THE EUROPEAN EXPERIENCE OF TAX STIMULATION OF FOREIGN INVESTMENT

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Abstract: *Key mechanisms of tax stimulation of foreign investment in the EU and Ukraine. The directions of creation of favorable investment environment in Ukraine on the basis of studying of the European experience of tax stimulation of foreign investment.*

Keywords: *European Union, foreign direct investments, tax incentives, European integration of Ukraine*

JEL classification: *F38, H25*

1 INTRODUCTION

In the conditions of strengthening of integration processes among the various forms of international movements of capital and inter-state cooperation important role belongs to foreign direct investment (FDI). They stimulate economic growth, contribute not only to the accumulation of capital, but also to the unique experience of management, technological know-how. Thanks to the FDI potential integration of national economies into the world economic space significantly accelerates. All countries compete to attract foreign capital.

The task of any government is the proper use of these revenues. They should be held for the conquest of new markets, improvement of quality of products and services, improving the economic and social level in the country. Almost all countries use different tools to stimulate foreign investment, among which a prominent place belongs to the tax.

Among the research works, that contain the scientific development of attracting FDI, including tax regulations, there should be highlighted the works of such foreign and domestic scientists: G. Dernburg, V. Medvedev, V. Sharpe, P. Fischer, P. Gaydutskiy, Y. Zhalilo, Y. Ivanova, Y. Pakhomov, A. Sokolowski, and many others.

However, the problem of attracting foreign capital taking into account the leverage of tax regulation in Ukraine in the conditions of integration processes remains under-researched. Given the fact that Ukraine had chosen strategic course of integration into the European Union (EU), which is one of the largest foreign investors in Ukraine today, the study of the European experience of tax stimulation of foreign investment is extremely important.

2 STATE, PROBLEMS AND PROSPECTS OF ATTRACTING FOREIGN INVESTMENTS TO UKRAINE

In the modern economic situation, the task of attracting FDI is recognized for Ukraine as a priority for sustainable economic growth, restructuring, development through innovation [14]. Analysis of the main macroeconomic indicators of the Ukrainian economy indicates a worsening situation in the sphere of economic activity. Creating an open competitive model of the economy largely depends on the level of activity of foreign investors on the territory of Ukraine, the intensity of the movement of capital and labour.

The volume of FDI in Ukraine's economy in 2015 amounted to $3 billion 763,7 million direct investments against $2 billion 451,7 million in the past year. Total volume of FDI for the whole period of investment as at 31 December 2015 amounted to $51 billion 195,6 million. From EU countries since the beginning of the investment process, investments were made in the amount of $33 billion 042,3 million (76.2% of total share capital). Most of the investments came from Cyprus - $11 billion 744,9 million, The Netherlands - $5 billion 610,7 million and Germany - $5 billion 414,3 million. [16]

However, the current state of FDI in Ukraine in dynamics for countries, industries and regions of Ukraine, despite their growth, indicates the insufficient volume of foreign capital. FDI are usually directed to profitable industries and industries with quick turnover of capital, and their structure does not meet the objectives of the restructuring of the economy and its growth. In addition, 33% of FDI in Ukraine comes from Cyprus and the virgin Islands, which are capital predominantly of Ukrainian origin, that first was moved to offshore zones and later was returned to Ukraine. Moreover, most FDI - 56% - came in the trade, financial and brokerage activities. The industry, which requires significant upgrading of production assets, must rely on its own investment and credit resources. The same applies to agriculture and construction. [9]

The level of FDI per capita remains low in comparison with neighbouring countries. According to UNCTAD in Ukraine in 2014 FDI per capita were accounted in amount of $ 1 420 at current prices and current exchange rate. This is less than in Hungary - $ 9 902, Slovakia - $ 9 757, Poland - $ 6 414, Romania - $ 3 453, Georgia - $ 2 832, Russia - $ 2 657, Turkey - $ 2 224, Belarus - $ 1 905, even more than in Moldova - $ 1 054. [14]

The Ministry of economic development and trade in 2016 plans to raise $ 5 billion foreign direct investment by large foreign investors [1].

According to the President of Ukraine Petro Poroshenko, despite the fact that "today there are safer places for investments than Ukraine,...—...there is no place in the world with the potential of Ukraine, which still remains unclaimed, not known and not used" [8].

However,for FDI in Ukraine, there are serious obstacles, namely: the unstable and unpredictable legislation, the lack of an independent judiciary, corporate raiding, pressure from tax authorities, shortcomings in the implementation of laws, delays and opacity in VAT refunds, corruption and low protection of property rights.

Also according to international authoritative experts, in particular, PricewaterhouseCoopers and sociologists from Research & Branding Group, the main barriers to improving the investment climate in Ukraine are corruption, judicial system, administrative barriers and tax system. The main problems in the taxation system are high tax rates, a large volume of tax reporting, a large number of taxes, as well as the imperfect system of refund of value added tax (VAT). [4]

Great efforts are needed to improve the investment climate in Ukraine. Partial entry into force on 1 January 2016 of a Deep and Comprehensive Free Trade Area (DCFTA) should improve the business climate in the country. A free trade area with the EU will open new opportunities for investments in the real sector of economy of Ukraine.

In general, according to the Institute of Economics and forecasting of NAS of Ukraine, the state needs 160 billion euros to modernize the economy according to EU standards. These calculations are made proceeding from cost of the same modernization in Poland, the Czech Republic, Slovakia and Hungary in the period after they had signed Association agreements with the EU.

However, Ukraine can not count on such large-scale support from the EU, which had, for example, Poland. In the early 1990s in Poland the debts were restructured, and for three years from 83% the debt reduced to economically safe level - 56% of GDP. After joining the EU in 2004, Poland within the European assistance received net proceeds - taking into account contributions to the total budget - more than 60 billion euros. Huge amounts of aid were spent on its modernization. During the 1990-ies only China, India and Egypt received more[5].

Now the possibility for EU helping Ukraine is weakened: the European Union has its own internal economic problems, the global economy shows positive growth trends, while global financial markets have become limited and extremely careful. In the context of limited financial resources, there is an objective need to attract foreign investment.

Among the set of influences on investor behaviour – integration, globalization, economic conditions, political situation and social conditions - taxation is one of the determining factors of state regulation of the investment process. Taxes can be an obstacle as well as a neutral factor and, above all, - a stimulant for the foreign investment.

The government of Ukraine had already made a number of important steps to attract foreign investment. Thus, according to the recovery Plan of Ukraine for 2015-2017, one of the directions in the medium term prospect of further reforms is to attract investment, including by means of taxation [11].

Current tax laws provide favorable benefit conditions in taxation while making investment in Ukraine's economy. For example, according to subparagraph 136.1.3 paragraph 136.1 of article 136 of the Tax code of Ukraine FDI, that is economic operations, which provides depositing funds or property in exchange for corporate rights, issued by legal entity whilst its placement by such person, are not taken into account for determining the object of taxation with the income tax [12].

Moreover, by the Law of Ukraine of 06.09.2012 № 5205 "On stimulation of investment activity in priority sectors of the economy for the purpose to create new work places" are determined the basics of the state policy in the investment sphere for 2013-2032 about stimulation of the attraction of investments in priority sectors of the economy [13].

However, the sphere of interests of non-resident investors is not yet coincides with the sphere of national interests of Ukraine and does not ensure the needed dynamics of the economy development and its restructuring, and domestic tax benefits still have not yet become a sufficient motivating factor for foreign investors.

The question about optimal structure and the share of direct foreign investments in Ukraine's economy still remains open today. There is no definite answer in relation to the appropriateness of the main criteria in the selection of priority areas of investment FDI both at the industry and regional levels. It is, therefore, useful to draw on the experience of tax incentives for FDI of the EU countries.

3 THE EXPERIENCE OF THE COUNTRIES OF THE EUROPEAN UNION ON TAX STIMULATION OF FOREIGN INVESTMENT

A range of incentives for foreign investors generally is structured to:

- tax (deferred taxes in return for investment capital; accelerated depreciation; «tax holidays»; exemption from import duties on equipment, raw materials, semi-finished products; reducing tax rates);
- financial (subsidies, loans, preferential loans).

The most economically developed countries are oriented on the financial benefits, while in the practice of states with lower economic development, tax incentives are used more.

Considering the European experience of tax stimulation of foreign investment, it should be noted that an important element of the process of economic integration within the EU is convergence of tax policies and national tax systems of the participating countries. Thus, in the EU had formed such "tax standards":

- the tax burden should not exceed 45% of GDP;
- proportional share of direct, indirect and social taxes in total tax revenues;
- control tax competition in the EU through the Code of taxation (adopted by the EU Council in 1977).

Harmonization of national tax systems of the EU manifests in the following:

- the establishment of general principles, forms and methods of tax control;
- harmonisation of tax privileges and preferences;

- unification of structure and functions of tax authorities;
- implementation of a single method of taxation of all countries participating in the EU.;
- consistency of legal regulation and its synchronization. [2]

Despite the diversity of national tax systems of member countries of the EU, in these countries there is a tendency for the formation of a unified approach to harmonization of tax systems for the purpose of regulation and stimulation of investment processes. Harmonization of national tax systems provided equal conditions for all potential investors, created the conditions for the free movement of capital in the domestic integrated market, stimulated the development of international scientific and technical cooperation and intensified the process of attracting international investment.

At the same time, according to the criterion of the degree of influence of the tax mechanism on the processes of foreign investment two groups of countries can be distinguished. The tax systems of Germany and South-Scandinavian countries of the EU are characterized by the presence of high and numerous tax rates and the dominance of the role of the state in redistributive and social functions. Therefore, there is the complexity of the processes of tax harmonization in these countries with European standards, so their tax systems are currently less adapted to integration.

In the second group of states (United Kingdom, Austria, France, Italy and Spain) national tax systems to the greatest extent meet the European standards in the provision of tax privileges and preferences to foreign investors. Beside this, there can be added great flexibility of these tax systems in relation to foreign investors.

Therewith, national tax regulation has an important role in stimulating foreign investment. It shows the improvement of economic indicators of EU countries, namely: the reduction of unemployment, growth in gross domestic product, increasing tax revenues to the budgets of European countries.

Most of all, Ukraine is interested in the countries of Central and Eastern Europe (CEE), which joined the EU recently and had serious problems with the development of their economies.

CEE occupy a significant position in the global FDI flows. From a low base in the beginning of the 1990-s they became one of the main places for the contribution of global FDI. High dynamics of FDI illustrates the ability of the individual CEE countries to compete with larger developing countries in the global battle for FDI. [6]

Most countries of CEE have the systems of investment incentives, including tax. The leaders of such stimulation are the Czech Republic and Slovakia. Thus, Slovakia had shown one of the fastest and most effective transformation of the business environment in the world. Tax reforms, highly skilled workforce and government incentives of the country have established the so-called paradise for investors. This had interested such world- known companies as Peugeot-Citroen, Hyundai, Kia Motors, Ford Motors, Volkswagen, Dell Computer Corporation, IBM, Lenovo, Sony, Samsung, US Steel, Tesco Stores SR in investing FDI. [6].

Incentives for FDI in countries of CEE are determined by special laws or had been determined in a number of individual laws. For example, in Croatia the incentives are defined in a special law on investment incentives; in Macedonia the incentives are the component of the state program; in Romania they are set out each year in the budget; in Bulgaria they are defined in the Law on foreign investment; in the Czech Republic there is the Law on incentives for investment. Romania had established the agency for investment promotion. Similar agencies have been functioning in other EU countries for a long time. Hungary has the most complex system of incentives, which implies the provision of tax and customs benefits for R&D and subsidies for infrastructure.

Among EU countries should be allocated those countries, in which primarily the tax system is aimed at attracting investment and improving their economic attractiveness. In most cases, these features are expressed in reduced rates of profits tax of enterprises, tax on dividends, a simplified system of tax accounting and reporting. These countries include the Republic of Cyprus, Ireland, the Netherlands and several other countries. [7]

Among EU countries Ireland has the lowest taxes on corporate profits and the lowest average tax of companies. At the same time, this country occupies the 6th place among OECD-28 countries in the share of tax revenues in GDP (31%). Introducing a very liberal regime for FDI, there was a sharp increase in foreign investment in Ireland - annually up to $ 13 billion (comparing with $ 1.5 billion to the Ukrainian economy). Nowadays, Ireland takes 2nd place among EU countries by the level of private sector investment in fixed capital; the 4th place among OECD-28 countries by the level of foreign direct investment; 7th place (OECD-28) by index of access to capital. [10].

In accordance with EU practices, the fiscal promotion of the investment may be provided in one of three forms: tax deferral, tax reduction, tax credits [18].

The use of various incentives for investors in the EU is determined primarily by the tasks of solving the existing structural and social problems of the economy or a particular region. The availability of incentives depends on the type and volume of investment, location of investment and other factors. Usually tax incentives are used to: stimulate the development of production; stimulate the creation of working places; attraction of investments in specific regions or areas with special conditions of the functioning (Special economic zones (SEZ) and Territories of priority development (TPD)); promoting research, development work (R&D).

Thus, tax benefits on corporate tax in Hungary for investments can be granted for investment in projects: 1) associated with production; 2) which involve the extension and updating (development); 3) to create working places; 4) other investments.

Among incentives for investors, who implement new products or extend existing production in the manufacturing industry of the Czech Republic, there is the exemption from tax of income of legal (physical) persons for 5 years for newly established enterprises and partial in the case of expansion of production.

The feature of stimulating of investment for creating new work places in Hungary is the lack of a minimum investment. The tax benefit is provided in the amount of 80%, if staff is increased by 300 people (in Budapest or in Western Hungary), or 150 in the regions with low level of development, and only 20 in the 48 least developed areas.

In addition, 20 % of new employees must be graduates of the current year. The company must meet these two mentioned conditions during a five year period, beginning with the third tax year after the year, in which it was used reduction in paying development tax for the first time.

In Bulgaria in 2003 the government introduced tax incentives for investment projects in regions with high level of unemployment. In addition, in Bulgaria, the “Law on the corporate income tax”, enterprises, which operates in the processing industry (including manufacturing / processing of raw materials of the customer), are entitled to 100% exemption from corporate tax, if the conditions, mentioned in the law, are carried out.

In Croatia benefit rate of corporate tax is applied to companies, that invest in economically disadvantaged areas and employ more than 5 employees, among which at least 50 % are in the economically underdeveloped region. Depending on the region, the corporate tax rate may be reduced to 15 %, 5 % or 0 %.

In Poland, additionally to encourage investment in the territories of certain regions, local authorities can also grant exemption from payment of property tax, benefits in payment for the use of electricity and other utilities, prepared platform for business activity at a discounted price and etc.

The most important feature of the mode of attracting investments in Poland, Hungary and the Czech Republic is its innovative orientation.

Thus, the experience of the EU countries indicates that European states are using the extensive system of tax incentives to stimulate FDI inflows.

4 CONCLUSION.

Tax mechanism plays an important role in attracting foreign investments into the economy of countries. First of all, tax incentives on FDI gives an opportunity to direct them in the development of high technologies, production of household appliances and innovative industry, increase the pace of economic development.

The experience of the EU indicates that in terms of international tax competition, all countries, depending on strategic goals and objectives, the conditions of the economy and political situation, carry out a flexible system of using tax incentives to stimulate FDI inflows into the economy.

For Ukraine the European experience of tax incentives on FDI is extremely useful and instructive taking into account the strategic goals – EU integration.

The government of Ukraine had defined priorities for 2016 - the holding of large-scale reform of the State fiscal service and customs, transparent privatization, completion of tax reform and the continuing process of deregulation.

Thus, the increase of foreign investments and their efficient use will depend on how Ukrainian state, using the European experience, will carry out started reforms effectively, create attractive conditions for foreign investment, primarily by means of taxation.

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