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South Centre Inputs on "Tax Incentives Principles"

I. Background

The South Centre is the intergovernmental organization of developing countries that helps developing countries to combine their efforts and expertise to promote their common interests in the international arena. The South Centre has 55 Member States coming from the three developing country regions of Africa, Asia and Latin America and the Caribbean. It was established by an Intergovernmental Agreement which came into force on 31 July 1995. Its headquarters are in Geneva, Switzerland.

The South Centre in 2016 launched the South Centre Tax Initiative (SCTI). This is the organization's flagship project for promoting South-South cooperation among developing countries in international tax matters.

The South Centre submits the following inputs to the Platform for Collaboration on Tax (PCT) on Public Consultation on Tax Incentives Principles. For further queries, please contact taxcooperation@southcentre.int.

II. Overview

The South Centre welcomes the opportunity to provide feedback on the Tax Incentives Principles enumerated in the Public Consultation Draft developed by the Platform for Collaboration on Tax.

Tax incentives constitute tax expenditure for governments offering them and tax savings for recipients enjoying them. Tax incentives of all kinds including but not limited to reduced tax rate, tax holidays or reduced tax base are intended to enhance the competitiveness of countries for the purpose of attracting investments and attendant creation of direct and indirect jobs. At the same time, these incentives create a race to the bottom with countries competing against each other to offer more

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generous incentives which leads to increased loss in revenues. Unarguably, tax incentives are prone to abuse and hence the suggestions in the draft to regulate incentives are welcome.

The scope of the commented draft is broad covering both direct and indirect taxes, including Value Added Tax (VAT). The principles may not be applicable to all kinds of taxes. As such, the draft can clearly mention that they apply specifically to corporate income taxes.

The draft focuses on restricting the use of profit-based incentives and suggests that they are "intrinsically bad" though without strong justification. Further, it overlooks the rise of other business incentives such as tax credits, subsidies and grants which are now being promoted under the OECD Global Minimum Tax (GMT), particularly under the mechanism of Qualified Refundable Tax Credits (QRTC). Such incentives reflect a worrying development as they distort the investment playing field and privilege developed countries who have more finances at their disposal to offer them and thus attract more investment. This dynamic can have negative implications on developing countries trying to attract, for instance, investment meant to enable them to upgrade their technological capacities, such as in areas like clean energy.

The draft should therefore take a more neutral tone towards profit-based incentives and explain that they could be improved if the applicable legislations provide for sunset clauses and clear anti-abuse provisions. The draft should also point out the dangers of subsidies like QRTC in the OECD Global Minimum Tax distorting the investment playing field against developing countries and the possibilities that it may restrict their ability to rise up in the value chain.

III. Comments on the six principles

Principle 1: Justification

1. The wording "macro-critical activities" in principle 1.1 should be explained. Some of the activities constituting macro-critical could be listed.

2. The draft disapproves of incentives for start-ups. The opposite should be the case, particularly since this guidance is supposedly meant for developing countries. In other words, incentives targeted at start-ups should be encouraged, though with sunset provisions, including offering graduated incentives for businesses that transition from informal to formal economy.
3. While the draft mentions the importance of having ex-ante assessments, providing guidance on how to conduct them would be beneficial.

Principle 2: Design

1. The draft rules out profit-based incentives and seeks to portray them as "intrinsically bad". However, tax holidays or reduced tax rates are a legitimate policy option widely used in developing countries and can be useful if anti-abuse provisions such as sunset provisions are provided for in the legislation granting the incentives.
2. The wording "crediting of any input tax has no impact on business purchases" assumes that all jurisdictions credit input VAT which may not be the case. For instance, some jurisdictions may not credit input VAT paid by an enterprise for the purchase of plant and equipment. Further, indirect taxes like VAT should not be covered by the draft, which should focus only on direct taxes.
3. The draft makes no mention of subsidies like Qualified Refundable Tax Credits that are promoted under the OECD Global Minimum Tax. The draft should point out how the use of such subsidies can distort the investment playing field against developing countries and the possibilities that it may restrict their ability to rise up the value chain.

Principle 3: International Considerations

1. Principle 3.1 suggests that if countries do not follow non-binding commitments like those made on following OECD standards, they will be "penalized". This is

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harsh and inappropriate language and can be replaced with the concept of "disputes".

2. The wording "commitments as are made should be honored… including in relation to Pillars One and Two" should be redrafted. For instance, commitments to OECD statements such as in October 2021, are political and legally non-binding. The requirement to honor commitments should apply solely to hard law obligations with no mention of OECD political commitments like those made under the Two Pillar solution.
3. The threats of European Union (EU) blacklisting and denial of development aid for not honoring political commitments are condemnable and should be deleted from the draft.
4. Principle 3.2 describes the OECD GMT and Controlled Foreign Company (CFC) rules as "instruments". CFC rules are domestic laws and the Global Minimum Tax consists of Model Rules accompanied by administrative guidance and a Commentary. The Model Rules and administrative guidance are supposedly "approved by the OECD Inclusive Framework" which is not a statutory body and has no rules of procedure. The consolidated Commentary makes no mention of which was the authority that issued the Commentary. It is therefore inappropriate to describe the OECD GMT and CFC as international law "instruments". The word instruments should thus be deleted.
5. The wording "Incentive design should pay due regard to the impact on other countries" in paragraph 3, could limit countries from exercising their sovereignty and from pursing policies that address their unique country needs.

Principle 4: Legislation

1. A clear and transparent legal framework that minimizes discretion of public officials is important and should be reinforced by legal anti-abuse safeguards such as stricter penalties for misuse of incentives.

Principle 5: Implementation

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1. The decision to grant incentives under the law should not be under the sole responsibility of the revenue administration. Rather, the decision to grant incentives should be made in consultation with relevant government agencies (for instance, the Ministry or Agency responsible for Trade and Investment). However, the final approval should reside in the Ministry of Finance in order to promote broader fiscal analysis and economic management.

Principle 6: Assessment

1. The draft allows for anonymized disclosure of beneficiaries of tax incentives. This may undermine transparency, given that tax incentives are intended to deliver social benefits and serve the public interest.
2. The draft should include a guidance for simple evaluation metrics for countries with limited capacity in conducting impact assessments.

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