

CONSTITUTIONAL FRAMEWORK OF TAX FREE ZONES

Professor Addy Mazz, Facultad de Derecho de la Universidad de la República, Montevideo, Uruguay

Contents

| | |
|-------------------------------------------------------------------------------------------------|----|
| 1. Tax incentives. Concept and modalities..... | 1 |
| 1.1. Concept of incentives | 1 |
| 1.2. The effects of taxes. | 2 |
| 2. Economic development and public finances | 3 |
| 3. The constitutional framework of tax benefits | 4 |
| 3.1. Tax incentives and the principles of equality and ability to pay | 4 |
| 3.2. Justification for tax justice | 5 |
| 3.3. Justification by the principles of the "economic" Constitution | 6 |
| 3.4. The justification for the principles of social welfare and solidarity..... | 7 |
| 3.5. Latin American theory..... | 7 |
| 4. The principles in the Constitutions. Some cases | 9 |
| 4.1. Spain..... | 9 |
| 4.2. Italy..... | 10 |
| 4.3. Brazil..... | 10 |
| 5. Tax incentives used in developing countries | 10 |
| 6. Free tax zones: Uruguay..... | 11 |
| 7. The free tax zones and BEPS..... | 12 |
| 7.1. BEPS Action 5..... | 12 |
| 7.2. Evolution in the relations between developed countries and underdevelopment countries..... | 12 |
| 8. CONCLUSIONS..... | 13 |

1. Tax incentives. Concept and modalities.

1.1. Concept of incentives

Independently of a political decision of interventionism or neutralism, taxation - by its volume - affects the economic activity of individuals. This circumstance is not ignored by the State, which uses preferential tax regimes to encourage some activity, and thus promote the country's development, and, from this, achieve greater equality among citizens. The objectives to be achieved would be increased investment and, consequently, the promotion of economic development. Tax benefits are a substantial genus, comprising a multitude of heterogeneous figures (exemptions, deductions at base, detractions from the quota, substitute tax regimes, remission of taxation, suspension of collection, etc.).

In this conception is supported that the State can or should influence in the economy and in particular, in the distribution of income. It should be noted that beyond a political decision of interventionism or neutrality, taxation -by its volume - affects economic activity of the particular circumstances that the State cannot ignore, and which should take steps aimed at the equality of citizens. If it is necessary to achieve or increase economic development, taxation cannot ignore this objective.

It means that taxation can be used as a tool to achieve equality among citizens and which justifies treatment unequal of the law for the sake of other objectives, such as income redistribution policy or policies of stabilization and development.

1.2. The effects of taxes.

The tax is intended to raise resources for the state and non-tax has other objectives, but, every tax figure causes, in a greater or lesser degree, economic effects, other than the purely tax collection . Or, as Lejeune's¹ say, *"the existence of chemically pure taxation is something that, in our view, is totally impossible to verify in any tax code."*

It is possible to distinguish, exclusively tax collection, those who have this function and at the same time an extra-fiscal purpose manifested to a greater or lesser degree, until the extra fiscal tax in its pure state. Economic

¹Lejeune Valcarcel, Ernest "El principio de igualdad" en Tratado de Derecho Tributario dirigido por Andrea Amatucci, Tomo primero.

interventionism, or extra-fiscal use of the tax for economic policy purposes, can cover all areas: agriculture, industry and energy, social economy, foreign trade, regional economic development, savings, business development, etc. (an example is environmental taxation).

The diversity of exemptions and tax reductions contributes to the fact that their relief has diffuse characteristics, as well as to the lack of reliability of the labeling adopted by the legislator, which usually adopts in different ways the expressions of those species that identify them, and can also introducing true tax benefits in ever new and diverse ways.

In order to identify the common denominator of tax benefits, it would not be sufficient to point out that they consist of a lower taxation (with respect to an alleged "ordinary" regime) because in that case the notion would lose all its meaning, ending in being necessarily referable to all "tax discrimination". It cannot be said that the tax benefits are always originate in derogation rules, since there are measures which, although they do have such a subsidy, do not derive from provisions of that kind.

In this way, the tax benefits in themselves, are true and authentic public expenditure (and not just a lower taxation or non-imposition) and the relative extent of their substitution with other similar measures can be considered to be clear in the search for suitable solutions To make them compatible, as far as possible, with the rules and principles that according to their specific characteristics should reflect.

The principle of ability to pay has always been the basic reference of the constitutional issue with regard to tax benefits, because they are usually considered as clearly injurious to the requirement of equality in the context of all to the public expenses.

2. Economic development and public finances

The analysis of the incidence of taxation in economic development implies defining, in a financial approach, several issues: 1) whether it is feasible to influence taxation in the economy, and 2) whether it is desirable that this incidence occur. The latter has given rise to various concepts of fiscal policy,

which answer to opposing economic theories, to which the solution of the subject matter is inextricably linked

Through the reduction of the fiscal cost, tax incentives look for to boost economic activity by increasing investment. That means use tax incentives and public finance for economic development involves deciding whether (i)it is feasible to have an impact with the taxes in the economy, (i) it is desirable that this incidence occurs, and (ii) if those purposes are possible in the constitutional framework of each State.

3. The constitutional framework of tax benefits

3.1. Tax incentives and the principles of equality and ability to pay

In a primary analysis, the existence of tax incentives, which are reductions or tax exemptions, seems to be in conflict with the principle of equality and ability to pay, since it implies an unequal treatment of persons with equal economic capacity. But if the purpose is the development of the country and in this way increases the employment, they are compatible with those principles. The extra-fiscal purposes of the tax, must be, then, compatible with the ability to pay and respond to a reasonable criterion and be protected by the Constitution's own system of values (economic, health, housing, protection of the environment, etc.).² The constitutional systems in its majority receive the principles of equality and ability to pay.

Tulio Rosembuj³, says "*The extrafiscal function of the State tax system does not appear explicitly recognized in the Constitution, but that function can be derived directly from those constitutional precepts which establish out guiding principles on social and economic policy since both the tax system as a whole and each particular tax figure, are part of the instruments available to the State to achieve the constitutionally ordained economic and social goals*".⁴

²Conforme Mazz, Addy, Curso de Derecho Financiero y Finanzas, Tomo 1, Volumen 2, pg.47 y sigts-

³Rosembuj, Tulio, "The environmental tax", Barcelona,1994, pg. 21 Do you mean environm environme

Casado Ollero⁵ stated «of the EEC Treaty, taxation will take place in extrafiscal perspective to the point to say that extrafiscality is an indivisible phenomenon of the entire process of Community tax harmonization».

Moschetti⁶ says "the use of the tax for economic-social and redistributive purposes in particular, not only not violate, but it makes the principle of contributory capacity". It is a duty of the Republic "to remove economic and social obstacles that limit in fact the freedom and equality of citizens" in order to promote "the full development of the human person" and the effective participation of all workers to the political, economic and social organization of the nation"

Bobbio,⁷ identifies in tax benefits one of the most significant expressions of the promotional function of law.

These incentives would constitute the normal exercise of the Legislature, in the field of fiscal law, not exceptional but special rules, which contain a different discipline from the rules of taxation, would be expressions of principle.

3.2. Justification for tax justice

A sector of the doctrine, considers total or partial exemptions from the tax burden would have a regulatory function, different from tax justice, and could disrupt the fair distribution of the public charge. Therefore, its use should be coordinated with other fiscal measures that tend to restore equitable tax distribution.

Sáinz de Bujanda⁸ says that exemptions cannot ignore the principle of Justice, they must adjust to this and should be exempt what it is just that does not tribute.

⁵ Casado Ollero , Gabriel , "Los fines no fiscales de los tributos", en Revista diritto Finanziario y hacienda pública, 1991 página 489

⁶Moschetti Francesco, "El principio de la capacidad contributiva", en Tratado de Derecho Tributario, dirigido por Andrea Amatucci, Tomo primero, pg. 240

⁷Bobbio, Norberto, Della Struttura a la funzione, Milano, 1977

⁸Sainz de Bujanda, "Hacienda y Derecho", Instituto de Estudios Políticos, Madrid, Tomo III pag. 417

In the case of fiscal incentives for economic development, they can be said to enshrine a new objective concept of justice, as an idea that public power is exercised for the benefit of the common good, since "*fairer even than equitably distributing Tax, is to increase the income of the country and distribute it with justice*". The development exemption agrees with this criterion of justice and would be a method to make possible the equitable distribution of the tax burden

Pérez Royo⁹ says: "*Tax benefits are established to promote certain activities. The extra fiscals objectives must be compatible with the ability to pay and respond to a requirement or criterion reasonable and be covered by the system of values own of the Constitution (political of development economic, health, of housing, of protection of the environment)*". "

What is clear is that economic development cannot be achieved at the expense of tax justice, so that the exemptions established as a stimulus for a given economic policy must be produced in such a way that the taxation principle of non-payment capacity disappears as a guiding element of the tax breakdown.

The ideal would be to obtain economic development with tax justice, but if this is not possible, the ideal of justice should prevail.

3.3. Justification by the principles of the "economic" Constitution

A sector of the doctrine distinguishes the tax norms, which would constitute fiscal law, would be governed by the fiscal Constitution and obey primarily the principles of legality and fiscal equality, of extra-fiscal rules that are economic fiscal law, subject to the Constitutional principles of the "economic Constitution", and which obey the principles of economic legality and equality and proportionality lato sensu. He attributes to them, as we see, different nature.¹⁰

⁹Perez Royo Fernando Derecho Financiero y Tributario, Parte general, 4 Edición, pg. 133

¹⁰Casalta Nabais, José. O deber fundamental de pagar impuestos. Coleção Teses, Almadine, Coimbra, 1988.

This could happen if the volume of the exemptions causes, for other groups, an increase of the global tax burden that is not related to its wealth, a hypothesis in which these sectors would pay the exemptions of the benefited sector. Each tax and the tax system as a whole must be structured according to the principle of contributory capacity and discriminations between the various economic activities must be carried out rationally.

It follows that exemptions are limited to areas where there can be no other effective stimulus for the achievement of extra-fiscal purposes.

Tipke¹¹ considers *“Tax benefits are the link between standards with the target fiscal and the direction or orientation, is external or technique and not material, because the latter are not tax law but economic law”*.

3.4. The justification for the principles of social welfare and solidarity

For Valdes Costa¹² in the actual conception of the relations of the State with the individual, and of the function that he must fulfill to achieve progress and social welfare, these instruments cannot be dispensed with, as in other legal fields, such as labor and housing, in which inequalities are created with similar objectives.

The solution for this author is to harmonize the principle of equality with others of equal rank, such as "general welfare", expressly recognized in the United Nations Bill of Rights, and "solidarity" enshrined in Article 3 of the Italian Constitution and present in other Constitutions.

3.5. Latin American theory

3.5.1. VII ILADT Conference (Caracas 1975)

ILADT VII Conference Caracas, 1975 on the topic “Tax incentives and economic development” the recommendations stated “Tax incentives schemes sometimes contradict the principle of equality conceived as a principle of contributory capacity, in such cases, their harmonization with other public

¹¹Tipke, citado por Perfecto Yegra Martul-Ortega, en “Los fines extrafiscales del impuesto”, en Tratado de Derecho Tributario, dirigido por Andrea Amatucci, Tomo primero, pg 355 y sigts.

¹²Valdés Costa, Instituciones de Derecho Tributario, DE Palma, pag. 388

interest values enshrined expressed or implicitly in the Constitution, must be admitted”.

3. *“The interpretation of the rules that create tax incentives should be made in accordance with the general principles of interpretation of Tax Law, and not be limited to literal or restrictive criteria”*”.

4. *“Tax incentives should be created on a temporary basis The rules that create incentives can be repealed or modified by another law It is advisable that the benefits provided in the respective laws should be maintained, despite their modification Or derogation, for the period for which they were established in respect of those who had complied with the legal requirements, without prejudice to the responsibility that the State may incur if it did not maintain them”*

3.5.2. XXI ILADT Conference held in Genova, in 2002, on topic 2, "Tax incentives for economic development",

Recommendation 2 and 3 state:

2. *“Tax benefits are reductions based on foreign reasons unrelated to the basis of taxation, which give rise to a total or partial exemption from the tax obligation. The use of tax benefits is based on the final cause of the State, that is, in the common good, understood as the set of conditions that favor the development of people in society. Therefore tax benefits do not mean constitutional tort, provided they are based on other principles or rights of equal legal status”*.

3. *“That respect for the principle of ability to pay is an essential element in the tax legal relationship and operates as a limit to the power of the State, as it reflects the principle of equality in the field of Tax Law, so that it does not constitute violation of this principle, that they establish rules that grant different or more beneficial treatment to certain sectors or persons, provided that it finds basis in the constitutional norms and responds to criteria of justice.”*

It does not constitute a breach of this principle that rules be established for giving a different treatment or more beneficial to certain sectors, provided that this find basis in the constitutional normative and responds to criteria of Justice.

ILADT Conference Recommendations:

1. *"The essential purpose of the tribute is the revenue, notwithstanding that along with it other purposes that support within the legal system can be pursued and that that purpose do not disturb the sense of Justice in all tribute".*

2 *"Insofar as tax benefits claim to socio-economic objectives directly related to economic development or a more equitable redistribution of income, they are not incompatible with the principle of ability to pay, because although the income distribution and distribution of fiscal burdens are substantially different operations, an equitable distribution of the tax burden may be the road used by the legislator to promote the equitable distribution of wealth".*

3. *"The establishment of tax benefits, which in principle should be by law, responds to achieve extra fiscal objectives of an economic or social character with the purpose of encouraging the realization of certain behaviors deemed desirable by the legislator".*

4. *"Admitting that tribute may have tax and extra fiscal purposes, the extrafiscal should be subject to the following limits:*

a. temporary, in the sense of limiting its duration, which in turn constitutes a guarantee of implementation;

b. of rigorous selectivity;

c. quantitative, in order to contribute to its necessary budgeting and transparency;

d. using evaluation and permanent control, with publication;

e. of coordination between the various levels of Government".

4. The principles in the Constitutions. Some cases

4.1. Spain

Article 14 of the 1978 Constitution stipulates that *"Spanish people are equal before the law, and no discrimination on grounds of birth, race, sex, religion, opinion or any other personal or social condition or circumstance may prevail"*. This article is interpreted by the doctrine as translating the principle of

contributory capacity: *"Equality, thus conceived, requires that economically equal situations be treated in the same way, taking into account that the economic capacity that is emphasized it's the same"*. The Constitutional Court has accepted that "the discriminations are not arbitrary when they are established according to a criterion protected by the order".

Article 31 refers to the principle of equality in relation to ability to pay contributory and progressivity, and jurisprudence stresses the relationship between the two, so that equality in the Spanish tax sphere can be considered to be connected with progressivity, and tends towards the attainment of real equality.

Finally, article 9.2 states that: *"It is the responsibility of the public authorities to promote the conditions for the freedom and equality of the individual and the groups in which they are integrated to be real and effective, to remove obstacles that impede or hinder their fullness and facilitate the participation of all citizens in public, economic, cultural and social life"*.

4.2. Italy

The Constitution of 1946, in article 3 states that "all citizens have equal social dignity and are equal before the law."

4.3. Brazil

Article 150 of the Federal Constitution prohibits "... II. *Instituting unequal treatment of taxpayers who are in an equivalent situation, prohibiting any distinction by virtue of professional occupation or function exercised independently of the denomination*".

5. Tax incentives used in developing countries

Developing countries that require investment, must grant them to raise capital, since they could not grant another type of benefits such as subsidies, which means a public spending. The tax incentives are relevant, especially at the time of installation of the companies or specific when they make an

investment. The special free zone is an example of territorial incentive, awarded to a given territory.

6. Free tax zones: Uruguay

Free tax zones are areas of the territory, fenced and isolated efficiently, where business consisting of commercial, industrial and service activities is entitled to a privileged tax treatment

Operational conditions: state or other authorized persons provide for all necessary infrastructure, business activities may include manufacturing, logistics for ports, trade and business services companies, activities must be exercised within the area (with exceptions), users may not develop industrial commercial and service activities outside the areas, 75% of staff must be Uruguayan citizen (with exceptions).

The objectives are to promote investments, expand exports, increase the use of domestic labor and foster international economic integration. It must be substantive activity within the area: sale, promotion, display, delivery of goods, collection related to such transaction and similar activities

Activities that can be performed by users exceptionally outside area:

- a) Collection through third person,
- b) Display at specific events whose duration is less than seven days, and provided they are no more than three per year. To carry on at non free territory, auxiliary activities users must request prior authorization

Activities in the free tax zones are: commercial activities include marketing of goods (with exceptions), storage, packing, sorting, classifying, splitting, assembling, dismantling, handling or mixing of goods or raw material foreign or domestic origin, industrial activities, services inside the tax free zone, from tax free zone to third countries, and from the tax free zone to non free territory, only international calling centers, internet service providers, education at distance, electronic signature certificates

Activities should be function to development of area and the country.

The users are exonerated from all national taxes, no exemption state social security contribution. Subjective tax exemption for users, objective tax exemptions for goods, services and raw materials entering or leaving the area

7. Free tax zones and BEPS

7.1. BEPS Action 5

The aim of action 5 is to make more effectively counter harmful preferential regimes (pg. 23 report of October 2015), basically requiring substantial activity and transparency, including mandatory exchange of rulings related to these regimes. The aim is also to avoid the existence of elusive structures that achieve a low or non taxation in the benefits of the jurisdictions.

They accept only exceptionally in very restrictive assumptions, defined by a mathematical equation: the proportion of costs directly related to the development of activities, which shows the real value added by the taxpayer and acts as an approximation of the volume of substantial activity made by the taxpayer. Costs act as an indicator of the number of activities, it is not the amount, it is the ratio. The purpose is to ensure benefits only the income that arises from the preferential where the activity is carried out by the same taxpayer.

7.2. Evolution in the relations between developed countries and underdevelopment countries

From the time that is considered that developed countries should contribute to the development of the underdevelopment, until BEPS, it pass a long time

There is still a large difference between underdeveloped countries and developed ones.

The first one grant tax franchises (territorial, specific to certain activities, etc) with the intention of attracting investment).

These regimes can collide with BEPS “pernicious harmful regimes”

In BEPS there is no consideration to the different degree of development of the countries or to the possibility of granting incentives to promote this. But

BEPS stated that States are owners of the economic and fiscal policy, based in the sovereignty.

We think that the state sovereignty, legitimate the right to establish fiscal policies designed to attract direct investment, on the basis of a substantial activity in its territory.

Each State is free in establish privileged tax regimes as well as not to allow the deduction of the payments that are made to persons benefiting from a regime of this kind in another State.

Conference ILADT 2015, Mexico, Recommendation:

“The challenge for countries in the decision process about the possible incorporation of measures comprising the BEPS Plan in their national legislation, is to have a consensual and serious reflection with all sectors involved, always attending to reality and plans for economic development to maintain, tax sovereignty, as well as its particular legal system and constitutional principles that underline them”.

8. CONCLUSIONS

1. Tax free zone is a territorial tax incentive. It does not conflict with the constitutional principle of equality enshrined in the Constitution if its purpose is economic development and, through this, the greatest equality among citizens.
2. Each State is free to establish its fiscal policy an establish privileged tax regimes.
3. The compatibility of the principle of equality and the tax incentives arises from its harmonization with others of equal hierarchy, as “national solidarity”, justice”. Currently these postulates as well as economic development, are as important as the equality and are justified by the remaining objectives to meet.

