



The Global Minimum Tax and Special Economic Zones

IISD POLICY BRIEF



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The Global Minimum Tax and Special Economic Zones

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This policy brief is part of a series that aims to examine the impacts of the global minimum tax on the design and use of fiscal and financial incentives in developing countries. It builds on the 2023 *Guide for Developing Countries on How to Understand and Adapt to the Global Minimum Tax* (IISD and ISLP, 2023).

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Abbreviations and Acronyms

Action 5	Action 5 on countering harmful tax practices
BEPS	base erosion and profit shifting
CIIP	Competitive Industries and Innovation Program
CIT	corporate income tax
ETR	effective tax rates
FDI	foreign direct investment
FHTP	Forum on Harmful Tax Practices
GloBE	global anti-base erosion rules
GMT	global minimum tax
IIR	income inclusion rule
ISDS	investor-state dispute settlement
ISLP	International Senior Lawyers Project
MFEZ	multi-facility economic zone
MNE	multinational enterprises
OECD	Organisation for Economic Co-operation and Development
QDMTT	qualified domestic minimum top-up tax
SEZ	special economic zone
SFTZ	Shanghai Pilot Free Trade Zone
UNCTAD	United Nations Conference on Trade and Development
UTPR	under taxed payments rule



1.0 Introduction

The Pillar Two global anti-base erosion (GloBE) rules were proposed as a tool to ensure that large multinational enterprises (MNEs) pay a minimum level of tax in each jurisdiction where they operate (OECD, 2023). The rules require that MNE Groups with an annual consolidated revenue of more than EUR 750 million calculate their income, the taxes paid on that income, and determine the effective tax rate (ETR) incurred in each jurisdiction (OECD, 2023). Where the ETR amounts to less than the 15% minimum rate, the MNE Group is required to pay a top-up tax to meet the difference (OECD, 2023).

One of the main impacts the GloBE rules will have, even for countries that choose not to adopt the rules, will be minimizing the effectiveness of certain corporate tax incentives for in scope MNEs (IISD and ISLP, 2023). The main goal of the GloBE rules is to discourage the “race to the bottom” through tax competition, and provide countries with a renewed opportunity to achieve a better balance between using tax policy to attract investment and effectively mobilizing domestic revenues (OECD, 2022). The global minimum tax (GMT) should prompt countries to analyze the potential impact on tax incentives and options for reform, including incentives in special economic zones (SEZs).

SEZs have typically been defined as “geographically delimited areas within which governments facilitate industrial activity through fiscal and regulatory incentives and infrastructure support” (UNCTAD, 2019). Various publications (FIAS, 2008; UNCTAD, 2023), further discussed in Section 3, have documented the widespread use of tax incentives—in up to 80% of SEZs—despite continued concerns about their effectiveness in the long term. Some countries have reduced the ETR in SEZs to almost zero (Celani et al., 2022). These findings are particularly concerning since the adoption of SEZs continues to expand across the globe, with 6,000 zones operating in 150 economies in 2022 (UNCTAD, 2023).

The use of incentives in SEZs has been found to be beneficial only in the short term, attracting investors, but not establishing global competitiveness (Farole, 2011). In addition, they have been found to be ineffective in improving zone performance (FIAS, 2008). This suggests that countries should reduce their reliance on overly generous tax incentives, particularly within SEZs. GloBE is yet another prompt to revisit the types, design, and extent of tax incentives (corporate income and beyond) in zone frameworks. GloBE is not the only driver for this critical need for reflection. SEZs have long been subject to review by the Forum on Harmful Tax Practices (FHTP) against the standards set by the Harmful Tax Competition report (OECD, 1998) and the base erosion and profit shifting (BEPS) Action 5 report on countering harmful tax practices (OECD, 2015). As of 2023, 21% of the 319 regimes reviewed by the FHTP since its formation were SEZs (UNCTAD, 2023).

Given the shift in policy landscape overall, countries will now need to re-examine the design, use, and governance of tax incentives (UNCTAD, 2023). Since the GloBE rules will not affect all taxpayers or all tax incentives in the same way or to the same extent, due to the various exclusions and method of calculating the ETR, a wide review of corporate income tax incentives will be necessary (OECD, 2022). IISD’s previous work on understanding and adapting to GloBE highlighted that the process of identifying all ineffective tax incentives



will require a national plan (IISD and ISLP, 2023). This should include mapping the various investment promotion regimes, the types of incentives they offer, and identifying the governing authority to establish wide coordination to mitigate any legal risks and select the most appropriate policy response. This is important because many countries tend to have incentives dispersed across a variety of legal sources, including the laws governing SEZs (IISD and ISLP, 2023).

SEZ authorities and policy-makers will need to take into consideration other national obligations in responding to the GMT. Investment promotion policies have typically offered investors either extensive protections that could set hurdles for the withdrawal or re-design of any incentives or stabilization clauses that may introduce additional legal complexity in the face of pressure for reform. There is now an opportunity for countries to reflect on the effectiveness of SEZs, how to improve their performance, the role that tax incentives should continue to play, and the impact that a changing tax and investment policy environment will have.

This policy brief aims to contribute to building the understanding of SEZ authorities and investment and tax policy-makers on the growing need for reform of tax incentives and the impact this will have on the typical benefits they offer to investors. It emphasizes the need for countries to critically assess whether tax incentives remain a priority for investment promotion; whether they have been a help or hindrance to zones; and how new international tax standards impact their design and use, as well as opportunities for reform.



2.0 Understanding SEZs

There is no one-size-fits-all approach to SEZs. A large variety of zones operate around the world with different objectives, markets, and activities. Consequently, SEZs are defined loosely according to their key features (FIAS, 2008). Broadly speaking, SEZs may be identified based on their special regulatory framework—distinct from that which applies to the rest of the domestic economy—and an incentive regime accessible only to enterprises operating and located within the zone (FIAS, 2008). There are other common characteristics of an SEZ (FIAS, 2008; UNCTAD, 2019):

- Geographically delimited area.
- “Business friendly” regulatory regime that is distinct from that which applies to the broader national or subnational economy.
- Central management or administration for the SEZ—this could either be a public, private, or public-private partnership effort.
- Eligibility conditions—e.g., being physically located within the SEZ.
- Relief from customs duties and tariffs.
- Fiscal and non-fiscal incentives—e.g., tax incentives, availability of niche infrastructure such as technology development labs.
- Streamlined administration processes—e.g., increased efficiency of registration or licensing processes.

Countries typically introduce SEZs for a variety of reasons, including:

- To support wider economic reform.
- To address wide-scale unemployment.
- To attract foreign direct investment (FDI).
- To experiment with new policies and administrative approaches through a distinct regulatory framework (FIAS, 2008).

SEZs are established to achieve a wide variety of objectives and several examples exist. The Shanghai Pilot Free Trade Zone (Shanghai FTZ), launched in September 2013, was established as part of China’s national strategy to open up its economy (HKTDC, 2019; *Introduction*, 2024; Shanghai Municipal People’s Government, 2023; UNCTAD, 2023b) and adapt to global free trade (see Box 1). (Huang et al., 2017). The Shanghai FTZ built on China’s previous development zones and was integrated in its broader economic policy framework (UNCTAD, 2023b). China’s experience shows that SEZs can support policy reform, improve the business environment, and facilitate the growth and maturing of certain industries. All of which could then be leveraged into the national economic framework.



Box 1. Shanghai FTZ

The Shanghai FTZ (SFTZ) was the pilot free trade zone in China and included the special customs supervision areas of Waigaoqiao Free Trade Zone, Waigaoqiao Free Trade Logistics Park, Yangshan Free Trade Port Area, Pudong Airport Free Trade Zone, Lujiazui Finance and Trade Zone, Jinqiao Economic and Technological Development Zone and Zhangjiang High-Tech Park. The SFTZ designed a four-pronged institutional innovation strategy aimed at investment management, trade facilitation, financial services, and transformation of government functions.

The intention was to build an institutional innovation system aligned with common international rules on investment and trade and create an FTZ with the highest degree of openness, investment and trade facilitation, currency conversion freedom, convenient and efficient regulation, and a sound legal environment. The establishment of the STZ led to a further 21 Pilot FTZs which would ultimately catalyze China's development strategies update, deepen economic integration, improve trade and FDI promotion and introduce industrial high-quality development. The strong growth of trade and FDI in FTZs has supported a shift towards technologically intense goods and reinforced economic cooperation and integration with developing economies, particularly ASEAN members.

By the end of 2022, Shanghai FTZ had attracted 84,000 new firms and received USD 58.6 billion in actual foreign investment and pioneered nearly half of the 302 institutional innovation achievements that were first rolled out in FTZs and then nationwide (Shanghai Daily, 2023).

SEZs have been used as “highly specialized facilities, configured to the needs of specific industries and activities” (FIAS, 2008). They can support the realization of “agglomeration benefits” by concentrating an industry in one geographical area (FIAS, 2008). This can make it easier for government to supervise activities, provide infrastructure, and implement the necessary environmental controls. SEZs can also be an opportunity for governments to identify best practices for encouraging investment in specific sectors.

However, even where countries set clear objectives, whether they realize these goals will depend on the design and implementation of the SEZ. For instance, a country may not take the necessary steps to ensure the entire framework surrounding the SEZ facilitates the meeting of that objective. There are several cases where SEZs have remained “un- or underdeveloped” for decades; or even if they have been successful in generating investment, the benefits to the broader economy have been minimal. In other instances, they have operated in isolation, disconnected from local suppliers and given rise to very few spillovers (UNCTAD, 2019). Zambia's experience highlights some of these challenges (see Box 2).



Box 2. SEZ Adoption in Zambia

Zambia introduced multi-facility economic zones (MFEZ) in 2005 to enhance the country's competitiveness and industrialization. The MFEZ were intended to foster an attractive business environment, promote exports, and enhance domestic trade with an aim of overcoming ongoing business constraints including procurement of land, infrastructure, inefficiency in public service, and burdensome customs clearance and taxation systems. The MFEZ in Zambia offer a range of infrastructure and have so far attracted several investors. However, notable challenges have been identified.

In 2016, the World Bank Group carried out interviews with zone developers, investors, and government officials. It identified the following issues:

- Weak institutional capacity and inefficient services of the public sector, including a lack of expertise amongst the Zambia Development Agency officials that means they cannot provide the right incentives and efficient services on demand.
- Inadequate infrastructure.
- Weak links between the zones and local firms, particularly where zone businesses are interested in local sourcing. Most local small and medium enterprises (SMEs) cannot meet the desired volume, quality, or standards. There was also a view that suitable labour was not available locally.

The challenges identified highlighted underlying limitations that are preventing the realization of the objectives set for the MFEZ, particularly the goal of establishing an attractive business environment.

A 2020 study of SEZs in Zambia found that the challenges persisted. These included inadequate infrastructure financing, weak local supplier capabilities and links, inadequate business support services, institutional coordination failures, a fragmented incentive framework, and weak design.

Source: Phiri & Shimukunku, 2020; Zheng, 2016.

Despite mixed success, SEZs remain a priority for industrial and investment policy-makers for several reasons, including (UNCTAD, 2019):

- The ease of introducing, testing, and implementing business reforms where nationwide changes would otherwise be difficult.
- The pressure to remain competitive to attract FDI.
- The ability to offer a distinct regulatory and governance framework which may include ease of access to licensing and registration.
- The benefits package—including tax incentives, particularly exemptions from customs, taxes, and other administrative requirements. Non-fiscal incentives often include access to a skilled labour force, availability of appropriate infrastructure, the convenience of a developed local supplier base, business facilitation, and shared services.



SEZs can be effective tools if they are designed with clear objectives for both the government and the businesses expected to operate within them. Clear objective setting includes determining which industry the government is seeking to promote—as this will impact the design of the SEZ; the type of labour required; supplier and buyer needs; the regulatory requirements to facilitate operation, including existing obstacles in the national framework; the necessary infrastructure, including financing model; and incentives. Establishing a link to the local economy is essential to provide primary product suppliers and labour to the enterprises operating in the zone—reducing business costs—and create local markets. Finally, policy-makers, SEZ authorities and managers, and investment promotion authorities must integrate robust monitoring and evaluation frameworks to review the performance of SEZs and identify and resolve challenges faced by government, investors, and local communities.



3.0 Design and Use of Tax Incentives in SEZs

Fiscal and non-fiscal incentives remain a prominent feature of SEZ regimes. According to UNCTAD, “in today’s global business and investment climate, the strategic focus, the regulatory and governance models, and the incentives package offered remain the key ingredients of a successful SEZ policy framework” (UNCTAD, 2019). The inclusion of tax incentives in SEZ regimes is a widely established practice across the globe and their design and implementation can have an impact on zone success (Farole, 2011). Alongside a beneficial customs regime, many zones provide exemptions or reductions of corporate income tax (CIT), withholding taxes, capital gains taxes, any form of dividend distribution taxes, VAT and local taxes, and import duties (UNCTAD, 2023a).

3.1 Type of Tax Incentives Used in SEZs

Common CIT incentives provided in SEZs include (Competitive Industries and Innovation Program [CIIP], 2017):

- Complete (100%) exemption from CIT.
- Exemptions or reductions in CIT dependent on performance requirements being met—i.e., economic activity, minimum investment amount, employment generation.
- Reduced fixed CIT rate.

Some zones adopt time limitations for a CIT incentive (i.e., up to 5 or 10 years), or a minimum export level for the business to achieve to benefit from the incentive (CIIP, 2017).

Income-based tax incentives were found to be more prevalent in developing countries, with reduced tax rates or full tax holidays being more common than allowances or credits (OECD, 2022). According to the available research, in South Africa, Mauritius, Eswatini, Kenya, Senegal, Angola, and Botswana, a range of tax incentive instruments have been adopted (Celani et al., 2022). The most common were income-based incentives and “all seven countries had at least one reduced CIT rate, either on a temporary or permanent basis, and four countries use tax exemptions” (Celani et al., 2022). Five of the seven countries introduced special CIT regimes in their SEZs and all made use of tax allowances (Celani et al., 2022).

3.2 Effectiveness of Corporate Tax Incentives in SEZs

Across the African continent, it has been identified that many zones have become “overly reliant on granting general tax incentives rather than addressing other aspects of the investment environment, raising the risk of a race to the bottom with other zones” (Farole, 2011). In an evaluation of SEZ policy design and implementation in 10 African countries in 2011, it was concluded that the investment environment in most of the countries was poor and the improvements offered by SEZs were insufficient to establish competitiveness globally



or regionally (Farole, 2011). The survey found it more critical to address the daily challenges faced by investors operating in the zones (Farole, 2011).

According to the World Bank, the failure or success of a zone is tied to its policy and incentive framework, location, and how it is developed and managed (FIAS, 2008). This means that overly generous incentive packages may not be able to offset poor location or insufficient infrastructure (FIAS, 2008). By 2008, the high frequency of investment incentives within zones had already been found to be ineffective in improving zone performance (FIAS, 2008). The World Bank also found that tax exemptions alone cannot guarantee zone success (CIIP, 2017). In fact, tax holidays, have, over the long term, been found to give rise to poor export and employment performance (Farole, 2011). It can also result in investors becoming overly reliant on incentives with companies seeking to extend tax holidays (Farole, 2011).

“The focus on tax incentives distorts not only the behavior of investors but also that of those responsible for the zone program, leading them to respond to competitiveness challenges with short term fiscal breaks rather than targetting competitiveness more holistically through improved infrastructure and service delivery. This situation also leads to inflation in incentives, part of an inevitable race to the bottom for programs that rely on incentives as their primary basis of competitiveness” (Farole, 2011).

While tax incentives might attract initial FDI, in the long term there is a need to shift away from incentive-based competition (Farole, 2011). Ultimately, “incentives do not compensate for a poor investment climate,” government investment in financial and human resources, quality services, and a competitive business environment are all essential to improving investment conditions (Farole, 2011). If countries choose to use incentives because of some specificity in their jurisdiction, they should be simple and transparent, ensuring no opportunities for misuse or abuse (CIIP, 2017), and aligned with wider zone policies (CIIP, 2017).

In general, successful zone programs have a strategic plan to gradually eliminate tax incentives and integrate the SEZ tax regime with the national economy (Farole, 2011). China took this path of progressive integration and eventually eliminated a significant portion of tax breaks. Similar approaches have been taken in Vietnam and Mauritius. It is evident that despite the prevalence of tax incentives used in SEZs, they do not determine the success of the zone program. This is a key finding that should be carefully considered by SEZ authorities, investment promoters and policy-makers broadly—it should provide a central basis for monitoring, evaluation, and reform of incentives.



4.0 International Tax Reforms and SEZs

Previous sections highlighted the prevalence of tax incentive use in SEZs, particularly income-based incentives. These incentives are likely to be significantly impacted by changes in the international tax landscape, particularly the GMT.

4.1 The Global Minimum Tax

The GloBE rules raise the stakes for the design and use of incentives in SEZs. The rules require MNEs with an annual turnover of EUR 750 million or more calculate their income, and the taxes on that income, on a jurisdictional basis. Where this calculation results in an ETR that is below 15%, the rules require the MNE group to pay a top-up tax that will bring the total amount of tax on the MNE group's excess profits in that low-tax jurisdiction up to the 15% ETR rate. This top-up tax is either collected by the low-tax jurisdiction itself, under a so-called qualified domestic minimum top-up tax (QDMTT), or, where no QDMTT applies, by another implementing jurisdiction through the income inclusion rule (IIR) or under-taxed profits rule (UTPR). These rules are briefly described below. A detailed discussion can be found in the *2023 Guide for Developing Countries on How to Understand and Adapt to the Global Minimum Tax* (IISD and ISLP, 2023).

Box 3. GloBE rules

The **GloBE ETR** is calculated by determining the amount of GloBE income or loss of each constituent entity on a jurisdictional basis (this will be adjusted for permanent or temporary differences such as accelerated depreciation) (Liotti et al., 2022). Then the adjusted covered taxes—or the qualifying taxes paid by an MNE in a jurisdiction—will be added together. The covered taxes will then be divided by the GloBE income or loss in that jurisdiction, giving rise to the jurisdictional ETR.

To provide **relief for substance-based activities**, the GloBE rules apply only to “excess profits.” This means the GloBE income or loss will be made up of profits after the exclusion of 5% of eligible payroll costs and 5% of tangible assets (e.g., property, plant, and equipment).

Where the ETR falls below 15%, a top-up tax may be applied in the low-tax jurisdiction itself through a QDMTT.

If the source country chooses not to apply a QDMTT, the top-up tax may be collected through the imposition of either

- an **IIR**, in the jurisdiction of the ultimate parent entity (UPE) of the MNE group, which imposes top-up tax on a parent entity in respect of the low-taxed income of a constituent entity; or
- a **UTPR**, if no IIR applies, by other implementing subsidiary jurisdictions, where the UTPR denies deductions or requires an equivalent adjustment in a subsidiary jurisdiction to produce an equivalent incremental increase on taxes paid by the MNE group.



Certain types of corporate tax incentives will reduce the amount of covered taxes under GloBE. The most common types of incentives include tax holidays, exemptions, and reduced rates. This can reduce the overall ETR and raise the risk of falling below the minimum of 15%. Additional incentives may be impacted by GloBE depending on how they are designed. For example, deductible qualified expenses, tax credits, and incentives on capital gains taxes. Given that some of these incentives are commonly adopted in SEZs, a review of the potential implications will be necessary. Table 1 below provides an overview of the common tax incentives in SEZs and how GloBE is likely to impact them.

Table 1. How common SEZ tax incentives may be impacted by GloBE

SEZ common corporate tax incentives	GloBE Impact	Globe risk
Absolute (100%) exemption.	A 100% exemption from CIT applied to an in-scope MNE will lead to an ETR that is less than the minimum.	High
Exemptions dependent on requirements being met—i.e., economic activity, minimum investment amount, employment generation.	Exemptions from CIT applied to in-scope MNEs may lead to an ETR that is less than the minimum depending on the amount exempted.	High
Reduced fixed rate.	A reduced corporate income tax rate applied to an in-scope MNE can raise the potential for a lower ETR.	High

Source: Author.

In-scope MNEs will likely no longer benefit from the above regimes where an entity's ETR falls below the 15% minimum and a top-up tax is collected as a result of the QDMTT, IIR, or UTPR. In addition, a top up tax will be applied, whether or not a jurisdiction adopts the GloBE rules. It is important to note that a number of tax incentives will not be impacted by GloBE and may remain in use. These include cost-based incentives such as capital allowances and depreciation, and commonly used deductions. SEZ authorities will need to coordinate with tax policy-makers and administrators to understand the proposed national approach to GloBE, which may also include, as an option, an overhaul of the broader tax incentives regime.

4.2 The Forum on Harmful Tax Practices

There are also several other initiatives that precede GloBE that are intended to address tax competition and therefore have an impact on the design and use of incentives in SEZs. These include the OECD's Harmful Tax Competition (HTC) report, the Action 5 Report and the FHTP. These initiatives had already begun to impact incentives in SEZs. The two reports comprise the framework of standards and mechanisms to review harmful preferential tax regimes. Harmful tax competition was identified as a major concern in 1999, with low tax regimes having led to tax-driven investment decision making.



The HTC report sets out the factors to identify harmful preferential tax regimes including: no or low effective tax rates; ring fencing of regimes;¹ lack of transparency; and a lack of effective exchange of information (OECD, 1998).² It is concerned with reducing harmful effects of tax competition, including the distortion of financial and investment flows, undermining the integrity and fairness of national tax structures or increasing the administrative and compliance costs on tax authorities and taxpayers, among other factors (OECD, 1998).

To effectively address these concerns, the FHTP was mandated with facilitating a cooperative coordinated approach to review tax-related legislative provisions or administrative practices that constitute harmful tax practices (UNCTAD, 2023a). The scope of their review has included CIT incentive regimes in SEZ laws, where they apply to income from geographically mobile activities (like financial services or technology) and this may affect one or multiple zones in a country (Heitmüller & Mosquera, 2021).

The Action 5 report expanded the FHTP's scope of review to non-OECD member countries and introduced a substantial activity requirement to ensure that taxpayers are undertaking core income-generating activities. As a result of the work of FHTP, since 2000, eight SEZs have been abolished and 31 were found to have harmful or potentially harmful features requiring amendment. The ongoing work of the FHTP should also be considered by IPAs and SEZ authorities. Steps should be taken to ensure that incentive regimes within SEZs meet the criteria set by the FHTP.

¹ Partially or fully insulated from the domestic market of the country providing the regime—the fact that a country feels the need to protect its own economy from the regime by ring-fencing provides a strong indication that the regime has the potential to create harmful spillover effects.

² Additional factors that could be considered harmful include a negotiable tax rate or tax base, regimes which are promoted as tax minimization vehicles, and regimes that encourage purely tax-driven operations or arrangements.



5.0 Legal Considerations for Reforming Tax Incentives in SEZs

SEZ authorities and investment and tax policy-makers will need to critically evaluate the implications of withdrawing or amending incentives and determine how to balance the need to remain competitive whilst adhering to international tax standards. Most importantly, there will be a need to prioritize sustainable investments and the mobilization of revenues to finance development expenditures. The GloBE rules are likely to generate the political will to reform current tax incentive regimes, including those that apply to SEZs. Governments will need to prioritize cooperation and coordination between key authorities to facilitate an effective national response to GloBE and approach to incentives reform. Below, we provide considerations for governments as they embark on incentives reform.

5.1 Maintaining a Predictable Investment Environment

A predictable investment environment is key for investors (Phiri & Shimukunku, 2020). It is essential that governments ensure policy consistency, coordination between key agencies, transparency regarding the operation and design of tax incentives, and clarity regarding the need for and aims of future reforms. An unpredictable environment may make it difficult for investors to operate.

However, revenue certainty is also key for governments. SEZ regulations should provide for the ability of policy-makers and SEZ authorities to monitor, review, and reform the incentive package to align with international standards, prevent tax abuse, and achieve progressive alignment with the national or industry regimes.

5.2 Mitigating Potential Legal Risks

In addition to the importance of creating a predictable investment environment, SEZ authorities need to be aware that efforts to reform incentives may interact with investor protections granted in domestic laws, investment contracts and bilateral investment treaties (BITs). Investors have raised 14 investor-state dispute settlement (ISDS) claims relating to SEZs under BITs (Tugushev, 2020). The main protections claimed include broad legal guarantees typically found in BITs, such as [Fair and Equitable Treatment](#), expropriation, and non-discriminatory measures (Tugushev, 2020). The risk of a breach of investor protections is highest where legal guarantees of fiscal stabilization³ have been provided for either in SEZ laws or investment contracts. Table 2 provides a summary of BIT cases dealing with the removal of incentives in SEZ regimes.

³ Fiscal stabilization clauses are explicit and specific commitments made by a host country to one or more foreign investors with the intention of shielding their investments from political risk, particularly legislative or regulatory changes.

**Table 2.** ISDS cases relating to the revocation of SEZ benefits

Case	Treaty/Agreement	Protections invoked	Measure challenged	Award outcome
Union Fenosa Gas v. Egypt	Egypt–Spain BIT (1992)	Fair and equitable treatment, full protection and security, national treatment, most-favoured nation treatment	Revocation of company’s status of resident in a SEZ. Loss of preferential regime under SEZ led to increase of tax burden	No breach found–Egypt did not guarantee under national law or the BIT that the tax regime would remain unchanged. Egypt had no stabilization clause for the regime.
Lao Holdings N.V. v. Lao People’s Democratic Republic	Lao People’s Democratic Republic–Netherlands BIT (2003)	Fair and equitable treatment, full protection and security, umbrella clause, national treatment, indirect expropriation, transfer of funds	Cancellation of free trade zone land concessions	No breach–but the tribunal found that the investor consciously planned to abuse the incentives and privileges that would have been offered by Lao under the SEZ. The tribunal focused on the need to balance public and private interests.
Ampal–American and Others v. Egypt	Egypt–United States of America BIT (1986) Egypt–Germany BIT (2005)	Fair and equitable treatment, full protection and security, umbrella clause and indirect expropriation	Revocation of the status of resident of SEZ. Loss of preferential regime under the SEZ leading to an increase in income tax burden.	Awarded with regards to expropriation–tax-free zone system was a fundamental part of the economic structure of the investment, which Egypt knew and accepted and confirmed by issuing a special licence. No prompt and adequate compensation made the revocation tantamount to an expropriation.
Link-trading v. Republic of Moldova	Republic of Moldova–United States of America BIT (1993)	Indirect expropriation	Tax and customs duties exemption revocation in violation of governmental guarantee of tax stability for a 10-year period.	No breach–the investor did not demonstrate that they were deprived of their investment.

Source: Author.



Considering the arbitral tribunal decision in *Ampal-American*, countries should exercise care in the process of amending the regulatory frameworks of SEZs as they can be vulnerable to being found in breach—particularly of indirect expropriation and fair and equitable treatment—even where no stabilization clause exists. Of particular concern for countries is that “when a state establishes an SEZ and endorses foreign investors as residents of this zone, it demonstrates additional willingness to favor foreign investments in SEZ compared to the rest of the host country” (Tugushev, 2020). The impact of this, from the perspective of the arbitral tribunal, is that investors may establish a higher level of expectation and a willingness to incur greater risks that place them at a higher loss in comparison to actions undertaken in accordance with national law (Tugushev, 2020).

In other words, by being accepted as SEZ residents, there is a risk that governments can be viewed by some arbitral tribunals as willing to guarantee the most favourable investment conditions raising an additional burden on the state to protect investors (Tugushev, 2020, n.66, p.15).

However, as noted by the tribunal in *Union Fenosa Gas*, in the absence of a stabilization clause, a foreign investor is not entitled to expect that a tax regime will not change. Therefore, the investor must demonstrate that their expectations were reasonable in the circumstances and that the state measure was unjust, arbitrary, unfair, violated due process of law, or was discriminatory, thereby amounting to a denial of fair and equitable treatment.

Therefore, IPAs should not only consider the process of introducing and sensitizing investors regarding the application of the GloBE rules, but also the need to reform their stock of BITs, investment contracts, and investment laws. Such legal reforms are essential to pro-actively preserving the policy space for legitimate measures in line with international commitments.



6.0 The Future of SEZ Design

As of June 2024, 61 jurisdictions have either made public commitments, published draft legislation, or enacted laws with respect to GloBE (PwC, 2024). A significant number of these jurisdictions are locations where ultimate parent entities of large MNEs are located. This should be viewed as a catalyst for crucial reforms that are now essential to improving SEZ outcomes over the long term. This brief has highlighted some of the pressing concerns—the most fundamental being the risk that overly generous incentives may result in a transfer of foregone revenue from the country where the SEZ is located to another jurisdiction where the parent or intermediary entity is located. Countries may wish to take the following steps to reform the design and use of incentives in SEZs.

Re-Evaluate the Design and Use of Incentives in SEZs

Countries should start by reviewing the type and prevalence of tax incentives in their SEZs to obtain an overview of the incentives currently offered. They should evaluate whether these incentives have been effective at attracting the desired investment, and whether they are efficient, considering the revenue foregone and costs of administration. These types of cost-benefit and tax expenditure analyses are necessary regardless of international tax reforms and GloBE makes it even more important. Countries will need to determine which incentives are impacted by GloBE and develop an appropriate response. To the extent that this response involves removing some incentives, countries should consider any legal risks they may encounter in doing so.

Going forward, to the extent that incentives remain relevant and appropriate in the context of SEZs, countries should ensure they are targeted to the needs and objectives of investors and are well-structured to prevent misuse. As much as possible, incentives should be aligned with the national framework or incentives offered to other industry players outside the zone. Incentives should be performance-based, introduced in the national tax law rather than SEZ legislation, and time-bound (FIAS, 2008).

Strengthen Coordination Between SEZ, Investment, and Tax Policy-Makers

Investment and tax policy-makers need to cooperate to reform tax incentives, including in SEZs and generally in the design and administration of incentives. The authority to grant tax incentives is typically spread across several institutions, which can lead to a lack of effective monitoring and reporting on the types of incentives that have been offered and to whom. Coordination is particularly important to improve tax expenditure reporting and to establish a coherent policy response to GloBE.



Better Target Incentives to Achieve Sustainable Development and Clean Energy Goals

SEZs are likely to play an important role in the energy transition, particularly in promoting investment in the renewable energy sector. UNCTAD's *World Investment Report 2023: Investing in Sustainable Energy for All* recommends that countries “leverage SEZs as energy transition models for the economy and to incubate sustainable energy investment” (UNCTAD, 2023c). This will require improving the capacity of SEZs to attract renewable energy projects and a detailed review of the drivers of investment, and any incentives required. Some non-fiscal needs include licensing and other government approvals, land access, infrastructure specific to renewable energy, and policies aimed at emission reduction or promotion of renewable energy (UNCTAD, 2023c).

Countries will also need to revisit any tax incentives required to attract renewable energy investments. Developing countries typically use profit and cost-based incentives, indirect tax exemptions, and production-based tax credits, to attract investment in renewable energy (UNCTAD, 2023c). Developed countries use more complex tools, such as feed-in tariffs, auctions, renewable portfolio standards, and guarantee schemes (UNCTAD, 2023c). Determining whether SEZs are necessary, and what incentives are relevant, if any, will depend on a careful understanding of the drivers of investment in renewable projects in a specific country.

Explore Greater Use of Non-Fiscal Incentives

In addition to setting objectives that are aligned with current global investment needs, SEZ authorities and managers should put more emphasis on non-fiscal incentives. Addressing the administrative obstacles to business processes can be an important factor for investors. The provision of essential infrastructure and labour can also be highly attractive, as they increase the number of jobs and create spillovers for the national economy.



7.0 Conclusion and Recommendations

Relying too heavily on tax incentives is unlikely to deliver successful outcomes for SEZs. Countries need to shift away from incentive-based competition, not only because incentives are unable to compensate for poor investment environments, but also because of the changing international tax landscape and the effects it is expected to have on corporate tax incentives going forward. GloBE rules will impact all countries regardless of whether they subscribe to the regime or not. This puts pressure on governments, IPAs, SEZ authorities, and investment and tax policy-makers to evaluate the potential impact and coordinate an effective response to GloBE.

Countries should take the following steps to reform the use of tax incentives in SEZs:

- Re-evaluate the design and use of tax incentives in SEZs considering GloBE, and other tax and investment reforms. The evaluation should consider the following factors:
 - Have incentives been effective at attracting investment in SEZs?
 - How much revenue is forgone from incentives and the cost of administration?
 - How will international tax standards impact the use of incentives in SEZs?
 - Are there any legal risks to consider when reforming incentives in SEZs?
- Build greater awareness amongst SEZ authorities and IPAs of the changing international tax standards, their impact, and opportunities to reform incentives.
- Evaluate tax incentives, and any subsequent reforms, together with finance ministries, tax authorities, and investment policy-makers to ensure policy consistency and predictability for investors. Assessing the impact of GloBE on incentives is vital. If this evaluation is not undertaken, countries risk losing revenue to another jurisdiction.
- If countries find some incentives necessary to attract investment in SEZs, they must first consider the type of industry they are trying to attract and any barriers to investment. Any incentives should aim to address these industry-specific barriers. SEZs should shift away from profit-based incentives to cost-based incentives, placing time limits and other conditions. MNEs affected by GloBE will not benefit from corporate tax incentives within SEZs, triggering a renewed focus on the investment environment generally or a request for additional incentives not affected by the rules. SEZs should also consider making improvements to the investment environment, such as providing skilled local labour. If tax incentives within the zone are found to be ineffective or subject to misuse, SEZ authorities should have the legal and practical tools to withdraw them without triggering other international obligations.
- Consider any legal risks arising from incentives reform to pro-actively mitigate them. A critical assessment of the existing legal framework including BITs, investment laws and investment contracts will be necessary and should include consultation with investors.



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