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CORPORATE INCOME TAXES AND INVESTMENT INCENTIVES

A GLOBAL REVIEW

HIGHLIGHTS

- The tax competition to promote investment has led to declining corporate income tax (CIT) rates in all geographical regions and in most economies since the 1980s. The worldwide CIT rate more than halved, from 40 per cent in 1980 to 23 per cent in 2021.

- Beyond CIT reductions, the tax competition extends to various types of incentives. Of 100 countries that adopted investment measures related to taxation in the past decade, 90 lowered taxes, introduced new tax incentives or made existing incentives more generous, bringing down drastically the effective tax rate in many regions.

- More than one third of fiscal incentives were profit-based (mainly tax holidays and reduced CIT). Expenditure-based incentives, which tend to reward reinvestment (e.g. allowances or tax credits) constituted just over 1 in 10 new tax incentives.

- Globally, most new tax incentives targeted manufacturing and services investments, while those targeting the agricultural and extractive sectors concentrated in developing countries and LDCs.

- In only about 30 per cent of cases, incentives are granted on the basis of measurable criteria (such as the invested amount, the volume of employment generated or the location of the investment), and the majority are not time-bound.

- Investment promotion agencies play a key role in the provision of incentives, mainly as facilitators or advisors. In one-third of the cases, they are actively involved in allocation decisions.

- Most recent industrial policies entail the introduction of new tax incentives for investment (61 per cent), while only 15 per cent call for their review or streamlining.

- The most recurrent motivations for introducing tax incentives in industrial policies are reducing the cost of doing business, supporting innovation, stimulating local production and developing SMEs.

Introduction

Foreign investors base their decision to enter a country on many factors, including political stability, economic potential, natural resources, transparency and efficiency of regulatory regimes and the level of infrastructure and skills. The tax regime is also a factor in investment decisions, and although tax incentives are frequently far from being the most important one in comparison with factors such as political stability and security, a stable and transparent legal and regulatory environment and the quality of infrastructure and skills (World Bank, 2018; Freund and Moran, 2017), they have traditionally been one of the most widespread policy tools to attract and retain foreign investment. The pandemic has accentuated the importance of incentives and tax relief efforts as part of the economic recovery and resilience packages adopted worldwide (Kronfol and Steenbergen, 2020).

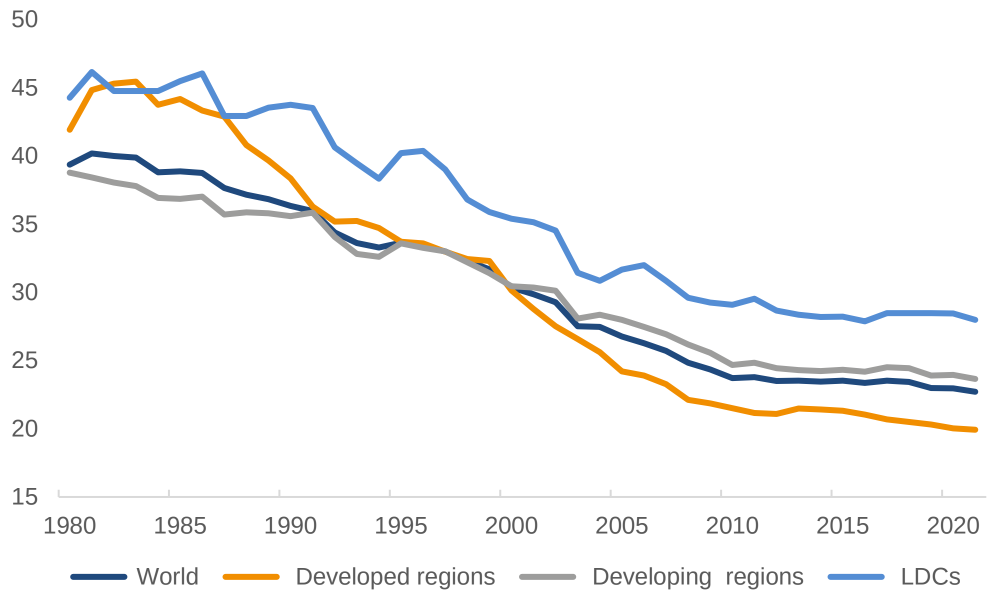
This Special Issue of the Investment Policy Monitor expands on the findings and analysis presented in the World Investment Report 2022: *International Tax Reform and Sustainable Investment* (UNCTAD, 2022). In the context of the ongoing reform of the international tax system, it highlights key trends in the taxation of investment by analyzing the evolution of corporate income taxes across the world (section A), as well as country efforts to attract investments through tax incentives (section B). It also highlights how, beyond engaging in tax competition for investment by lowering the statutory corporate income tax rates, countries rely heavily on investment incentives to attract investors to priority sectors or regions.

A. Evolution of Corporate Income Tax

In 1980, the worldwide CIT rate averaged 39.3 per cent, and 80 per cent of the jurisdictions for which data on CIT rates are available imposed rates of 30 per cent or higher. A steady decline was observed globally until 2010, when the number of economies charging CIT at or above 30 per cent decreased to 67 and the worldwide average CIT rate fell to 23.7 per cent. Since then, the average rate has practically stabilized at the current level of 22.7 per cent (figure 1). In 2021, fewer than one third of all countries applied CIT at 30 per cent or above.[1]

[1] The analysis carried out in this section is based on the data on the statutory CIT rate available at https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/ for economies (sovereign States and other types of territorial units) included in the UNCTAD classifications of geographical groups and regional development status https://unctadstat.unctad.org/EN/Classifications.html. The list of economies included in the UNCTAD classifications may differ from the M49 standard of the Statistical Division of the United Nations Secretariat. The data set includes historic statutory CIT rates for 1980–2021.

Figure 1: Statutory CIT rates, regional and world averages, 1980-2021 (Per cent)



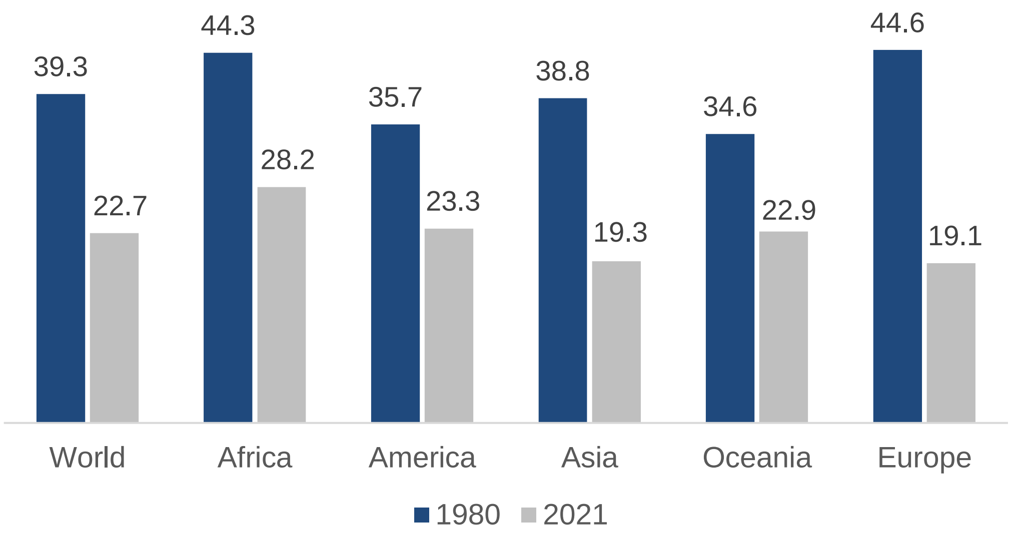
Source: UNCTAD, based on Tax Foundation

The largest downswing has occurred in developed regions, where the average CIT rate more than halved between 1980 and 2021 (from 41.8 per cent to 19.9 per cent) (see figure 1). The average rate for developing regions, which contain 75 per cent of the world's economies, has been very close to the worldwide average. Nevertheless, 105 developing economies (some 65 per cent) still have CIT rates above the world average. The average CIT rate for the least developed countries (LDCs) has followed the common downtrend but has been characterized by more volatility and the highest values among the three groups. Although the average rate in LDCs has dropped from 44.3 to 28 per cent over the last four decades, in half of these countries it remains at the level of 30 per cent or above. Whereas in many developing economies reducing the corporate tax became possible because of a shift from direct to indirect taxes in the structure of fiscal income, this was not the case for several LDCs, which rely much less on other sources of fiscal revenue than on CIT.[2]

In 2021, Europe, which has seen the largest reduction in CIT rates of all regions, had the lowest regional average rate, at 19.1 per cent, followed by Asia at 19.3 per cent. In contrast, Africa had the highest regional average statutory rate, at 28.2 per cent. Countries in Latin America and the Caribbean also tend to have higher corporate tax rates than do Asian and European economies, and in Oceania and North America corporate tax rates align closely to the world average at 22.9 and 23.3 per cent, respectively (figure 2).

[2] An analysis of a large pool of LDCs shows that unlike in developed countries, corporate rather than personal tax is the greater source of public finance for LDCs. It also highlights that although the corporate tax rate has been decreasing in LDCs, corporate tax revenues have been increasing as a share of total tax revenues and gross domestic product (Baker, 2018).

Figure 2: Average statutory CIT rate by region, 1980 and 2021 (Per cent)



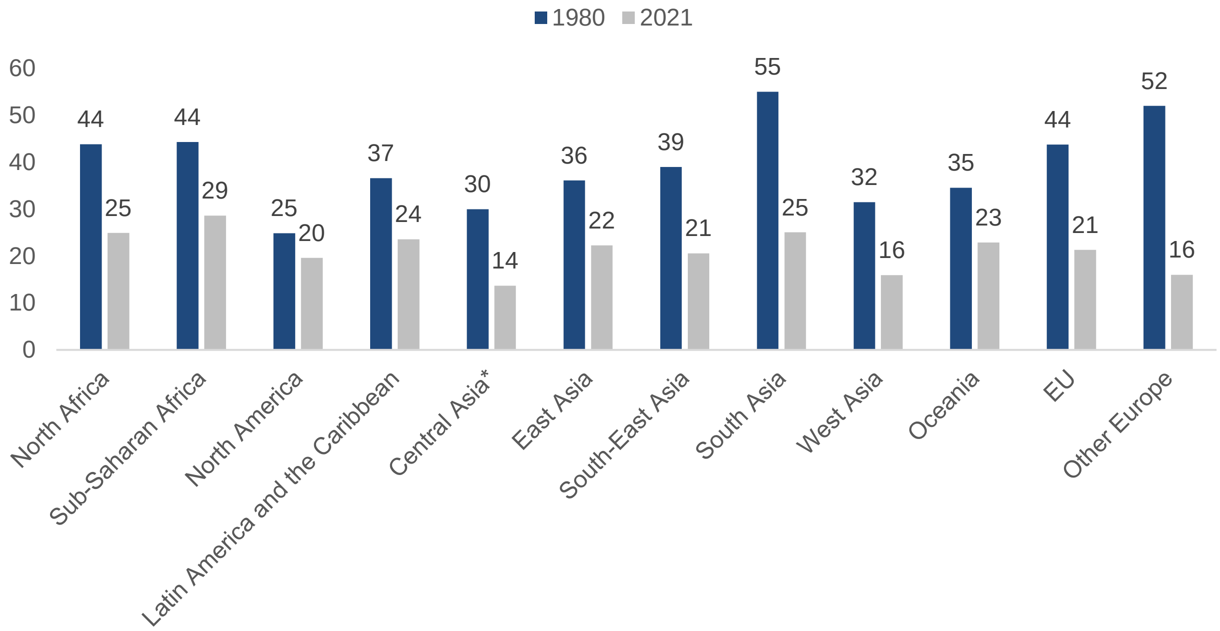
Source: UNCTAD, based on Tax Foundation

In 1980, Europe had the highest average rate among all regions – 44.6 per cent, which is attributed to the economies of West, North and partly South Europe.[3] Since then, most of these economies have lowered their rates by 25-40 percentage points.[4] Transition towards market-oriented economies in eastern Europe at the beginning of the 1990s had accelerated the downward trend as new EU member States and other East and South-East European economies adopted low CIT rates to attract investment. Already by the end of the 2000s, more than half of all European countries had adopted rates of 20 per cent or less. The average CIT rate among EU countries is 21.3 per cent, while the average rate among other European countries is 16 per cent (figure 3). Eleven European economies charge rates at or below 12.5 per cent. In general, larger and more industrialized European countries have higher CIT rates than smaller ones.

The average CIT rate in Asia has halved over the reviewed period (figure 2). Its current value, at 19.3 per cent, is very close to the European rate and is the second smallest among the five world regions. The largest decline in the Asian region was registered in South Asian countries, where the average rate dropped from 55 to 25.1 per cent (figure 3). The latter, however, remains higher than the worldwide and regional averages, mainly due to higher corporate income taxes imposed by India (30 per cent), Bangladesh (32.5 per cent) and Pakistan (29 per cent). In contrast, Central Asia has the lowest average CIT rate, at 13.7 per cent, and three out of the five countries in the region (Uzbekistan, Turkmenistan and Kyrgyzstan) are among the economies that levy the lowest non-zero corporate tax in the world (7.5, 8 and 10 per cent respectively).

[3] The data on other parts of the European continent are only available from the beginning of the 1990s onwards.
[4] For example, Finland reduced its CTR from 61.75 to 20 per cent, Sweden from 60.1 to 20.6, Ireland from 50 to 12.5 per cent, and Cyprus from 42.5 to 12.5 per cent to mention a few.

Figure 3: Average statutory CIT rate by subregion, 1980 and 2021 (Per cent)



Source: UNCTAD, based on Tax Foundation.
Note: * For Central Asia, data covers the period 1990 – 2021.

Corporate rates in West Asia averaged 15.9 per cent in 2021, with the highest rates found in the Syrian Arab Republic (28 per cent) and Israel (23 per cent). The lowest CIT rates in this group have been charged by the Gulf economies, except for Saudi Arabia. Over time, they have shifted to taxing corporations at or below 15 per cent, and two of them, Bahrain and the United Arab Emirates do not impose corporate income taxes.

East and South-East Asia's CIT rates tend to be close to the world average (22.2 and 20.6 per cent respectively). Within East Asia, rates in China, the Republic of Korea and Japan vary between 25 and 30 per cent, which is higher than in most industrialized and emerging Asian economies. At the subregional level, these rates, however, are counterbalanced by lower corporate income taxes in Hong Kong and Macao, Special Administrative Regions of China, as well as in Taiwan, Province of China. In South-East Asia, only Philippines taxes corporate profits at 30 per cent. In contrast, Timor-Leste falls under the list of countries with the world's lowest rates – 10 per cent. All other economies in the region apply rates around 20 per cent.

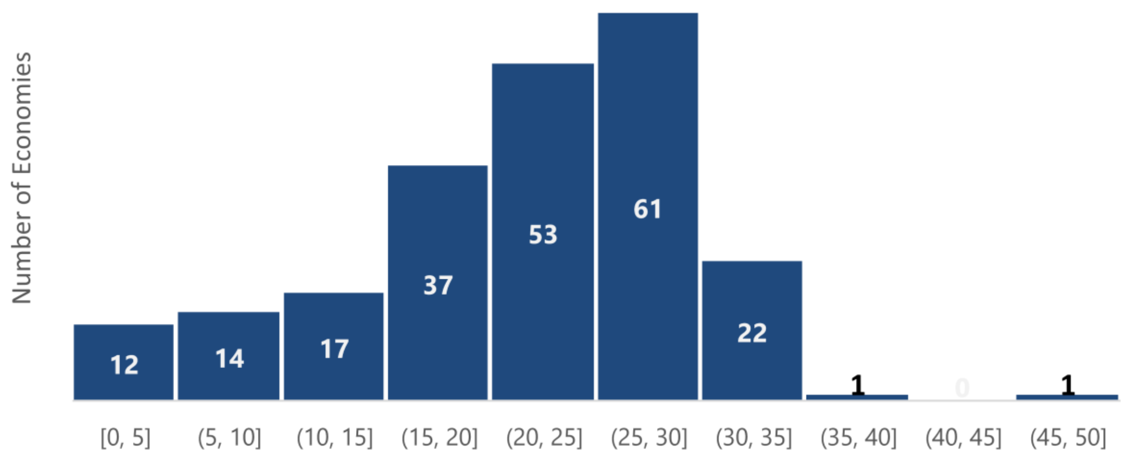
The average CIT rate in North America stood at 19.6 per cent in 2021. Over time, its decline has been driven by gradual lessening of the tax in Canada (from 50.9 to 26.1 per cent) and two tax cuts in the United States. The first one took place in the 1980s – early 1990s, when the rate fell by 10 percentage points and stabilized at nearly 40 per cent for the following 30 years. The second reduction was introduced by the 2017 fiscal reforms, when the statutory rate fell to 25.8 per cent, bringing the country closer to the middle of the worldwide CIT rate distribution. The rate in Greenland fluctuated between 35 and 26.5 per cent.

In Latin America and the Caribbean, the CIT averages 23.6 per cent, which is very much in line with the average for the entire American region (23.3 per cent). A notable difference exists, however, between the economies in the region. Forty per cent of them impose a CIT equal to or higher than 30 per cent. This comprises both large (Argentina, Brazil, Venezuela, Mexico, Colombia, etc.) and relatively small jurisdictions, including island States (Cuba, Suriname, Trinidad and Tobago, El Salvador, Nicaragua, Costa Rica, etc.). On the other hand, one fifth of the economies apply low (10 per cent or less) or no CIT. The remaining economies charge rates around 25 per cent. The financial centres in the Caribbean can be seen in all the three groups in nearly equal proportions.

Within Africa, North African countries have reduced the CIT rates to a 24.9 per cent average. This is 3.8 percentage points lower than in the sub-Saharan Africa. More than 50 per cent of African countries charge CITs at 30 per cent or above, and only two countries, Mauritius and Tunisia, apply rates under 20 per cent (15 per cent both).

In 2021, the median CIT rate over the world was 25 per cent. 133 economies out of 218 charged CITs at or below the median rate (figure 4). Among them 12 jurisdictions, mainly Caribbean or Pacific islands, had no CIT, and 31 economies had rates not exceeding 15 per cent. Among 85 economies imposing CIT above the median, 61 had a rate at or below 30 per cent and in 22 countries, CITs were above 30 and below 35 per cent. Only 2 countries, Comoros (50 per cent) and Suriname (36 per cent) charged CIT above 35 per cent.

Figure 4: Distribution of worldwide CIT rates, 2021 (Percentage intervals)



Source: UNCTAD, based on Tax Foundation
Note: Square bracket: number included; round bracket: number excluded.

B. Tax incentives for investment

The analysis of the tax incentives for investment in this section is based on the review of tax-related investment policy measures adopted worldwide in the last decade. This section also examines the treatment of tax incentives in investment laws, which often constitute the legal basis for their adoption; and in industrial policies, which generally provide their broader policy background or motivation.

Among the various incentives for investment (table 1), this section focuses primarily on tax incentives. For the purpose of this analysis, they are broadly categorized into CIT-based and other incentives. CIT-based incentives include:

(i) Profit-based incentives, i.e., those determined as a percentage of profit, including tax holidays, reduced CIT or loss carry forward or carry back to be written off against profits earned later

(ii) Expenditure-based (or capital investment-based), i.e., those that reduce the after-tax cost of capital investment expenditure, including investment allowance, accelerated depreciation, tax credits and the like[5]

Profit-based incentives provide tax relief based on earnings and not on new investment. In this regard, they are particularly attractive to mobile FDI. Expenditure-based incentives, by contrast, tend to promote re-investment and therefore further integration into the local economy. In addition, expenditure-based incentives typically target specific types of capital investments or activities that can be associated with countries' sustainable development objectives, such as skills development and the low carbon transition. Other tax incentives include reduced rates on indirect taxes (e.g. VAT, duties and tariffs), taxes on labour, land, social security contributions and other payments.

The analysis confirms that countries rely intensively on tax incentives for investment, and that profit-based incentives, i.e., those which are most likely to be affected by the international tax reforms, are among the most widespread and frequently adopted ones.

[5] For details on this classification, see UNCTAD (2000).

Table 1 Key investment incentives by type

Financial	
Investment grants	"Direct subsidies" to cover (part of) capital, production or marketing costs in relation to an investment project
Subsidized credits and credit guarantees	Subsidized loans Loan guarantees Guaranteed export credits
Government insurance at preferential rates, publicly funded venture capital participating in investments involving high commercial risks	Government insurance at preferential rates, usually available to cover certain types of risks (such as exchange rate volatility, currency devaluation and non-commercial risks such as expropriation and political turmoil), often provided through an international agency
Fiscal	
Profit-based	Reduction of the standard corporate income tax rate or profit tax rate, tax holiday, loss carry forward or carry back to be written off against profits earned later (or earlier)
Capital-investment-based (or expenditure/cost-based)	Accelerated depreciation, investment and reinvestment allowances, tax credits
Based on particular expenses	Deductions based on qualified expenditures (e.g. R&D, training, export marketing, etc.)
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
Import-based	Duty exemptions on capital goods, equipment or raw materials, parts and inputs related to the production process
Others	Reduced taxes on dividends and interest paid abroad, preferential treatment of long term capital gains; reduction of rates for expatriates etc.
Regulatory	
Exceptions and exemptions	Lowering of environmental, health, safety or labour standards Temporary or permanent exemption from compliance with applicable standards Stabilization clauses guaranteeing that existing regulations will not be amended to the detriment of investors
Market privileges	Preferential government contracts Closing the market to further entry or the granting of monopoly rights Protection from import competition