IMF WORKING PAPER

WP/90/70

INTERNATIONAL MONETARY FUND

Fiscal Affairs Department

Tax Policy and Reform for Foreign Direct Investment in Developing Countries

Prepared by Tax Policy Division 1/

Authorized for Distribution by Vito Tanzi

July 1990

Abstract

This paper identifies tax factors in 21 developing countries that have an impact on foreign direct investment flows. It categorizes those factors into issues associated with tax coordination; tax rates and rate structures; and composition of the tax base. Recent actions by countries reveal no clear pattern in their attempts to increase tax coordination, while many have reduced corporate tax rates and streamlined tax incentives. However, broad-based tax reform is lacking in most, leaving room for further possibilities in tax reform for attracting foreign investment. The paper also addresses nontax factors that can be instrumental in attracting foreign investment.

JEL Classification Numbers:
323; 325

1/ Paper prepared by the staff of Tax Policy Division and coordinated by Parthasarathi Shome, for a Symposium co-sponsored by the IMF and OECD on "The Interaction Between the Tax Systems of OECD Member Countries and Nonmember Countries," Paris, June 26-27, 1990. It will be included in the Symposium volume. Comments from Messrs. George Kopits, Leif Mutén, and Vito Tanzi were most helpful in finalizing the paper. The paper should not be interpreted to represent an official position of the International Monetary Fund and reflects information based on secondary published material.

Contents

Executive Summary

I. Introduction

In recent years many countries initiated reforms in their tax systems that had similar objectives: broadening of the tax base, attenuation of progressivity, lowering the number of rates, reducing the number of taxes, dismantling of tax incentive schemes, and a concern for efficiency, high yield, and the ease of enforcement. This paper focuses on the potential impact of tax reform in developing countries on the international movements of capital. It does not discuss external financing of the government sector, and does not emphasize portfolio or financial investment. Rather, it seeks to identify the main factors--in particular, the tax factors--that are likely to have an impact on foreign investment flows. The study is based on available published material on the tax structures of the sample countries from various secondary publications, and the recency of the information, therefore, reflects that of these sources. This Executive Summary summarizes the main findings and conclusions of the exercise.

II. Factors Affecting Foreign Direct Investment

Tax factors determining the relative attractiveness of a host country for foreign investment can be consolidated under four broad groups comprising: (1) issues associated with tax coordination; (2) tax rates and rate structure; (3) composition of tax base; and (4) other determinants. Their importance should not necessarily be linked to their order of appearance since that would tend to depend on the overall circumstances of an individual country.

The role of tax coordination and tax treaties cannot be minimized in the decision making of a potential foreign investor. For example, their role in resolving the basis for dividend taxation can be quite important. Thus, it would not be practical for a host country to tax a foreign investor purely on the basis of the source principle when he is taxed at home on the basis of the residence principle. Augmented efforts at tax coordination at various levels would aid in the resolution of potential conflicts arising out of the use of different bases of taxation across countries. More generally, foreign investment would be encouraged by tax coordination that reduced the risk attached to returns on investment, whether the coordination was in a global context, or even within regional groupings or bilateral arrangements.

With respect to issues regarding tax rates and rate structure, while a low nominal rate of the corporate tax may not by itself comprise a sufficient incentive for the potential foreign investor, tax reform leading to successive and substantive reductions in tax rates could be presumed to affect investment favorably. Similarly, a rate structure that is proportional rather than progressive is more attractive in that it reduces "fiscal drag." In the same vein, overall simplicity in the rate structure that avoids differential taxation of different types of

economic activity certainly improves the foreign investment potential (inasmuch as the manufacturing sector, into which most foreign investment is likely to flow, is taxed at the higher rates under schedular taxation).

The determination of the effective corporate tax base, which is the result of the tax treatment of various cost items, is of paramount importance. For example, are deductions based on the "normality" principle or on some special considerations? Ambiguous definitions of base could imply an implicit tax burden and would be a deterrent to attracting foreign investment. More important perhaps is the tendency in many host countries to put restrictions on costs incurred abroad, particularly head office expenses. Also, forms of accelerated depreciation that improve the cash flow to firms and enable quicker recovery of investment costs are preferable to straight-line depreciation. Inventory valuation rules which do not aggravate the tax liability; or some latitude in choosing the most appropriate method of inventory valuation by each firm within the bounds of accepted accounting principles, are of great importance in particular contexts such as that of high inflation. In general, the incorporation of proper inflationary adjustments regarding tax rules on depreciation, valuation of assets and inventories, as well as capital gains would affect the tax base as well as comprise an important element in the potential foreign investor's decision making. Generous "recovery rules" for pre-operational expenditures, as well as loss carry-over provisions are also considerations that a potential foreign investor would tend not to ignore. Tax experts agree increasingly that a simpler overall tax structure plays a greater role in attracting foreign investment than specific tax incentives, even though such incentives as tax credits, tax holidays, and investment allowances continue to have an important place in the tax statutes.

There are other tax factors that are also likely to be important. For example, the rates and base of the capital gains tax could affect the foreign investor, and a corporate wealth tax is especially perceived to lead to inequitous burdens even though it might be a useful proxy for the corporate income tax for domestic companies. Withholding taxes on dividends, interest, and royalties, in general, tend to be accepted by legitimate foreign investors, but might weigh heavily on their decision to invest if they are perceived to be levied at prohibitive rates. The treatment of branch profits taxes can be another important criterion in the decision making. Finally, the treatment of foreign exchange gains and losses for tax purposes would affect a foreign investor's taxable income, and its treatment as regular taxable income/loss would be appropriate.

A foreign investor is also likely to take account of nontax factors that have to be complementary to a favorable tax environment. These would include: political stability; existing institutional and regulatory framework including protection of and restrictions on foreign investment, access to international as well as domestic credit, and labor market provisions and practices; and macro policies that include

stabilizing influences such as debt-equity swaps in heavily indebted countries as well as an overall policy environment that tends to reduce capital flight, currency substitution, and the like.

III. Tax Structure and Foreign Direct Investment in Selected Non-OECD Economies

Based on information drawn from published sources--seminar participants would be welcome to point out any inaccuracies in the information--a survey of the evidence regarding those aspects of the tax systems that seem to bear on foreign investment is attempted. A sample of 21 non-OECD countries has been chosen: Anglophone Africa--Kenya, Malawi, Nigeria, Zimbabwe; Francophone Africa--Côte d'Ivoire, Morocco, Senegal; Middle East--Pakistan, Saudi Arabia; Asia--China, India, Indonesia, Korea, Singapore, Thailand; Latin America--Argentina, Brazil, Mexico, Venezuela; and Eastern Europe--Hungary, the U.S.S.R. Selected nontax features currently prevalent in these economies that are likely to have broad ramifications for foreign investment are also surveyed.

India, China, and the U.S.S.R. have the more restrictive nontax environments. Neither rules out expropriation or nationalization. Practices of one or both include a ceiling on foreign equity, a floor on local participation, and a negative list ruling out foreign investment in selected sectors. Other countries that follow with various degrees of restriction appear to be Indonesia, Mexico, and Brazil. However, there seems to be little restriction on repatriation in the sample countries as a whole. The countries with the least restrictions appear to be Côte d'Ivoire, Senegal, and Singapore.

Foreign investors are, in general, technically allowed to borrow from the local banks as well as capital markets but most countries impose restrictions on such access in one form or another. Access to international capital markets is similarly restricted. Singapore is the least restrictive, followed by Côte d'Ivoire and Indonesia. The Latin American countries tend to link borrowing with interest costs. India again appears to use restrictions applicable to domestic investors as well as other administrative controls.

The source principle is the primary basis of taxing the returns on foreign investment in all countries, with some modifications applicable in a few of them. Also, most countries seem to apply the "arm's length" attribution rule as is to be expected for the minimization of tax avoidance. There is little clear pattern in bilateral tax coordination, though nine of the sample countries have concluded treaties with West European and Nordic countries as well as the United States, and a majority of them provide "unilateral" tax coordination through tax credit or deductions from gross income. Further, countries that rely on spontaneous coordination do not necessarily exclude themselves from bilateral tax treaties.

The highest nominal rate of the corporate income tax--around 50 percent--is applicable in a few countries (Malawi, Zimbabwe, China, Venezuela, and India, until April 1990); and foreign investors usually face an even higher rate than domestic ones. While most countries have tax rates below 40 percent, nine have higher rates if excess profits tax and rates applicable to foreign companies are considered; hence there is scope for reductions in the nominal rates. On the whole, the rate structure is relatively complicated across the sample countries with ample room for simplification toward a single-rate tax. Indonesia and Mexico, which have simplified their structures in recent years, could serve as a model for other countries. Finally, surcharges on the corporate income tax as well as the capital gains tax rates--mostly taxed at regular income tax rates--seem not to play a major role over and above that of the rate and rate structure of the corporate income tax.

The corporate income tax base is quite diverse across the sample countries as it is affected by different rules on asset pricing, depreciation, inventory valuation, and loss offsets, as well as by a variety of tax incentives. Asset price valuation is based on historical cost in all countries; therefore, there is room for introducing inflation adjustment (Argentina and Brazil already have it). Depreciation rules are stringent in many countries inasmuch as they adhere only to the straight-line method. These countries could compare depreciation rules with other, especially neighboring, countries for similar assets in order to gauge possible differences in the inducement to invest. For inventory valuation, most countries effectively use first-in-first-out (FIFO); only Argentina uses last-in-first-out (LIFO), Mexico allows immediate expensing, and Korea allows all methods. If attracting investment is the objective, other countries would follow the Korea model. A few African countries allow indefinite loss carry-forward but most do not extend beyond a three to five year range which appears to be the norm. Similarly, the bases of the capital gains tax can be seen to be quite diverse. While recognizing that country-specific factors often typify the actual structure of such a tax, there still seem to be significant possibilities for simplification in many instances from the point of view of the investment objective.

Tax incentives are used in some form or other by most countries, the most popular form being tax holidays for selected sectors, while a few countries use tax credit as well. Developing countries hopeful of attracting foreign investment should study carefully the ramifications of such tax incentives. As was indicated earlier, the role of such incentives in encouraging foreign investment might not always be positive because tax incentives may, in general, encourage only short-term investment, tax holidays may lead to postponement of investment if it carries with it inflationary expectations, foreign investors may prefer a simple tax statute rather than one riddled with multiple interpretation possibilities and hence subject to discretion. They would perhaps attach greater weight to the overall stability of the economic environment than to a complex system of incentives.

Withholding taxes on dividends are levied by most countries in the range of 10-20 percent which seems to be the norm, except for India and Brazil, which impose it at 25-30 percent, where there would be some room for reductions. A minority of countries allow imputation of the company income tax usually using tax credits, while a few others only exempt dividends paid to corporations. Most countries need to reform their tax structures in this area. Finally, most countries exempt emigrants' remittances except India which taxes it as the recipient's income. Again, India could perhaps take note of the tax treatment in the other countries.

IV. Recent Tax Reform Experience

Evidence from the sample pertaining to aspects of the tax structure with potential ramifications for foreign investment indicates that many countries have started reforming their tax systems. Among features of tax reform that would especially affect foreign investors, corporate tax rates have been reduced in most countries in recent years, with Hungary, Pakistan, Korea, India, Indonesia, and Argentina reducing it by 10 percentage points or more. A few countries have also attempted to broaden the corporate tax base by eliminating tax holidays and streamlining tax incentives in general, while others expanded various incentive schemes that eroded the tax base. However, broad-based tax reform has been lacking in most countries, leaving room for further simplification, broadening of the base, and rate reductions. On the whole, much seems yet possible in tax reform with the objective of attracting foreign investment.

Governments which want foreign investment to play a role in their development programs are well advised to design their tax structure with an eye to the taxation level in countries which are potential competitors. It is up to each national government to develop the institutional, fiscal, and monetary policy climate to attract the international investor. Moreover, within each country, the overall level of foreign investment is probably determined inasmuch by domestic institutional and political forces as by the economic policy environment. Thus, the effective tax burden, as well as the overall economic policy and politico-institutional environment are all important determinants of foreign investment.

I. Introduction

In recent years many countries initiated reforms in their tax systems that had similar objectives: broadening of the tax base, attenuation of progressivity, lowering the number of rates, reducing the number of taxes, dismantling of tax incentive schemes, and a concern for efficiency, high yield, and the ease of enforcement. This paper focuses on the potential impact of tax reform in developing countries on the international movements of capital. Section II discusses, at a descriptive level, the main tax and nontax factors that would affect foreign direct investment. Appendix I presents an analytical framework incorporating some of these considerations, while Appendix II elaborates on tax coordination experiences among different countries that would have important ramifications for foreign investment. Section III surveys salient parts of the tax structures of a selection of 21 non-OECD countries that are pertinent to a foreign investor, while Appendix III presents a set of cross-country tables delineating these features. Section IV presents available evidence of tax reform recently undertaken or in progress in the sample countries, with a focus on corporate income taxation as comprising the relevant investment inducing factors. Section V provides concluding remarks, highlighting the tax policies most conducive to attracting foreign investment.

This study does not discuss external financing of the government sector, and does not emphasize portfolio or financial investment. Rather, it seeks to identify the main factors--in particular, the tax factors--that are likely to have an impact on foreign direct investment flows. The study is based on available published material on the tax structures of the sample countries from various secondary publications, and the recency of the information, therefore, reflects that of these sources.

II. Factors Affecting Foreign Direct Investment

International investment is essentially mobile. Although the existing physical capital stock cannot be easily moved from one country to another, changes in host--recipient--country policies can affect the levels of existing capital if for no other reason but that physical capital depreciates and needs to be replenished by the foreign investor already operating in the country. This section describes the main features of a tax system that a potential foreign investor would consider important in making choices on the location of his investment: whether at home or abroad and, if it is the latter, which among possible foreign alternatives. Apart from the host government tax policies, however, there are many other complex determinants of the flow of foreign direct investment. Nontax economic considerations relating to the factors affecting the rate of return on capital investment obviously play a major role. Noneconomic factors, in particular the political and institutional environment in the host country, also weigh heavily in the decisions of the multinational firms on where to invest. Although the

focus of this paper is on the role of the tax factors, it might be useful, by way of background, to mention the main nontax determinants of the flows of foreign investment.

1. Nontax factors affecting foreign direct investment

Nontax factors affecting foreign investment can be grouped into four broad categories. The first group relates to the political environment and stability of the country. Political risks which tend to deter foreign investment include the possibility of coups and revolutions that could lead to expropriation of private domestic or foreign capital, or to major disruptions in production and commerce. They also involve the possibility of reversal of policies, whereby the authorities fail to deliver the favorable business climate and adhere to the agreements as promised to foreign investors. Generally, the consistency of government policies in a potential host country in welcoming foreign investment and in honoring its commitments to foreign investors is an important factor in attracting foreign investors.

Second, the institutional and regulatory environment can also significantly hinder or promote foreign investment. Hindrances may take the form of direct prohibition (e.g., in some sectors foreign investment may not be allowed), a protracted decision-making process or excessive red tape in the screening, registering, and monitoring of foreign investment, or restrictions on the free working of the price system. Examples would be restrictions on access to both international and domestic credit markets (various forms of control as well as the requirement of minimum terms for foreign financing, limited access to domestic liquidity through bank or capital market borrowing), on foreign trade operations (limited access to foreign exchange, advance deposits for imports, requirement to surrender foreign exchange when the domestic currency is overvalued), restrictions on the repatriation of after-tax profits, and labor laws and practices in the form of restrictions that increase the cost of labor (impediments to hire or to discharge workers, absence of a clear framework for labor rights).

Capital importing countries may find that the creation of a climate favorable to investment from abroad is facilitated by their adherence to multilateral arrangements of guarantees to private international investment. One such arrangement is the International Convention on the Settlement of Investment Disputes, created to resolve through conciliation and arbitration disputes arising under investment agreements among member countries. Another is the Convention Establishing the Multilateral Investment Guarantee Agency (MICA), aimed to protect and promote foreign direct investment in developing countries. 1/ Many countries have also engaged in bilateral agreements with the same purpose.

1/ The executing agency for the above-mentioned Convention is the International Center for the Settlement of Investment Disputes (ICSID). Both ICSID and MIGA are World Bank affiliates.

Third, macroeconomic policies play an important role on the formation of expectations about future economic conditions (Tanzi, 1989). A significantly overvalued exchange rate can be perceived by the potential investors as indicative of possible future restrictions on the flow of goods and capital in and out of the country and it increases the probability of large future devaluations. In order to protect their assets against such likely events, economic agents will not only avoid importing capital but may resort to taking capital out of the country (capital flight) or to holding foreign currency within the country (currency substitution). Consistently high public sector deficits generate expectations of inflation, tax increases, and macroeconomic instability in the medium run. Restrictive financial policies leading to negative real interest rates result not only in flight of portfolio capital but, by drying up the availability of domestic savings, also affect direct investment negatively. On the other hand, transparency and consistency in government policies and actions, and a clear and credible program of financing the government sector are conducive to establishing a healthy climate for attracting foreign investment.

A recent development in the category of macroeconomic policies that seems to have attracted some foreign investment has been the attempts by heavily indebted countries to facilitate debt-equity swaps as a way of reaching simultaneously the double objectives of reducing foreign debt and channeling new resources to investment. A debt-equity swap per se does not involve a net injection of capital into the host country but it changes the composition of the assets held by foreigners. However, if as a result of the swap, the foreign debt burden of the host country is alleviated, and thus the creditworthiness of the country and its prospects for better macroeconomic performance are improved, a climate of confidence emerges, attracting additional foreign investment.

Fourth, among the economic factors which affect foreign investment are also nontax incentives provided by the host government. Nontax incentives may take the form of reduced interest loans, cash grants, subsidization of certain inputs (e.g., energy, labor, transportation), and may be either generalized to all domestic and foreign investors in specific sectors or limited only to foreign investors. The tax system can be a major source of incentives or disincentives in more than one way and can accentuate or offset the sort of incentives and disincentives implicit in nontax factors described above. The next section discusses this issue.

2. The tax system and foreign direct investment

The fiscal parameters (e.g., tax rates, exemption levels, rules for base determination) that characterize a given tax system can be expected to influence the international allocation of a given pool of foreign capital. Although the impact of the fiscal parameters on the after-tax rate of return on investment is not the only determinant of the allocation of foreign direct investment, it could be crucial in the decision to invest in a given country. Its importance increases with the trend

toward more freedom of movement for goods and capital, because liberalization tends to make investment more responsive to tax differentials among countries. At the same time, liberalization makes investment less dependent on the location of the sources of finance. As a consequence, tax policy changes in one country affects investment not only in that country but in other countries as well. In what follows, the main tax factors affecting the return to capital are reviewed with a focus on those features that are likely to especially affect foreign investors. Appendix I develops a simple framework delineating tax and nontax parameters on the rate of return of a unit of foreign (vis-à-vis domestic) investment, incorporating the main aspects likely to affect investment decision making across countries.

a. A focus on the corporate income tax

This paper focuses mainly on issues regarding the corporate income tax for the following reasons. First, it should comprise the most important tax element in a potential investor's decision to invest. To the extent that capital exporting countries tax dividends received by their residents, regardless of where the income was generated--while the treatment of corporate income for tax purposes is more varied across countries--makes the personal income tax relatively less important than the corporate income tax for foreign investment decisions.

Furthermore, while companies may pay other taxes such as sales or turnover taxes, they do not directly affect the return to capital. Taxes such as the tax on wages and salaries withheld by firms, do not directly affect the company income and may be considered a burden on third parties since the company acts just as an agent for the tax administration. 1/ Other taxes enterprises may be required to pay include stamp duties, property taxes, and different types of fees. Such taxes are usually considered components of operating costs, and their burden is likely to be shifted to the consumers of the firm's product. Accordingly, the present analysis is limited to the taxation of corporate income.

Almost every country has some type of tax on corporate income, although the tax structures among countries vary widely. Corporate taxation may differ in a number of ways other than the statutory rates, for example, the definition of the base, various incentives, and the treatment of profits earned abroad. Together they determine the effective rate of the corporate income tax and the net return to capital. These characteristics are discussed below in some detail.

1/ There is one caveat. To the extent that in some developing countries, the top personal income tax brackets contain virtually exclusively expatriate staff, having very high top marginal tax rates could affect the cost of hiring them at internationally competitive salaries--a relevant consideration in investment decisions.

(1) Criteria for tax coverage

Whenever a firm's operations extend over two or more countries, a problem of tax jurisdiction arises: which state is entitled to tax the firm's profits and dividends? Two basic criteria have been used in the case of dividends: the residence principle, according to which the firm is taxed in the country where it is headquartered, and the source principle, according to which the firm is taxed by the country where its operations take place and its income is generated. The effects of the implementation of the two criteria are not without ambiguities, however. The positions of capital importing and capital exporting countries are affected differently by the application of these criteria. Capital importing developing countries cannot accept the general application of the residence principle for the reason that *nonresidents' incomes constitute a considerable part of their tax base*, though the use of the residence principle creates incentives for multinational companies to establish their headquarters in low or no tax countries, that is, tax havens. On the other hand, it is also possible that the residence principle puts the resident domestic investor at a competitive disadvantage vis-à-vis the foreign investor, especially when the host country has higher taxes than the home country because, in such a situation, the resident domestic investor would be subject to taxation by the host country, whereas the foreign investor would not. At the other extreme, a radical adoption of the source principle may not be feasible either, 1/ even though capital exporting countries usually accept its use in host countries and are virtually always ready to apply source taxation in combination with more or less consistent residence taxation, thus setting the stage for double taxation. There are, however, clear distinctions in the extent to which the priority of source country taxation is recognized. For instance, many capital exporting countries are ready to exempt foreign-source profits, even beyond the virtually generally recognized principle of deferral with respect to profits of foreign-based corporations. Fewer countries extend the same rule to dividends.

1/ To illustrate, suppose that a firm operating in country A exports some commodity to country B. It is presumably realizing some profit in country B which is built into the export price. However, the information available to the tax authorities of country B does not extend beyond quality, quantity, and export price; for example, it does not include costs in country A. As a result, country B can impose a tariff on the imports but not a tax on the profits of the exporter. Thus, there is a need for rules defining the minimum amount of economic activity a foreign company must carry out in order to become liable to taxation in the host country. Usually the rules are summarized in the concept of "permanent establishment," defined unilaterally or in tax treaties.

Another important source of differentiation in the international taxation of business income is in the definition of the corporate tax base. The majority of countries tax profits on an accrual basis. 1/ The cash basis method is often reserved for the taxation of small businesses. In the assessment of the tax, all revenues due to operations, sale of assets, and incidental revenues are summed up, and the corresponding costs and expenditures are deducted from this sum. Since excessive deductions may be claimed, the tax codes often include detailed rules attempting to draw a line between what is and what is not deductible. These rules can differ significantly from country to country. Attempts to define precise deductibility criteria by tax legislation are less than fully successful, since it is virtually impossible to anticipate the diversity of situations created by the business activity. Therefore, there is the need to establish some general principles to apply to the "gray areas" with the purpose of minimizing tax avoidance and litigation. A general deductibility criterion is the principle of normality, according to which those expenses that are reasonable and commonly incurred by other taxpayers in the same sector of activity are deductible. Another is the principle of necessity whereby deductions are allowed only for the operating costs which have to be incurred to ensure the sustainability of the firm's operations. Therefore, in addition to the company tax rate, a clear and reliable definition of the tax base is also essential in the determination of the tax burden on, and the net rate of return to, foreign capital. A more burning issue is perhaps the recognition or nonrecognition of costs incurred abroad, in particular, head office expenses on behalf of the foreign subsidiary or branch, technical assistance given to them by the head office or parent company, and so on. This problem gets acerbated when the home country applies stringent rules on the allocation of costs.

(2) Depreciation rules

The cost involved in the wear and tear of capital goods (buildings, machinery, vehicles, furniture, etc.) is recognized through the imputation of a fraction of the value of the goods on the current costs. Since economic depreciation, which would include market obsolescence, is difficult to determine, tax regulations usually rely on a short table of estimated lives of capital goods for the determination of the depreciation rates, which are then applied to the book value of the assets.

Depreciation rules vary substantially across different tax systems. The straight-line method writes off a constant value over the lifetime of capital. A few countries require, and many countries offer as an option, the use of the declining balance or written-down value method,

---

1/ As we will examine below, taxation of inflationary and capital gains upon realization are major exceptions.

whereby the rate applies to the previous book value. 1/ Given the same life span of an asset, the declining-balance method would be more advantageous to the taxpayer than the straight-line method since it would have to allow a larger depreciation at the beginning. Less common methods of depreciation include various forms of accelerated depreciation: for example, initial allowance, whereby a sizable proportion of the investment is cost-recovered in the first year and the balance is depreciated either by straight-line or declining-balance; the (declining) sum of the years' digits method, whereby the assets are depreciated each year at a linearly declining rate; 2/ and immediate expensing, whereby the total amount of the investment is deducted as cost in the first year of operation. Inflation may require special adjustments in depreciation, a matter discussed later.

As a measure intended to provide incentives to specific activities favored for the purpose of developing certain sectors of the economy, several countries have introduced accelerated depreciation and depletion allowances applicable to some types of projects for which foreign investment is most needed (e.g., oil exploration). Accelerated depreciation allowances improve the cash flow to the firm, and in effect may operate as an interest-free loan from the Treasury to the firm, reducing the costs of financing the acquisition of new capital. This depends, of course, on the existence of otherwise taxable profits within the same jurisdiction. Furthermore, accelerated depreciation enables quick recovery of the cost of investment and reduces the recovery risks in the long run. On the other hand, it is not an attractive incentive for new foreign investors who count on initial losses.

Costs of intangible assets can be recovered through rules similar to depreciation rules. For example, patents and exploration rights have a time frame specified by the host country's laws or a bilateral contract between the country and the foreign investor. Pre-operational or pre-production expenditures are usually written off in a specified number of years after operation or production begins. Clearly, the more generous the rules for the recovery of such costs, the faster the recovery of investment, and the greater the incentive for the foreign investors to invest in a host country.

1/ Thus, the depreciation allowance of an asset valued at 100, depreciable at a rate of 20 percent per year, would be 20 in the first year, 16 (= 20 percent of 80 (=100-20)) in the second year, 12.8 (=20 percent of 64 (=80-16)) in the third year, and so on, a zero book value never being reached unless there is a supplementary rule to assure full depreciation after some time; this is usually the case.

2/ For instance, an asset of value 100 depreciated in 5 years has for sum of the digits 15 (=1+2+..+5) and annual allowances of 33 (=5/15), 27 (=4/15), 20 (=3/15), 13, and 7, respectively.

(3) Deductibility of interest

Interest on corporate debt is normally considered a legitimate cost, therefore the composition of capital, as summarized by the debt/equity ratio, affects the tax liability. As a result, with the purpose of minimizing the tax liability, 1/ the firms may exhibit a preference for debt financing as opposed to equity financing. The issue of attracting foreign investment gets somewhat reversed in this particular case for, in principle, foreign investors are in a better position than domestic investors to disguise as debt the equity capital transferred to the host country and claim undue tax deductions. 2/ The problem is made more acute when the host country creates "excess profits" taxes, or sets limits to dividend remittances, thereby creating an even greater incentive to disguise transfers of profits as interest payments on debt. Such response by the taxpayer to a possible asymmetry between debt and equity financing created by the differentiated treatment under the corporate income tax is referred to as thin (or hidden) capitalization in the tax literature.

A solution for thin capitalization, such that the financing ratio were neutral to the corporate tax, is hard to find. In some developed countries practical rules to overcome this problem are being considered. A radical solution may consist of disallowing the deductibility of interest, while enacting a compensating reduction in the statutory tax rate so as to keep the tax revenue constant. By this criterion, the base of the tax would be expanded to reach all value added attributed to capital, whether it is due to dividend or interest earnings. The major drawback of this approach is that it may increase the tax burden on businesses which are temporarily recording true losses without resorting to thin capitalization schemes. An alternative is to allow the firms to deduct interest on debt and also imputed interest on equity in the determination of the taxable profit; however, at the same time the statutory tax rate would have to be raised in order to compensate for the narrowing of the tax base so that the tax revenue remained unchanged. A third method, virtually the only one implemented so far to deal with the problem of thin capitalization, consists of setting a ceiling for debt equivalent to a multiple of the value of equity (Canada, the Netherlands, Switzerland, the Federal Republic of Germany, and the United States). When the ceiling is exceeded, the corresponding interest is not deductible, or is deductible only if the taxpayer is able to provide evidence that the entire debt is contracted under normal

---

1/ Interest, as a rule, is deductible as operating expenses, whereas dividends are not.

2/ Other factors besides tax avoidance may encourage a higher debt ratio of investment in developing countries. For instance, remittances abroad of interest may face less stringent controls of foreign exchange than remittances of dividends. Also, contractual interest payments may be perceived as a more predictable stream of income to the controlling company than dividends.

market conditions, and that the creditor does not have control of the equity capital of the debtor, or vice versa. This solution, by providing a relatively clear-cut criterion, provides the authorities with an effective tool to detect abuses. Its main disadvantage is that it could encourage firms to practice their capitalization up to the legal ceiling. To conclude, for a developing host country, the possibilities of thin capitalization might comprise a disguised incentive for attracting foreign investment.

(4) Valuation of inventories

According to standard accounting principles, inventories of raw materials and intermediate and finished products are recorded at the historical cost of acquisition or production. 1/ However, inventories are undervalued under the historic cost principle of accounting if there is persistent inflation. Three basic criteria have been utilized for the valuation of inventories, with different impact on costs. Under the first-in-first-out (FIFO) method, the costs of stock at the end of the year are calculated on the basis of the price of the oldest acquisition of stock. As a result, with FIFO accounting, inventories sold are valued below their replenishment cost, if prices are increasing; hence, nominal profits and tax liability increase. Under the last-in-first-out (LIFO) method, the costs of stock at the end of the year are calculated on the basis of the value of the inventories and stocks sold accordingly valued on the basis of the most recent price; therefore, nominal profits calculated under this method are less likely to be distorted by inflation, that is, the tax liability is not unduly increased. A third method, the average cost method, determines the unit value of every inventory item as a weighted average of the most recent acquisition price (or cost of production) and the previous average unit cost. The value of inventories so determined is then used to derive the production or sales cost. The impact on the tax liability implied by this method is intermediate between LIFO and FIFO. 2/ In cases of high inflation in capital importing countries, there would have to be some latitude for the firms to choose the method of inventory valuation so as to minimize any unintended increase in the tax burden.

1/ Except when the adoption of the criterion results in a value higher than the prevailing market price. In this case, tax laws of many countries allow for a reduction in the value of the inventories, or the formation of a corresponding reserve.

2/ These findings can be summarized as in the table below.

	Effect on the value of inventories	Effect on costs	Effect on the taxable base
FIFO	increase	decrease	increase
Average cost	average	average	average
LIFO	decrease	increase	decrease

(5) Treatment of capital gains

Capital gains are often taxed more lightly than recurrent income. This difference in tax treatment is motivated, inter alia, by the desire to provide incentive to investment, and to minimize the "lock-in effect." 1/ In recent years, however, several countries have moved in the direction of uniform taxation of recurrent and nonrecurrent income. The reasons for this trend are no less compelling than those for differential tax treatment. 2/ First, in practice, there is always the problem of distinguishing recurrent from nonrecurrent operations. The differential tax treatment may lead to litigation on borderline operations, which is costly to the taxpayers as well as to the tax authority. Second, the existence of differential tax treatment interferes with business decisions in ways not intended by the tax legislation. For example, if profits in the stock market--when stock is held for, say, at least six months--are taxed as capital gains and not as current income and at the lower rate, trade in stocks held for four or five months would be inhibited, creating market inefficiencies. Third, differential taxation of capital gains makes the overall tax liability of the businesses less predictable due to the difficulty involved in separating the recurrent and nonrecurrent components of income. The criteria of transparency and ease of enforcement have been important determinants of the growing consensus that capital gains should be taxed at the same rate as ordinary business income. Fourth, it is worth mentioning that the definition of capital gains itself tends to differ in different legal systems. Quite a few countries have uniform treatment as ordinary income of all gains on business assets, while maintain-

---

1/ The difficulty involved in assessing unrealized gains leads to their taxation only when they are realized. Since the capital gains tax can be deferred until the point of sale, an incentive is created not to sell the asset. This effect of capital gains taxation is sometimes called the "lock-in effect."

2/ Arguments in favor of differential tax treatment are based also on the premise that capital gains and losses differ from other types of income in a number of ways. First, capital gains are not periodic, so a regular pattern in their realization is not usually observed. Indeed, tax laws in many countries establish some frequency of similar operations in a given time span as a dividing line between nonrecurrent and recurrent operations, with different tax treatments. Another criterion is to legally classify a company's operations as "normal" and "incidental," depending on how they correspond to the primary purpose of business. Second, the volume of transactions that give rise to capital gains or losses is often relatively large, with payment distributed over time. This fact may create a significant lag between the time the tax liability occurs and the time the capital gains are actually realized, resulting in potential cash flow difficulties related to the payment of the tax. For this reason, taxation of capital gains sometimes allows for adjustments of the accrual criterion, so that tax payments go hand-in-hand with cash realization.

ing the privileged treatment of capital gains on assets outside business. Also, most countries do not even attempt to reach nonresidents with capital gains tax on their dealings in shares of resident companies.

Thus, unification of rates goes a long way toward simplifying the overall taxation of business profits, and thus may be conducive to attracting further investment.

Unification does not, however, remove problems which are peculiar to capital transactions. Large payments might require tax deferral to avoid an undue cash squeeze on the company. A second issue is whether net capital losses--occurring when capital losses exceed capital gains--can be applied against profits in current operations. If that is not allowed, net capital losses should be carried backward or forward to be written off against net capital gains from other periods. Third, the taxpayer, if given the right to deduct capital losses from other income elements, may gain by realizing his losses while postponing the realization of gains. Thus, symmetric treatment of unrealized capital gains and losses would also need to be preserved.

(6) Loss carry-backs and carry-forwards

Operating losses made in a given year not only preclude corporate tax liability for that year but usually also entitles the firm to a credit against future or past tax liabilities, that is, to a carry-forward or carry-back of losses. Carry-backs are less common because they involve tax refunds, which tax authorities are less willing to grant, and they usually extend over fewer years than carry-forwards. Carry-forwards are typically granted for four or five years, 1/ but much longer periods--even indefinite--for carry-forwarding also exist in practice. Intertemporal compensation of losses can be granted through adjustments in the tax base or through tax credits. Generous loss carry-forward allowances in a country will increase the net rate of return, making that country more attractive for foreign investment.

(7) Adjustments for inflation

Absence of inflation adjustment in the assessment of corporate tax would result in an effective increase in the tax burden in most instances. For example, when the depreciation allowances are assessed at historic cost of capital, the tax base and therefore the tax liability is larger. Another example is the case of loss carry-forward which, without inflation adjustment, becomes less and less significant in real terms over time. Inflation adjustment features in tax rules could be important in attracting foreign investment to capital importing econo-

1/ The time limit for loss carry-forwards is usually the statute of limitations which applies to the determination of the tax liability over time.

mies that have experienced high rates of inflation, and despite current stabilization policies.

Inflationary adjustment involves the indexation of tax rules on depreciation, inventory valuation, and other cost items which determine the taxable income, including capital gains and, to be more appropriate, the valuation of assets as well as the valuation of liabilities (or change in net worth). Indexation is usually carried out on the basis of some price index, for example, the consumer price index. However, indexation of the tax base requires comprehensive and complicated accounting procedures to be followed by the firms, which in turn calls for complicated tax laws and regulations. Thus, as comprehensive inflation accounting becomes necessary, the corporate tax regulations could become increasingly complex.

Though inflation adjustments usually affect the assets side, full indexation would include the liability side as well. Therefore, in many systems, going from partial indexation to full indexation could be viewed as a negative development by investors.

Inflation may also affect tax liability directly whenever the corporate income tax is not proportional but has a progressive structure. In this case, failure to adjust the tax brackets in a timely fashion will cause "fiscal drag"--a phenomenon that puts taxpayers in ever increasing income tax brackets at the same real incomes during high inflation (Shome and Dalton, 1986)--commonly observed in the case of personal income tax since the personal income tax is progressive in most countries, and indexation of the tax schedules is incomplete. In such a case, particularly due to the fluctuations in the expected inflation rate when there is price instability, the expected tax liability becomes volatile, increasing the risks associated with investment.

(8) Exchange rate adjustments

An overvalued exchange rate creates distortions similar to inflation in the absence of adjustment. For example, the cost of the goods imported at the beginning of the production period in terms of domestic currency is understated at the end of the production period when the firm's income is realized and the company income tax liability occurs. Given the tax rate, the tax liability rises because the base is larger in the absence of exchange rate adjustment, which reduces the net rates of return. Thus, an overvalued exchange rate can be seen as a deterrent to foreign investment in a given economy.

b. System of withholding taxes

Most host countries usually withhold tax on certain types of income such as dividends, interest, royalties, and management fees transferred abroad. The usual treatment is to tax the partner on his share of the partnership's income and hold the resident partner or the manager in charge responsible for the tax to be paid, with recourse to the property

of the partnership. In order to encourage reinvestment, some countries exempt capitalized profits from the remittance tax conditional to the permanence of the new capital for a stated period, say five years, typically paying only the corporate income tax. If repatriation is made before that time, forgone taxes are due, sometimes with accrued interest. Some countries, in order to maximize investment incentives, set a rather low rate on the corporate tax while establishing a higher level of withholding tax on dividends for the purpose of inducing reinvestment; but with respect to interest, royalties, etc., paid to third parties, no such motive would be involved.

c. Branch profits taxes

Gradually, there is more widespread use of branch profits taxes. Most countries recognize the difficulty in taxing dividends paid by foreign corporations to nonresident shareholders, even if these dividends are based on profits made by activities in the host country where the foreign corporation has a permanent establishment. They may require local incorporation, in which case, they are in a better position to tax first, the profit, and then, the dividend. But they may also accept the branch arrangement while, at the same time, claiming tax in lieu of dividend withholding tax on remittances from the branch to the head office. Normally, a branch profits tax based on actual remittances is too difficult to administer. Therefore, the more common practice is to impose an additional tax on the branch profit, normally related to the dividend withholding tax. 1/ This could be expressed in the simple form of a higher corporate tax rate applying to nonresident corporations. Some opposition has been heard against branch profits tax as discriminatory but after its introduction by the United States in 1986, it seems to have diminished.

d. Corporate wealth taxes

In view of the difficulties in assessing taxable profits, policymakers in some countries have tried to tax the corporate sector through a levy on its net worth. Clearly, this is an imperfect way to reach corporate income for taxation purposes, since companies with significant wealth may also be incurring losses. Profitable companies with a lower level of assets may end up paying less tax than they would under a single corporate profits tax, whereas unprofitable companies with a high level of assets may face higher taxation. The corporate wealth tax may lead to uneven taxation in relation to profits, which may deter prospective investors. These investors will also see as a strong negative element that a corporate wealth tax normally is not creditable against home country profits tax.

1/ For example, assuming that the latter is 20 percent and that half of the profit net of tax is distributed, the proper branch profits tax should be 10 percent of the net-of-tax profit.

e. Minimum corporate tax

Different forms of the corporate wealth tax might also be thought of as a proxy for the corporate income tax. In application, the conventional corporate income tax may be an unproductive source of revenue in view of its complex nature which leaves room for tax avoidance. Indeed, it is not uncommon to observe that some companies manage to stay in business year after year, generating a positive cash flow, while showing consistent accounting losses. In order to deal with this problem without creating a new and separate corporate wealth tax that could compound the existing difficulties, policymakers have devised mechanisms to contain the erosion of the corporate tax base. The minimum corporate income tax--often taking the form of a percentage of turnover, but sometimes related to corporate gross assets--may be applied as a credit against the corporate income tax, so that the company would be paying either the corporate income tax or the minimum corporate tax, whichever is higher. This would ensure that at least a minimum amount of taxes would be collected from every business. While a modest minimum tax may not have a strong negative impact, overdoing it may deter investors, not least because the tax may then not be creditable against home country tax (Mutén, 1982).

f. Tax incentives

During the 1950s and 1960s, it was quite popular to utilize tax incentives to pursue many different objectives, including attracting foreign investment. With time came the realization that the results were more modest than anticipated. The lack of transparency of tax expenditures, as well as their relative effectiveness compared to outright subsidies, came to be questioned (Sanchez-Ugarte, 1987). Tax incentives have gradually lost their appeal also on equity grounds, since they tend to favor those with the highest ability to pay. Yet, they are often seen as a necessary evil, not least if countries are seen competing for investors' interest.

It would go beyond the scope of this study to examine the various types of, and motivations for, incentives, but the picture that emerges from the corporate tax laws allows the grouping of tax incentives in the following main categories: (1) deduction of actual payments or imputed expenditures that otherwise would not be considered deductible; (2) deduction of costs and expenditures by a multiple of the amount actually incurred; (3) accelerated depreciation (see (2) above); (4) partial or total exemptions from the corporate tax for a specified or unlimited time (tax holidays); (5) tax credit for the whole or for a fraction of some types of capital expenditures; (6) permission to earmark a part of the tax payment as a deductible contribution to some funds and programs; and (7) creating tax havens (Casanegra-Jantscher, 1976).

The long-term impact of tax incentives on foreign direct investment is not obvious, although it is clear that firms will be looking for ways to reduce their tax liabilities. For example, tax holidays could lead

to a postponement of investment toward the end of the holiday period when accelerated depreciation would begin to apply since a potential investor could be interested in the "average" (over the years) tax burden rather than "marginal" (holiday period) incentives (Auerbach 1990). Also, it has been argued that incentives such as tax holidays effectively represent a temporary lowering of costs that could fuel future inflationary expectations and lead, again, to a postponement of investment. If the incentive mechanism is not believed to be sustainable, entrepreneurs could shy away from long-term commitments, 1/ and it has been argued that, in any event, tax incentives tend to encourage short-term investment. A case can be made that the best environment for attracting foreign direct investment, given other prerequisites (viz., nontax factors), is not one of generous tax incentives but of relatively low tax rates for all business and a low government deficit, which would contribute to convincing prospective investors that the tax environment is indeed stable and durable.

g. Tax coordination

In a world where capital is mobile, tax systems become interdependent. Whenever interdependency occurs there is scope for coordination. 2/ Yet, international coordination on tax matters is still in its infancy. On the whole, there has been little sustained effort to date on the part of the general international community to coordinate taxation despite its potentially augmentative impact on foreign investment. Tax coordination has, however, been attempted within regional country groupings. Some of these are reviewed in Appendix II, together with a discussion on ways in which taxation--especially taxation affecting foreign investment--can be coordinated among countries. In general, there has been little coordination in capital income taxation in regional country groupings including the EC, confined primarily within bilateral tax treaties. Indeed, as discussed by Tanzi and Bovenberg (1990), there is a need to harmonize capital income taxes within the EC as the Community moves toward a unified market with free capital movements and fixed nominal exchange rates.

In practice, most capital exporting and capital importing countries have unilaterally introduced their own mechanisms, either dispensing with all taxation of income from abroad, or putting in place one or more

---

1/ That is, if it is believed that the prevalence of too many tax incentives will lead to government deficits, revenue considerations thus forcing the authorities to raise taxes.

2/ It is a well-established result of economics that in the presence of interdependence, noncooperative strategies are not efficient in a global sense. That is, the results they achieve could be improved for all parties involved if they behaved in a coordinated way and made the redistributions necessary to assure that no party is worse off with cooperation than when acting in isolation.

mechanisms of tax relief. Tax deferral is a method in which the taxation of profits made abroad is deferred until they are repatriated. 1/ From a revenue viewpoint the least costly of such schemes for the capital exporting country is tax deduction, whereby the tax paid abroad is deducted as a necessary expense. A scheme with a higher degree of neutrality on the allocation of investment is tax credit, whereby the profits made abroad are taxed only to the extent the domestic tax liability on the foreign income exceeds that incurred in the host country. 2/ In this case, for the capital importing country there is a range of rates within which to move without adversely affecting foreign investment--on the assumption that the international investor does not care about where the taxes are paid. Finally, tax sparing is a particular feature of the tax credit arrangement whereby taxes forfeited by the host country as investment incentives are treated by the home country as tax liabilities.

The foreign tax credit has been adopted by many countries in tax treaties but also unilaterally, and the reasons for its popularity may rest less in generosity than in feasibility. On the one hand, by being a unilateral device it may be simpler to set up, operate, and modify than cooperative schemes, while on the other hand, operations conducted abroad are to some extent out of reach of tax enforcement authorities; a high level of overall domestic taxation on investment abroad is difficult to enforce (Mutén, 1982).

1/ In general, two things are aimed at. First, the "remittance rule" still applied in quite a few countries, where foreign-source income is taxed only when remitted; as a help against double taxation this rule is, of course, only incomplete. The other thing is the self-evident rule that the residence country of a shareholder has no rights to tax a foreign corporation as such on its profits, only because some, or all, of the shares are held by its residents. Taxing the shareholders on their share in the corporation's profits before they have received it in the form of a dividend is an extraordinary practice that usually is limited to real or alleged abuse cases. Economically, however, it is sometimes argued that the distinction between investment in a foreign subsidiary or through a branch is insignificant, and that the rule that subsidiary profits, or, more generally, all profits realized by foreign corporations in which residents have shares, are taxable only when distributed, constitutes a deferral.

The legislation of the United States and a great number of other countries allows tax deferral only regarding the income of subsidiaries. The income of foreign branches--a type of organization more commonly found in the petroleum and banking sectors--is taxed when accrued, whether or not remittance has taken place.

2/ See footnote 2, p. 2, of Appendix I.

3. Summing up

This section has highlighted the main tax and nontax aspects determining the relative attractiveness of a host country for foreign investment. The tax factors can be consolidated under four broad groups comprising: (a) issues associated with tax coordination; (b) tax rates and rate structure; (c) composition of tax base; and (d) other determinants, but their importance should not necessarily be linked to their order of appearance since that would tend to depend on the overall circumstances of an individual country.

The role of tax coordination and tax treaties cannot be minimized in the decision making of a potential foreign investor. For example, their role in resolving the basis for dividend taxation can be quite important. Thus, it would not be practical for a host country to tax a foreign investor too highly on the basis of the source principle when he is also taxed at home on the basis of the residence principle. Augmented efforts at tax coordination at various levels would aid in the resolution of potential conflicts arising out of the use of different bases of taxation across countries. More generally, tax coordination in a global context, or even within regional groupings or bilateral arrangements that reduce the risk attached to returns on investment would support foreign investment.

With respect to issues regarding tax rates and rate structure, while a low nominal rate of the corporate tax may not by itself comprise a sufficient incentive for the potential foreign investor, tax reform leading to successive and substantive reductions in tax rates could be presumed to affect investment favorably. Similarly, a rate structure that is proportional rather than progressive is more attractive in that it reduces "fiscal drag." In the same vein, overall simplicity in the rate structure that avoids differential taxation of different types of economic activity, certainly improves the foreign investment potential.

The determination of the effective corporate tax base, which is the result of the tax treatment of various cost items, is of paramount importance. For example, are deductions arbitrarily limited or unduly restricted with respect to costs incurred abroad? Ambiguous definitions of base could imply an implicit tax burden and would be a deterrent to attracting foreign investment. Also, forms of accelerated depreciation that improve the cash flow to firms and enable quicker recovery of investment costs as against straight-line depreciation are preferred provided there are profits to deduct them from. Inventory valuation rules--LIFO as against average cost (or even worse, FIFO)--to assure the least tax liability; or some latitude in choosing the most appropriate method of inventory valuation by each firm within the bounds of accepted accounting principles, are of great importance in particular contexts such as that of high inflation. In general, the incorporation of proper inflationary adjustments regarding tax rules on depreciation, valuation of assets and inventories, as well as capital gains would affect the tax base as well as comprise an important element in the potential foreign

investor's decision making. Generous "recovery rules" for pre-operational expenditures, as well as loss carry-over provisions are also considerations that a potential foreign investor would tend not to ignore. Last, but not least, while various specific types of tax incentives such as tax credit, tax holidays, and investment allowances continue to play an important role in the statutes dealing especially with foreign investment, their role in attracting foreign investment has increasingly been questioned by tax experts as substitutes for a simple overall tax structure.

There are other tax factors that are also likely to be important. For example, the rates and base of the capital gains tax could affect the foreign investor, and a corporate wealth tax is especially perceived to lead to inequitous burdens even though it might be a useful proxy for the corporate income tax for domestic companies. Withholding taxes on dividends, interest, royalties, etc., in general, tend to be accepted by legitimate foreign investors, but might weigh heavily on their decision to invest if they are perceived to be levied at prohibitive rates. Branch profits taxes are gradually winning acceptance as imposed in lieu of withholding tax on dividends. Finally, the treatment of foreign exchange gains and losses for tax purposes would affect a foreign investor's taxable income, and their treatment as regular taxable income/loss would be appropriate.

In conclusion, in his decision to invest abroad, a foreign investor is likely to take account of nontax factors that have to be complementary to a favorable tax environment. These would include: political stability; existing institutional and regulatory framework including protection of and restrictions on foreign investment, access to international as well as domestic credit, labor market provisions and practices, as well as infrastructure and access to markets; and macro policies that include stabilizing influences such as debt-equity swaps in heavily indebted countries as well as an overall policy environment that tends to reduce capital flight, currency substitution, and the like.

III. Tax Structure and Foreign Direct Investment in Selected Non-OECD Economies

Based on information drawn from published sources, this section surveys the evidence regarding those aspects of the tax systems that seem to bear on foreign investment. A sample of 21 non-OECD countries has been chosen: Anglophone Africa--Kenya, Malawi, Nigeria, Zimbabwe; Francophone Africa--Côte d'Ivoire, Morocco, Senegal; Middle East--Pakistan, Saudi Arabia; Asia--China, India, Indonesia, Korea, Singapore, Thailand; Latin America--Argentina, Brazil, Mexico, Venezuela; and Eastern Europe--Hungary, the U.S.S.R. It also describes selected nontax features currently prevalent in these economies that are likely to have broad ramifications for foreign investment.

1. Nontax factors 1/

a. Protection of and restrictions on foreign direct investment (Table 2)

The scope, conditions, and guarantee (in some form) of foreign investment is covered in most of the sample countries either formally through a foreign investment act (Kenya, Nigeria, Zimbabwe, Morocco, Korea) or through stated government policy (India, China, Thailand, Argentina). In some countries, provisions for nationalization or expropriation with compensation are included (India, China, Indonesia, Mexico) while others guarantee against it (Pakistan, Thailand, Korea). Other countries may not have any overall legislation--depending more on bilateral arrangements--yet there may be little or no restrictions or conditionality on foreign investment except for registration or authorization (Côte d'Ivoire, Senegal, Saudi Arabia, Singapore, Argentina, Brazil).

Most countries do, however, impose some restriction or conditionality on the form, location, or purpose of foreign investment. Some countries are more restrictive than others, for example, forbidding foreign investment in certain sectors ("negative list"--Nigeria, Morocco, India, Korea, Brazil, Venezuela). Most countries stipulate local equity participation, exceptions being Côte d'Ivoire, Senegal, Singapore, Brazil. India puts a ceiling of 40 percent on foreign equity, while other countries stipulate minimum local participation (25 percent in China and Saudi Arabia; 20 percent in Indonesia, but having to rise to 51 percent within 15 years of operation) or group industries into those in which majority foreign equity is allowed or those where it is not (Nigeria, Thailand, Mexico).

In most countries, there are no restrictions on the repatriation of interest, dividends, royalties, fees, or equity on liquidation or sale of business. They are, however, usually subject to proof of deduction of withholding tax, if any (i.e., a tax-clearing certificate) to be presented to the central bank (Kenya, Malawi, Nigeria, India, Venezuela). Some require prior approval or permission (Korea, Thailand, Argentina, Mexico). While there are no requirements regarding the reinvestment of profits, some countries apply occasional dividend repatriation limits by putting them in blocked or suspense accounts (Kenya, Nigeria, Zimbabwe), or require reinvestment to increasingly use domestically produced machinery (Korea).

1/ Information on Hungary and the U.S.S.R. was not readily available.

b. Accessibility of international capital markets and local borrowing (Table 3)

As can be expected, access to international capital markets is permitted in all cases but is subject to various types of control in all countries (except Singapore) such as approval by the central bank (Kenya, Malawi, Morocco) or the Ministry of Finance (Nigeria, Zimbabwe, Côte d'Ivoire, Senegal--though for the last two countries, no approval is necessary within the French Franc Zone), or through stipulation of costs (Argentina--interest rates may not exceed LIBOR plus 1 percent; Mexico--interest costs not deductible; and Venezuela--interest rate on foreign loans between affiliated companies subject to a ceiling).

Local bank borrowing is allowed in all countries--in some without limitations (Saudi Arabia, Thailand, Korea, Indonesia, Singapore) while in others it is subject to certain limitations (confined to specific sectors--Kenya, Nigeria; limited to a percentage of aggregate paid-in capital--Venezuela; allowed in proportion to local shareholders' share in total equity--Kenya, Malawi, Zimbabwe, Morocco; decided in view of the company's financial situation--Côte d'Ivoire, Senegal; in tandem with credit restrictions on domestic companies--India, Argentina, Mexico; or repayable within a specified period--Nigeria).

Local capital markets exist in the majority of countries--Kenya, Malawi, Zimbabwe, Morocco (though for a limited number of national companies), Côte d'Ivoire, Pakistan, India, Thailand, Korea, Indonesia, Singapore, Argentina, Brazil, Mexico, Venezuela--but access to them by foreign investors is again subject to limitations in most of them (except Côte d'Ivoire, Indonesia, Singapore) based on criteria such as local shareholders' share in equity (Kenya, Argentina), specified requirements for listing on local stock exchange (Zimbabwe), approval by the Ministry of Finance or central bank (Pakistan, India, Korea), or depending on the borrower, whether local or foreign investor (Venezuela).

c. Debt-equity swaps

Debt-equity swaps for foreign investors are not of any significance in the sample countries under discussion except in Argentina and Venezuela where they are allowed under specified conditions, and Mexico which only recently suspended its debt-equity swap program. In Argentina, they require an additional investment in foreign or local currency totaling 30 percent of the project cost. In Venezuela, debt-equity swaps are available for investments in selected sectors subject to limits on the repatriation of dividends and capital.

2. Tax factors

a. Tax jurisdiction (Table 4)

The basic residency criterion for a company in all sample countries is local incorporation except in Argentina where there is no concept of a "resident company" for tax purposes. Some of the countries have additional attributes: physical presence of a registered office (Malawi, Pakistan, India); location of head office (China, Korea, Brazil, Mexico); management and control of business exercised from host country (Singapore).

The source principle is the basis of taxation in the sample countries, that is, income derived from host country operations is taxed. However, once residency is established, Pakistan, China, Korea, Thailand, and Mexico tax worldwide incomes, while Singapore taxes foreign income remitted to Singapore. Information on attribution rules, that is, criteria applied for determining inter-country allocations of income and expenditure was not available for all countries, but the general indication is that countries attribute incomes and expenditures at "arm's length," that is, the tax authorities of the host country expect the foreign investor to account for such transactions between parent company and subsidiaries as well as between head office and branches at prices and conditions as if they were between separate and independent entities (Nigeria, India, Argentina, Brazil; but generally, all countries have such rules in one form or another). In Mexico and Venezuela, the tax commissioner's discretion determines attribution while in Senegal, a pro-rata basis is applied to turnovers for each (branch) country if separate accounts are not available. 1/

The number of capital exporting countries with which each sample country has tax treaties varies, but many have tax treaties with major West European and Nordic countries, and some also with the United States (Kenya, Malawi, Morocco, Pakistan, China, Korea, Singapore, the U.S.S.R., Argentina). Some countries stand out for their differences: Nigeria has treaties with the British Commonwealth and the United States; Zimbabwe with the United Kingdom and South Africa; Senegal and Saudi Arabia with France; India's treaty net with Europe is close to complete, whereas the United States treaty is not yet ratified, India also plays a leading role in concluding South-South treaties; and Thailand and Brazil not with the United States but with Japan, Canada, and selected EC countries (and also Nordic countries for Brazil); while Venezuela is currently negotiating with the United States and some EC countries.

The treatment of taxes paid abroad and of foreign income varies in the sample. The most common form is tax credit: Kenya (only in the

---

1/ Secondary information on Hungary and the U.S.S.R. would indicate the source principle and the residence principle as, respectively, applicable in the two countries.

case of treaty), Nigeria, Zimbabwe, Senegal, Argentina, Brazil (in those cases where foreign income is taxable), Pakistan, India, Korea, China, Indonesia, Singapore (only for income tax, in treaty as well as non-treaty countries). Some countries do not tax foreign income: Malawi, Senegal (in most instances), Côte d'Ivoire, Saudi Arabia. A few countries allow income deductions for foreign taxes paid: Kenya, Senegal (in those cases where foreign income is taxable). Mexico applies differentiated tax rates on profit remittance depending on the level of taxes paid abroad, and Venezuela does not provide for any special treatment for foreign companies or subsidiaries.

b. Rate structure of taxes (Table 5)

The standard rate structure of the corporate income tax can be grouped in different ways: (1) few versus wide-ranging multiple (3 or more) rates; (2) 40-50 percent range, those primarily below this range, and those above; (3) differential rates among domestic, foreign, and joint ventures; and (4) rates differentiated by sectors. First, the multiple rate countries are Saudi Arabia (4 rates), China (8 rates plus surcharge where applicable), Indonesia and Venezuela (3 rates). Second, those in the 40-50 percent range are Kenya, Malawi, Nigeria, Zimbabwe, Côte d'Ivoire, Morocco, India (brought down by 10 percentage points to 40 percent in 1990), Hungary, the U.S.S.R.; those primarily below are Senegal, Saudi Arabia, China, Indonesia, Korea, Pakistan, Singapore, Thailand, Argentina, Brazil, Mexico, Venezuela. While some of the sample countries levy surcharges, their rates are not high enough to shift them from the overall groupings. Third, countries that tax domestic companies differently from foreign or joint ventures are Kenya, China, Korea, Thailand, Argentina, Hungary, the U.S.S.R.--all generally applying a lower rate for foreign or joint ventures; only Kenya and India impose a higher tax rate for foreign compared to domestic companies. Fourth, countries with mineral or petroleum resources have higher tax rates for this sector--Côte d'Ivoire, Saudi Arabia, Indonesia, Thailand, Venezuela, while Hungary and China use differentiated sectoral tax rates. The most complicated standard corporate income tax nomenclature is ostensibly that of China.

In most of the sample countries, capital gains are taxed at the regular income tax rates--Côte d'Ivoire, Morocco, and Senegal (in all three, full exemption applies if reinvested but, in the last, only for capital gains from fixed assets), Senegal, Saudi Arabia, China (in sectors where applicable), India, Indonesia, Korea (with selected surtaxes), Thailand, Hungary, the U.S.S.R., Argentina, Brazil, Mexico, and Venezuela. In a few countries, they are taxed at a lower rate--Nigeria, Zimbabwe, Pakistan; while three countries, Kenya, Malawi, and Singapore, do not tax capital gains.

c. Tax bases (Table 6)

The bases of both capital gains and corporate income taxes perhaps comprise the most important determinants of the final tax burden that a

foreign investor would bear on his returns made in a host country. The effective base is the result of various tax deductions, allowances, credits, holidays as well as valuation principles for depreciation, inventories, and assets. As can be expected, these are specified in a wide variety of ways in the sample countries and the actual calculation of effective burdens would be a significant exercise for each of them.

The base of the capital gains tax is quite broad in some of the sample countries and include gains from both physical and financial capital (Côte d'Ivoire, Morocco, Senegal, Korea, Indonesia, Argentina, Brazil, the U.S.S.R.), but in most the base comprises only certain parts of overall capital (all properties other than government securities--Nigeria; immovable property and securities--Zimbabwe; fixed assets--Saudi Arabia, China; all properties excluding stocks--India; properties excluding immovable properties and shares of public companies--Pakistan; profit-motivated properties--Thailand; fixed assets and shares--Mexico; immovable property and shares--Venezuela). Even in those instances where the base is broad, taxation usually relates to gains under specific conditions (number of years held--Morocco, Senegal; size of shareholder in overall stock position--Senegal, Korea; size of specified assets in overall asset position--Korea).

The effective base of the corporate income tax is made even more complicated through the multiple factors that affect it. Among deductions, asset price is based on historical value in all countries; in Argentina and Brazil the historical value is adjusted for inflation. For depreciation calculations, some countries use a single formula while others allow alternative methods: straight-line--Nigeria, Zimbabwe, Saudi Arabia, China, while in Argentina, Brazil, and Mexico, it is inflation adjusted; declining-balance--Pakistan (except straight-line for ships), India; formula varies according to asset--Kenya, Côte d'Ivoire, Morocco, Senegal, Pakistan, Korea, Indonesia; any generally accepted method--Thailand, the U.S.S.R., Venezuela; by government ordinance--Hungary. For inventory valuation, many countries use cost or market value (Kenya, Malawi, Zimbabwe) and, within them, most use the lower of the two thus making it the "standard rule" (Nigeria, Côte d'Ivoire, Morocco, Senegal, Pakistan, India, Singapore, Thailand, Venezuela). 1/ Some countries cannot be grouped easily: Saudi Arabia uses only cost; China uses a variety of methods--FIFO, moving average and weighted average, while Indonesia and Brazil use FIFO and moving average; Korea allows all methods; Argentina uses LIFO, and Mexico allows immediate expensing. Information on loss offsets was not available for many countries but among those available two groups are possible: indefinite carry-forward (Kenya, Malawi, Zimbabwe) and three- to five-year carry-forward (Nigeria--four, Côte d'Ivoire--three, Morocco--four, Senegal--three, Hungary--five and extendable, Argentina--five,

---

1/ Note that LIFO and FIFO are different methods to establish how this rule will be applied; in other words, what cost price will be applied to the inventories on the balance date.

Brazil--four, Mexico--five, Venezuela--three); Saudi Arabia does not allow loss offsets. From the above, it may be concluded that the different factors that reduce the base of the tax do not move in unison in the sample countries so that it is difficult to rank them in terms of a favored foreign investment status, a task that becomes all the more difficult when investment allowances, tax credit, and tax holidays are considered.

Except Saudi Arabia, India, and the U.S.S.R., all sample countries grant investment allowances, tax credit or both. Those that grant investment allowances are: Kenya, Malawi, Nigeria, Zimbabwe, Morocco, Indonesia, Singapore, Brazil; India abolished investment allowances in 1990. Those that use the tax credit method are: Pakistan, China, Korea, Hungary; those that use both instruments for incentives are: Côte d'Ivoire, Senegal, Thailand, Argentina, Venezuela. Tax holidays are utilized in most countries for specified sectors other than Kenya, Malawi, Zimbabwe, Senegal, India, Argentina, Brazil, Mexico. Countries using them may be grouped into two broad categories: those with a maximum five-year holiday period (Nigeria, China, Thailand, Korea, and the U.S.S.R. for joint though not solely foreign ventures) and those heavily leaning toward five- to ten-year holiday periods (Côte d'Ivoire, Morocco, Saudi Arabia, Pakistan, Indonesia, Singapore, Venezuela). In Hungary, the Government uses its discretionary powers. In addition, the sectors to which the holiday applies vary across the sample countries and encompass agriculture (Nigeria, China, Venezuela, the latter two including forestry), manufacturing (Nigeria, Côte d'Ivoire, Pakistan, Korea, Singapore, Thailand, for high technology industries, Venezuela), mining (Nigeria, Côte d'Ivoire, Morocco, Pakistan, China, Indonesia, Venezuela), shipping (Morocco, Korea), tourism (Côte d'Ivoire, Morocco, Venezuela), export industries, offshore financing, international trading companies, and investment promotion zones (Singapore, Thailand). Saudi Arabia grants blanket holidays to all development projects according to the Foreign Capital Investment Code while the U.S.S.R. Government decides them for all "special activities."

d. Withholding taxes (Table 7)

To some extent, a corporation's decision to invest abroad can be seen to depend on withholding taxes on dividends in the host country, whether it is final, as well as whether the tax paid by the company is imputable to the shareholder. With respect to the latter, only a few countries make the company tax imputable: Kenya, Malawi, Nigeria, Singapore, Thailand (mainly using tax credits) and, in India, Argentina, Brazil, Mexico, and Venezuela (dividends paid to corporations are exempted). With respect to a withholding tax most countries impose it in the range of 10-20 percent; with India and Brazil exceeding that range at 25-30 percent, and the U.S.S.R. being below that range at 5 percent; while Saudi Arabia, Singapore, Hungary do not withhold. Withholding is final in Zimbabwe, India, Korea, Indonesia, Argentina, Brazil, Mexico, and Venezuela--mainly for nonresidents--a tax credit against tax due on "grossed up" receipts being used in the other cases.

e. Available evidence on the treatment of foreign exchange gains and losses (Table 8)

Among other tax factors that may play a role in his decision making for investment abroad, a foreign investor would consider the tax treatment of foreign exchange gains and losses. In the sample countries, exchange gains and losses are treated as ordinary income in the countries for which information is available: Kenya, Nigeria, Côte d'Ivoire, Morocco, Senegal, Saudi Arabia, Korea, Singapore, Thailand, Hungary, Argentina, Brazil, Mexico (here only inflation-adjusted gains are taxed); in the U.S.S.R. it is treated as capital gains (but capital gains and corporate tax rates are the same).

3. Summing up

Among the more restrictive nontax environments are probably India and China, neither of which rules out expropriation or nationalization, while applying a ceiling on foreign equity, or a floor on local participation, or a negative list ruling out foreign investment in selected sectors. Other countries that seem to follow with various degrees of restriction appear to be Indonesia, Mexico, and Brazil. However, there seems to be little restriction on repatriation in the sample countries as a whole. The countries with the least restrictions appear to be Côte d'Ivoire, Senegal, and Singapore.

Foreign investors are, in general, technically allowed to borrow from the local banks as well as capital markets but most countries impose restrictions on such access in one form or another. Access to international capital markets is similarly restricted. Singapore is the least restrictive, followed by Côte d'Ivoire and Indonesia. The Latin American countries tend to link borrowing with interest costs. India again appears to use restrictions applicable to domestic investors as well as other administrative controls.

The source principle is the primary basis of taxing the returns on foreign investment in all countries, with some modifications applicable in a few of them. Also, the general indication is that most countries apply the "arm's length" attribution rule as is to be expected for the minimization of tax avoidance. There is little clear pattern in bilateral tax coordination, though nine of the sample countries have concluded treaties with West European and Nordic countries as well as the United States, and a majority of them provide "spontaneous" tax coordination through tax credit or deductions from gross income. Also, it cannot be concluded that the countries that rely on spontaneous coordination are the ones that have not concluded the most bilateral tax treaties.

While most countries have nominal corporate tax rates below 40 percent, nine have higher rates; hence, there is scope for reductions in the nominal rates. On the whole, the rate structure is relatively

complicated across the sample countries with ample room for simplification toward a single rate. Two countries that have simplified their structures in recent years are Indonesia and Mexico. Finally, surcharges on the corporate income tax that may effectively be a branch profits tax might play some role over and above that of the rate and rate structure of the corporate income tax.

The corporate income tax base is quite diverse across the sample countries as it is affected by different rules on asset price, depreciation, inventory valuation, and loss offsets, inasmuch as by a variety of tax incentives. Asset price valuation is based on historical cost in all countries; therefore, there is room for introducing inflation adjustment (Argentina and Brazil already have it). Depreciation rules are stringent in many countries inasmuch as they adhere only to the straight-line method. These countries could compare depreciation rules with other, especially neighboring, countries for similar assets in order to gauge possible differences in the inducement to invest. For inventory valuation, most countries effectively use FIFO; only Argentina uses LIFO, Mexico allows immediate expensing, and Korea allows all methods. If attracting investment is the objective, other countries would follow the Korea model. A few African countries allow indefinite loss carry-forward but most do not extend beyond a three to five year range which appears to be the norm. Similarly, the bases of the capital gains tax can be seen to be quite diverse. While recognizing that country-specific factors often typify the actual structure of such a tax, there still seem to be significant possibilities for simplification in many instances from the point of view of the investment objective.

Tax incentives are used in some form or other by most countries, the most popular form being tax holidays for selected sectors, while a few countries use tax credit as well. Developing countries hopeful of attracting foreign investment should study carefully the ramifications of such tax incentives. As was indicated earlier, the role of such incentives in encouraging foreign investment might not always be positive because tax incentives may, in general, encourage only short-term investment, tax holidays may lead to postponement of investment if there are inflationary expectations, foreign investors may prefer a simple tax statute rather than one riddled with multiple interpretation possibilities and, hence, subject to discretion and, last but not least, they would perhaps attach greater weight to the overall stability of the economic environment rather than to a complex system of incentives.

Withholding taxes are levied by most countries in the range of 10-20 percent which seems to be the norm, except for India and Brazil which impose it at 25-30 percent, where there would be some room for reductions. A minority of countries allow imputation of the company income tax usually using tax credits; while a few others only exempt dividends paid to corporations. Most countries need to reform their tax structures in this area. Finally, most countries exempt emigrants' remittances except India which taxes it as the recipient's income.

IV. Recent Tax Reform Experience

This section provides recent available evidence from the sample countries of recent measures pertaining to those aspects of the tax structure with potential ramifications for foreign investment. During the 1980s, when the United States began to contemplate tax reform with the objective of improving the supply-side response of tax policy, a number of other industrial, developing, and centrally planned economies also started reviewing the prospects for carrying out tax reform. By the end of the decade, many countries had implemented reforms in the prevailing tax systems in varying degrees and forms in the expectation of promoting growth by minimizing distortions for the use of factors of production, including foreign capital. Many countries concentrated, as the United States did in its 1986 Tax Reform Act, on the income tax by attempting to simplify its structure by broadening its base and lowering its rates. 1/ However, some others such as Indonesia, Singapore, and Venezuela went beyond income tax reform by overhauling their entire tax structure and introducing new taxes.

It may be argued on theoretical grounds that a reformed tax structure on the whole, comprising not only the corporate income tax but also others such as the personal income tax and consumption taxes, improves the economic environment by reducing price distortions, encouraging simplicity and improving clarity of tax burdens. However, it is beyond the scope of this paper to enter into the overall ramifications of the structural reform of all taxes. This section of the paper will, therefore, concentrate mainly on corporate income tax reform, in host countries, that seems more directly pertinent for foreign investment decisions. Regarding the other two taxes, suffice it to say that there was a switchover from the sales tax to some variant of the value-added tax in Kenya, Morocco, Pakistan, Indonesia, Thailand, and Venezuela; and the nominal personal income tax rates were reduced in about half of the sample countries, accompanied by a broadening of the base in selected cases.

1. Reductions in tax rates

Most sample countries revised their corporate tax rates, some notable exceptions being Côte d'Ivoire, Malawi, and Saudi Arabia; while Zimbabwe increased it (Table 1). Centrally planned economies, namely China, Hungary, and the U.S.S.R. also carried out reforms by introducing standard tax systems as prevalent in market-based economies. The extent

---

1/ As a result of the reduction of the U.S. corporate tax rates, the rates applied by some host countries became higher than in the United States, thereby likely to give rise to excess foreign tax credit; the resulting disincentive to investment constituted an incentive to these countries to revise their rates downward. On the other hand, more stringent rules for capital recovery in the United States created a new factor inducing investment abroad.

of reduction in corporate tax rates varies. In the case of Hungary, the 60 percent tax rate applicable to foreign-owned companies was reduced to 40 percent in 1989 (plus a 4 percent additional tax on 1988 income) depending on profit levels. Other countries reducing their highest rates by substantial percentage points included Pakistan (15), Argentina (13), India (10), Indonesia (10), Korea (10), Singapore (8), and Mexico (7). Those reducing their tax rates by 5 percentage points or less included Nigeria, Venezuela, India, Thailand (5 in each case), and Kenya (2.5).

2. Broadening of the tax base

Broadening of the corporate tax base was attempted through the elimination of tax holidays upon their expiration or shortly thereafter (Venezuela, Singapore); reduction of extent and duration of tax holidays (Korea); removal of investment allowances (India); reduction in the number of tax-exempt industries (from 44 to 6 in Pakistan); and a detailed scrutiny of existing exemptions (e.g., the establishment of a Registry for the Industrial Promotion Tax Benefits in Argentina to facilitate an accurate measure of the tax revenue that the Treasury had waived). In Brazil, the Constitution created an annual budget of tax expenditures. In some instances, the initial payment of the corporate income tax was imposed as a fixed proportion of the net worth of the enterprise which then applied as a credit toward the payment of actual income tax liability to reduce the erosion of real revenues (Argentina, Mexico). However, Mexico also introduced full indexation of business profits and assets. In one instance, provision was made for the payment of minimum company tax along the same lines as in the United States (India). In Venezuela, the scope for tax avoidance through an artificial de-integration of companies producing the same or complementary product was eliminated by requiring such companies to consolidate their incomes for tax purposes, while Korea laid down clear rules for transfer pricing. Finally, Kenya abolished the capital gains tax, and Argentina the net wealth tax.

In the process of broadening the tax base, a number of countries simplified incentives while providing new incentives especially for foreign investment. For instance, India relaxed residency rules so as to attract savings from nationals living abroad. Mexico provided a tax break to nationals repatriating their funds back to the home country. Saudi Arabia reduced effective tax rates for both domestic foreign financial institutions--banks and insurance companies--by allowing nonperforming loans and insurance commissions as deductible costs. Some countries, however, introduced new investment incentives geared to specific objectives. Korea and Singapore introduced special accelerated depreciation allowances on high technology machines and equipment. India extended full tax exemption to income derived from export earnings of industries, while the U.S.S.R. introduced a two-year income tax exemption to all joint ventures.

In Mexico, relief was provided to shareholders by introducing partial imputation of the company income tax. However, in other countries special incentives provided to promote savings by exempting certain interest income from taxation (India, Korea), or granting other forms of special treatment (Venezuela) eroded the tax base. In Argentina, dividend incomes which were previously not taxable were made taxable in the hands of shareholders, with a partial imputation of the tax paid at the corporate level. The bases for net wealth and stamp taxes were widened to include certain hitherto not included assets (Korea, Singapore) and transactions (Argentina). The enforcement of income tax laws was intensified on the basis of visible evidence from business and individual taxpayers (Korea).

3. Summing up

Many of the sample countries have started reforming their tax systems. Among features of tax reform that would affect foreign investors especially, it might be noted that corporate tax rates have been reduced in most countries in recent years, with Hungary, Pakistan, Korea, and Indonesia reducing it by 10 percentage points or more. A few countries have also attempted to broaden the corporate tax base by eliminating tax holidays and streamlining tax incentives in general, while others expanded various incentive schemes that eroded the tax base. However, broad-based tax reform has been lacking in most countries, leaving room for further simplification, broadening of the base, and rate reductions. On the whole, much seems yet possible in tax reform with the objective of attracting foreign investment.

V. Concluding Remarks

The paper has attempted to (1) discuss tax and nontax factors likely to affect foreign investment; (2) review those parts of the tax systems of selected non-OECD countries that are likely to have ramifications for decision making by a foreign investor; and (3) provide available evidence on the tax reform experience in the sample countries especially those pertinent to foreign investors. Cross-country comparisons revealed a wide variety of tax structures as well as scattered instances of reforms in recent years to attract foreign investment. Doubtless, room remains for further tax reform in these countries if greater foreign investment is the objective.

The review of the main features of business profits taxation reveals a wide range of determinants such as definition of taxable profits, rules for depreciation, inventory valuation, treatment of capital gains and operating and capital losses, adjustments for inflation and exchange rate changes, tax incentives, and tax coordination. As far as tax policy is concerned, governments which want foreign investment to play a role in their development programs are well advised to design their tax structure with an eye to the taxation level in the other countries which are potential competitors as venues for foreign

investment. In addition, the overall economic climate is a major determinant of foreign investment. It is up to each national government to develop the institutional, fiscal, and monetary policy climate so that the international investor responds to the given environment. 1/ Moreover, within each country, the overall level of foreign investment is probably determined inasmuch by domestic institutional and political forces as by the economic policy environment. Thus, the effective tax burden, as well as the overall economic policy and politico-institutional environment are all important determinants of foreign investment.

Although every country is either a net importer or a net exporter of capital, it is often the case that it exchanges capital with the rest of the world. Since it is reasonable to assume that resident investors react to the same set of incentives as foreign investors, it follows that the same factors and policies that serve to attract foreign investment also work to retain within the country the capital owned by domestic residents. Conversely, when capital has incentive to move abroad the domestically owned part does not necessarily stay behind. Therefore, the need for the use of tax instruments to prevent capital flight is apparent.

1/ In some cases, however, especially in petroleum exploration and similar "enclaves," the fiscal conditions, established in contracts and backed by law, may result from direct negotiations between the investor and an official agency.

Choosing Domestic versus Foreign Investment: A Framework of Analysis

Two aspects of foreign investment decisions are considered in this Appendix. First, what makes a firm invest abroad, that is, to go multinational. Second, what makes a firm invest in country A and not in country B, or more in one foreign country than in another. In order to examine these questions, consider first an enterprise operating in the home country (exporter of capital). The real rate of return to capital net of taxes can be written as

$$r = (1-t_c)\ R + X \tag{1}$$

where t_c is the marginal rate of the corporate income tax in the home country, R is the real rate of return to capital, and X is a term that captures the impact of accelerated depreciation allowances, tax credits, and other factors which may positively or negatively affect the rate of return, to be elaborated below. 1/

We can compare (1) with a similar expression for the host country (importer of capital) which the home country investors may be considering for investment. We may write,

$$r^* = (1-t_f^*)\ [(1-t_c^*)\ R^* + X^*] - Z^* \tag{2}$$

where an asterisk indicates the parameters relevant in the host country, t_f^* is the effective rate of withholding tax imposed by the host country on dividend remittances abroad, and Z^* is a variable which measures the implicit political and other risks associated with investing in the host country. More broadly, Z^* can also be interpreted as a measure of the costs associated with all the nontax factors, implicit or explicit. Clearly, (2) can apply to any number of host countries (countries A, B, C) under consideration.

Equation (2) can be viewed as a criterion to decide in which host country investment should be allocated. If investment in country A provides a return of r^{*A}, whereas investment in country B provides a return of r^{*B}, and $r^{*A} > r^{*B}$, then a potential investor from the home country will invest first in country A up to the point where the net rates of return between countries A and B are equalized. The breakdown of the formula in (2) into its components will reveal why country A is more attractive than country B to a foreign investor.

Without loss of generality, by comparing r to r^*, we can examine a firm's decision to invest in the home country versus the host country. This decision will critically depend on the tax treatment in the home country of the profits made abroad. Let us assume that the exchange rate between the two currencies is unity, so we can compare the rates of

1/ For a comprehensive micro-foundations derivation of the return to capital at home and host countries, see Kopits (1980).

return directly. It is important to remember that the formulas above can be treated as expected rates of return over a planning horizon. We consider three general cases.

1. Taxation applies only in the country where the profits are generated (i.e., the source principle). In this case the return r in (1) can be directly compared to the return r* in (2), and the decision can be made as to which country to invest in.

2. The capital exporting country taxes the profits made abroad (i.e., the residence principle) and the taxes paid abroad are not deductible in the assessment of the taxable base at home. In this case, the profit made abroad net of all foreign and domestic taxes, is

$$r^{*\prime} = (1-t_c)\ r^* \tag{3}$$

and $r^{*\prime}$ can now be compared to r for the investment decision. 1/ This is a case of international double taxation. In the absence of mechanisms to relieve double taxation (e.g., unilateral exemptions or credit, or exemption or credit stipulated in tax treaties), for the host country to attract investment, it needs to offer the foreign investor advantages that outweigh the burden of double taxation, such as moderate nontax costs and lower tax rates.

3. Taxation is still based on the residence principle, but the home country grants a certain amount of tax credit for the taxes paid abroad. 2/ The credit can at most be

$$t_f^* \{(1-t_c^*)\ R^* + X^*\} + t_c^*\ R^*$$

where the first term refers to the tax on dividends withheld by the host country and the second refers to the corporate tax paid in the host country. Combining the above expression with equations (2) and (3), the net rate of return on investment in the host country can be written as

$$r^{*\prime\prime} = (1-t_c)\ (R^* + X^* - Z^*) \tag{4}$$

1/ Here, and also in (4) below, t_c should be interpreted as an effective, rather than a statutory, rate. This would allow for the financial consequences of tax deferral; for tax sparing, whereby taxes forfeited by the host country as investment incentives are treated by the home country as actual tax liabilities; and for the differences between the two countries in the definition of taxable income.

2/ According to Musgrave (1983) this regime became the international standard of tax equity. As noted by Kopits (1976), a complete credit for the taxes paid abroad corresponds to capital export tax neutrality, whereby taxation in host countries is not important for the decisions about allocation of investments. Conversely, tax exemption of profits from foreign sources implies capital import tax neutrality, whereby the tax parameters relevant for the investment decisions are those of the host country only.

The value of $r^{*''}$ will be lower to the extent the foreign tax cannot be effectively credited against the tax liability in the home country. A comparison can now be made between r and $r^{*''}$ to assess the relative profitability of investment at home and abroad.

The discussion above reveals that the decision to invest in one country depends on the rate of return as determined by the overall level of taxation that the investor faces in each country--and not only the corporate tax rate--together with nontax risk factors.

The formulas presented above are intended to be a general statement of the tax factors that affect the rate of return on capital and do not capture all real world complexities in the tax treatment of investment income. Yet, it is possible to locate various tax and nontax features that affect foreign investment as discussed in the text within the framework presented in this Appendix. For example, an increase in the implicit tax burden caused by the risk of arbitrary taxation resulting from an ambiguous tax base, or an increase in the risk of price instability--leading to volatility in expected tax liability--would increase Z^* in equation (4).

Similarly, referring to equations (1) and (2), the benefit of accelerated depreciation or loss carry-forward can be measured by the increase in X or X^*, leading to an increase in r or r^*. Suppose that, initially, $r = r^*$, that is, the international firm is indifferent between investment in the home or the host country. Clearly, everything else held constant, if the host country grants a more generous depreciation allowance, X^* rises and r^* rises above r, giving the firm an incentive to invest in the host country.

In an inflationary environment, the undervaluation of inventories without adequate inflationary adjustments, would raise the tax burden. In the context of equations (1) and (2) above, the undervaluation leads to an increase in the effective tax rates, t_c or t_c^*. The same effect would occur if depreciation is based on historic cost of capital. To illustrate, suppose the tax base is calculated as revenues from sales less production costs less depreciation allowances applicable in the period of taxation. When the depreciation allowance is calculated as some fraction of the historic (or the initial acquisition) cost of capital, it is smaller than it would be if it were adjusted for inflation that took place since the time of acquisition of the capital. Thus, without inflation adjustment, the tax base is larger, and for a given tax rate, the tax liability is larger.

Finally, the absence of exchange rate adjustment in an environment of overvalued exchange rates would also tend to raise the effective tax rate; and a remittance tax would apply as a surtax t_1^* in equation (2), thereby raising tax burdens.

Tax Coordination: Methods and Experience

1. Industrial economies

The European Community (EC) is currently moving toward close economic integration. The Single European Act of 1987 aims at complete freedom of movement of goods and factors within the EC. In the area of taxation, harmonization to date has brought a common external tariff, elimination of intracommunity tariffs, and some uniformity in the type and base of commodity taxes. Negotiations continue toward at least partial harmonization of rates of various commodity taxes. Notwithstanding the slow pace of fiscal convergence in Europe, the prospect of a unification of markets should eventually make necessary the harmonization of at least the treatment of capital income.

Although uncoordinated, a trend toward tax reform and convergence followed the implementation of the United States Tax Reform Act of 1986. Many industrialized economies followed this move with their own tax reforms, involving reduction of the tax rates for income taxes and a widening of the tax bases (Tanzi, 1987). Wide-ranging tax reforms along the same lines were also pursued in recent years by a number of developing economies.

The focus to standardize tax treaties with developing countries based on the first OECD model (1963) was due to the initiative of ECOSOC. OECD's Model Double Taxation Convention on Income and Capital, published in 1977, is the most recent one, and inspired many existing bilateral conventions. This was followed by a model drafted by the United Nations (UN) intended to provide a unified framework of negotiations. Though less precise in details than the OECD model, the UN model faces problems that arise when there is no reciprocity in the economic relations between the parties involved. 1/ These conventions are both an instrument for relieving international double taxation by means of tax harmonization.

2. Capital importing countries

To the extent that they compete in the same market for international investment, capital importing countries are more likely to behave in a competitive than in a cooperative way. One of the few examples of multilateral coordination in this area is given by the Andean Model Treaty of 1971, convened by the country subscribers to the Andean Subregional Integration Agreement. The initiative, however, did not prosper, mostly because coordination was ineffective among the group. In spite of the modest results achieved so far, tax coordination among capital importing countries presents advantageous opportunities, if for no other reason than facilitating the operation of binational companies and the

---

1/ United Nations Model Double Taxation Convention Between Developed and Developing Countries, 1980. For antecedents see UNCTC (1988).

exchange of information to prevent tax evasion. It is also the case that tax competition--understood as unilateral lowering of taxes on capital--may result in significant losses of revenue for the competing countries, without a counterpart in terms of foreign investment inflows. 1/

3. Bilateral tax coordination

Bilateral tax conventions open a wide range of possibilities for mutually profitable exchanges. They can be tailored to fit broad interests, like the UN model, or to respond to special preferences of a country toward its ex-colonies, or to other diverse situations. Negotiations can lead to arrangements that are advantageous to all parties involved. Two-country treaties are currently the most common form of tax coordination. International practice and national constitutions usually give treaties preference when they conflict with domestic statutory laws. Their effectiveness, however, depends on ratification by the legislative bodies, which could be a protracted process. Two main methods are used in treaties to avoid double taxation: one, the exemption method; the other, the foreign tax credit. Reduction in rates is often stipulated when the residence country admits the priority right of the source country while insisting on keeping a sizable residual right to tax, as well as when the source country tax is applied to gross income, and the home country feels that such tax is too high in relation to actual real income. Standard clauses provide for exchange of information on tax matters and define mechanisms for settlement of disputes. In practice, treaties are a way of reaching tax splitting on some mutually agreed sharing basis. At the same time, a reduction in the obstacles to trade and investment flows is an objective.

4. Unilateral tax coordination

In the absence of international conventions, national tax laws have to define the treatment of income originated abroad or earned by foreigners, and also the treatment of taxes paid abroad. Clearly the home country can disregard any tax paid to foreign governments, but this would represent such a hindrance on the development of business that it may not be in its best interest. Therefore, countries have allowed, often on their own accord, exemption of foreign-source income, tax credit, tax deferral, and the like, for taxes paid in foreign countries by domestic corporations operating abroad.

1/ However, see Conrad (1989) for a defense of tax competition on the grounds of efficiency. For a review of the instruments for coordination among developing countries, see Musgrave (1987).

Cross-Country Tables

Appendix III presents a set of cross-country tables that consolidate information on nontax and tax factors that are likely to be important for decision making by a potential foreign investor. The sources of information are secondary, comprising published material on relevant nontax factors as well as on the tax structures of the 21 sample countries from various publications of the International Bureau of Fiscal Documentation, tax journals, and country investor guides by consultancy firms. The information, therefore, necessarily reflects the recency of the published information that was available at the time the tables were prepared.

Table 1. Reductions in Individual and Corporate Income Tax Rates in Selected Countries

Country	Individual Income Tax: Pre-reform tax rates	Individual Income Tax: Time of reform	Individual Income Tax: Post-reform tax rates	Company Income Tax: Pre-reform tax rates	Company Income Tax: Time of reform	Company Income Tax: Post-reform tax rates
	(In percent)	(Year/s)	(In percent)	(In percent)	(Year/s)	(In percent)
Africa						
Francophone						
Côte d'Ivoire	10-60	No change		44	No change	
Morocco	3-45	No change		45	1988	40
Senegal	Schedular tax being replaced by a global tax.			33.3	1990	Lower rate
Anglophone						
Kenya	10-65	1987	10-50	45; 52.5 1/	1989	42.5; 50 1/
		1989	10-45			
Malawi	3-50	No change		50; 55	No change	
Nigeria	10-70	1987	10-55	45	1987	40
Zimbabwe	10-45	1989	10-60	45	1987	54
Latin America						
Argentina	10-45	1989	6-35	33; 45 1/	1990	20; 36 1/
Brazil	10-45	1989	10-25	35-40	...	35
Mexico	3.1-55	...	3-50	42	1987-91	35
Venezuela	4.5-45	1990	4-35	18-50	1990	18-45
					1991	18-40
					1992	18-35
Middle East						
Saudi Arabia	5-30	No change		25-45	No change	
Asia						
China			5-45			20-40
India	33-60	1984	25-40 2/	55; 70 1/	1987	50; 65 1/
		1989	20-40		1990	40; 55 1/
Indonesia	5-50	1984	15-35	20-45	1984	15-35
Korea	6.6-76.5	1982	6-55	25-30	1982	20
	--	1989	5-50			
Pakistan	15-66	1985	5-45	60	1985	45
Singapore	4-45	1987	3.5-33	40	1987	33
					1989	32
Thailand	7-65	1986	7-55	35; 40 1/	1986	30; 35 1/
Eastern Europe						
Hungary	Schedular	1988	17-56	25-60	1989	40 3/

Sources: Various publications by International Bureau of Fiscal Documentation; various tax journals; and country summaries by consultancy firms.

1/ Foreign or nonresident companies.

2/ Excluding surcharge of 5 percent and 8 percent.

3/ For foreign-owned companies only--4 percent additional tax on 1988 profits.

Table 2. Foreign Investment Protection and Restriction Rules

Country	Whether Investment Guaranteed/Protected (And How)	Restrictions or Conditionalities of Foreign Investment	Safeguards and Related Incentives	Repatriation of Dividends, Royalties, and Fees	Retention Requirement
Kenya	Foreign Investment Protection Act, 1964; ICSID. 1/	No protection of speculative investment or of owning of agricultural land; or of investment competing with local tourism, agricultural, or distributive enterprises.	Full repatriation of interest, dividends, and loans; and of equity on liquidation and sale of business; compensation for compulsory acquisition.	Subject to proof of deduction of withholding tax to the central bank for authorizing repatriation.	Occasional dividend control policy (1978-80) limiting repatriation to 10 percent of capital invested (excess held in blocked account or government securities for five years before automatic repatriation).
Malawi	No formal guarantee; ICSID.	Registration of foreign capital with exchange control authorities strongly recommended.	Registration provides evidence of inflow of funds required for repatriation of capital and dividends.	Subject to proof of deduction of withholding tax to the central bank for authorizing repatriation; no recourse to local borrowing for remittance.	None; occasional dividends control results in holding them in suspense account.
Nigeria	Nigerian Investment Promotion Acts, 1972, 1977; ICSID.	Foreign investment in certain industries prohibited; majority local equity holding required in some and of minority equity ownership in others.	Favorable consideration for repatriation of dividends, interest on loans, of capital, and of royalties, management fees, and technical services fees.	Subject to production of tax clearance certificate.	Maximum permissible dividends is up to 50 percent of after-tax profits; for royalties 1 percent of net sales, for technical fees 2 percent of net profits and 20 percent for consultant fees.
Zimbabwe	Government foreign investment policy statement of September 1982, no formal guarantee; ICSID.	Foreign investment in specified areas 2/ is usually approved by the Foreign Investment Committee of the Ministry of Finance and Development Planning.	Favorable treatment for repatriation of capital, borrowing dividends, interest, royalties, and fees.	No local borrowing allowed for repatriation of dividends.	Blocked account for capital and for dividends.
Côte d'Ivoire	ICSID.	None.	No restriction with French franc zone; for other countries, prior approval by Ministry of Finance.	Same as the previous column.	None.
Morocco	Industrial Investment Code (1982); ICSID.	Restrictions in selected areas, such as transportation, sugar refining, cement, phosphate, mining.	No restrictions.	No restrictions.	None.
Senegal	ICSID.	None.	No restriction within the French franc zone. For other countries, prior approval of the Finance Ministry required.	Same as the previous column.	None.
Pakistan	Guarantees against expropriation under national legislation; bilateral investment guarantees also exist.	Prior approval required.		No restrictions.	None.
Saudi Arabia	ICSID.	None; but for tax incentives, joint venture needed (a minimum of 25 percent Saudi Arabian participation).	None.	None.	None.

Table 2 (continued). Foreign Investment Protection and Restriction Rules

Country	Whether Investment Guaranteed/Protected (And How)	Restrictions or Conditionalities of Foreign Investment	Safeguards and Related Incentives	Repatriation of Dividends, Royalties, and Fees	Retention Requirement
China	Bilateral protection agreements; guarantee declarations by Bank of China; expropriation with compensation.	Approval by host country; joint ventures require minimum 25 percent foreign participation.		No restrictions (subject to withholding taxes).	No requirement.
India	Nationalization with compensation.	Approval by central government and Reserve Bank of India required; general ceiling on foreign equity investment is 40 percent; foreign portfolio investment not allowed; foreign investment not allowed in many industries.	Approval by Reserve Bank.	Freely allowed (other than exceptional cases with foreign equity exceeding 40 percent, in which case approval by Reserve Bank required).	
Indonesia	Bilateral investment guarantee agreements; multilateral investment protection agreement with ASEAN; ICSID; expropriation with compensation.	Approval required; all new foreign investment must be joint ventures; Indonesian participation at least 20 percent to start; increasing to at least 51 percent within 15 years.		No restrictions.	No restrictions.
Korea	Guarantee against expropriation is provided by host country.	Approval required; negative list exists; minimum equity investment US$100,000 (US$50,000 if new technology introduced under joint venture).		Prior approval required.	Certain industries subject to local content requirements: progressive increase in use of machinery made in the host country.
Singapore	No explicit legislation; bilateral investment guarantee agreements exist.	Almost none.		No restrictions.	None.
Thailand	Guarantee against expropriation of business ventures under national legislation.	Approval required; numerous fields require Thai majority ownership.		Permission required.	None.
Argentina	Guarantees foreign investors the same rights as domestic investor.	Foreign investment subject to alternative regimes: (1) compulsory approval by the executive branch; (2) automatic registration (approval not required); (3) compulsory authorization from the Under-Secretary of Economic Policy; and (4) choice between registration and nonregistration, depending on particular sectors, and form and amount of reinvestment.	Investment may not be repatriated for at least three years; may be suspended if foreign currency: investor receives a foreign currency bond bearing the international market interest rate. Right to repatriate investments in foreign currency suspended since 1984 (have repatriated investment using External Bonds of the Argentine Republic (Bonex) denominated in U.S. dollars).	In principle, withdrawal of profits allowed. If central bank limits withdrawals, they are available only to registered foreign investors.	Retention equivalent to 13.2 percent of net income before deduction for losses.

Table 2 (concluded). Foreign Investment Protection and Restriction Rules

Country	Whether Investment Guaranteed/Protected (And How)	Restrictions or Conditionalities of Foreign Investment	Safeguards and Related Incentives	Repatriation of Dividends, Royalties, and Fees	Retention Requirement
Brazil		Registration with the Central Bank of Brazil; prior approval needed. No legal restrictions on percentage of foreign ownership; but limits for participation in public banks, petrochemicals, transportation, and computers.	Repatriation limited to amount of investment and reinvestments registered with the central bank. 3/ Temporary suspension of capital repatriation possible.	No legal limitation on remittance of profits; except during balance of payment disequilibrium: limited to 10 percent per annum on registered capital; royalties and fees, restricted to a maximum of 5 percent of net income of the company.	None.
Mexico	Expropriation through court decision and adequate compensation allowed.	Investment limited to 49 percent of a company's shares on fixed assets; otherwise, requires authorization of the National Committee for Foreign Investment (NCFI).	In NCFI cases, subject to a period when repatriation of capital forbidden.	No specific restrictions on the payment of dividends to foreign investors; for royalties and fees, payments in excess of a certain percentage of sales not allowed.	
Venezuela		Authorization and registration by the superintendent of foreign investment required. Local majority ownership encouraged except for large initial capital or high technology. Most are joint ventures with the private or public sectors. Foreign investment is excluded from oil and mining; and 80 percent local capital required in public services, utilities, domestic transportation, broadcasting, and newspapers and magazines.	Amortization of principal and the payment of interest permitted for registered foreign capital. Maximum interest set on foreign loans between affiliated or related companies, the annual interest rate may not exceed by more than three points the first-class interest rate chargeable in the country in whose currency the loan is registered.	Remittance of profits of foreign investors allowed up to 20 percent plus LIBOR per year of the registered investment in certain cases. Limitation does not apply to agriculture, tourism, national enterprises, and mixed enterprises that export 60 percent or more of their production.	Payment of royalties not permitted if contribution of technology provided by parent company or subsidiary.

Sources: Same as Table 1.

1/ International Convention for Settlement of Investment Disputes.
2/ Mainly rural enterprises; new technology and export-oriented activities; labor-intensive and local raw material utilizing intensive industries; new investment to improve productivity of existing enterprises.
3/ Any amounts above these limits are considered gains and their transfer will be subject to a 25 percent withholding tax.

Table 3. Accessibility of International Capital Markets and Existence of Local Markets

Country	International Capital Market: Whether access permissible to foreign investors	International Capital Market: Kinds of restrictions (conditionality)	Local Bank Borrowing	Existence of Local Capital Market: Whether in existence	Existence of Local Capital Market: Availability to foreign investors
Kenya	Yes.	Prior central bank approval--not given if competitive with successful local enterprises in agriculture, tourism, and distributive trade.	Yes, subject to maximum limit tied to local shareholder's share in total equity of specified sectoral activities (agriculture, manufacturing, exporting, and tourism.	Yes.	Subject to maximum limit tied to local shareholder's share in total equity.
Malawi	Yes.	Prior registration with exchange control.	Yes, subject to fixed ratios of local borrowing to equity shareholders' interests. 1/	Yes.	Except in times of financial resources shortage when offshore procurement of financing is encouraged.
Nigeria	Yes.	Prior approval of Finance Ministry required; subject to complete exclusion in specified industries, at least 60 percent local ownership in some others; and 40 percent in remaining ones.	Yes, subject to 55 percent of assets for merchant banks' loans and 8 percent of commercial bank loans; borrowing by controlled companies in import-export business repayable within three years.	No.	
Zimbabwe	Yes.	Subject to Ministry of Finance and Development Planning and exchange control approval, readily given in specified areas. 2/	Yes, subject to specified ratio of local investors to total capital.	Yes.	Subject to specified requirements for listing on local stock exchange (regular reporting; disclosure; minimum public holding; etc.).
Côte d'Ivoire	Yes.	No restriction for French franc zone; for other countries, prior approval from Ministry of Finance.	Yes, subject to limits established by central bank in consideration of borrowing company's capitalization and financial situation.	Yes.	No restrictions.
Morocco	Yes.	Prior approval by the office of exchange control required.	Yes, up to foreign-invested equity interest.	Yes, but only for a limited number of national companies.	No.
Senegal	Yes.	No restriction for French franc zone; prior approval of Finance Ministry for other countries.	Yes; subject to limits established by central bank in view of the company's financial situation.	No.	No.
Pakistan	Yes.	Approval required.	Yes.	Yes.	Approval required.
Saudi Arabia	Yes.	Prior approval by the Foreign Capital Investment Committee.	No restrictions.	None.	
China	Yes.		Yes.	No.	
India	Yes.		Credit restrictions imposed by Reserve Bank on financial and other companies.	Yes.	Yes, but approval by Reserve Bank required.
Indonesia	Yes.		No limitation.	Yes.	No restrictions.

Table 3 (concluded). Accessibility of International Capital Markets and Existence of Local Markets

Country	International Capital Market: Whether access permissible to foreign investors	International Capital Market: Kinds of restrictions (conditionality)	Local Bank Borrowing	Existence of Local Capital Market: Whether in existence	Existence of Local Capital Market: Availability to foreign investors
Korea	Yes.		No limitation.	Yes.	Approval of Minister of Finance required.
Singapore	Yes.	None.	No limitation.	Yes.	No restrictions.
Thailand	Approval required.		No limitation.	Yes.	Yes, but debt-equity ratio cannot exceed 7.
Argentina	Yes.	Interest rates on foreign loans may not exceed LIBOR +1 percent.	Access to domestic credit on same terms as nationally controlled enterprises.	Yes.	Subject to restriction of US$2,000,000 for single foreign investor; or 2 percent of the capital for the recipient enterprise; shares acquired by foreign investor may not exceed in aggregate 20 percent of its capital.
Brazil				Yes.	Available to foreign investors: indirectly through investment companies managed by Brazilian financial groups; and directly through mutual investment funds.
Mexico	Yes.	Stock market.	The same treatment as for Mexican companies.	Yes.	No.
Venezuela	Yes.		Limited to 40 percent of aggregate paid-in capital and legal reserves.	Yes.	If purchased from a national investor, authorization required. If purchased from foreign investor, just registration required.

Sources: Same as Table 1.

1/ For different categories of borrowers; exporters extended preferred treatment.
2/ Mainly rural enterprises; new technology and export-oriented activities; labor-intensive and local raw material utilizing intensive industries.

Table 4. Tax Jurisdiction

Country	Residency Criterion	Source Principle	Attribution Rule	Tax Treatment of Taxes Paid Abroad	Existence of Tax Treaties with Capital Exporting Countries
Kenya	Whether central management and control exercised in Kenya; whether locally incorporated; notification by company in Government Gazette.	Income derived from or accruing in host country.	Income attributable to permanent establishment; location of property; residence of employee.	Deductions of foreign taxes paid (unilaterally); tax credit (under treaty provisions).	EC (in part); Norway, Sweden, Zambia
Malawi	Registration in host country; appointment of agent with authority to negotiate contract; share transfer or registration office of a foreign company.	Deemed to derive from host country if attributable to work done or assets situated in host country.	Work done or business entered into or tax deductible payments made in host country.	Foreign income not normally taxable in Malawi.	EC (in part); Kenya; South Africa; Sweden, Switzerland; and the United States.
Nigeria	Any company incorporated under Company's Act.	Profits of a company deemed to be derived from host country.	Transactions deemed to be at "arm's length;" unjustifiable prices are discounted.	Worldwide income of a locally incorporated company taxable; tax credit for tax paid abroad.	Most British Commonwealth countries; the United States.
Zimbabwe	Local incorporation of companies.	Amounts received or accrued from sources within or deemed to be within host country.	Geographical basis (place of performance of services).	Foreign tax credit up to the amount of host country's tax due.	The United Kingdom; South Africa.
Côte d'Ivoire	Local incorporation.	Territorial source of income.	Profits derived in host country.	Foreign income not normally taxable.	Belgium, Canada, France, Federal Republic of Germany, Italy, Norway, and the United Kingdom.
Morocco	Local incorporation.	Territorial source of income.	Profits derived in Morocco taxable.	Foreign income not normally taxable in Morocco. When taxable, taxes paid abroad allowed as credit against Moroccan tax.	France, Belgium, Canada, Germany, Italy, Luxembourg, Netherlands, Norway, Spain, Sweden, the United Kingdom, and the United States.
Senegal	Local incorporation.	Territorial source of income.	Profits derived in Senegal taxable. If separate accounting is not kept for the enterprise in Senegal, which has foreign operations or a parent company abroad, total profits are attributed on a pro-rata basis applied to turnovers in each country.	Foreign income not normally taxable in Senegal; when taxable, tax paid abroad is deductible from Senegalese tax base.	France (1974).

Table 4 (continued). Tax Jurisdiction

Country	Residency Criterion	Source Principle	Attribution Rule	Tax Treatment of Taxes Paid Abroad	Existence of Tax Treaties with Capital Exporting Countries
Pakistan	Registered office in host country.	Resident companies: worldwide income. Nonresident: Pakistan-source income.		Tax credits available for income deemed to accrue or arise outside of host country.	North America, Japan, Australia, most major European countries.
Saudi Arabia	Local incorporation.	Territorial source of income.	Profits derived in host country.	Foreign income not taxable.	France.
China	Foreign enterprises: location of head office.	Equity joint ventures: worldwide income. Foreign enterprises: host country.		Deductible against tax liabilities in host country.	North America; major EC countries, Japan, Australia; other European countries.
India	Registration under Indian law and registered office in India; or prescribed arrangements for the declaration and payment in India of dividends out of income subject to tax.	Received, accrued, arisen, or deemed to be such, in India.	A parent company and its subsidiaries taxed as separate entities.	Unilateral tax credit given to income from a country with which India has no double taxation agreement.	Limited double taxation agreement (on income from air transport) exists with the United States. Treaty net with Europe close to complete.
Indonesia	Companies: establishment under law of host country; or domiciled in host country. Permanent establishment: fixed place of business in host country established by a nonresident enterprise.	Worldwide income. Derived from host country.		Tax credit given on foreign income tax payable or paid by resident taxpayer.	North America, Japan, major EC countries.
Korea	Head office in host country.	Domestic corporations: worldwide income.		Tax credits available to domestic corporations on tax paid to foreign government arising from foreign-source income.	North America, Japan, Australia, major European countries.
Singapore	Management and control of business exercised in host country.	Resident companies: Singapore-source income and foreign income remitted to Singapore. Nonresident: Singapore-source income.		Tax credits for taxes paid in Commonwealth countries; and for income taxes paid on specified income from specified countries with which no tax treaty exists.	Australia, Japan, Canada, major European countries.

Table 4 (concluded). Tax Jurisdiction

Country	Residency Criterion	Source Principle	Attribution Rule	Tax Treatment of Taxes Paid Abroad	Existence of Tax Treaties with Capital Exporting Countries
Thailand	Incorporated in host country.	Resident companies: profits arising from, or in consequence of, the business carried on worldwide. Nonresident: Thai-source income.		No unilateral measures against double taxation.	Japan, Canada, major European countries.
Argentina	No concept of "resident company" for tax purposes. For withholding, those that receive income abroad through representatives in Argentina but do not appear to have a permanent residence are considered nonresidents.	Income derived from source located in Argentina.	Arm's length.	Not deductible.	Yes; Austria, France, Germany, Italy, Sweden, and the United States.
Brazil	Headquarters or main offices located in Brazil.	Income tax levied on Brazilian-source income only. Source is defined as the place of payment.	Arm's length transactions.	In the absence of a treaty, reciprocity must be proved.	EC, Japan, Canada, and some others, following the OECD model convention with some deviations.
Mexico	Legal entities that have established principal administration of business in Mexico.	Residents: Worldwide income. Nonresidents: local-source income.	Tax Commissioner's discretion.		None.
Venezuela	Registered in accordance with the commercial code of Venezuela, or permanent establishment.	Income derived from Venezuelan source.	Subject to Tax Commissioner's discretion and legislation limiting deductions on payments made to parent company for royalties and interest.	No special treatment of subsidiaries or branches of foreign company.	In negotiation with the United States and some EC countries.
U.S.S.R.		Foreign companies and joint ventures: U.S.S.R-based income only.			The United States; the United Kingdom and many other EC; Japan; selected other European countries.

Sources: Same as Table 1.

Table 5. Corporate Tax Rates and Capital Gains Tax

Country	Income Tax		Capital Gains	
	Standard tax rates	Special tax rates (if any)	Tax base	Tax rates
Kenya	42.5%.	27.5% life insurance; 40% minerals; 50% branches of foreign companies.	25% of gains on all assets; but suspended as of June 1985.	Effective rate of 11.25%, but suspended as of June 1985.
Malawi	50%.	25% trusts; 55% branch profits.	Nil.	Nil.
Nigeria	40%.	85% petroleum.	All tangible and intangible property (excluding government securities, compulsory land sale, and Nigerian currency).	20%.
Zimbabwe	50%.	58.4%, including 15% surcharge on foreign companies.	Immovable property; marketable securities.	30%.
Côte d'Ivoire	40% plus 10% as compulsory saving for National Investment Fund.	50% on petroleum companies.	Gains from sale of capital assets taxable as ordinary income. Gains reinvested within 3 years exempted.	40% plus 10% for compulsory saving.
Morocco	45%.	10% for resident companies on gross receipts of sale of raw materials to nonresident companies; 12% on gross receipts for nonresident companies with a construction or assembly site in Morocco and opting for lump-sum taxation.	Full gain from capital assets held for less than 4 years; 75% of gain if held between 4-8 years; 50% of gain for more than 8 years. Full exemption for gains reinvested within 3 years of realization.	Standard tax rate. Exempted if gains reinvested within 3 years.
Senegal	33.33%.	None.	50% of gains from fixed assets (except buildings) if sold within 5 years after acquisition. After 5 years: one third of the gains from fixed assets (except buildings). Exempted if reinvested within 3 years. Gains from the sale of building sites reduced, based on coefficients relating to acquisition year. One third of gains from transfer of shares taxable, only if beneficiary is a 25% shareholder.	Standard tax rate. 15%.
Pakistan	30%. 10%: surcharge on income tax and super tax for income exceeding PRs 200,000.	15%: super tax (30% for banking companies); separate rates apply to domestic dividends.	Resident companies: worldwide capital gains; Nonresident companies: Pakistani-source capital gains. Gains arising from transfer of immovable property exempt; and from the sale of shares of public companies exempt until June 30, 1992.	25%; short-term gains (sale within 12 months) taxed as ordinary income.
Saudi Arabia	Company tax on non-Saudi Arabian shareholders: First SRls 100,000: 25% Next SRls 400,000: 35% Next SRls 500,000: 40% Over SRls 1,000,000: 45% Zakat on shares of Saudi Arabian citizens: 2.5%.	On oil companies: 85%.	Gains from disposal of fixed assets.	Regular rates.

Table 5 (continued). Corporate Tax Rates and Capital Gains Tax

Country	Income Tax: Standard tax rates	Income Tax: Special tax rates (if any)	Capital Gains: Tax base	Capital Gains: Tax rates
China	Foreign enterprises 20-40% (5 brackets).	10% (local).	Sales of fixed assets.	Taxed as ordinary income.
	Special entities			
	Equity joint ventures 30%.	3% (local).		
	Special economic zones 15%.	1.5% (local).		
	Economic development zones 15%.	1.5% (local).		
	Domestic enterprises			
	Collectively owned 10-55% (8 brackets).	0-200% (tax on worker bonus exceeding minimum wage).		
	State-owned 55% (medium-large), 10-55% (small-8 brackets).	None.		
	Private 35%.	40% (tax on investment income from profits).		
	Agriculture 13-19%.	22% (maximum surcharge).		
India	Domestic Substantial public interest: 40% (reduced from 50% in 1990). Investment and trade: 60%. Other: 45% (reduced from 55%).	Surcharge on nonpublic interest companies.	All properties (excluding stock-in-trade) at time of transfer.	Regular rates (some exemptions apply to transfer of long-term capital assets).
	Foreign 55% (reduced from 65%) except certain incomes at lower rates.			
Indonesia	Companies and individuals: 15%, 25%, 35%.	20% (branch profit tax). Oil and gas: 20%, 30%, 45%. Mineral resources: 35% (first 10 years), 45% (beyond 10 years). (No tax holiday for sales tax/customs duties.)	Sales or transfer of property.	Taxed as ordinary income.
Korea	Domestic/foreign companies with place of business in Korea: 20% (first W 80 million), 27-33% (on balance, depending on whether nonprofit, listed or not listed in stock exchange). Without place of business: 25% (withholding tax, but exemptions may apply).	Inhabitant tax: 7.5% of corporate income tax.	Domestic companies: disposal of shares, equity, fixed assets of a profit-making business. Foreign companies: transfer in Korea of land, buildings, and stocks of at least 50% of any corporation whose aggregate value of land and buildings account for 50% or more of its total assets; or at least 50% of whose stocks owned by one person.	Taxed as ordinary income; for transfer of land and buildings a surtax of 35% (transfers without registration) or 25% (other transfers).
Singapore	31%.	Reduced rate of 10% applies to many types of income derived by Asian currency units, insurance companies, and other entities.	Not taxed.	

Table 5 (concluded). Corporate Tax Rates and Capital Gains Tax

Country	Income Tax		Capital Gains	
	Standard tax rates	Special tax rates (if any)	Tax base	Tax rates
Thailand	Resident: Registered 30%. Other 35%. Nonresident: With business in Thailand: 35%. Without business in Thailand: 25%.	50%: petroleum; 20%: profit remittance.	All gains except sale of properties acquired with no view to trading or making profits.	Taxed as ordinary income.
Argentina	Resident: 20% (reduced from 33% from 1990). Foreign enterprises: 36% (reduced from 45%).	Surcharges if after-tax profits exceed 12% of capital of foreign registered investment: taxed at an additional 15-25% (depending on the level of excess profits). Compulsory savings deposits, computed in connection with taxpayer's income and capital, but reimbursed with interest after 60 months.	Movable depreciable assets; immovable property; marketable securities. Capital losses can be set off against gains, and carried for 5 years.	Normal income tax rate applies on the difference between the sale price and the inflation-adjusted cost.
Brazil	General rate: 35%. 10% additional on profits in excess of 40,000 OTNS (indexed unit). Foreign enterprises: 25% final withholding of net profits (15% if reinvested); 40-60% excess profit tax on distributed profits and dividends exceeding 12% of capital.	6%: agricultural enterprises, public services telecommunication (excluding radio and TV broadcast). 17%: public services up to income not exceeding 12% of their capital. The excess subject to normal taxation.	Revaluation, transfer, write-off, or liquidation of goods or rights included. Fixed assets; sale, transfer of own shares; securities; intangible property.	Residents: gains added to business profits and taxed as ordinary income. Nonresidents: gains subject to final withholding of 25% except gains derived from transfer or liquidation of securities, debts, or placements producing fixed returns which are subject to a final 45% withholding tax.
Mexico	37%: 1989. 36%: 1990. 35%: 1991.	Agriculture: 40% of the normal rate (if also driving income from industry or commerce discount is just 25% of normal rates). Oil: Pemex (state-owned oil monopoly) exempt from ordinary income tax but subject to a special tax. Publishing of books: 50% of standard rate.	Sale of fixed assets; mergers; liquidation of nonresident company; transfer of shares.	Subject to standard tax.
Venezuela	15-50%.	Oil: 67.7%. Mines: 60%. Holding companies surtax on undistributed profits of more than 50%.	Transfer of immovable property and shares.	Same as income tax (15-50%).
Hungary	40%.	Agriculture: 30%; manufacture: 20%; hotels: 20%; food retail trade: 30%; food processing: 30%; public entities: 10 percent; joint ventures: 40%; national banks: 0%.	Taxed as regular income.	
U.S.S.R.	Foreign: 40%.	Higher tax rate applies if foreign country taxes Soviet companies at rates higher than 40%.	Monetary gains; no exemption.	Standard income tax rate.
	Joint ventures 30%; plus 20% on profits transferred abroad.	Ministry of Finance has the authority to lower or remove tax altogether.	Same as above.	Same as above.

Sources: Same as Table 1.

Table 6. Corporate Income Tax Base

Country	Deductions: Asset price	Deductions: Depreciation: Formula applied	Deductions: Depreciation: Initial	Deductions: Depreciation: Annual	Availability of Investment Allowance, Tax Credit, or Grants	Basis of Inventory Valuation	Tax Holiday: Activities covered	Tax Holiday: Number of years	Loss Offset
Kenya	Historical.	St. line (IBs), WDV (others).	100% for planting land or preventing soil erosion. 40% for mining operations and shipping.	Farm works (33.3%) IBs (2.5-4%) Ts (37.5%) Vs (25%) Others (12.5%) Mining operations (10%)(St. line).	IB, P&M, hotels: IA (20%).	Cost or net realizable value (whichever is lower).	None.	None.	Unlimited carry-forward of losses from same source.
Malawi	Historical.	WDV.	IBs (10%) FIs (10%) IF (33.3%) P&M (20%) Vs (20%).	IBs (5%) FIs (5%) IF (10%) P&M (10-15%) Vs (20-33.3%).	Following IAs: IBs (10%) P&M (10%) FIs (10%) Fixed assets in farming and manufacturing (40%).	Cost price or market value (but not LIFO).	None.	None.	Unlimited carry-forward of losses from same source.
Nigeria	Historical.	St. line.	P&M (20%) IBs (15%) NIBs (5%) Vs (25%).	P&M (8%) IBs (8.5%) NIBs (9.5%) Vs (15%).	Following IC/IAs: oil-producing companies exploratory (100%).	Cost or realizable value (whichever is lower); FIFO preferred by tax authorities.	Specified agricultural, manufacturing, and mining companies.	3.	Carry-forward of 4 years for losses from same sources.
Zimbabwe	Historical.	St. line.	IBs, CBs, FIs, Vs, and P&M (in growth point areas and for farming (100%).	CBs (2.5%) IBs (5%) P&M (10%) F&F (10%) Vs (20%).	Following IAs: agricultural equipment (100%); manufacturing export (5%); assets used for training purposes (50%); "growth point incentive" on all investment (15%).	Cost price; replacement or market value (LIFO not permitted).	None.	None.	Unlimited carry-forward.
Côte d'Ivoire	Historical.	St. line. Accelerated depreciation is also allowed for P&M.	45% employee housing.	IBs (5%) P&M (20%) Vs (33%).	IA TC.	At the lower of cost or market value.	Priority investments in mining, manufacturing, tourism, and housing.	4-6-8 depending on the zones.	3-year carry-over allowed.
Morocco	Historical value; revaluation of fixed assets allowed.	St. line--accelerated depreciation also allowed for P&M.	7.5-20% for investments in accordance with tax incentives laws.	P&M (10-30%) IBs (5-10%) IF (10%).	Investment premium may be granted.	At the lower of cost or market value.	Tourism, mining, shipping, industries.	5-7 and 10.	4 years for carry-over of losses.

Table 6 (continued). Corporate Income Tax Base

Country	Deductions: Asset price	Deductions: Depreciation: Formula applied	Deductions: Depreciation: Initial	Deductions: Depreciation: Annual	Availability of Investment Allowance, Tax Credit, or Grants	Basis of Inventory Valuation	Tax Holiday: Activities covered	Tax Holiday: Number of years	Loss Offset
Senegal	Historical.	St. line; DB and accelerated depreciation are also allowed in specified cases. Accelerated depreciation is also allowed for P&M.	None.	IBs (3-5%) P&M (10-25%) Vs (20-33%).	IA: up to 50% of the taxable income deductible for specified investment in all sectors. TC: in energy 30% of qualifying investment allowed as tax credit.	At the lower of cost or market value.			Three-year loss carry-over; operating loss resulting from depreciation carried over indefinitely.
Pakistan	Buildings; plant, machinery, and furniture: original cost or WDV.	DB except for ships.	IBs (30-40%) P&M (10-25%).	IBs (5-10%) P&M (10-100%).	TC for certain industries; tax rebates for export profits and super tax liabilities of certain companies.	Cost, market value, or lower of the two.	A range of industrial undertakings in specified areas, including extractive industries.	4-10.	
Saudi Arabia	Historical.	St. line.	None.	IBs (3%) P&M (7.5-25%) IF (10-25%).	None.	Cost.	Development projects per Foreign Capital Investment Code with at least 25% Saudi participation.	5-10.	No loss carry-over allowed.
China	Foreign enterprises and special entities: tangible assets: 0.9 x historical; intangible assets: historical.	St. line.	—	Yes.	TC.	FIFO; WAM; MA.	Farming, forestry, animal husbandry, deep well coal exploitation.	Foreign: first profit year; Joint: 2-3 years; Special economic zones: 1-2 years.	

Table 6 (continued). Corporate Income Tax Base

Country	Deductions: Asset price	Deductions: Depreciation: Formula applied	Deductions: Depreciation: Initial	Deductions: Depreciation: Annual	Availability of Investment Allowance, Tax Credit, or Grants	Basis of Inventory Valuation	Tax Holiday: Activities covered	Tax Holiday: Number of years	Loss Offset
India	WDV plus acquisitions less sales of "blocks of assets."	DB.	Assets of value less than Rs 5,000 may be written off at once.	Buildings: 5-100% F&F: 10-15%. F&M: 33.33-100%. Ships: 20%.	IA (abolished in 1990 budget).	Lower of cost or market value.	None (incentives are usually given in the form of tax allowances and deductions).		
Indonesia	Acquisition cost.	General: DB. IBs: St. line.		50% (less than 4 years of useful life); 25% (4-8 years); 10% (over 8 years); 5% (buildings); special rates and schedules available for oil, gas, mining.	IA available only for oil, gas, mining.	SA: FIFO.	Mining.	10.	
Korea	Acquisition value.	St. line; DB; accelerated depreciation *(under the* Foreign Capital Inducement Act).	None.	3.8-6.4% (buildings); 17.5% (machinery and equipment); special rates available to various assets.	TC.	All methods allowed.	High technology in mechanical, electronic, aeronautic, defense, chemical, biochemical, neo-material industries. From 1990, for newly abolished companies, 50 percent tax reduction.	5. 4.	
Singapore	IBs: original expenditure. P&M: original expenditure.	St. line. St. line.	25%. 20%.	3%. 6-16%.	IA.	End-of-period stocks valued at the lower of cost or market value.	Pioneer and service industries; and their expansion; countertrade, offshore financing, and approved international trading firms.	5-10.	

Table 6 (continued). Corporate Income Tax Base

Country	Deductions: Asset price	Deductions: Depreciation: Formula applied	Deductions: Depreciation: Initial	Deductions: Depreciation: Annual	Availability of Investment Allowance, Tax Credit, or Grants	Basis of Inventory Valuation	Tax Holiday: Activities covered	Tax Holiday: Number of years	Loss Offset
Thailand	Acquisition cost.	St. line; but any generally accepted method allowed.	None.	Buildings: 5% (100% if temporary); depletable natural resources: 5%; other properties (excluding land and inventory): 20%.	IA; TC.	Cost (FIFO or LIFO) or market price, whichever is lower.	Export related; raw materials production for engines and machinery in specified regions; investment promotion zone.	3-5.	
Argentina	Current value (with updating of value or market cost).	St. line (adjusting for inflation).		Vs (20%) IBs (2%) IF (2%) P&M (10%) Office furniture (10%).	Construction, electronics: income deductions and tax exemptions. Forestry: TC. Mining: income deductions and exemptions; tax deferral. Oil: excess profits tax exemption; IA. Petrochemicals: income tax deferral.	LPP (if no purchase made within two months preceding the close of year, last purchase made adjusted by general wholesale price index between the dates of purchase and closing of tax year).	None.		Carry-forward for 5 years (adjusted for inflation). Deduction limited to 50% of taxable income in any given year. Emergency measures: losses pending before 1988 not deductible until 1991.
Brazil	Original cost adjusted for inflation.	St. line.		10% for all fixed assets; higher rates permitted if proof furnished.	No special rules to promote foreign investment. Aeronautics, computers: IA (limit 50%). Legal entities and individual enterprises: TC (50%) if invested in specified sectors. Mineral exports profits from taxation. Hotels and other approved facilities for tourism: income tax reduction for 10 years; reduction can reach 70% of tax liability.	FIFO or SA.	Investment companies (investment of capital in a diversified securities portfolio).	Unlimited.	Carry-forward allowed in case asset actually sold.

Table 6 (concluded). Corporate Income Tax Base

Country	Deductions: Asset price	Deductions: Depreciation: Formula applied	Deductions: Depreciation: Initial	Deductions: Depreciation: Annual	Availability of Investment Allowance, Tax Credit, or Grants	Basis of Inventory Valuation	Tax Holiday: Activities covered	Tax Holiday: Number of years	Loss Offset
Mexico	Historical.	St. line.		IBs (5%) Vs (20%) P&M (5-35%). Also varies by activity; between 3% (electricity) and 25% (agriculture).	Usually unavailable to majority-owned foreign enterprises. In general, TC given to construction (20% of investment); fishery (10%), industry (15-40%) for small-medium scale units.	Cost of merchandise net deductible upon sale but may be allowed as an expense.			
Venezuela	Historical.	Any reasonable and consistent method accepted but once selected cannot be changed without approval.	No prescribed rates. Taxpayer estimates asset's useful life, generally: P&M 10% IB 4%. Depreciation on personal planes, helicopters, and boats limited to 50% of their cost.		TC (15-20% of new investment in fixed assets not previously used in Venezuela) to various sectors (8% to mining); rebate can be carried forward for 2 years. Tax reduction for 5 years for anti-pollution measures. Income tax reduction for 15 years for profits of registered open capital corporations ranging between 25-50% of the tax according to amount of capital owned by the public. Income tax exemptions or reductions (20-50% and 50-100%) for a period of 7 years to specified activities including production of capital goods and new industrial enterprises.	Valued at the lower of cost or market price. In determining cost "FIFO" or "SA" generally used.	Agriculture, stock raising, and fisheries. Rational exploitation of wood and forest. Registered saving institutions. Exploitation, industrialization and marketing of mineral coal and petrochemical. Touristic projects and expansion of existing hotels.	10. 5. 5. 5. 5.	Carried forward for 3 years.
Hungary	Specified by Act.				Joint ventures: 100% TC for reinvested profits. Domestic companies: investment in economically underdeveloped areas.		Activities of "special importance" decided by Cabinet.	Initially 5; can be extended.	
U.S.S.R.	Foreign and joint ventures: No special depreciation rules (enterprise expensing rules accepted apparently).				None.	Same as for depreciation rules.	Foreign: none; joint ventures: all.	Foreign: none; joint ventures: 2.	

Sources: Same as Table 1.

Abbreviations used: CBs = commercial buildings; DB = diminishing balance; F&F = fixtures and fittings; FIFO = first-in-first-out; FIs = farm improvements; IA = investment allowance; IBs = industrial buildings; IF = industrial fencing; LIFO = last-in-first-out; LPP = last purchase price; MV = moving average; NIBs = nonindustrial buildings; P&M = plant and machinery; SA = simple average; TC = tax credit; Ts = tractors; Vs = vehicles; WAM = weighted average method; and WDV = written-down value.

Table 7. Withholding Tax on Investment and Tax Treatment of Dividends of Shareholders

Country	Whether Tax Paid by Company Imputable to Shareholder	Method of Imputation	Withholding Tax, If Any	Whether "Final" or Not
Kenya	Yes.	Tax credit.	Dividends (15%); interest (12.5%); royalties and management fees (20%).	No; tax credit given against tax due on "grossed up" receipts.
Malawi	Yes.	Tax credit.	Dividends, interest royalties and fees paid to nonresidents (15%); commissions and rent (10%). For residents, regular tax with credit for deduction at source.	No.
Nigeria	Yes.	Tax credit.	Dividends, bond interest and royalties (15%); rent, management and consultancy fees, and commissions (10%).	No; tax credit given against tax due on "grossed up" receipts.
Zimbabwe	No.	None.	Dividends (20%), Interest (10%), and royalties (20%).	Yes. No; tax credit given against tax due on "grossed up" receipts.
Côte d'Ivoire	No.	None.	General: 12%; special: 18% for dividends distributed by tax-exempt companies.	Deductible from the general income tax.
Morocco	No.	None.	15%.	No tax credit against income tax.
Senegal	No.	None.	16%.	No; deductible from general income tax base.
Pakistan	No.	None.	15% for dividends paid to nonresident shareholders.	Not final.
Saudi Arabia	None.	None.	None for Saudi Arabian citizens; for dividends paid to non-Saudi Arabian citizens from profits which have not been taxed, deduction made at corporate tax rates.	None for Saudi Arabian citizens. Final for non-Saudi Arabians.
China	No.	None.	20%. Some exemptions, for example, joint ventures' dividends paid to a resident.	Final.
India	No (but certain dividends are exempt).		Domestic companies: 21.5%. Foreign companies: 25%. Resident individuals: 20% Nonresidents: 30%	Not final. Final. Not final. Not final.
Indonesia	No.	None.	15% (resident), 20% (nonresident). Preferential rates applicable to countries with tax treaties; also certain dividends exempted.	Final to nonresidents.
Korea	No.		Applies to certain categories of interest and dividends.	For nonresidents and certain categories of interest and dividends.
Singapore	Imputable in full.	Tax credit.	None (deemed withheld at 33% under imputation).	Not final.
Thailand	Yes.	Tax credit given at 30%.	Various rates.	Not final.

Table 7 (concluded). Withholding Tax on Investment and Tax Treatment of Dividends of Shareholders

Country	Whether Tax Paid by Company Imputable to Shareholder	Method of Imputation	Withholding Tax, If Any	Whether "Final" or Not
Argentina	Dividends exempt for recipient corporation; not exempt and partially imputable for resident individual; tax not imputable for nonresident individuals and entities organized abroad.	Tax credit. Increase in tax liability due to dividends treated as advance payment credited against final liability, up to 27.5% of dividends.	17.5% on dividends paid by corporations to nonresident entities and individuals. None for residents.	Final. For tax payments not made within 60 days, resident shareholders who identify themselves within 1 year pay final rate of 22.5%.
Brazil	None.		25% if paid by sole proprietorship entities to legal entities. For dividend paid to resident individuals: 15% if paid by agricultural enterprises; 23% if paid by open capital companies; 25% if paid by any other company; 25% for nonresident individuals and entities.	Choice of resident taxpayer to consider the withholding as final. For nonresidents, it is final.
Mexico	Yes.	Tax credit.	Individuals: 10% when paid out of distributable profits; 40% in other cases. Business entities: Residents: exempt when paid out of distributable profits; 35% in other cases. Nonresidents: exempt when paid out of distributable profits if taxed in the recipients' country at more than 30%; if not so, subject to 10% withholding. If paid out of other funds, withholding is 40% in the first case and 35% in the second.	All dividend withholdings are final.
Venezuela	For recipient corporations, dividends not included in gross receipts. 20% withholding tax applies except for mines and oil. For recipient individuals, dividends included in gross receipts.		20% of dividends for nonresident corporations and individuals; 5% of dividends for resident individuals.	Final. Not final.
Hungary	No.	--	No.	No.
U.S.S.R.			Domestic companies: none. Joint ventures: 5%.	Not final.

Sources: Same as Table 1.

Table 8. Tax Treatment of Foreign Exchange Gains and Losses, Emigrants' Remittances, and Foreign Currency Deposits

Country	Tax Treatment of Foreign Exchange Gains/Losses
Kenya	Taxable as ordinary income, but suspended as of June 1985.
Malawi	None.
Nigeria	Yes.
Zimbabwe	None.
Côte d'Ivoire	Includable in profits or loss.
Morocco	Includable in profits or loss.
Senegal	Includable in taxable profits or loss.
Saudi Arabia	Includable in profits or loss.
India	Adjustment due to fluctuations in foreign currencies allowed.
Indonesia	--
Korea	Taxed as ordinary income.
Singapore	Taxed as ordinary income.
Thailand	Taxed as ordinary income.
Argentina	Full deductible.
Brazil	The same as regular capital gains.
Mexico	Taxed as regular capital gains just on the real component (i.e., net of inflation).
Venezuela	Not taxed.
Hungary	Taxed as regular income.
U.S.S.R.	Taxed as capital gains.

Sources: Same as Table 1.

References

Auerbach, Alan, "The Cost of Capital and Investment in Developing Countries," Tax Incentives Discussion Paper No. 1, Public Economics Division, World Bank, Washington, D.C. (January 1990).

Casanegra-Jantscher, Milka, "Tax Havens Explained," Finance and Development, Vol. 13, No. 1 (March 1976).

Conrad, Robert F., "Considerations for the Development of Tax Policy when Capital is Internationally Mobile," World Bank, World Development Report Working Paper No. WPS 47 (March 1989).

Kopits, George F., "Taxation and Multinational Firm Behavior," Staff Papers, International Monetary Fund (Washington), Vol. 23, No. 3 (November 1976).

_____, "Effects of Tax Changes on Direct Investment Abroad," in United States Taxation and Developing Countries, ed. by Robert Hellawell, (New York: Columbia University Press, 1980), Chapter 7, pp. 223-62.

Musgrave, Peggy B., "The Treatment of International Capital Income," in Taxation Issues in the 1980s, ed. by John G. Head, (Australia: Tax Research Foundation, 1983).

_____, "Coordination of Taxes on Capital Income in Developing Countries" (Washington: World Bank, 1987).

Mutén, Leif, "A Cascade Tax by Any Other Name," Public Finance, Shoup Festschrift, Vol. 2, 1982(a), pp. 263-68.

_____, "Some Topical Issues Concerning International Double Taxation," in Comparative Tax Studies, ed. by Sijbren Cnossen, Essays in Honor of Richard Goode, Rotterdam (1983).

Sanchez-Ugarte, Fernando, "Rationality of Income Tax Incentives in Developing Countries: A Supply-Side Look," in Supply-Side Tax Policy: Its Relevance to Developing Countries, ed. by Ved P. Gandhi (Washington: International Monetary Fund, 1987).

Shome, Parthasarathi, and Alfred H. Dalton, "Why Rate Reductions are not a Substitute for Inflation Adjustment of the Personal Income Tax Base," International Bureau of Fiscal Documentation Bulletin, Vol. 40, No. 11 (November 1986).

Tanzi, Vito, "Tax Reform in Industrial Countries and the Impact of the U.S. Tax Reform Act of 1986," IMF Working Paper, WP/87/61 (September 1987).

Tanzi, Vito, "The Impact of Macroeconomic Policies on the Level of Taxation and the Fiscal Balance in Developing Countries," Staff Papers, International Monetary Fund (Washington), Vol. 36, No. 3 (September 1989).

_____, and A. Lans Bovenberg, "Is There a Need for Harmonizing Capital Income Taxes Within EC Countries?", IMF Working Paper, WP/90/17 (March 1990).

United Nations Centre on Transnational Corporations (UNCTC), "International Income Taxation and Developing Economies" (New York: United Nations, 1988).