Special Economic Zones and How to Tax Them

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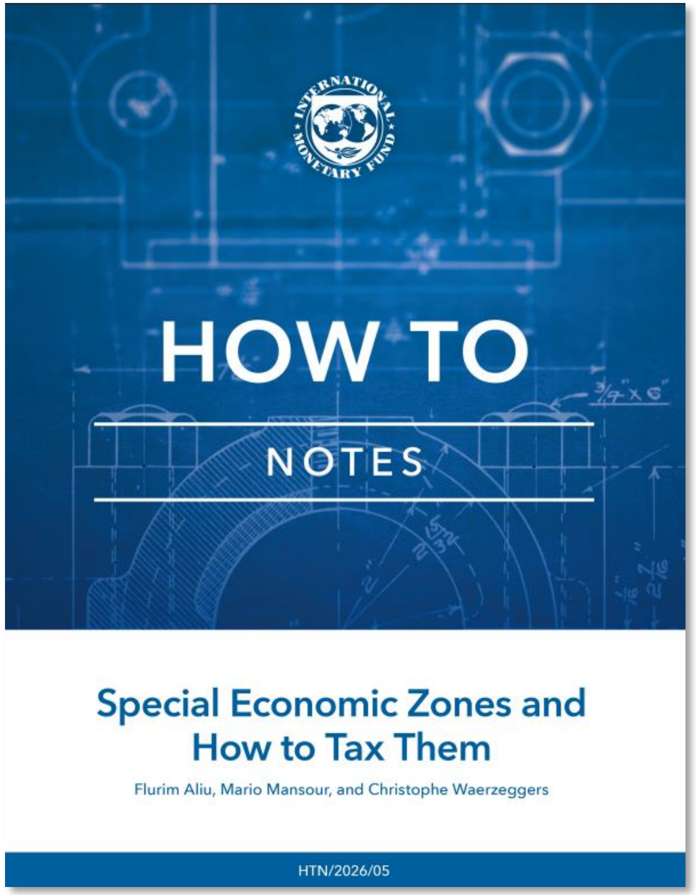
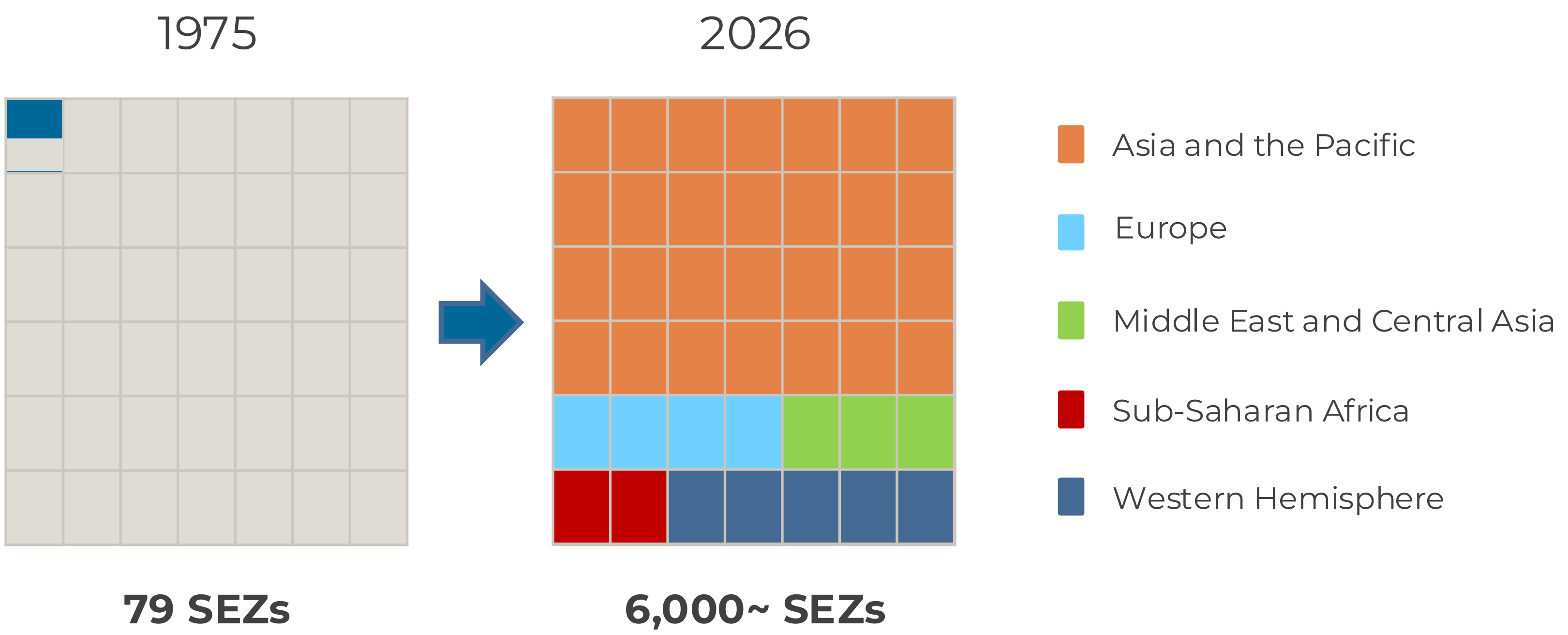
Three questions about SEZs

The new **IMF How-To Note** (published on 27 August 2026) reviews global experience with SEZs and focuses on three key questions:

1. What do SEZs **look like** around the world?
2. What does the evidence tell us about **when they work** (and when they do not)?
3. What does this imply for **how** governments should **design and tax** them?



SEZs are everywhere



Source: Authors' visualization, based on data from UNCTAD (2023)

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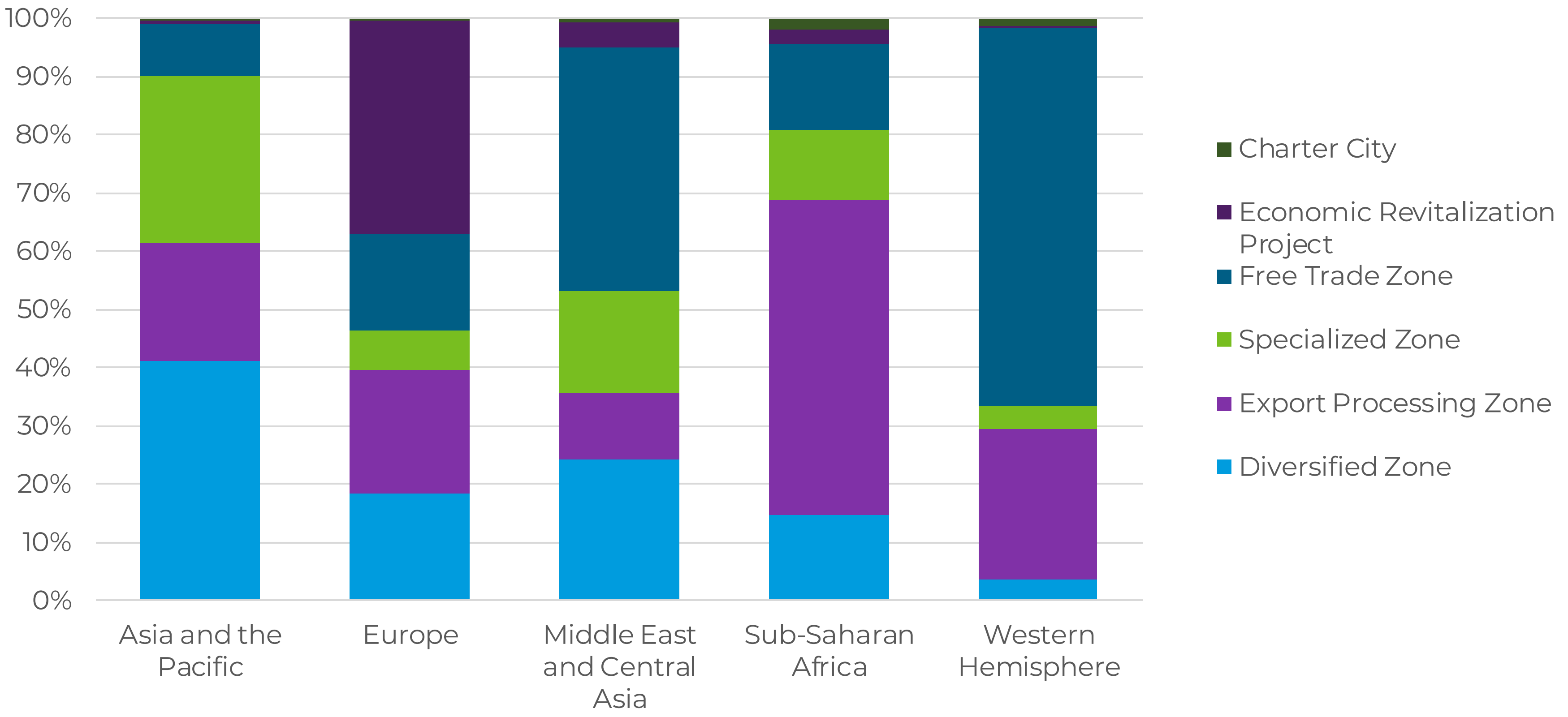
But they look different in different regions

Most Common Types of SEZs, by Region



Source: Authors' visualization, based on data from Adrianople Group (2021)

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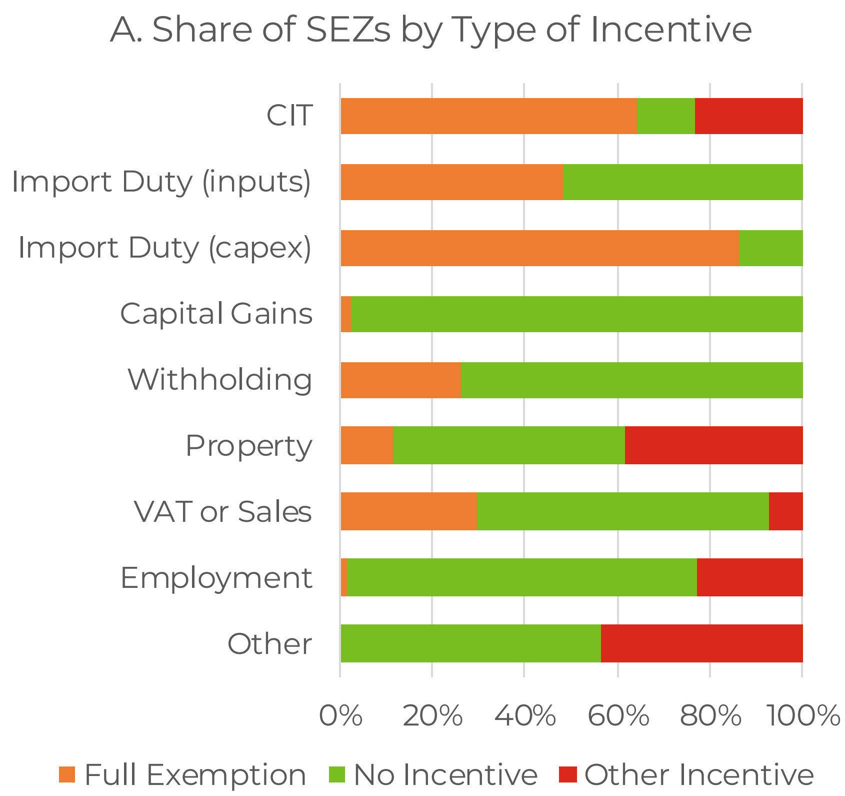
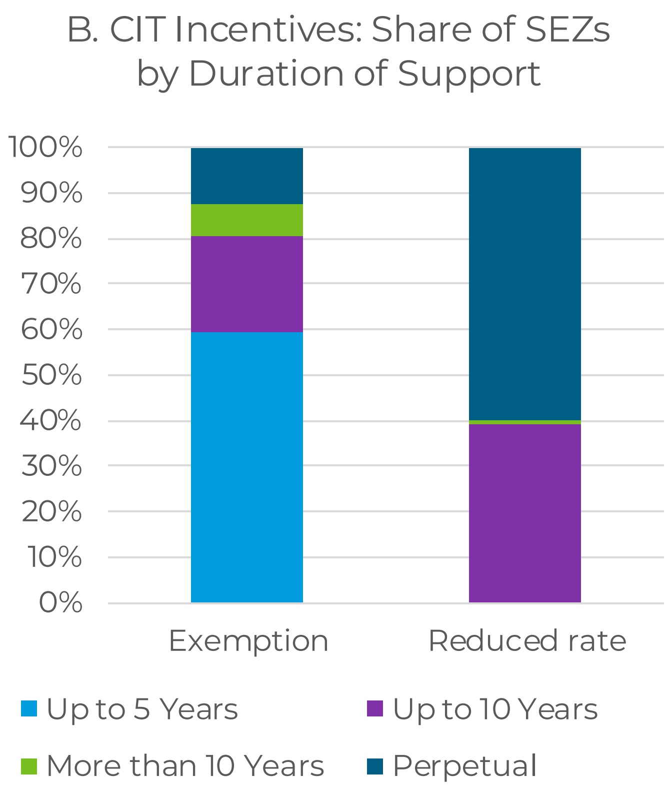
Some tax incentives are always present in SEZs





Source: Authors' visualization, based on data from the Competitive Industries and Innovation SEZ Database.

Do SEZs actually work? Evidence is mixed

Some SEZs have performed **very well**:

- China, Dominican Republic, Mauritius, Panama, Poland, Vietnam, etc.

Others have delivered **limited benefits:**

- Weak investment, exports, or spillovers, despite high fiscal costs

Three key caveats:

Selection bias:
We know much more about the successes than failures

Additionality:
Activity in the zone may be relocated rather than new

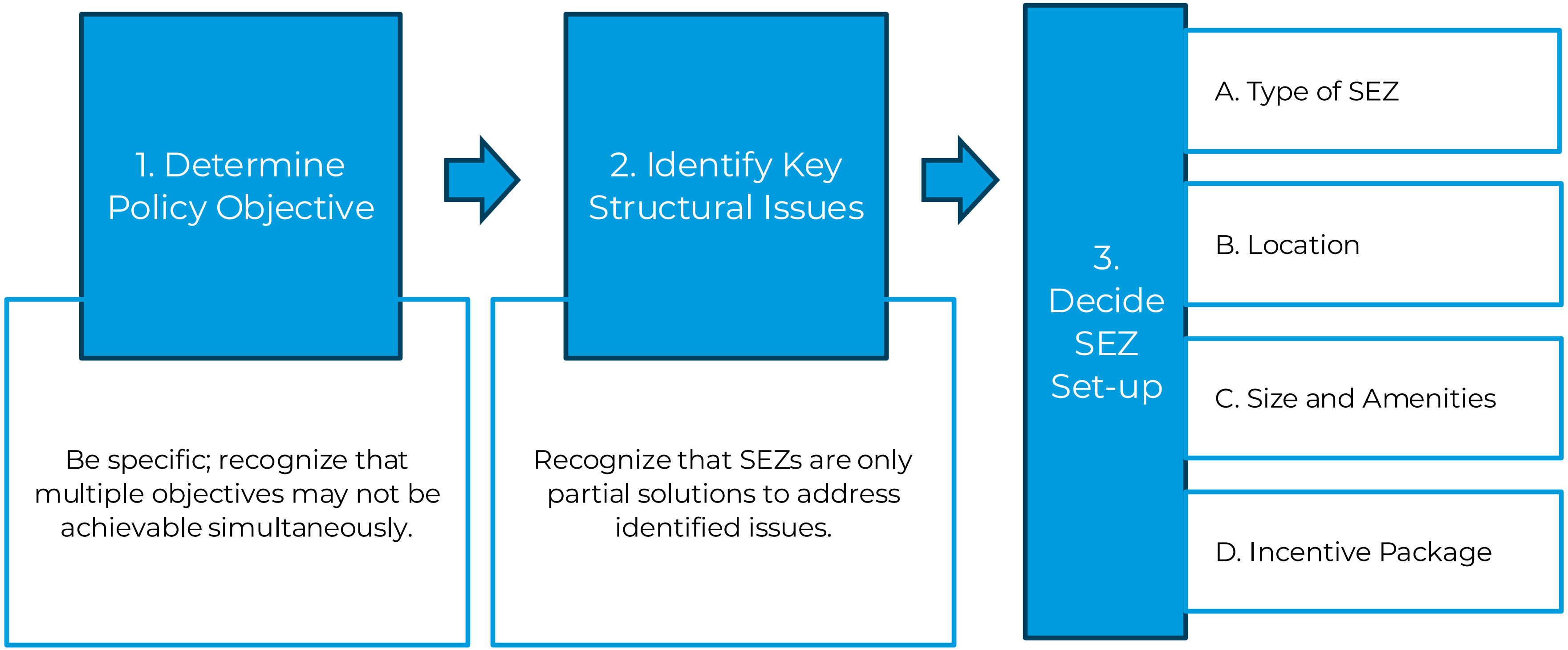
Spillovers:
Effects often decline sharply beyond ~10–20 km

What seems to make SEZs work?

Strong fundamentals matter more than generous tax incentives.

Location	Skills	Market Access
Proximity and connectivity to ports, airports, suppliers, and major markets	Access to workers with the skills firms need to operate and grow	Easy access to domestic and export markets through trade links
Infrastructure	**Governance**	**Domestic Linkages**
Reliable transport, electricity, water, digital networks, and other services	Clear rules, efficient administration, and a predictable business environment	Integration with local firms and suppliers

Tax should come last, not first



Source: Aliu et al. (2026)

So how should SEZs be taxed? Indirect Taxes

Tax	Rationale and Risks of Tax Incentives	Suggested Tax Treatment
	Indirect Taxes	
Customs Duties	May lower input costs, improve SEZ efficiency, and attract investors. However, they reduce tariff revenues, create risks of fraud and arbitrage, and complicate compliance if not paired with efficient procedures.	- Limit exemptions to capital goods and production inputs. Make those exemptions time-bound, legislated, and subject to periodic review. - Introduce on-site customs clearance and integrate SEZs into single window systems. - Ensure uniform customs regimes across SEZs, with regular oversight, audits, and reporting.
VAT and Sales Taxes	May reduce cash-flow burdens for SEZ firms and support exporters. However, exemptions undermine neutrality and create revenue leakages, while refund delays discourage local sourcing.	- Ensure neutrality via input VAT credits. - Consider VAT suspension with ex-post customs checks for export-oriented SEZs. - Require mandatory VAT registration and reporting for all SEZ firms, and fully tax domestic sales.
Excises and Production Taxes	May lower production costs and support exports. However, exemptions shift health and environmental costs to the domestic economy and encourage relocation of polluting activities	- Apply excises (alcohol, tobacco, fuel, etc.) fully to SEZ firms.

Source: Aliu et al. (2026)

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So how should SEZs be taxed? Direct Taxes

Tax	Rationale and Risks of Tax Incentives	Suggested Tax Treatment
	Direct Taxes	
CIT	May be used to signal competitiveness. However, over-reliance on CIT holidays could lead to revenue loss and profit shifting. Similarly, long-term CIT exemptions can create dependence.	- Maintain neutrality with domestic firms. - If justified, implement cost-based incentives (accelerated depreciation, investment credits). - Use sunset clauses and mandate regular policy evaluation. - Require reporting for all firms, including exempt ones.
Wage Taxes	May lower labor costs for firms. However, benefits often accrue to firms rather than workers. Can distort labor markets and reduce overall competitiveness	- Avoid wage tax incentives. - If justified, apply them broadly, not only in SEZs.
Dividends, Interest, Royalties, Capital Gains	May reduce the cost of capital for investors. However, exemptions are costly and generally ineffective at attracting FDI. They also erode source-country taxing rights and can allow MNEs to shift gains on domestic assets abroad.	- Do not exempt. Maintain normal withholding or income taxation, subject to generally applicable treaty limitations. - Tax capital gains on direct and indirect transfers of domestic assets, licenses, and rights.
Property Taxes	May lower firms' operating costs and make the zone more attractive. However, exemptions deprive local services of revenue and shift infrastructure costs to the wider economy.	- Do not exempt recurrent property taxes. - Ensure regular valuations (using book values or size where markets are thin).

Source: Aliu et al. (2026)

Three takeaways

1. **SEZs can work, but they are not a shortcut around the fundamentals** of economic development. Infrastructure, governance, skills, market access and links to the domestic economy matter enormously.

2. **More generous tax incentives do not necessarily produce a more successful zone.** They can instead create substantial fiscal costs, distortions and opportunities for tax avoidance.

3. **The right question** is not "what tax incentives should an SEZ receive?" It is: what are we trying to achieve, what is preventing us from achieving it, and is preferential tax treatment actually an effective and cost-effective way of addressing that problem?

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Thank you!