MENA-OECD INVESTMENT PROGRAMME

OECD

Tax Incentives for Investment – A Global Perspective:

experiences in MENA and non-MENA countries

Draft[1]

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www.oecd.org/mena/investment

1 . Information on the tax systems of MENA countries still need to be confirmed by country representatives.

1. Introduction

1. The purpose of the present paper is to analyse the effects of the use of tax incentives on foreign direct investment performance in the Middle East and North Africa (MENA) region, based on a review of international best practice and some empirical evidence. It is hoped that the discussions in Working Group 3 (*Tax Policy for Investment*) of the MENA-OECD Investment Programme will provide a forum for information updating and peer review on this issue.

2. All MENA countries offer direct and/or indirect investment incentives to boost employment, encourage the development of the private sector and improve their competitive position in today's global economy. During the past twenty years, incentives in many respects have become an important policy tool of many MENA governments to increase their share of investment in order to gain the attention of potential investors and to stay competitive with other countries offering incentives. While most international studies have shown that general economic and framework conditions, rather than incentives, are far more important in determining the size and quality of investment flows, incentives can compensate for market failures, are seen as easy to implement, and often seen as effective policy tools for achieving economic and social objectives.

3. Some MENA countries have multiple laws offering incentives, whose design and administration is the responsibility of separate ministries. Responding to pressure from investors, these ministries in many cases have made existing incentives more generous and increased the number of new incentives. Often these different ministries do not coordinate their work on incentives, with the result that the incentives often overlap, are not entirely consistent, or work at cross-purposes. Many incentives are also readily exploited by investors, as well as by those administering them.

4. Despite the popularity and widespread use of incentives in the MENA region, there generally have not been systematic reviews of the effectiveness of the various incentives offered, either by individual countries or at a regional level. In many countries, there is an absence of reliable data on actual investments made, direct and indirect benefits to the host economy and the cost of the incentives in terms of direct spending or revenue lost.

5. This paper is organised in seven sections. Section 2 summarises the main factors that influence investment location decisions. Section 3 describes the main advantages and disadvantages of tax incentives used through corporate taxation. Main tax incentives used in the MENA region are summarised in Section 4. Some empirical evidence on the effectiveness of the use of tax incentives is presented in Section 5, including two cases of successful elimination of tax incentives. Section 6 discusses other tax features relevant on investment location decisions besides tax incentives. Section 7 concludes.

2. Factors influencing foreign direct investment

6. There is a consensus in the literature about the main factors affecting (foreign) investment location decisions.[2] The most important ones are market size and real income levels, skill levels in the host economy, the availability of infrastructure and other resource that facilitates efficient specialisation of production, trade policies, and political and macroeconomic stability of the host country (see Table 1).[3] The relative importance of the different factors varies depending on the type of investment.

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2 . See for example Dunning (1993), Globerman and Shapiro (1999), and Shapiro and Globerman (2001).

3 . Some of the MENA countries offer a quite good physical investment climate (e.g. modern roads, ports and electricity grids), a reasonably well-educated labour force, and have at least taken steps toward raising

Table 1: Factors influencing FDI		
Non-tax factors	market size	
	access to raw materials	e.g. natural resources, energy supplies
	availability and cost of skilled labour	
	access to infrastructure	
	transportation costs	
	access to output markets	e.g. high consumer demand in region, low export costs
	political stability	
	macro-economic stability	
	financing costs	
Tax factors	Transparency, simplicity, stability and certainty in the application of the tax law and in tax administration	
	Tax rates	
	Tax incentives	

7. Additionally, the location of foreign direct investment (FDI) may be influenced by various incentives offered by governments to attract multinationals. These incentives include fiscal (or tax) incentives (such as reduced corporate tax rates),[4] financial incentives (such as grants and preferential loans to multinationals), as well as other incentives like market preferences and monopoly rights.

8. Survey analysis shows that host country taxation and international investment incentives generally play only a limited role in determining the international pattern of FDI (e.g. manufacturing FDI). Factors like market characteristics, relative production costs and resource availability explain most of the cross-country variation in FDI inflows. Transparency, simplicity, stability and certainty in the application of the tax law and in tax administration are often ranked by investors ahead of special tax incentives. Control of government finances is also identified as a key element, which helps provide stability in tax laws and thus greater certainty over tax treatment, as well as greater stability and less risk in the economy overall.

9. An example illustrating these empirical findings is a recent survey of investors in South East Europe (OECD (2003)). In particular, this survey can give a flavour on how tax systems are perceived by investors. This survey suggested that strategic investors consider tax factors as only one of the obstacles to investment (counting only 24 per cent), instability and unpredictability of the tax system (adding risk) being perceived the key tax impediments. Tax issues were not mentioned in the responses of the opportunistic investors, indicating that they were not so important in the decision making process (see Figure 1).

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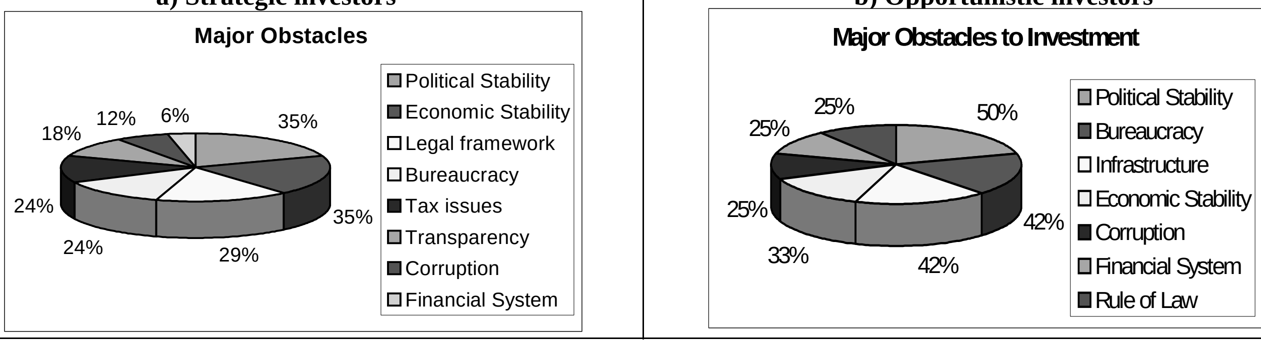
administrative and regulatory efficiency. However, more remains to be done, and investors are much stronger attracted to some economies than to others.

4 . Fiscal incentives are defined as those special exclusions, exemptions, deductions or credits that provide special credits a preferential tax treatment or deferral of tax liability. Tax incentives for foreign direct investment (FDI), are often structured through income tax systems, providing relief from corporate-level taxes on income from capital (e.g., tax holidays, reduced corporate tax rates, special corporate tax deductions, allowances and credits), and in some cases providing relief from personal income tax (e.g., imputation relief, preferential tax treatment for expatriates). They can also take the form of reduced import tariffs or customs duties.

Figure 1. Major obstacles to investment

a) Strategic investors **b) Opportunistic investors**



Source: OECD (2003).

10. Additionally, the same SEE investor survey found that special tax incentives, rather than encouraging FDI, either were not taken into account (were judged to be unimportant), or operated to discourage investment. Tax incentives were discouraging to investment where the provisions were difficult to track, understand or comply with and/or invited corrupt behaviour on the part of tax officials, tending to increase project costs and uncertainty. Particularly discouraging were non-transparent incentive regimes, including those subject to frequent change and involving excessive administrative discretion. Investors exhibited a strong preference for stable and sound tax systems that did not deviate significantly from international norms.

11. Then, if in general tax incentives are not seen by investors a key factor to attract inbound investment, why are tax incentives chosen by governments to attract investment in general and FDI in particular? There are three simple answers to this question of particular relevance for developing countries:

- tax incentives are much easier to provide than to correct deficiencies in, for example, infrastructure or skilled labour;
- tax incentives do not require an actual expenditure of funds or cash subsidies to investors; and,
- tax incentives are politically easier to provide than funds.

12. Best practices recommend that policy makers, in the decision of whether or not to introduce special tax relief mechanisms, address the impediments inhibiting investment and question whether these should be tackled through the tax system, or through structural policy changes in other areas, or both. There are four particular issues that should be considered in this decision process:

- Transparency, simplicity, stability and certainty in the application of the tax law and in tax administration are often ranked by investors ahead of special tax incentives.
- Tax relief may enhance the attractiveness of a potential host country, but experience shows that in many cases the relief provided will be insufficient to offset additional business costs incurred when investing there and, therefore, it does not realistically address the actual need (relevance of tax incentives).
- Where a firm is able to generate profits in a given host country, tax incentives may be successful in attracting additional FDI, and may be viewed as necessary where similar relief is being offered by another (e.g., neighboring) jurisdiction also competing for foreign capital. This raises questions concerning the appropriate design of tax incentive relief (whether the benefits are given

to unintended activities and/or are not given in full to target activities) as well as whether foreign direct investors would invest in the region in the absence of special tax incentives.

- Where additional FDI resulting from tax relief can be expected, policy makers should be encouraged to undertake an analysis of the social benefits and costs of tax incentives use (efficiency and effectiveness issues).

13. Additionally, the empirical literature has found that targeted tax incentives are not generally very effective. However, their effectiveness will depend on the specific country situation. We stress the need for effort by policy makers to assess the likely benefits and cost of incentives, while recognising that policy officials may be confronted with demands for the adoption of investment incentives with insufficient data to assess overall effects, and possibly little leverage to discourage their use even where roughly estimated costs exceed the likely benefits. We also encourage countries to consider a broad-based approach; i.e., a low effective tax rate through low statutory tax rate on broad base. [5]

3. Pros and cons of main tax incentives used through corporate income tax

14. Table 2 summarises the main advantages and disadvantages (in addition to revenue forgone) of the different tax incentives used in MENA countries.[6] Policy makers are encouraged to consider whether the costs of fiscal and financial incentives, in terms of complexity, neutrality and revenues forgone, more than offset their benefits in terms of attracting investment.

15. The associated costs of tax incentives can be classified in four main categories:

1. *Forgone revenues*: the losses in tax revenue from tax incentives mainly come from three sources; first, the forgone revenue that otherwise would have been collected from the activities undertaken; second, the forgone revenue from projects that would have been undertaken even if the investor did not receive any tax incentives; and, third, lost revenue from investors and activities that improperly claim incentives (taxpayers abuse) or shift income from related taxable firms to those firms qualifying for favourable tax treatments (tax planning).

2. *Resource allocation (neutrality) costs*: originated when tax incentives create distortions on investment choices among sectors or activities instead of correcting market failures.

3. *Enforcement and compliance costs*: these costs increase with the complexity of the tax system and the system of fiscal incentives (in terms of qualifying and reporting requirements, different schemes). Additionally, there is a problem of perception of lack of fairness when targeted incentives are used, which reduces compliance and, therefore, increases enforcement efforts.

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5 . Irish tax system has been shown to be a positive component of the success story of Ireland in attracting foreign direct investment. The corporate tax system in Ireland is based on a low tax rate applicable to all income, with accelerated depreciation, losses carry-forward allowed indefinitely and no tax holidays. However, a combination of factors in addition of the Irish efficient tax system has played a role in attracting FDI: its access to the large European market, investment in education and its ability as an English speaking country.

6 . See Annex 1 for a brief definition of the different tax incentives.

Table 2: Pros and cons of main tax incentives

Tax measure	Advantages	Disadvantages
tax holidays	Reduction on tax liabilities Relative low compliance costs Simple to administrate	Discriminates btw old and new investment Deny certain tax deductions (depreciation costs and interest expenses) over the tax holiday period or defintiely, tending to offset at least in part any stimulate effect Amount of relief depends on starting period of holiday and treatment of losses Tax-planning opportunities: shifting capital to new business if incetive targeted to new establishments, routing interests and other deductible payments (interests of loans, convert interest income in dividend income), transfer pricing
reduction on CIT rate for certain sectors	Attractive for mobile investors (reduces the rate of tax on profits) Dynamic effect on stimulating economy Simple to administrate	Discriminates against other businesses Zero or negilible tax rate could result in tax haven status Revenue forgone can be offset by reduced home country country foreign tax credits Reduces the PNV of capital allowances Increases the after-cost of debt finance Tax-planning opportunities
exemption of CIT for export companies	Incentives for business that operate internationally Encourages domestic companied in host country to look outward for new markets	Discriminates against non-export businesses Against EU and WTO rules
accelerated capital (investment) allowances	Deductions on the first year of operation that lower the effective price of adquiring capital- Helps with liquidity constraints	Revenue forgone (the higher the tax rate the higher the allowance)
- Buildings - Plant and machinary	Facilitates investment in new equipment and machinary Facilitates development of industrial parks	Could result in excessive investment (e.g. unutilised buildings) Where deductions must be claimed in the year earned, the treatment of losses is critically important. Deductions provide benefits only if they can be carried forward to offset future tax liabilities.
investment tax credits	large impact on ETR at lower revenue cost can be targeted to certain types of investment with highest positive spillovers Helps with liquidity constraints	Discriminates btw old and new investment Larger impact with short-lived assets because can offset a larger % of tax revenues on a given stream of earnings Greater adminsitrative burden Discriminates agains investments with delayed returns if loss carry-forward provisions are inadequate
location based incentives	Encorages the rejuvenation and development of certain areas socially, culturally, industrially and esthetically	Revenue forgone
reduced taxes on dividens and interests paid abroad		Tax-shifting The lower the dividend tax the lower the incentive to reinvest profits
preferential treatment of long-term capital gains	Encorages investors to retain funds for a long period	
deductions for qualifying expenses - training expenses - R&D - export marketing expenses	transfer of technology if considered with other measures	
exemptions from indirect taxes (VAT, import tariffs)	allows taxpayers toa void contact with tax administration (important if it is complex and corrupt)	Little benefit form VAT exemptions if tax on input is creditable prone to abuse: easy to divert exempt purchases to unintended recipients
Export processing zones	allows taxpayers to avoid contact with tax administration (important if it is complex and corrupt)	Distorts local decisions Tpically substantial leakage of untaxed goods into domestic market, eroding tax base

Source: OECD (2001), United Nations (2000), Fletcher (2002).

4. *Lack of transparency*: when the rationale for granting tax incentives is based more on discretionary and subjective qualification requirements, instead of automatic and objective requirements, they can originate rent-seeking behaviour and facilitate officials' abuse on the granting process. In particular for developing and emerging economies, it is important to move away from discretionary incentives towards greater reliance on *rules-based* means of attracting FDI - national and international rules that maintain or strengthen environmental and labour standards and create stability, predictability and transparency for policy makers and investors alike.

16. In general best practices discourage the use of special tax incentives to attract FDI and argues in favour of a reduced statutory corporate income tax rate on a broad tax base (this simpler approach benefits both old and newly acquired capital, avoids many pitfalls associated with other forms of relief while taking tax-planning pressures off the domestic base). However, at the same time, it is recognised that pressures can mount to introduce special incentives in response to "tax competition" amongst competing states, and

that policy makers can benefit from a review of design considerations to target assistance and minimise unintended revenue loss.

17. When considering the introduction of tax incentives, governments should take into account the following (summarised) best practices on the use and design of tax incentives:

- Governments should assess in advance tax incentives targeted to boost investment;

- if introduced, the tax incentives should be evaluated (using cost-benefit tests) on a periodic basis to gauge whether their effectiveness;

- to enable proper evaluation and assessment, the specific goals of a given tax incentive need to be explicit at the outset;

- "sunset clauses" calling for the expiry of the incentive should be included to provide opportunity to assess whether the availability of the incentive should be extended or not.

18. Many OECD and some non-OECD countries (including Morocco in the MENA region from 2006) report tax incentives in their Tax Expenditures Report. This Report not only has the objective of allocating efficiently resources (provides information for the comparison of the effectiveness and cost of direct spending and tax expenditure programs) but also of strengthening government finance and contributing significantly to fiscal transparency.

4. Main tax incentives offered in MENA countries

19. From a global perspective, a reduction in the base rate of corporate income tax is the most widely used fiscal incentive. However, the next most widely used tax incentives vary across developed and developing countries. In OECD countries, accelerated depreciation, specific deductions for corporate income-tax purposes, and reductions in other taxes (including state and local) are the next most widely used (in descending order). In contrast, developing countries tend to offer more tax holidays and import-duty exemptions and drawbacks after reduced base income tax rates. Among targeted incentives, those geared to promoting exports have been most effective.

20. Table 3 summaries the main fiscal incentives offered in the MENA region in 2004 (see Annex 2 for a detailed description of tax incentives by country). In general (in both developed and developing countries) tax incentives are target to attract investment in specific types of activity or geographic areas. The principal targets are: *i)* specific *sectors*, notably in manufacturing, infrastructure, tourism, health and transportation, and in several cases education; *ii)* specific *regions* (geographic locations) which are less developed areas; *iii) exports*.[7]

21. Most MENA countries offer corporate tax holidays. They range between 2 years (Jordan) and 20 years (Egypt), and in many cases are extendable in case of supplementary investments. In Algeria, where incentives under the new investment code are offered on a case-by-case basis by the approval of the National Investment Council, tax holidays can be indefinite. On the other hand, in Morocco tax holidays for exports are limited only to 5 years. Reduced corporate rates, targeted to specific sectors/locations are also offered in four MENA (Jordan, Lebanon, Morocco and Tunisia).

7 . Tax incentives targeted to exports are mainly used in developing countries.

Table 3: Main tax incentives used in the MENA region, 2004

	Tax holidays (years)	Reduced CIT	Exemption CIT for exports	Accelarated depreciation	Location-based incentives	Exemption from indirect taxes/ duties	Export/free zones
Algeria	10	no	yes	yes	yes	yes	no
Bahrain	-	-	-	-	-	manufacturers	yes
Egypt	5-10-20	for exports	no	yes	yes	in specific zones	yes
Jordan	2-12	sector specific	yes	yes	yes	sector and location specific	yes
Kuwait	10	no	no	no	no	on production items	yes
Lebanon	10	location specific	no	no	yes	sector specific	yes
Morocco	5	exports and sector specific	yes	yes	yes	export and sector specific	yes
Oman	5 + 5	no	no	no	no	some imported goods	yes
Qatar	5 + 5	no	no	no	no	on particular production inputs	no
Saudi Arabia	10	no	no	yes	no	for industrial projects	no
Syria	5	no	no	no	no	on production inputs	yes
Tunisia	10	sector specific	yes	yes	yes	exports only	yes
UAE	-	-	-	-	-	in free zones	yes
Yemen	7	no	no	no	no	on project fixed assets	yes

Source: OECD (2005), Investment climate statements of the US State Department, United Nations (2000), and National countries investment and tax laws.

22. Among the fiscal incentives that are apparently offered by only few countries we can find exemption of foreign staff from income taxes and/or social security contributions in some countries (e.g. Jordan) or an indefinite exemption of reinvested earnings from corporate taxation in Tunisia.

23. Some countries as Bahrain and United Arab Emirates attract FDI to exploit rich natural resources (mainly oil) that are a main source of income. These countries rely less on special preferences like tax holidays and special financing regimes, and have high corporate income tax rates and withholding taxes earned from oil production and exploitation (Bahrain, 46 per cent of net profits on income of oil companies; United Arab Emirates does not have corporate taxes at federal level. At emirate level oil-producing companies and branches of foreign banks are required to pay tax rates between 0 and 55 per cent).

24. Export/free zones (FEZs) are also common in the MENA region; only three countries have no FEZs at all (Algeria, Qatar and Saudi Arabia[8]). The fiscal incentives offered to investors in the general economy are available to companies in the FEZs as well. Additionally, governments often offer exemption of corporate taxation (Kuwait, United Arab Emirates and Jordan) or reduced corporate tax rates (Egypt and Morocco), exemption from duties and tariffs (Morocco, Tunisia, United Arab Emirates), and more generous tax holidays (Lebanon, Morocco and Yemen) among other privileges in these zones. The FEZs that are so far considered most successful are those in the United Arab Emirates. Several MENA countries have expressed the intention of trying to emulate the success of the Emirates with FEZs. Arguably, the most advanced plans can be found in Egypt and Jordan. In the case of Jordan, there is a long-standing tradition for relying on FEZs to encourage investment. Egypt also has a relatively long history of relying on free zones (the oldest ones still in existence were established in 1973), but recent years appear to have brought a change in the overall strategy. No general zones were established since 1993, and more recently the focus has been on special economic zones and industry zones.[9]

5. Some empirical evidence on effectiveness of tax incentives

5.1 Experiences in other regions

25. Evidence shows that tax incentives are generally not sufficient to attract major flows of investment. Mauritius, Costa Rica, Ireland and Malaysia[10] are examples of successful countries attracting investment that offer many advantages to investors other than tax breaks, such as stable economic and political conditions, a well educated labour force, good infrastructure, open trade for exporters, dependable rule of law, and effective investment promotion systems.

26. Furthermore, experiences such as in Uganda and Indonesia, where tax holidays and selective tax incentives programmes were terminated in favour of a more attractive general tax regime, reinforce the

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8 . However Saudi Arabia has been pursuing a strategy of establishing industrial parks that have certain common traits with FEZs.

9 . The category of free zones (FEZs) covers the ground from free ports to export processing zones – FEZs that are generally accessible to investors, but do not go as far as offering a tailored regulatory environment. Special economic zones (SEZ) are basically ring-fenced customs-free areas with a regulatory environment of their own. They are mostly backed by a piece of legislation establishing a governing council for each individual SEZ and mandating it to enact rules that shall apply to investors within the zone. Industry zones (IZ) are basically free zones, but targeted at specific sectors or economic activities. IZ may restrict the access of companies in non-priority sectors, and their infrastructure is mostly tailored according to their sectoral targets.

10 . Technical Report SADC Region.

theory that special tax incentives are effective in attracting investment or stimulating economic development.

5.1.1 Two success stories of eliminating tax incentives: Uganda (1997), Indonesia (1984)

Uganda (1997)

27. A major tax reform took place in Uganda in 1997. This reform included complete elimination of new tax holidays in favour of a rate of 30 per cent on company income, with generous capital allowances for all investors and unlimited loss-carry forward. A zero import duty was also set on a wide range of capital goods. The elimination of selective incentives also greatly simplified investment licensing.

28. The main effects of this tax reform were (comparing averages of three years before and after 1997): an increase of one percentage point in the ratio of investment to GDP, 70 per cent increase in foreign investment inflows, and a one percent of GDP increase in tax revenue.

29. It is worth it to note that despite these positive effects, business appealed once again for tax incentives in 1998, when asked what the government could do to improve the business environment.

Indonesia (1984)

30. In 1984 an ambitious tax reform took place in Indonesia whose main aims were reducing administrative costs, and economic distortions, increasing equity and reduce evasion and corruption. The company tax rate was reduced from 45 per cent to 35 per cent and selective tax incentives were totally eliminated; including tax holidays, preferential rates, special investment allowances and selective accelerated depreciation.

31. Despite the strong fear that foreign investors would shun Indonesia in favour of countries like Malaysia and Singapore, the number of FDI projects dipped in 1884 but then climbed rapidly for the rest of the decade. Additionally, in value terms, FDI fell from a plateau achieved the previous two years, but then soared to new heights after 1987.

32. Once again, despite these positive effects, pressure to restore tax incentives has been persistent, and in 1994 (several exemptions) and 1996 (discretionary tax holidays, although dropped in 2000 in favour of a new tax allowance and accelerated depreciation) some incentives were reintroduced.

5.2 Experience in the MENA region

33. This section presents some evidence for the MENA region on the effectiveness of tax incentives in four MENA countries as well as on the non-clear link between taxation and FDI attraction.

5.2.1 Moroccan Tax Expenditure Report

34. Many OECD and some non-OECD countries report tax incentives in their Tax Expenditures Report. Although there is not an internationally consistent format for these reports (regarding definition and measurement of tax expenditures, coverage, presentation and usage of tax expenditure accounts), they provide very useful information on the effectiveness and cost of tax expenditure programs. Morocco has been the first MENA country that has elaborated a Tax Expenditure Report, which has been integrated in the documents for the government's budget process from 2006.

35. The macroeconomic evaluation of the effectiveness of tax expenditures shows a positive effect on private investment for the first year of application of incentives, a positive (but decelerated) effect

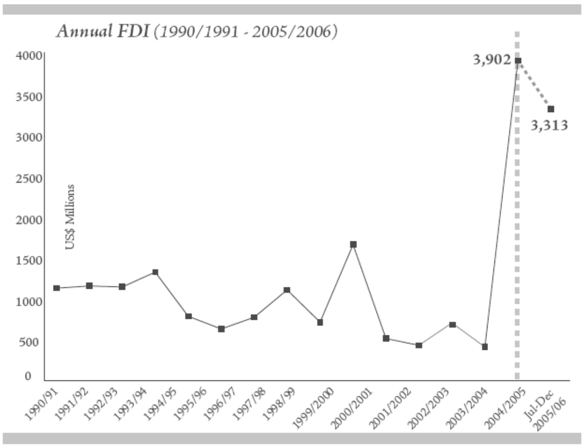
during the second year and negative effect after the third year. At the time that this report was written complete information on the evaluation framework was not available; this makes difficult to explain the possible causes of these trends. However, it is not the first study that finds a reduction in the effectiveness of tax incentives over time (see section 6.2.4).

5.2.2 New Egyptian Income Tax Law

36. A new income tax law (Law No. 91 of 2005) came into force in Egypt on 10 June 2005.[11] Its main aim was to simplify the tax system, improve vertical and horizontal equity and remove tax obstacles to investment and growth. This law lowered the maximum corporate income tax rate from 40 per cent to 20 per cent and abolished the totality of the income tax exemptions provided in the investment guarantees and incentives law No. 8 of 1997 for establishments incorporated after entry into force of the law.[12] It also unified the corporate tax rates across industries and simplified tax procedures.

37. Although it still premature to evaluate the impact of the abolishment of the tax incentives on FDI performance, available FDI data for the first six months of the fiscal year 2005-2006 (provided by the Egyptian Ministry of Finance) suggest that FDI flows almost double in absolute value compared to last year (see Figure 2).

Figure 2: FDI flows in Egypt, US millions of dollars, 1990/91 to 2005/06 fiscal year.



Source: *Recent domestic trends*, Ministry of Finance, Egypt, June 2006: at http://www.mof.gov.eg/English/Reports/june2006/recent-domestic-trends.pdf

11. The Egyptian fiscal year starts in July.

12. The new law stipulates that companies and firms established under the old Investment Guarantee and Incentives Law but which have not commenced operation or production until the effective date of the new law (10 July 2005), are required to start operation or production within three years from the effective date of the new law.

5.2.3 Tunisia (FIAS)

38. In 2002, the Foreign Investment Advisory Service (FIAS) of the World Bank conducted a study on the promotion of private investment in Tunisia. In particular, the study analysed the role of the fiscal system, including the fiscal and financial incentives, on the private investment trends. Between 1996 and 2001, private investment in Tunisia was increase by 10 per cent in average, which was higher than in other countries in the region, and places Tunisia at the same level than countries as Ireland.

39. This study recommends the abolition of exonerations, despite of finding a determinant role of the fiscal and financial incentives on the development and growth of private investment, particularly in the export sector. The main argument is that the costs derived form the incentives system in terms of complexity, neutrality and revenues forgone exceeds their benefits. Tunisian tax system is not simple (with complex different tax rates and bases and large list of incentive regimes) and creates distortions. By calculating effective tax rates across sectors and assets, the study identifies 3 main sources of distortions: 1) in the access to incentives (small and medium enterprises versus multinationals), 2) among types of assets used by the enterprises, and 3) among sectors.

40. Additionally the study finds that these distortions, jointly with the duplication of instruments to reduce corporate taxation (e.g. credits to reinvestment and accelerated depreciation) and the lack of coherence between the multiple systems of incentives and other aspects of economic policy (e.g. high level of tariffs) have implied a reduction of the effectiveness of the incentives by 35 per cent between 1996 and 2001. By reducing the corporate tax rate from 35 to 15 per cent and broadening the base by eliminating tax incentives, the tax system will be simplified at the same time that many of the above distortions will be eliminated without losing tax revenues (given the broadening of the tax base).

5.2.4 Jordan (Institute for International Business, University of Toronto)

41. A report from the Institute for International Business of the University of Toronto in Canada,[13] found that the investment incentive programme in Jordan is too complicated (e.g. there are at least 11 differentiated income tax treatments of business activities) and inefficient. They found evidence that besides the long history of investment incentives, Jordan has not succeeded on attracting significant capital investment in areas favoured by the government, and instead these discretionary measures have simply eroded the base for tax revenues.

42. Additionally, calculating marginal effective tax rates for different sectors, they show that investment incentives in Jordan are creating tax distortions against Jordan's services sector, which undermines efforts to modernise the economy.

43. To conclude, the study recommends a comprehensive tax reform, which should include eliminating Jordan's tax incentives, arguing that it will eliminate tax distortions, remove unnecessary administrative and compliance costs and improve government's capacity to generate revenue.

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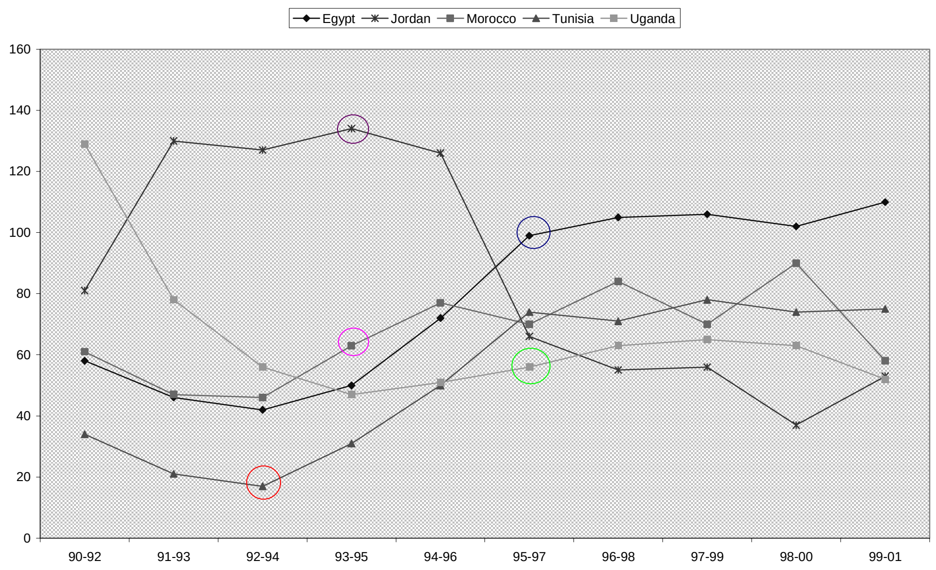
13. This report had the primary objective of assisting Jordan's Minister of Industry and trade and Minister of Finance in the creation of a new programme of investment incentives that can be used as the basis for regulations to support The Investment Law.

5.3 Tax Incentives Reforms and FDI Performance Index

44. The FDI performance (rank) index (measured as the ratio of the share of global FDI inflows to the share of global GDP)[14] may be used to consider whether special tax incentives systematically positively impact FDI. Figure 3 shows the trend of the FDI Performance Index for four MENA countries (Egypt, Jordan, Morocco and Tunisia) that introduced tax relief measures between 1994 and 1997 and for Uganda, which complete eliminated new tax holidays in favour of a rate of 30 per cent on company income in 1997 (year of introduction/abolition marked as circles in Figure 3).[15]

45. FDI performance trends in Figure 3 seem to indicate that while the FDI performance index is not decreasing after tax incentives are introduced (except in the case of Jordan), a steady or increasing trend is also observed when tax incentives are eliminated (Uganda). Only in the case of Tunisia, the Index is rapidly increasing after the reform. However, the Inward FDI Performance Index ranks countries by the FDI they receive relative to their economic size; therefore, many other factors besides the tax system (tax rates and incentives) influence the index results. In order to have a global picture and be able to explain the results, it will be necessary to complete the information provided in Figure 3 with information on political and economic stability; information on trends of tax revenues will be also useful.

Figure 3. FDI Performance Index



Source: Own elaboration using FDI Performance Index from World Investment Report 2006 UNCTAD.

14 . This paper uses the Inward FDI Performance Index calculated by UNCTAD: United Nations Conference on Trade and Development. This index ranks countries by the FDI they receive relative to their economic size. It is the ratio of a country's share in global FDI inflows to its share in global GDP. The Performance Index is shown for three-year periods to offset annual fluctuations in the data.

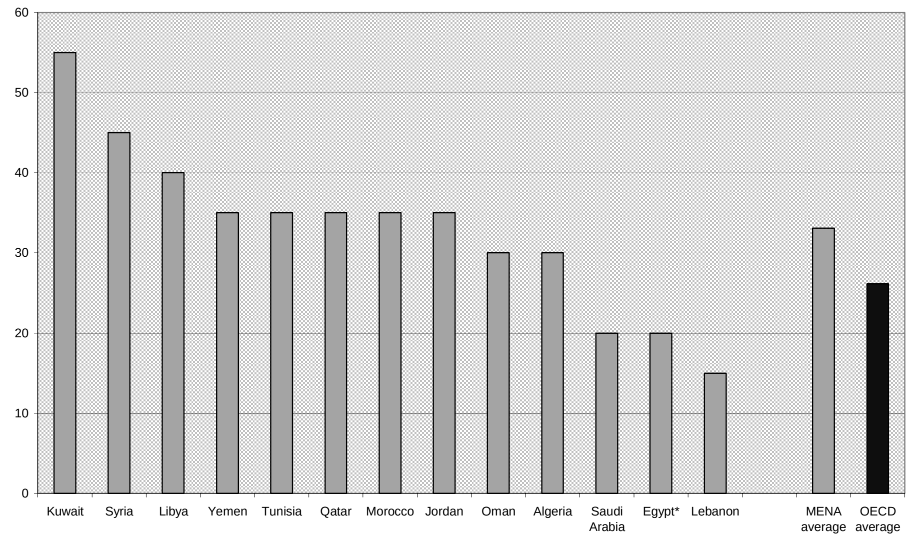
15. The circles in this graph show the year of introduction of main tax incentives: 1997 for Egypt, 1995 for Morocco and Jordan, and 1994 for Tunisia. Confirmation on this information is still pending from country representatives.

6. Overview of the tax systems in the MENA region as potential host countries for investment

46. Often one of the main justifications for the introduction special incentives is "tax competition" amongst competing countries. While the experience of some OECD officials is that host country tax comparisons by investors often stop at the statutory tax rate (headline rate), others take the view that other main tax provisions are also routinely factored into effective tax rate comparisons and should be given policy attention (OECD, 2007). Almost all the corporate tax reforms in the OECD area of the last two decades can be characterized as (headline) rate reducing and base broadening reforms. Top statutory corporate income tax rates for OECD countries in the 1980s were rarely less than 45 per cent. In 2006, the OECD average rate was below 30 per cent and an increasing number of countries have rates below 25 per cent. Within the MENA region, Egypt has joined this international trend of lowering corporate tax rates and broadening tax base with its last income tax reform implemented from July 2005.

47. Figure 4 show the basic statutory corporate rate in a selection of MENA countries in 2005. The average basic statutory corporate tax rates in the MENA region in 2005 was 33.1 per cent, a high rate compared to the OECD average (26.1 per cent) in the same period.

Figure 4: Top Statutory Corporate Tax Rate, 2005



* Egypt corporate tax rate was changed from 40% to 20% from July 2005.

Source: OECD Tax Database, OECD (2005).

48. Nevertheless, there are still some cases when tax comparisons among competing locations may not occur and tax burden may be irrelevant to investment decisions. The prevalence of location-specific profits – that is, may require investment (i.e. a physical presence) in a specific location, is one of such cases. In principle, the tax burden on location-specific profit may be increased up to the point where economic profit is exhausted without discouraging investment. Thus, where an economy offers an abundant set of location-specific profits, policy makers may understandably resist pressures to adjust to a relatively low tax burden, to avoid tax revenue losses and windfall gains to investors and/or foreign treasuries. Reducing the effective host country tax rate to levels observed in certain competing countries, while possibly attracting capital in elastic supply, would give up tax revenues without impacting inelastic investment demand. Examples of location-specific profits are profits in the case of privatizations (time

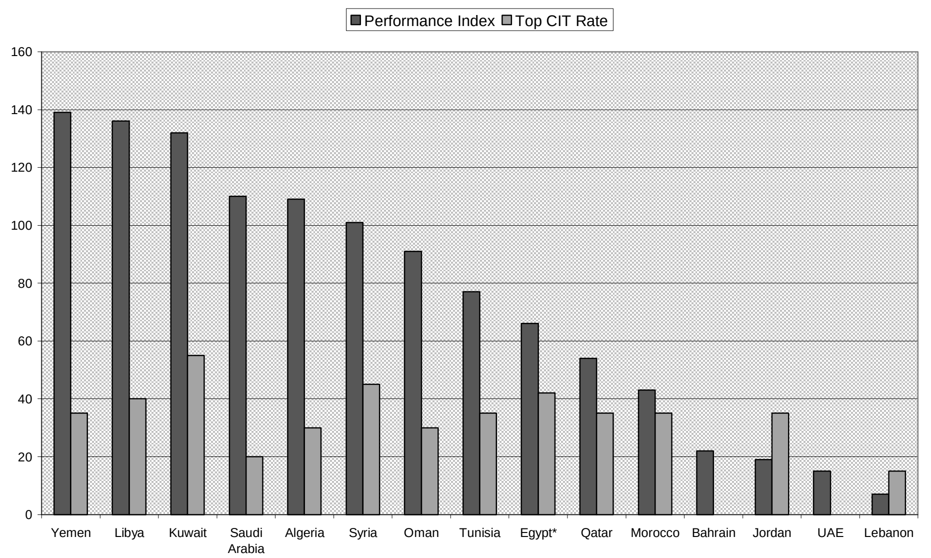
specific profits as well), the extraction of natural resources, and the provision of restaurant, hotel and certain other services.

6.1 Headlines tax rates and FDI Performance Index

49. A comparison between a country's tax burden and a measure of its FDI performance may be also used to consider the link between taxation and investment attraction. Figure 5 compares the statutory corporate tax rate to an inbound FDI performance (rank) index in MENA countries. This figure suggests that certain countries with a relatively high inbound FDI index have a low statutory rate (e.g. Yemen, Libya, Kuwait) while certain other countries with a relatively low corporate statutory rate do not have a relatively high inbound FDI index (e.g. Lebanon, Oman, Tunisia).

50. Similar results emerge when considering average effective and statutory tax rates in OECD countries. Additionally, countries with high tax to GDP ratio have high ranking on the FDI performance index. For example, Denmark has one of the highest tax to GDP ratio (48.8, after Sweden with 50.4) and ranks first among the OECD countries (Sweden ranks 21). These results suggest a no clear link between tax burden and investment location decisions.

Figure 5. Statutory Corporate Tax Rate and Inbound FDI Performance Index, 2005



Source: OECD (2005), FDI Performance Index from World Investment Report 2006 UNCTAD, Investment climate statements of the US State Department, and National countries investment and tax laws.

6.2 Other features to consider in the design of a tax system supportive for investment

51. Host country corporate tax rates and tax incentives are not the only important features in the tax system when considering total tax burden and, therefore, FDI attraction. Withholding taxes (on dividends, interests and royalties) anti-avoidance rules and complexity of the tax system in the host country as well as the treatment of foreign source income in the home country, can play an important role in investment decisions and effectiveness of tax incentives schemes. This section reviews some of these tax rules in MENA countries and compares them with those in OECD countries.

52. Where a broad objective is to encourage investment while at the same time raise a certain share of tax revenue, avoidance is seen as something that undermines the ability of the system to deliver these

objectives. Provisions providing for a partial or full profit tax exemption can open up transfer pricing opportunities to artificially shift taxable income of business entities in the host country that do not qualify for special tax relief to entities that do. Given the growing use of tax planning techniques, more and more OECD countries have in place thin capitalisation rules, transfer pricing rules, and general anti-avoidance provisions to counter tax planning to protect the tax base. This was not the case in MENA countries in 2005. An exemption is Egypt, which has introduced some transfer pricing and thin capitalisation rules in its last income reform in July 2005.

Table 4. Overview of tax characteristics affecting FDI in MENA countries as host countries

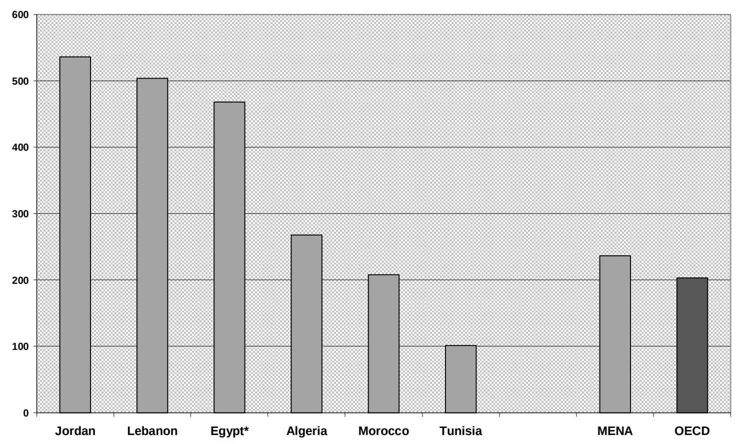
		Non-resident withholding tax						
Country	Top CIT Rate	dividends	interests	royalties	Capital Cost Write offs	Loss carry forward (years)	Transfer pricing rules	Thin capitalisation rules
Algeria	30	15	10	20?	acc	yes		
Bahrain	-	-	-	-	-	-	no	no
Egypt	42	-	32	32	acc	5	no	no
Jordan	35	-	10	10	acc	indefinitely	no	no
Kuwait	55	-	-	-			yes	no
Lebanon	15	10	10	7.5			no	no
Libya	40							
Morocco	35	10	20	10	acc	4		yes
Oman	30							
Qatar	35						no	no
Saudi Arabia	20	5	-	5-20	acc		no	no
Syria	45							
Tunisia	35	-		15	acc	4		
UAE	-	-	-	-	acc	indefinitely	no	no
Yemen	35	-	-			4	no	no

Source: OECD (2005), Investment climate statements of the US State Department, United Nations (2000), and National countries investment and tax laws.

53. While statutory provisions are clearly important, policy markers are also encouraged to consider difficult to measure compliance costs associated with the level of transparency, complexity and stability when assessing the total tax burden linked to the tax system. There is not an international measure of compliance costs. However, the measure of compliance costs calculated by *Doing Business* (World Bank) can be used as a simple proxy. According to this measure, Figure 6 shows that compliance costs in six selected MENA countries (Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia)[16] were relatively high compared to those in OECD countries in 2005. Business in these MENA countries in 2005 spent 34 hours more in average complying with tax requirements than in OECD countries.

16 . *Doing Business* measures compliance costs as time to prepare, file and pay -or withhold- three major types of taxes: the corporate income tax, value added or sales tax and labor taxes, including payroll taxes and social security contributions for a medium-size company.

Figure 6. Compliance time (hours), 2005



* Egypt corporate tax rate was changed from 40% to 20% from July 2005.

Source: Doing business, World Bank, 2005.

54. Finally, in order to assess the likely effects of host country tax incentives, it is necessary to look beyond the host country tax rules and consider the treatment of foreign source (host country) income in the home country of foreign direct investors. Addressing tax-interaction effects is important as tax consequences in the home country can reduce or even offset the impact of a given host country incentive. Indeed, tax rules of several countries can factor into the analysis, for example where financing comes via an offshore affiliate or holding company. In this context, tax treaties and mutual agreement procedures are also often identified by investors as key to certainty and stability in the treatment of cross-border investment.

7. Conclusions

55. MENA countries (as well as some OECD and other non-OECD countries) offer a wide range of fiscal and financial incentives to promote specific policies, attracting foreign direct investment (FDI) being one of them. While financial incentives – generally more used among OECD countries - tend to offer governments greater administrative flexibility than fiscal incentives, non-OECD governments tend more than OECD governments to lack the resources necessary to pay for direct financial incentives, and to be much easier to provide than correct deficiencies (e.g. in the legal system).

56. In general best practices discourage the use of special tax incentives to attract FDI and argues in favour of a reduced statutory corporate income tax rate on a broad tax base (this simpler approach benefits both old and newly acquired capital, avoids many pitfalls associated with other forms of relief while taking tax-planning pressures off the domestic base). However, at the same time, it is recognised that pressures can mount to introduce special incentives in response to "tax competition" amongst competing states, and that policy makers can benefit from a review of design considerations to target assistance and minimise unintended revenue loss.

57. It is also recognised that the elimination and/or redesign of tax incentive systems already in place represents a challenge for policy makers. Business leaders will always keep their pressure to maintain, restore and even increase tax incentives, even when their ineffectiveness has been demonstrated. Nevertheless, it is an effort worth it to try in order to simplify the country tax system, eliminate tax distortions, remove unnecessary administrative and compliance costs, increase transparency and improve government's capacity to generate revenue. This effort will help to improve the framework conditions and

market characteristics of the host country for attracting investment. It should be, however, pointed out that tax relief tied to prior investment generally should be respected to not undermine policy credibility and avoid weakening the ability of government to influence investment behaviour in the future.

58. Countries should consider elaborating a tax expenditure report. This report not only provides information on the effectiveness and cost of tax incentives, but also helps to strengthen government finance and contribute significantly to fiscal transparency.

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Annex 1. Definition of main fiscal incentives

Tax Holidays

Under a tax holiday, qualifying “newly-established firms” are not required to pay corporate income tax for a specified time period *(e.g.,* 5 years), with the goal of encouraging investment. A variant is to provide that a firm does not pay tax until it has recovered its up-front capital costs (payout). Targeting rules are required to define “newly-established firm”, qualifying activities/sectors, and the starting period of the tax holiday.

Reduced corporate income tax (CIT) rates

As it own name indicates, it is a reduced (statutory) corporate income tax rate on qualifying income to particular types of activity (e.g. manufacturing), locations or regions. The rate reduction may be broad-based, applicable to all domestic and foreign source income, or it may be targeted at income from specific activities, or from specific sources (e.g., foreign source income), or at income earned by non-resident investors alone (forms of “ring-fencing”), or some combination of these.

Exemption of CIT for export companies

Export companies are not required to pay corporate income.

Accelerated capital allowances

Special deductions against (*i.e.*, reducing) taxable income earned as a fixed percentage of qualifying investment expenditures for which firms are allowed to write-off capital costs over a shorter time period than dictated by the capital’s useful economic life (true economic depreciation), which generally corresponds to the accounting basis for depreciating capital costs. While this treatment does not alter the total amount of capital cost to be depreciated, it increases the present value of the claims by shifting them forward, closer to the time of the investment. The present value of claims is obviously the greatest where the full cost of the capital asset can be deducted in the year the expenditure is made.

Investment tax credits

Special deductions against corporate income tax otherwise payable earned as a fixed percentage of qualifying investment expenditures. Since tax credits provide an offset against taxes otherwise payable, rather than a deduction against the tax base (thereby removing the dependency of the value of a tax credit claim on the income tax rate).

Location based incentives

Tax reliefs for investments located in particular areas or regions within the country.

Reduced taxes on dividends and interest

Reduction or the elimination of non-resident withholding tax on dividend or interest income, and the extension in full or in part of integration relief (*i.e.,* in respect of corporate-level tax on distributed income) in systems that provide imputation or dividend tax credit relief to domestic shareholders.

Preferential treatment of long-term capital gains

Preferential tax treatment for appreciation in value of capital (assets) held by enterprises if the capital (or assets) is held over a fixed period of time. Long-term capital gains (capital retained for longer than a minimum period) are usually taxed at half the rate of short term capital gains with the intention of encouraging investors to retain funds for longer periods.

Deduction for qualifying expenses

Full deduction of certain qualifying expenses (for example, training expenses, R&D expenses, export or marketing expenses) to encourage certain types of investors' behaviour.

Exemptions from indirect taxes

Exemption from customs duties and/or import taxes, VAT or sale taxes.

Free zones and special economic zones

Countries use two types of special "zones" to attract investment: (i) duty-free zones, enjoying exemption from customs duties (and usually from VAT); and (ii) special economic zones, in which investors enjoy other tax privileges not granted in other parts of the host country. In practice, the distinction between the two types of zones is not always so clear. Investors in duty-free zones often receive other tax privileges (especially in export processing zones) and special economic zones sometimes enjoy customs privileges.

Annex 2. Tax incentives: Country details

Algeria

Regional Incentives	Special incentives are offered for investments in special development zones and for privileged investments that utilize environmentally-friendly or energy saving technologies. - Partial or total state funding for infrastructure investments; - Application of reduced customs duties on imported goods directly related to the investment; - Exemption for ten years from the corporate income tax (IBS), Gross Income Taxes (IRG), flat rate payment (VF) and Tax of Professional Activity (TAP); - Exemption for ten years from property taxes; and - Additional incentives to improve or facilitate the investment, such as the carry-forward of losses and depreciation.
Sectorial Incentives	
Export Incentives and free trade zones	Additional incentives may be offered to companies whose production and investment are export-oriented. On December 1, 2004, the government of Algeria signed an executive decree to dismantle its only free trade zone, at Bellara, in preparation for WTO accession. This zone had never been operational since its creation in 1997. Bellara has since been transformed into an industrial zone for regional development.
Statutory tax rate	The standard rate is 30 per cent although some reinvested profits are taxed at the reduced rate of 15 per cent. on the turnover, except VAT
Other tax incentives	Incentives under the new investment code are offered on a case-by-case basis by the approval of the National Investment Council. - Exemption from property taxes; - Exemption from corporate income taxes; - VAT exemption for goods and services directly related to the investment; and - Exemption from transfer taxes for real estate purchases directly related to the investment. Several two-to five-year exemptions are granted for partnership and joint ventures or to companies whose activities are declared of priority (exports, hydrocarbons, etc.).
Legislation	Investment Code, ordinance No. 01-03, August 2001

Egypt

Regional Incentives	Law No. 8 adopts a geographically and activity based investment incentive structure. The following tax incentives are granted to inland projects under the law: - A basic five-year tax holiday is awarded for priority sectors in the Old Valley, including:infrastructure, manufacturing venture capital projects, financial leasing, software, tourism, livestock, fish and poultry, refrigerated transportation services for agricultural produce, foodstuffs, marine transportation, oil sector support services, hospital and medical centres offering 10 per cent of their overall capacity free of charge, and aviation projects. There is a 10-year tax holiday for projects in new industrial zones, urban communities, and remote areas and those implemented through the Social Fund for Development. Projects in the New Valley are entitled to a tax holiday of 20 years. - Imported capital assets, construction materials, and components required to establish an approved project are subject to import duty at a low flat rate of 5 per cent of the cost, insurance and freight value. Approved projects are eligible for paying duty on a deferred basis or by instalments. Under Law No. 59, a company that locates in a new town and whose activities are confined to that location is eligible for the following tax incentives: - Profits are exempt from corporate income tax for 10 years, starting from the first fiscal year following the year in which production commenced. Furthermore, under Law No. 8, the profits of projects established in the New Valley are exempt from corporate income tax for 20 years; - Imported machinery and equipment and construction materials required to establish factories or similar premises are subject to import duty at the low flat rate of 5 per cent; - Returns on bonds, finance deeds and income from similar securities issued for public subscription are exempt from tax on revenue of movable capital; - A percentage of the paid-up capital to be determined in accordance with Central Bank rules shall be exempt from tax on projects of stock companies; and - A five-year residence is granted to founders of joint stock and limited liability companies and partners in a partnership of established companies and institutions.

Egypt

Sectorial Incentives	- A number of other tax incentives are available apart from those granted under Law No. 8 and Law No. 59. For example, * New industrial (manufacturing) companies with more than 50 employees are exempt from corporate income tax for five years, starting from the first fiscal year following the commencement of production; * Enterprises in the hotel ownership and management business are exempt from corporate income tax and all other taxes for five years, starting from the commencement of activities. Local authorities may not levy any taxes or duties on such enterprises without the approval of the Ministry of Tourism; * Companies formed in 1981 or thereafter to reclaim and cultivate barren land are exempt from corporate income tax for the first 10 years after the land becomes productive; * Cattle- and poultry-raising companies and fisheries incorporated after 1978 are exempt from corporate income tax for five years, starting from the commencement of business; * Bookkeeping companies are exempt from corporate income tax without any time limit; * Tourism projects, and their extensions, that are located in a remote area are exempt from corporate income tax for 10 years, starting from the commencement of activities.
Export Incentives and free trade zones	The following tax incentives are available to free zone projects under Law No. 8: - No tax is levied on free zone projects or on dividends paid out of the profits of such projects. This exemption has no tim limit. Such projects are subject to a 1 per cent annual duty on the added value of goods entering or leaving the zone for the account of the project (excluding transit goods). A project whose main activities do not involve the entry or departure of goods from the zone is subject instead to a 1 per cent fee on the its annual turnover. - No customs duties are levied on goods entering free zones from abroad or from other free zones, including capital

Egypt

Statutory tax rate	Corporation tax rates depend on the type of income: - Foreign dividend, interest or royalty income is taxed at 32 per cent. - Profits from export and industrial operations of companies is taxed at 32 per cent. - The income of oil exploration and production companies is taxed at the rate of 40.55 per cent. - All other companies are taxed at 40 per cent. - In addition, a development duty is charged at a rate of 2 per cent on taxable income in excess of 18,000 Egyptian pounds. - No withholding tax is charged on dividends. - Interest and royalties are subject to a withholding tax of 32 per cent. Under domestic law there is no withholding tax rate on interest on savings and deposit accounts in banks and post offices, and on interest on public sector bonds and debentures.
Other tax incentives	Foreign experts' salaries are exempt form income tax if their stay in Egypt is for less than one year.
Legislation	Law No. 8 of 1997 on Investment Guarantees and Incentives

Jordan

Regional Incentives	The country is divided into three development areas: Zones A, B, and C. Investments in Zone C, the least developed areas of Jordan, receive the highest level of exemptions. - Exemptions from income and social services taxes of up to ten years for projects approved by the Investment Promotion Committee (which includes senior officials from the Ministry of Industry and Trade, Income Tax Department, Customs Department, the private sector, and the Director General of the Jordan Investment Board), in accordance with the designated zone scheme: 25 percent in zone A, 50 percent in zone B and 75 percent in zone C. An additional year of these tax exemptions is granted to projects each time they undergo expansion, modernization, or development resulting in a 25 percent increase in their production capacity for a maximum of four years. - Capital goods are exempt from duties and taxes if delivered within three years from the date of the investment promotion committee's approval. The committee may extend the three-year period if necessary. - Imported spare parts related to a specific project are exempt from duties and taxes, provided that their value does not exceed 15 percent of the value of fixed assets requiring spare parts. They should be imported within ten years from the production date. - Capital goods used for expansion and modernization of a project are exempt from duties and taxes, provided they result in at least a 25 percent increase in production capacity. - Increases in the value of imported capital goods are exempt from duties and taxes if the increases result from higher freight charges or changes in the exchange rate.
Sectorial Incentives	- Foreign and domestic investment laws grant specific incentives to industry, agriculture, hotels, hospitals, maritime and rail transportation. Leisure and recreation projects, convention and exhibition centers, transportation and distribution of water, gas, and oil/oil derivatives using pipelines were added to this list. The laws also allow the cabinet flexibility in offering investment incentives to other sectors. - All agricultural, maritime transport, and railway investments are classified as Zone C, irrespective of location. Hotel and tourism-related projects set up along the Dead Sea coastal area, leisure and recreational compounds, and convention and exhibition centers receive Zone A designations. Qualifying industrial zones (QIZS) are Zoned according to their geographical location, unless they apply for an exemption. The three-zone classification scheme does not apply to nature reserves and environmental protection areas, which are granted special consideration. - Hotel and hospital projects receive exemptions from duties and taxes on furniture and supply purchases, which are required for modernization and renewal once every seven years. - In addition to the Investment Promotion Law, additional exemptions are granted to investments within industrial estates designated as Special Industrial Zones.

Jordan

Sectorial Incentives (cont)	- Industrial projects are granted exemptions on income and social services taxes for a two-year period. Established industrial facilities that relocate to an industrial estate also receive this benefit. - Industrial projects are granted property tax exemptions throughout their lifetime. - Industrial projects are granted partial or full exemptions from most municipality and planning fees
Export Incentives and free trade zones	- The Zarqa Free Zone is Jordan's major free zone area. Other areas include the Sahab Industrial Estate Free Zone, Queen Alia International Airport Free Zone, and the Gateway Qualifying Industrial Zone. - In May 2001, the government converted the Aqaba port and surrounding area into a special economic zone (SEZ) with streamlined bureaucracy, lower taxes, and facilitated customs handling. - Both Jordanian and foreign investors are permitted to invest in trade, services, and industrial projects in free zones. Industrial projects must fulfill one of the following conditions: * New industries which depend on advanced technology; * Industries requiring raw material and/or locally manufactured parts that are locally available; * Industries that complement domestic industries; * Industries that enhance labor skills and promote technical know-how; * Industries providing consumer goods, and that contribute to reducing market dependency on imported goods. - Investors in the designated free zones are granted: * Profits are exempt from income and social services taxes for a period of twelve years, with the exception of profits generated from storage services that involve goods released to the domestic market. * Salaries and allowances payable TO non-Jordanian employees are exempt from income and social services taxes. * Goods imported to and/or exported from free zones are exempt from import taxes and customs duties, with the exception of goods released to the domestic market. * Industrial goods manufactured in free zones enjoy partial customs duties exemption once released to the domestic market, depending on the proportion of the value of local inputs and locally incurred production costs. * Construction projects are exempt from licensing fees and urban property taxes. * Free transfer of capital invested in free zones, including profits. - Net profits generated from most export revenues are fully exempt from income tax. Exceptions include fertilizer, phosphate and potash exports, in addition to exports governed by specific trade protocols and foreign debt repayment schemes. Under the WTO, the exemption is extended until the end of 2005 and is expected to be extended again, on annual bases, until the end of 2007.

Jordan

Export Incentives and free trade zones (cont)	- Foreign inputs used in the production of exports are exempt from custom duties and all additional import fees on a reimbursable or drawback basis. - In addition, Qualifying Industrial Zone investments may be eligible for further incentives and exemptions. For example, at the end of 2004 the government was considering lowering banks' guarantees and guest workers' work fees in all QIZ factories. Studies had commenced to examine means to ease and speed up the transport of QIZ production input and output materials.
Statutory tax rate	The corporate tax rate is: - 15% for companies in the following sectors: hospitals, hotels, mining, industry, construction and transportation. - 35% for companies in the sectors of banks and finance. - 25% for companies in the sectors of insurance, exchange, trade, telecommunications, services and other.
Other tax incentives	
Legislation	Investment Promotion Law (2003, temporal) The government is revamping the investment promotion system in Jordan. It is re-examining investment incentives, and is considering the consolidation of all investment promotion activities under a new “Jordanian Agency for Economic Development (JAED)”. These developments will likely lead to expanded investment opportunities in Jordan for foreign investors.

Lebanon

Regional Incentives	- The Investment Law divides Lebanon into three investment zones located outside Beirut, with different incentives provided in each zone (Zone A -coastal area-, B-center- and C-north and south-). The law encourages investments in the fields of technology, information, telecommunications and media, tourism, industry and agriculture. Incentives include: * facilitating issuance of permits for foreign labour * allowing introduction of tailor-made incentives through package deals (for large investments projects), including tax holidays up to 10 years and reductions in construction and work permit fees; * exempting companies that list 40 percent of their shares on the Beirut Stock Exchange from income tax for two years. - Investors who seek to benefit from facilities in the issuance of work permits under "package deals" must hire two Lebanese for every foreigner and register them at the National Social Security Fund. - In areas designated as "industrial zones", 75 per cent of a company's tax liabilities may be exempted. In order to take advantage of this regulation, investments should consist of capital expenditures designed to increase the company's staff and other employees. - Industrial investments in rural areas benefit from tax exemptions of six or ten years, depending on specific criteria (Law No. 27 dated 7/19/80, Law No. 282 dated 12/30/93, and Decree No. 127 dated 9/16/83). - Exemptions are also available for investment in south Lebanon, Nabatiyah and the Biqa' (Decree No.3361 dated 7/7/00): * new industrial establishments manufacturing new products will benefit from a 10-year income tax exemption * Factories currently based on the coast that relocate to rural areas or areas in south Lebanon, Nabatiyah and the Biqa' benefit from a six-year income tax exemption.
Sectorial Incentives	- Farms (provided they do not display farm products in sales outlets or sell products after processing), shipping and transport companies (subject to certain restrictions) are exempted from income tax. - Real estate development companies are granted income tax exemptions of 50 percent on profits derived from the construction or subdivision of buildings into housing units and sale to third parties. - Machinery, equipment, spare parts and building material imported for the setting up of new industrial firms, and equipment and raw material imported for the agricultural sector are subject to only 2 per cent customs duty. - Imported hotel equipment is exempt from certain duties provided that the operating period is for at lest 10 years. Imported buses for tourism agencies are also exempt from customs duties.

Lebanon

Export Incentives and free trade zones	Lebanon has two free zones in operation, the Beirut port and the Tripoli port. - Offshore companies are exempt from income tax. Dividends distributed by offshore companies are exempt from capital gains tax. - Companies established in free trade zones are exempt from customs duties and are not subject to corporate taxes for 10 years. In addition, foreign employees employed in them are exempt from personal income tax.They are not required to register their employees with the Social Security Service if they provide equal or better benefits.
Statutory tax rate	- Corporate tax rate is 15 per cent. Although tax rates are generally low, companies are subject to other changes that are relatively high. For example, normal security contributions are set at 38.5 per cent. - Capital gains resulting from the disposal of fixed assets or investments are taxed at a rate of 10 per cent. Distribution of profits, payment of interests and directors' fees are subject to a 10 per cent withholding tax.
Other tax incentives	- Companies using operating profits to finance certain capital investment are allowed income tax exemption up to 50 per cent for a period of up to four years, provided that such exemption does not exceed the original investment made. - Holding companies are exempt from income tax and capital gains tax. - SOLIDERE (a Lebanese company established in 1994 for the development and reconstruction of Beirut Central District) is exempt from tax on profits during a period of 10 years. Dividends paid to shareholders, as well as capital gains arising from the exchange of shares, are also exempt from tax for 10 years. - The Government reduces to five percent the tax on dividends for: (a) companies listed on the Beirut Stock Exchange (BSE); (b) companies that open up 20 percent of their capital to Arab companies listed on their country stock exchange or foreign companies listed on the stock exchange of OECD countries; and (c) companies that issue GDRs (Global Depository Receipts) amounting to a minimum 20 percent of their shares listed on the BSE. - Domestic and foreign investors can benefit from five to seven percent interest rate subsidies from the Central Bank of Lebanon (CBL) for loans (up to a ceiling of approximately $10 million) provided by banks, financial institutions and leasing companies to industrial, agricultural, tourism, and information technology establishments.
Legislation	Source: ASIT Advisory Studies No 16, United nations, 2000 Investment Law

Morocco

Regional Incentives	Companies set up in the Western Sahara region are exempt from income tax.
Sectorial Incentives	- Agriculture is exempt from income tax until 2010. - There are practically no restrictions on the sectors in which foreigners can invest, except in agriculture. - Incentives are offered to develop certain priority sectors such as banking, manufacture, real estate and trade. They include reduced import duties, exemption from an import tax levy, exemption from patent tax during the first five years of operation, reduced rates on registration rights, exemption from urban tax for the first five years of operation and exemption from VAT for equipment, material and tools. - Tourism Sector is also offered: exemption from corporate tax for the first five years and taxed at 50 per cent of the regular rate for the next five years; reduced rate on registration rights (1%) and stamp duty (5%); reduced VAT rate (10%); provisions for patent and urban tax; and reduced tax rate on patent tax (25%). - Education sector is also offered an exemption from corporate tax for the first five years and taxed at 50 per cent of the regular rate for the next five years and exemption from VAT for equipment and scientific material, investment on construction and interest on students loans. - Other incentives available include exemption from National Solidarity Contribution, exemption from tax for creating an annual investment reserve. - Machinery and equipment are allowed depreciation on a sliding scale. Losses many be carried forward for a period of four years. - Exemption from Capital gains tax if reinvesting during the next 3 years on equipment or buildings reserved for professional use (kept for 5 years). - Exemption from VAT is accorded for equipment.
Export Incentives and free trade zones	- Firms engaged in export are exempt from corporate tax for the first five years and taxed at 50 per cent of the regular rate for the next five years. - Goods for export, international transport operations and their related services provisions are exempted from VAT. - The free trade zone in Tangiers is open to both Moroccan and foreign companies. Goods may be imported duty free to the zone. The companies are exempt from other taxes as well. The only requirement is that all local workers be paid directly in foreign hard currency, which they are obliged to convert to local currency at the Moroccan banks operating in the zone.

Morocco

Statutory tax rate	- The corporate tax rate is 35 per cent. Companies subject to corporate tax must pay a levy, called the National Solidarity Contribution (PSN), at the rate of 10 per cent of the corporate tax. - When corporate tax is exempt, PSN is 25 per cent of the presumed corporate tax. - A business tax or patent is levied on individuals and Enterprises carrying out business in Morocco. the tax is based on the rental value of business premises and on a fixed amount based on the size and nature of the business. - Domestic corporations (irrespective of the extent of foreign ownership, a corporation incorporated in Morocco is considered to be a domestic corporation) are also subject to a minimum tax regardless of whether they make profits or losses. This tax is based on turnover and income (e.g. from interest, subsidies or bonuses) and is levied at the rate of 5 per cent of income. However, companies are exempt from paying this turnover tax during the first three years of operation. - Dividends paid to non-resident shareholders are subject to 15 per cent withholding tax while those paid to corporate shareholders from taxable entities incorporated in Morocco are not taxable. This does not apply to foreign investment income. - Interest paid to residents is taxed at 36 per cent. Interest paid to non-residents is subject to a 10 per cent withholding tax. - Royalties and management fees paid to residents are taxed at 36 per cent, while those paid to non-residents are subject to a 10 per cent withholding tax.
Other tax incentives	- Special incentives are available for companies installing environmental protection equipment using renewable energy sources and otherwise complying with environmental protection laws. - If the value of a foreign investment is more than 200 million dirham, investors can sign a special investment contract with Morocco that brings additional negotiated incentives.
Legislation	- Investment Charter (Law No. 18/95) of 1995; - Corporate Tax Law (1996).

Tunisia

Regional Incentives	Incentives are available to promote investment in designated regional investment zones in economically depressed areas These zones are subdivided into two categories, the “Encouragement Zone” and the “Priority Zone”, in which investors may benefit from a direct subsidy of 15% and 25% of the investment value. Many of the fiscal incentives available to offshore companies may also be made available to them. In addition, the State may assume the employers’ contribution to the social security schemeand undertake certain infrastructure expenses in support of the investment.
Sectorial Incentives	Incentives are available to promote investment in the following sectors: health, education, training, transportation, environmental protection, waste treatment, and research and development in technological fields.
Export Incentives and free trade zones	- Tunisia has two free trade zones, one in the north at Bizerte, and the other in the south at Zarzis. The land is state owned, but the zones are each managed by a private company. Companies setting up in the free trade zones, now officially known as "Parcs d'Activites Economiques" are exempt from most taxes and customs duties and benefit from special tax rates. - Companies producing at least 80 percent for the export market receive: full tax exemption on profits for the first ten years 50 percent reduction in taxes on profits thereafter; full tax exemption on reinvested taxes on profits thereafter; full tax exemption on reinvested profits and revenue; duty-free import of capital goods with no local equivalents; and full tax and duty exemption on raw no local equivalents; and full tax and duty exemption on raw materials and semi-finished goods and services necessary for the business. - Exporting resident companies are exempted from any tax, except taxes relative to vehicles of tourism, maintenance and national insurance contributions. - Fully-exporting companies are exempted from registration dues.
Statutory tax rate	The regular rate is 35%. However, a rate of 10% applies to some companies exercising a craft, agricultural activity, fishing or armament of fishing boats or to cooperatives of services or consumption. Whatever the taxable net result is, the company is subjected to a legal minimum of 0.5% of the turnover, with a ceiling of 2,000 TND.

Tunisia

Other tax incentives	Large investments that have high job creation potential may, under certain conditions to be determined by the High Commission on Investment, benefit from the use of state-owned land for a symbolic Tunisian dinar (less than one state-owned land for a symbolic Tunisian dinar (less than one U.S. dollar). Investors who purchase companies in financial difficulty may also benefit from certain clauses of the Investment Code; these advantages are determined on a case-by-case basis. For foreign investors: - tax relief on reinvested revenues and profits; - VAT limitation to 10 percent on many imported capital goods; and - optional depreciation schedules for production equipment.
Legislation	Investment Code Law No. 93-120, December 1993 1994 Investment Incentive Law

Yemen

Regional Incentives	In November 2004, the government announced the creation of three industrial zones in Aden, Hodaida and al-Mukallah th will concentrate on manufacturing and infrastructure
Sectorial Incentives	
Export Incentives and free trade zones	- An industrial and warehousing estate called Aden district park (ADP) was launched in November 2002, which includes th Container Terminal and the Aden Free Zone. This zone promotes light industry, repackaging and storage/distri operations. Future plans include development of heavy industry and more extensive tourist facilities in the grea - Free zone incentives include 100 percent foreign ownership, no personal income taxes for non-Yemenis, and a corporat holiday for 15 years (renewable for 10 additional years) 100 percent repatriation of capital and profits, no currency restricti and no restrictions on or sponsoring required, for the employment of foreign staff.
Statutory tax rate	Corporate tax is levied at a unified rate of 35% Subject to verification by the tax authority, losses may be carried forward for four years; they may not be carrie Capital gains arising form the sales of assests are liable to corporation tax. There is not withholding tax on dividends or income paid to non-residents.
Other tax incentives	Exemption from customs fees Exemption from taxes levied on fixed assets of the project; Tax holiday on profits for a period of seven years, renewable for up to 18 years maximum Right to purchase or rent land and buildings;
Legislation	2002 Investment Law