



BETTER POLICIES FOR BETTER LIVES

Taxation and Investment Tributación e inversión

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FORO SOBRE POLÍTICA TRIBUTARIA EN LOS PAÍSES LATINOAMERICANOS Y EL
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Steven Clark

Head, Business and International Tax Unit

Tax Policy and Statistics Division

steven.clark@oecd.org

Presentation topics – Presentación de temas

- Assessing tax effects on investment
- Evaluación de los efectos fiscales en la inversión

- Factors influencing investment decisions
- Factores que influyen la decisión de la inversión

- Possible corporate tax effects on investment
- Posibles efectos del impuesto de sociedades en la inversión

- Rationale for taxing corporate income
- Razones para el pago de impuesto de renta de las sociedades

- Policy considerations in taxing inbound FDI, and taxing outbound investment
- Consideraciones políticas en gravar IED (inversión extranjera directa) entrante y gravar inversión saliente.
- Various instruments of tax competition
- Varios instrumentos de competencia fiscal

- Potential pitfalls of current tax policies
- Limitaciones potenciales de las políticas fiscales

Assessing tax effects on investment

Evaluación de los efectos fiscales en la inversión

- Three main approaches:
- Tres enfoques principales:
 - survey questions on investment decision-making.
 - Sondeo en toma de decisiones en materia de inversión

 - theoretical analyses of influence of tax on profit-maximizing solutions for investment – yields:
 - Análisis teóricos de la influencia del impuesto en soluciones para maximizar ganancias de inversión
 - average effective tax rates, used to examine tax effects on choice over alternative investments (e.g. location choice)
 - Promedio de tipos impositivos efectivos, usados para examinar los efectos fiscales en las decisiones de inversión alternativas (ej: elección de la ubicación)

 - marginal effective tax rates, used to examine tax effects on the optimal level/ scale of investment in a given project.
 - Tipos impositivos efectivos marginales, usados para examinar los efectos fiscales en el nivel óptimo/escala de la inversión en un proyecto determinado.

 - Econometric (statistical) regression analyses:
 - Análisis (estadístico) de regresión econométrica:
 - estimate relationship between investment and explanatory variables including effective tax rate, and use results to measure the sensitivity of investment to tax (elasticity).
 - Estima la relación entre la inversión y las variables explicativas que incluyen la tasa efectiva de impuestos, y usa los resultados para medir la sensibilidad de la inversión al impuesto (elasticidad)

 - wide range of estimates (data and estimation problems).
 - Amplia gama de resultados (datos y problemas de estimación)

Factors influencing investment decisions

Factores que influncian la decisión de la inversión

(findings based mostly on investor surveys)

(Resultados basados principalmente en encuestas a inversores)

- Key host country factors/fundamentals:
- **Factores centrales y esenciales del país anfitrión / Fundamentos**
 - political and macro stability.
 - Estabilidad política y macroeconómica

 - rule of law; property rights; public governance .
 - Estado de derecho, derechos de propiedad, estado de administración pública

 - market size, physical infrastructure.
 - Tamaño del mercado, infraestructura física.

- Tax considerations:
- **Consideraciones fiscales**
 - main concern – certainty/ stability of tax treatment.
 - Principal preocupación - seguridad / estabilidad del tratamiento fiscal

 - La tributación no desalienta la inversión que gana beneficios de locación específica (presencia física requerida)
 - taxation not discouraging to investment earning location-specific profit (physical presence required).

 - taxation discouraging to highly mobile investment earning location-independent profits (minimal physical presence required).
 - La tributación puede ser desalentadora para inversiones altamente móviles que ganan beneficios independientes de la locación

Factors influencing investment decisions (cont'd)

Factores que influncian la decisión de la inversión

- Further tax considerations:
- Consideraciones fiscales mayores:
 - taxation may be discouraging to investment earning mobile firm-specific profit – sensitivity depends on:
 - La tributación puede desalentar a la inversión que gana beneficios de empresas específicas móviles – la sensibilidad depende de:
 - type of business activity (some more mobile than others)
 - Tipo de actividad empresarial (algunas más móviles que otras)
 - strength of key host country factors/ fundamentals
 - Fortaleza de los factores del país anfitrión / fundamentos
 - relatively low tax rate unable to offset/ compensate for weak host country fundamentals.
 - Tasa de impuesto relativamente baja que no puede compensar los aspectos débiles del país anfitrión
 - all taxes on businesses are relevant to tax burden assessment (on profits, revenues, assets, etc).
 - Todos los impuestos a las empresas son relevantes para la evaluación de la carga fiscal (en ganancias, recaudaciones, activos)
 - profit-insensitive taxes (e.g. on net capital assets) are discouraging to mobile investment.

Possible corporate tax effects on investment

Posibles efectos del impuesto de sociedades en la inversión

- Investment location choice.
- Elección de la ubicación de la inversión

- Level (scale) of investment.
- Escala de inversión

- Risk-taking (investments with uncertain returns).
- Toma de riesgos (inversiones con rendimientos inciertos)

- Type of investment (M&E, buildings, intangibles).
- Tipo de inversión (máquinas y equipos, inmuebles, intangibles)

- Financing instrument (debt vs. equity, hybrid).
- instrumentos de financiación (deuda vs. capital, híbrido)

- Financing structure (direct, indirect/ triangular).
- estructura de financiación (directo, indirecto /triangular)

- Method/ type of payment of earnings of foreign affiliates (e.g. dividends, gains, interest, royalties).
- Método/ tipo de pago de las ganancias retenidas de las filiales extranjeras (ej: dividendos, acciones, interés y regalías)

Rationale for taxing corporate income

Razones para el pago de impuesto de renta de las sociedades

- **Vertical equity.**
- **Enable current taxation of capital income.**
- **Enable taxation (at source) of economic profit accruing to non-resident investors.**
- **Instrument for influencing corporate decisions (e.g. R&D).**
- **Negative effects on investment may be mitigated by particular CIT design.**

Policy considerations in taxing inbound FDI

- Revenue requirements, competitiveness, equity, efficiency objectives.
- Ongoing pressures for competitive tax system.
- All taxes on business relevant – but particular focus on corporate income tax (CIT), with pressure to reduce statutory CIT rate:
 - highly visible ‘headline’ rate, attractive to investors
 - takes tax planning pressure off the tax base.
- More limited statutory CIT rate reductions in LAC countries (with exceptions).

Chart 1

CIT rates in OECD countries (1994, 2000, 2011)

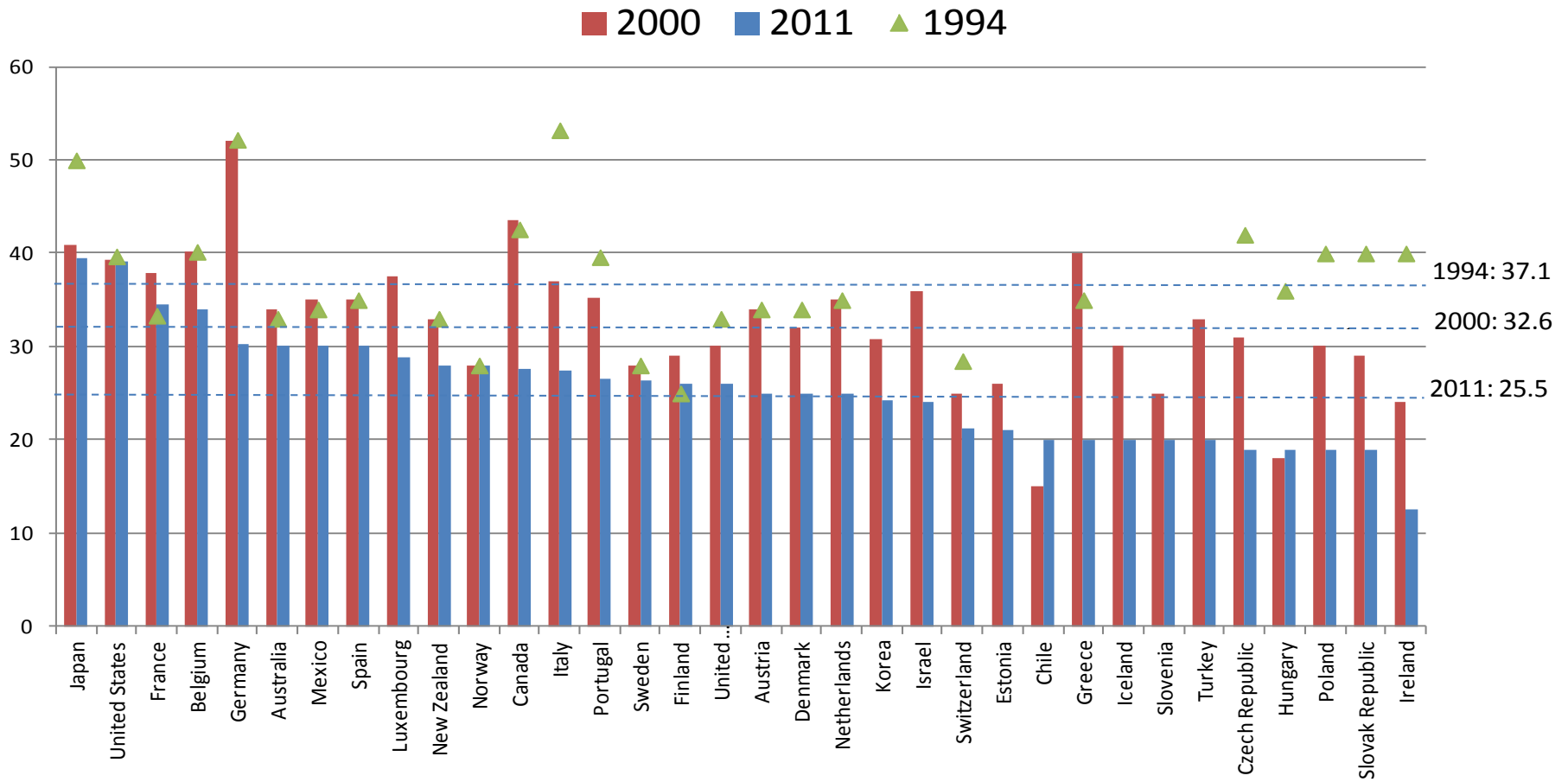
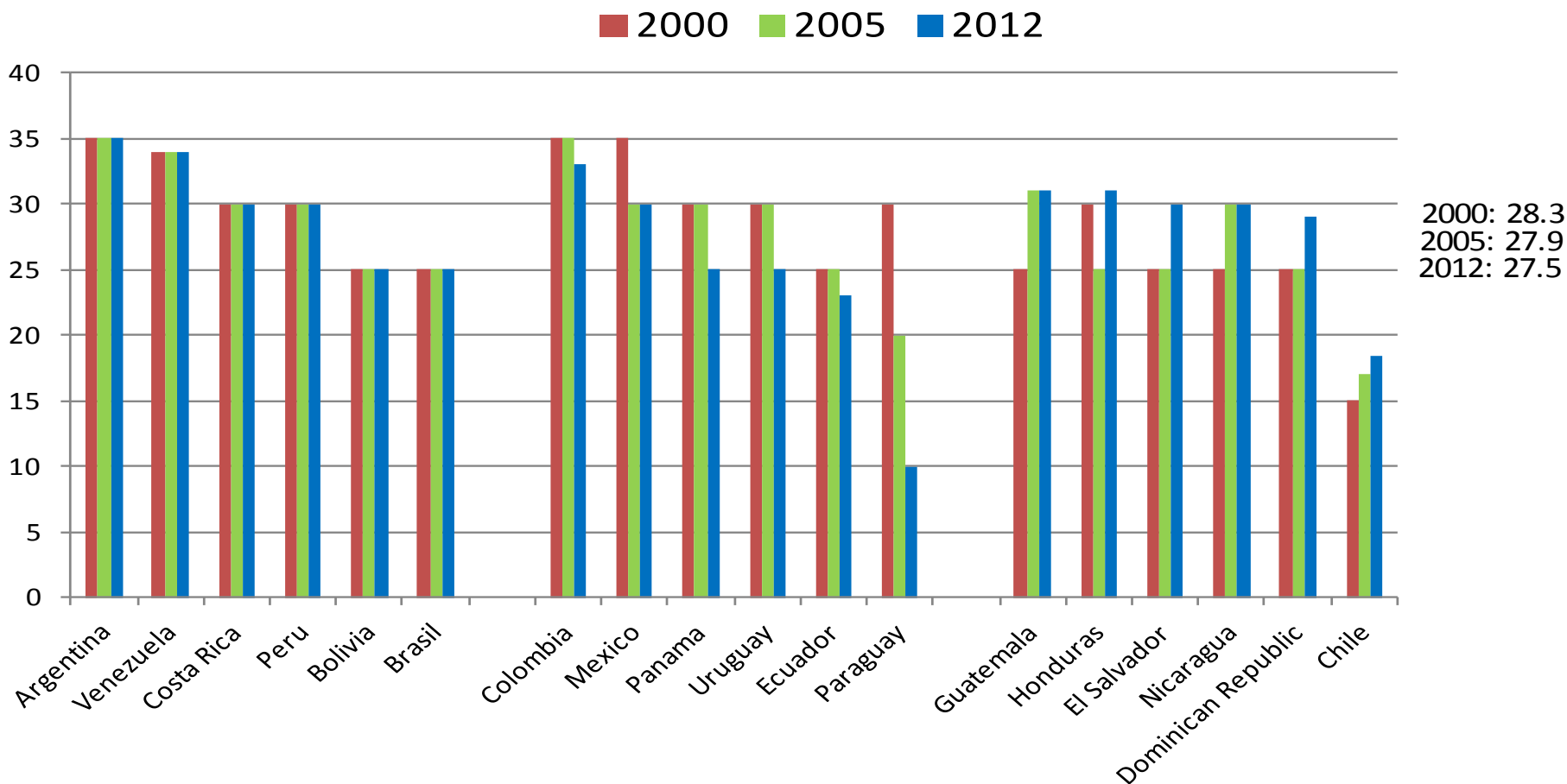


Chart 2

CIT rates in LAC countries (2000, 2012)



- **Limited ability to tax firm-specific profits on mobile investments.**
- **Ability to tax location-specific profits.**
- **Market size matters:**
 - general ability of larger OECD economies to impose higher CIT rates,
 - more limited evidence of this in countries in LAC region (notable exceptions are Brazil and Mexico with relatively low CIT rates).

Chart 3

CIT rates in OECD countries, 2011

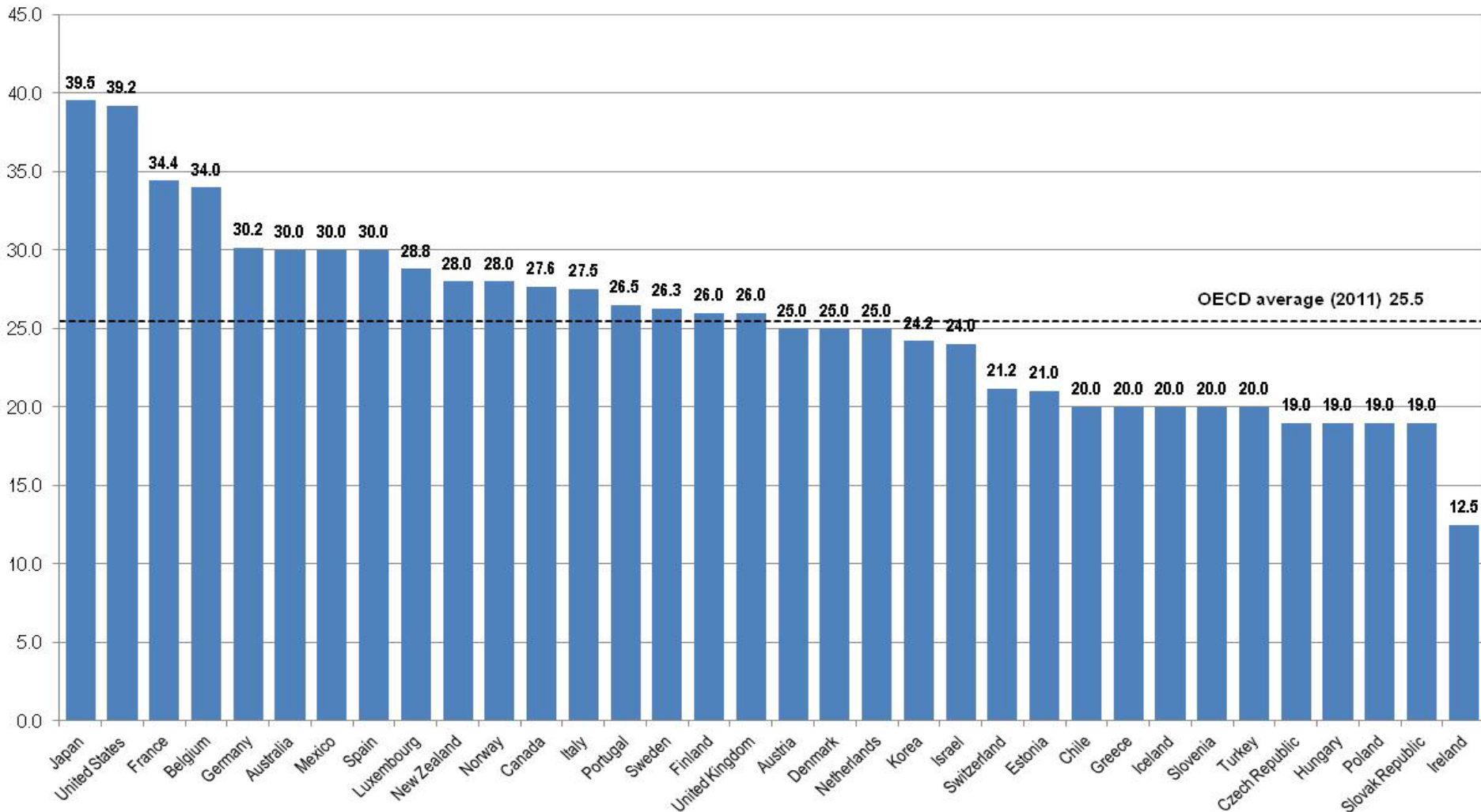


Table 1

CIT rates in OECD area, by country size

	Statutory corporate income tax rate			
	2000	2004	2007	2011
Larger OECD economies	39.5	36.0	35.9	32.8
US-JPN-GER-UK-FRA-ITA				
Medium-sized OECD economies (NLD)	35.4	32.8	29.6	27.8
CAN-ESP-KOR-MEX-AUS-NLD	(35.0)	(34.5)	(25.5)	(25.0)
Smaller OECD economies	29.9	26.4	23.9	22.8
AUT-BEL-CHE-CHL-CZE-DNK-EST-FIN-GRC-HUN-ISL-IRL-ISR-LUX-NOR-NZL-POL-PRT-SVK-SVN-SWE-TUR				
OECD Average	32.6	29.2	27.0	25.5

Table 2

CIT rates in LAC region, by country size

	Statutory CIT rate, 2012
Larger LAC countries	27.5
- Brasil, Mexico	
Medium-sized LAC countries	30.1
- Argentina, Colombia, Venezuela, Chile, Peru	
Smaller LAC countries	26.3
- Ecuador, Dominican Republic, Guatemala, Uruguay,	
Costa Rica, Panama, El Salvador, Bolivia, Paraguay,	
Honduras, Nicaragua	
LAC Average	27.5

Considerations in taxing outbound investment

- Revenue, competitiveness, equity, efficiency.
- Competitiveness concerns tend to dominate.
- Preferential treatment of foreign profits – production inefficiencies, domestic job losses?
- Similar inefficiencies under worldwide tax systems and territorial/exemption systems.
- Calls for tax relief extend beyond exemption/ indefinite deferral of home country tax on foreign active business income (significant scope for tax avoidance/ profit shifting/ base erosion).

Figure 1

Direct financing and licensing of IP (intellectual property) to foreign manufacturing affiliate

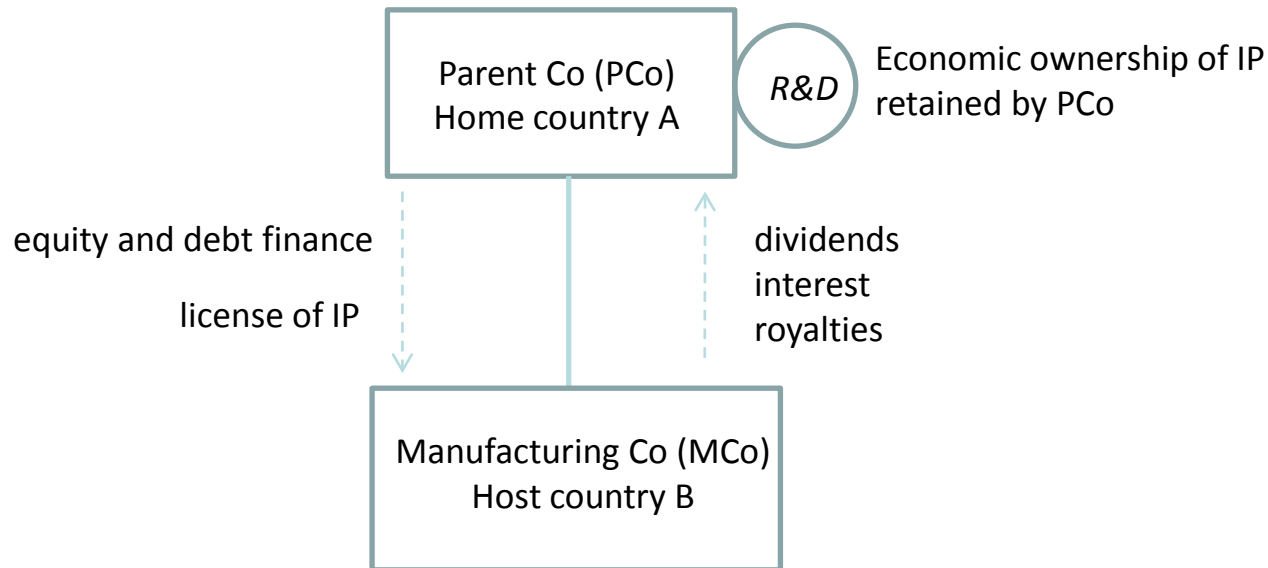


Figure 2

Indirect ('triangular') financing and licensing of IP to foreign manufacturing affiliate through offshore holding company

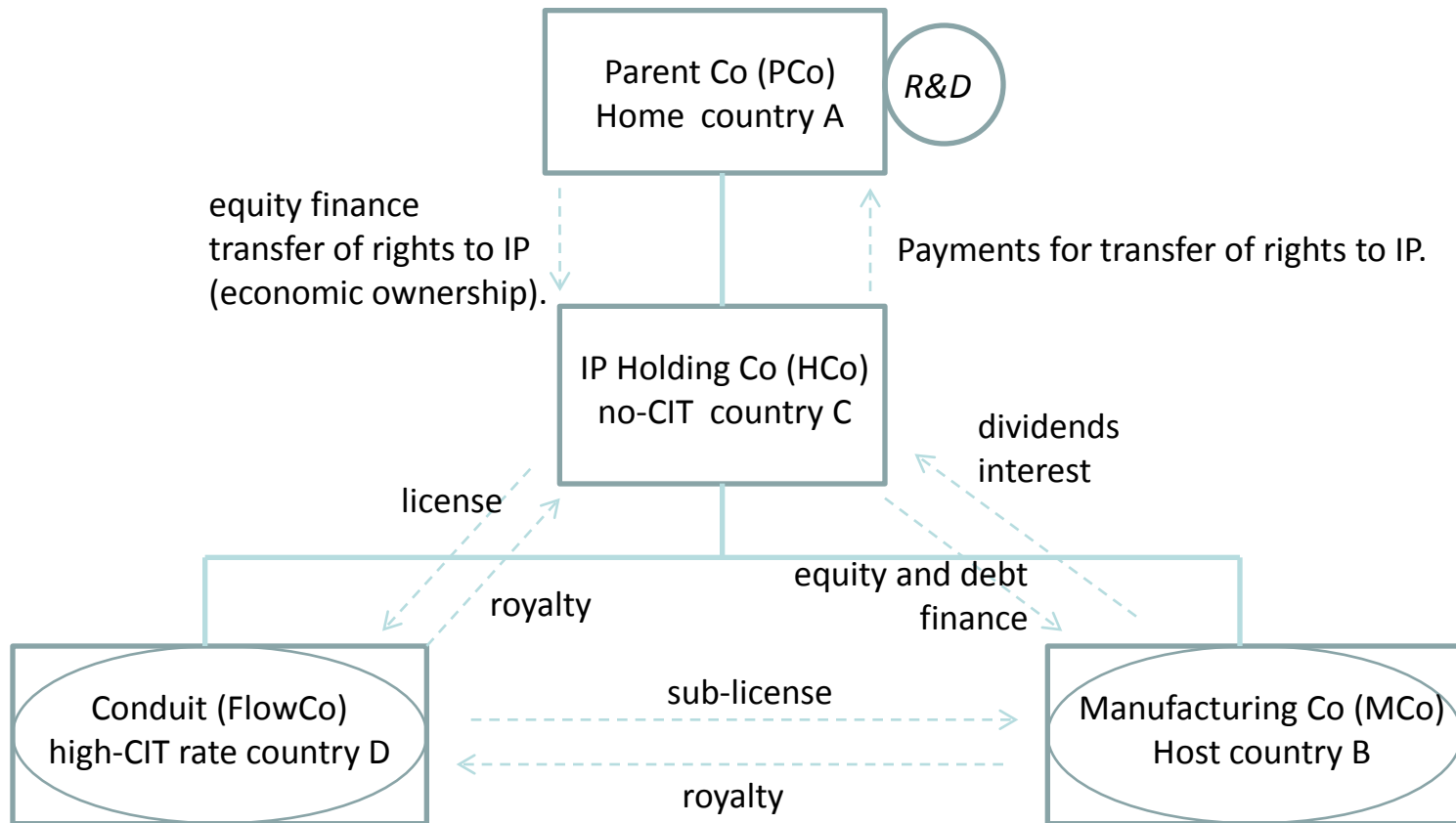
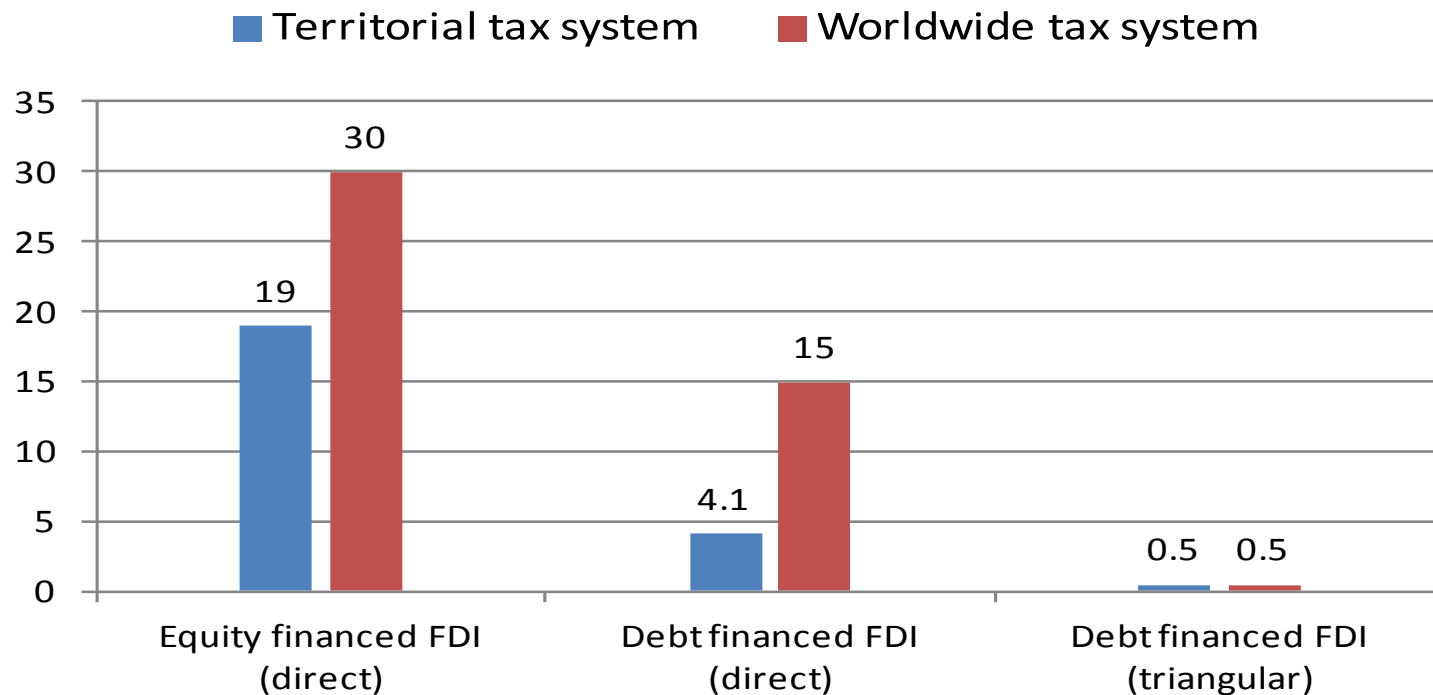


Chart 4

Average effective tax rates (AETRs) with direct vs. indirect (triangular) FDI



Assumptions: 30% home country CIT rate, 15% host country CIT rate, 5% withholding tax rate on dividends and interest, 30% pre-tax rate of return, tax depreciation equals economic depreciation.

Various instruments of tax competition

- **Basic statutory ‘headline’ CIT rate.**
- **Targeted tax relief (tax incentives).**
- **Loss carryover/ group consolidation rules.**
- **Rules governing interest deductibility.**
- **Reduced rates of non-resident withholding tax on dividends, interest and royalties.**
- **Treatment of income of offshore affiliates.**
- **Tax administration/ base protection.**
- **Compliance costs.**

Potential pitfalls of current tax policies

- Significant CIT revenues foregone with cuts in CIT rates (tax competition).
- Limited effectiveness of tax incentives.
- Reductions in top personal income tax (PIT) rates, in part to avoid distortions arising where CIT and PIT rates differ widely.
- Income inequality concerns with reduced CIT, reduced top PIT rates, alongside increased reliance on VAT and property taxes.

Potential pitfalls of current tax policies (cont'd)

- Possible output loss where inbound FDI is taxed at relatively low host/ home country tax rate, displacing investment by resident-owned firms with a higher pre-tax return.
- Possible output loss where outbound FDI displaces domestic investment with a higher pre-tax return (e.g. higher foreign production costs are more than offset by tax relief).
- Increased tax administration (and compliance) costs with increased complexity in tax laws (e.g. countering aggressive tax planning).

Thank you!