident company to non-resident shareholders — whether companies or individuals — and profits remitted by a Uruguayan branch of a foreign company to its head office abroad, are subject to a final withholding tax in Uruguay if the dividends or remittances are subject to tax in the recipient's country of residence and a credit is granted in that country for taxes paid in Uruguay. If the recipient's country does not tax the dividends or profit remittances, or taxes them but does not give a credit for Uruguayan tax, no Uruguayan tax is withheld. No withholding tax is charged on interest.

12. Venezuela

(a) Regional incentives

Imports and sales within the insular region (Margarita Island) under a free port regime, are exempt from the general sales tax of 16.5 per cent.

(b) Sectoral incentives

New investments discount

An incentive available until July 1999 allowed credit against income tax of 20 per cent of investment in new fixed business assets other than real property. The assets had to be kept in use for a minimum of four years and had to represent an effective increase in productive capacity of the taxpayer or be used for new enterprises. Only taxpayers engaged in industry, agribusiness, tourism, farming and fishing were eligible.

Oil and gas promotion

Taxpayers engaged in the exploitation of hydrocarbons and connected activities, such as refining and transportation, are granted a tax credit equal to 8 per cent of investments in new fixed assets in Venezuela. An additional tax credit equal to 4 per cent of the total cost of new investment made in exploitation, drilling and other connected activities is granted. This extra credit can only be offset against income tax derived from hydrocarbon and related undertakings. Those not used may be carried forward for up to three years.

Farming, fishing and forestry incentive

Entrepreneurs engaged in farming, fishing and forestry are exempt from income tax on profits from primary activities. Primary level activities are those that do not involve industrial processing.

(c) Export incentives and free trade zones

Foreign trade zones and free port areas have been created to promote manufacturing and other activities. They provide exemptions on customs duty, among other tax benefits.

(d) Other incentives

Under a tax refund (drawback) regime, a total or partial refund of import tax paid by Venezuelan or foreign exporters is available, for example, on materials used to produce goods for export. Refunds are effected by means of a tax refund certificate, which can be used to pay national taxes.

(e) Statutory tax rate

The maximum corporate tax rate is 34 per cent. The rate is 15 per cent on the first 2,000 tax units, 22 per cent on the next 1,000 units and 34 per cent on income exceeding 3,000 tax units. A tax unit is currently 7,400 bolívares.

There is no withholding tax on dividends. Interest paid to a non-resident individual is subject to withholding tax at a rate of 34 per cent applied to 95 per cent of the gross payment, producing an effective withholding tax rate of 32.3 per cent. Interest paid to non-resident banks is subject to a withholding tax of 4.95 per cent. Royalties paid to a non-resident company or individual are subject to tax at a maximum rate of 34 per cent applied to 90 per cent of the gross payment, producing an effective rate of 30.6 per cent.

Abbreviations

ASCM	Agreement on Subsidies and Countervailing Measures
ASP	approved service project (Malaysia)
BOI	Board of Investments
BOT	build, operate, transfer projects (Viet Nam)
CFZ	commercial free zone
DTT	double taxation treaty
EDB	Economic Development Board (Singapore)
EEIA	Economic Expansion Incentives Act (Singapore)
EPZ	export processing zone
ETDZ	economic and technological development zone (China)
FDA	foreign dividend account (Australia)
FDI	foreign direct investment
FIE	foreign investment enterprise (China)
FOB	freight on board
GSP	Generalized System of Preferences
ITA	investment tax allowance (Malaysia)
ITAA	Income Tax Assessment Act (Australia)
OBU	offshore banking units (Australia)
PEZA	Philippines Economic Zone Authority
R&D	research and development
RA	reinvestment allowance
SEZ	special economic zone (China)
STC	secondary tax on companies (South Africa)
TNC	transnational corporation
TRIMS	Trade-Related Investment Measures
UDEAC	Union douanière et économique des Etats de l'Afrique centrale (Central African Customs and Economic Union)
VAT	value added tax
VCC	venture capital company