ATI webinar: Perspectives from ATI partner countries on the design of tax incentive regimes

Background

On 17 September 2020, Addis Tax Initiative (ATI) Consultative Group 3 held an online webinar to present and discuss the findings of the ATI brief "Perspectives from ATI partner countries on the design of tax incentive regimes", based on case studies from Ghana, Malawi and the Philippines. The webinar was moderated by Mr. Mark Montgomery, Department of Foreign Affairs and Trade Ireland and Co-Coordinator of the ATI Consultative Group 3. Besides the presentation of the publication, the webinar aimed at sharing experiences, challenges, good practices and lessons learned regarding the design of tax incentive regimes.

Presentation of the ATI brief "Perspectives from ATI partner countries on the design of tax incentive regimes"

The ATI brief on the design of tax incentive regimes in three ATI partner countries (Ghana, Malawi and the Philippines) was presented by Mr. Mustapha Ndajiwo, Executive Director of the African Centre for Tax and Governance. The publication is based on a questionnaire and interviews conducted with representatives from the Ministries of Finance from the three partner countries that volunteered to participate as pilot countries.

The publication pointed out that attracting and encouraging foreign direct investment (FDI) is a **common goal** among the three countries for the grant of tax incentives. Beyond this, there are additional reasons that can be sector specific. For instance, Malawi aims to promote domestic production of goods for exports to reduce trade deficits. Ghana purposes to promote employment and the Philippines to account for social policies.

One **common challenge** that cuts across the three countries is the inadequacy of required data, which hinders the monitoring and evaluation processes as well as the cost-benefit analyses that ought to be done prior to the implementation of a new policy. Another challenge that is predominant in two of the three pilot countries (Ghana and Malawi) is inadequacy of personnel which makes it difficult to properly monitor incentives (e.g. abuses of tax incentive regime; extension of incentives to ineligible third parties, application to other purposes, transfer to related parties, and extension to transactions not covered by the incentive).

The ATI brief provides **good practices** in the design of tax incentive regimes, which are based on lessons learned from the pilot countries. These good practices include:

- clear objectives for implementing an incentive scheme;
- defined eligibility criteria for tax incentives;
- no discretionary power in granting of tax incentives;
- the design of incentives schemes that follow specific processes, involving both the public and the parliament (the granting of tax incentives requires compliance with a pre-determined

process, scrutiny, in order to avoid the risk of abuse and the granting of tax incentives that are not beneficial to the country).

The publication provides the following recommendations:

- the process of designing tax incentive regimes must be tailored to the country-specific conditions; legal and regulatory frameworks as well as the socio-economic climate of the country must be considered;
- sunset clauses should be included;
- the effectiveness of each incentive should be systematically monitored and evaluated, with agreed timeframes to ensure that the intended goals are achieved and that the incentives are beneficial to the economy;
- countries should consider reporting annually the review and monitoring of all tax incentives to the Parliament;
- there should be formalised procedures and guidance on how to audit beneficiaries of tax incentives to ensure they comply with the terms and conditions of incentives;
- there should be penalties in place for beneficiaries that do not comply with the terms and conditions of the tax incentives granted (e.g. cancellation and revoking of incentives);
- technical cooperation and collaboration among ATI partner countries is needed to build capacities, share knowledge, resources, and successful initiatives.

Inputs from ATI partner countries

Ghana

Mr. **Daniel Nuer** (Head of the Tax Policy Unit, Ministry of Finance, Ghana) presented some of the challenges faced by Ghana in the design and administration of tax incentives. These include: negotiation of exemptions without the prior knowledge of the Ministry of Finance; exemptions tied to donor-funded projects; granting of exemptions without sunset clauses; exemptions granted on foreign supply of goods and services that can be sourced locally; abuse and transfer of exemptions to third parties and abuse of third parties and inadequate monitoring and review.

In order to respond to these challenges, the country enacted laws and adopted measures to better manage tax incentives. These measures include the insertion of a requirement in the Public Financial Management Act for the Minister to submit an annual report on tax expenditures to Parliament; addition of sections in the Revenue Administration Act requiring MDAs to obtain clearance from the Minister before negotiating any agreement that grants waivers or variation of taxes; empowering the Commissioner-General to ignore any exemption unless it is sanctioned by law; new provisions in the Income Tax Act and Value-Added Tax acts that indicate that only exemptions granted under those laws are valid; exclusion of income tax and third-party payments from exemptions and automation of the exemption administration process. Ghana foresees additional actions to turn the exemptions regime more transparent and to rationalize it, reviewing rates and removing unbeneficial incentives.

Malawi

Mr. **Kenneth Mutapa** (Director of the Revenue Policy Division, Ministry of Finance, Malawi) highlighted that tax incentives have been promoted in Malawi (i.e. tax breaks, tax free zones, industrial rebates, duty drawbacks etc.) to attract investments and foster economic growth. There is a regional competition amongst developing countries to attract FDI. Over the years, Malawi has adopted sector specific tax

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incentives in sectors such as mining, energy, tourism, manufacturing. The legal instruments for administering these tax incentives are the Taxation Act, VAT Act and the Customs & Excise Act. These are part of a key reform introduced in the country's system: legal instruments for administering these tax incentives.

Challenges faced by Malawi include: conflicting mandates between Ministry of Finance and Ministry of Trade, including responding expectations from private sector stakeholders; tax incentives granted outside the provisions of the law; lack of capacity to monitor and evaluate the performance of tax incentives due to inadequacy of data; abuse of tax incentives by some investors and companies; ineffectiveness of incentives to encourage the growth of infant industries. Some of the **good practices** Mr. Mutapa shared include that tax incentives should be well-designed to have beneficial effects, and not eroding revenue base; issues of political economy and pressure from investors need to be addressed; developing countries should not underestimate their potential especially where investments are in a unique resource where there is adequate comparative advantage.

Philippines

Ms. **Juvy Danofrata** (Director of the Department of Finance, the Philippines) pointed out that fiscal incentives have been discussed in the Philippines for more than two decades, and that the national system counts on more than 300 laws with investment provisions. The country has implemented policies to improve efficiency of tax incentives based on 4 elements. These features include providing tax incentives that are (i) timebound, (ii) transparent, (iii) targeted and (iv) performance based. The process of granting tax incentives has a significant political aspect that must be considered. One of the most difficult issues to be addressed is the misconception of the purpose of granting tax incentives and a shallow understanding of how tax incentives work. Ms. Danofrata stressed that the nature of political economy of tax incentives must be well understood and assessed.

Presentation of the PCT toolkit for the assessment of tax incentives

Ms. **Ashima Neb**, Platform for Collaboration on Tax (PCT) Secretariat, noted that tax incentives are becoming increasingly popular and have different forms and features across countries (e.g. preference for tax holidays and exemptions in low-income countries; seen as a means to achieve State objectives like attracting FDI, job creation, development of specific sectors). There are high expectations on effectiveness of tax incentives to achieve the objectives, while evidence does not support the effectiveness. Tax incentives imply high fiscal costs, and an "efficient use" needs to consider opportunity costs and other forms to achieve the stated objectives at low social cost. Despite evidence on ineffectiveness (e.g. for job creation, in the absence of tax expenditure data), tax incentives remain popular, which could be explained by spillover benefits, lack of transparency, vested interests and, as a key driver, tax competition between countries.

There is much scope for better design and governance, as well as greater use of tax expenditure reviews to improve transparency. The PCT Toolkit provides practical recommendations for developing countries regarding cost-benefit analysis (served as a framework for debate and research); tax expenditure analysis (methodological guide as basis for TA) and effective tax rate calculation ("effective design" standard tool in Fund TA).

Input from a civil society perspective (Save the Children)

Mr **Ibrahim Alubala** (Save the Children Kenya) highlighted the important role of civil society in the design of tax incentives, although civil society actors often have not much space to take part in these discussions. He stressed the need for civil society to hold government accountable when it comes to tax incentives. Civil society can respond to issues around opaqueness of tax incentives. Civil society participation promotes transparency and accountability. In addition, civil society organisations have a role to play when it comes to advocacy through awareness raising. Finally, civil society shall unpack complex issues like tax incentives.

Ibrahim Alubala stressed that a lack of cost-benefit analysis in the grant of tax incentives is one of the core issues. Civil society can help to provide such assessments. Civil society organizations can also play a role in capacity building. Finally, citizen engagement is an important feature in order to claim their rights in the granting of tax incentives.

Conclusions

After an interesting Q&A session that included discussions on tax expenditure data, transparency, accountability and the role of civil society, some conclusions were drawn:

- Governments should ensure that the design of tax incentives provides clarity in terms of intended objectives, non-discrimination and transparency. Administrative discretion needs to be avoided and it should be ensured that objective legislative criteria are respected.
- Greater transparency is needed. Aspects of political economy should be considered, and public scrutiny is needed to improve transparency, including an active participation of civil society. Greater use of tax expenditure reviews improves transparency and effectiveness assessments. The adoption of tax incentives should be accompanied by a participatory and transparent process. Here, it is important that members of parliament and external stakeholders, particularly CSOs, are actively included.
- There is a need for improvement in institutional coordination among different government agencies and data collection. Monitoring and periodic evaluation and review of incentive policies is key to ensure efficiency and relevance. Better design includes the removal of redundant tax incentives especially profit-based ones (e.g. tax holidays), insertion of sunset clauses and claw back provisions to the benefits granted to the investors.

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