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Tax incentives as a main factor to attract foreign direct investments in Poland

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Abstract: *The inflow of foreign direct investment (FDI) is one of the most important stimuli boosting the economy of host countries. No wonder, therefore, that the governments of the countries show a great interest in the inflow of foreign capital and create favorable conditions for investors. Investment incentives take different forms and are offered within the framework of target programs, and also regulated by laws. In the paper, there are presented two most significant examples of supporting FDI with tax incentives in Poland: State aid addressed to investors in Special Economic Zones (SEZ), and subsequently exemption from property tax, offered to investors by individual municipalities. The research was based on the analysis of legal documents and reports relating to public aid granted in Poland, assessing the functioning of Special Economic Zones, and many other authenticated studies. The result of the conducted considerations indicates that foreign investors frequently and substantially benefit from the incentives offered by the Polish government, which is confirmed by the value of the capital invested by them in the form of FDI.*

Keywords: *tax incentives, investments, FDI, Poland*

JEL**:** E63; F21.
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Introduction

The ability of the economy to attract foreign direct investment (FDI) is an important measure of its investment attractiveness and it demonstrates its internationalization. It is also an important determinant of the economic growth of the host country (Tian2018; Almfraji and Almsafir 2014).

Poland, as a result of the liberalization of capital movements has been an active participant of the capital market for more than a quarter of a century. An important stimulus for increasing the inflow of capital in the form of FDI was the accession of Poland to the European Union. The accession strengthened the credibility and attractiveness of Poland as the location of investments. The value of foreign direct investment (FDI) in Poland reached712.1 billion PLN, i.e. 39.6% of GDP at the end of 2015. Consequently, Poland is in the middle of the rank of the

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OECD countries in terms of the share of FDI in the economy (Czerniak and Blauth, 2017; Androniceanu, 2017a). Taking into account the fact that nearly 90% of all significant investments in Poland are made by large foreign companies, it is important to refer to direct foreign investment in this study (Program for supporting investments 2011).Encouraging foreign investors to invest their capital in the specific country requires attractive incentives. Definitely, such an incentive is public aid, creating favorable conditions for realizing investments (Androniceanu, 2017b). The objective of the paper is, therefore, the presentation of selected forms of support for direct foreign investments by the Polish government.

1. Literature review

The aim of policies for attracting FDI must necessarily be to provide investors with an environment in which they can conduct their business profitably and without incurring unnecessary risk. Experience shows that some of the most important factors considered by investors as they decide on investment location are (OECD, 2003;Ślusarczyk&Kot, 2012; Horváthová, et al., 2017; Ohanyan, Androniceanu, 2017; Becerra-Alonso, et al., 2016):

- A predictable and non-discriminatory regulatory environment and an absence of undue administrative impediments to business more generally.
- A stable macroeconomic environment, including access to engaging in international trade.
- Sufficient and accessible resources, including the presence of relevant infrastructure and human capital.

In the economic literature many empirical studies have been published on the assessment of which key determinants explain the investment of multinational firms in a given location. Such research was conducted, by Assunção Forte and Teixeira (2013) among others. These authors verified the importance of location factors for FDI in terms of: OLI paradigm (infrastructure, human capital, economic stability and production costs, the institutional approach (corruption, political instability and institutional quality, and financial and fiscal incentives as well as the 'New Trade Theory' – market size, market growth, openness of the economy and factor endowments.

However, investment incentives have a special importance among factors that encourage foreign enterprises to invest capital in the form of direct investments. Investment incentives rank among the most important policy instruments governments employ to influence the local decisions of multinational firms. In spite of the fact that there is a lot of contradictory evidence referring to incentives, undoubtedly, they may serve as a tool for economic diversification and competitiveness but also can distort the allocation of trade and investment, which would take place in their absence and thus affect the competitive conditions in the markets in which they are present(Sauvé and Soprana, 2016).Although no universally agreed definition of investment incentives exists, the term most commonly refers to *“non-market benefits that are conferred by a national, regional, or local governmental entity to economic actors with the purpose of influencing their investment decisions”* (James 2009). According to OECD experts, the definition of FDI incentives is the following: “Measures designed to influence the size, location or industry of a FDI investment project by affecting its relative cost or by altering the risks attached to it through inducements that are not available to comparable domestic investors” (OECD, 2003). Governments widely use investment incentives including: (Stawicka 2015).

- fiscal incentives, among which the most popular are: exempting business start-ups from the obligation to pay income tax for a specified time, reduction in corporation tax rate, creating tax-privileged special zones or loss settlement in time;
- financial incentives, such as infrastructure subsidies, investment loans, participation in investment costs;
- legal incentives, consisting in exempting entrepreneurs from specific legal provisions in force in the specific country.
- Investment incentives can also be classified according to whether they are (OECD, 1996):
- **direct**(received directly by the firm undertaking the investment, e.g. a fixed amount per unit of investment) or **indirect**(received indirectly by the firm undertaking the investment e.g. a higher market price for enterprise's output or a lower market price for its inputs);
- **financial**(the one which is paid as a transfer to an investor in the form of a budgetary expenditure financial subsidies include relief from taxes) or **implicit** (the one which is given in-kind without a user charge sufficient to recover its true value, or the result of regulatory actions that alter market prices or access);
- **general** or **sector/industry/firm-specific** (investment subsidies may be generally available to all firms or apply only to a particular sector, industry, group of firms, or firm);
- **unconditional**(does not involve any requirements other than the undertaking of the specified type of investment) or **contingent**(involves additional unrelated requirements such as local content or employment rules);
- -**incremental** or **non-incremental** (The total amount of the subsidy may be capped at some level, in which case it is "non-incremental").

Zhan and Karl (2016) have presented a recent UNCTAD survey of investment promotion agencies (IPAs) and they found that fiscal incentives are the most frequently used type of incentives for attracting and benefiting from foreign investment, whereas financial and regulatory incentives are less commonly used for these purposes.

More specifically, and recalling that incentives are often offered jointly as a complex “package”, a representative list of individual fiscal incentives that are currently being offered by some jurisdictions includes (Table 1):

Table 1. Fiscal FDI incentives

Category	Example of tax incentives
Reduced direct corporate taxation. General measures aimed at easing the corporate tax burden.	*Reduced rates of corporate income tax.* Some governments have targeted such measures at incomes from specific sources, or at income earned by non-resident investors alone; *Tax holidays*. Under a tax holiday, qualifying "newly-established firms" are not required to pay corporate income tax for a specified time period; *Special tax-privileged zones.* The creation of "ring-fenced" areas with low rates of corporate taxation amount to fiscal FDI incentives in the cases where foreign-owned enterprises enjoy privileged access to operate in such zones; *Others.* Special corporate tax deductions, value added tax (VAT) —VAT zero rated goods, VAT exemption and remission, and customs duties — duty exemption and duty remission.
Incentives for capital formation. Policies of tying lower taxation to corporate investment are used by many jurisdictions as a way of conjointly attracting foreign enterprises and providing them with incentives to invest.	*Special investment allowances.* Under such allowances, firms are provided with faster or more generous write-offs for qualifying capital costs; *Investment tax credits.* Such tax credits are earned as a percentage of qualifying expenditures and offset against taxes otherwise payable; *Reinvested profits.* Some governments offer deductions or tax credits against profits that are reinvested in the host economy.
Reduced impediments to cross-border operation. Companies are attracted to locations where the fiscal system imposes minimal costs on the cross border transfer of funds, goods and services and manpower	*Withholding tax.* Some countries offer foreign-owned enterprises reduced rates of withholding tax on remittances to their home countries; *Taxation of foreign trade*. Reduced import taxes and customs duties (and in some cases export taxes) are sometimes used as FDI incentives; *Taxation of employees.* Lower personal income tax or social security reductions for expatriate executives and employees are used to make locations more attractive to foreigners.

(*Source:* Own elaboration based on: OECD, 2003, p. 19-20 and Sauvé, P. and Soprana, M., 2016, p. 2)

The objective of the paper is to present selected tax incentives, supporting foreign direct investments in Poland.

2. The analysis of selected aspects of support for FDI in the tax incentives

2.1 Research methodology

The research included two main forms of support of the implemented foreign direct investments: State aid addressed to investors in Special Economic Zones and exemption from property tax offered to investors by individual municipalities. The research was based on the analysis of legal documents and reports relating to public aid granted in Poland, assessing the functioning of Special Economic Zones and many other authenticated studies.

Then, tests were carried out to determine the strength of interaction between specific economic indicators which included capital expenditures, level of employment and financial aid in SSE. In order to characterize the studied values, basic descriptive statistics were used, which, using histograms, were used to study the symmetry of distributions of particular variables. In order to study the initial correlation between the explanatory and explanatory variables, scatter plots were prepared. The last stage of the research was to show specific values of correlations between variables using the Pearson index, which allowed to identify the direction and strength of interaction.

2.2 Tax exemptions in Special Economic Zones

In the era of globalization, each country strives for attracting investors who not only create new jobs but also implement new technologies and solutions in the field of organization and management in the national market. These reasons were the grounds for creating special economic zones in Poland at the end of the previous century, i.e. the areas where conducting a business activity takes place in slightly different, more favorable conditions than in the rest of the country (Dobrowolski 2008Kot, 2014, Witkowski, et al., 2017). The zones particularly affect the growth in employment and export, inflow of foreign direct investment, development of human capital and transfer of knowledge, new technologies and know how while, in the long term, contributing to the more rapid economic growth of the specific region.

In Poland, the basic legal act regulating the issues related to the establishment of SEZ and their functioning is the Act of 20 October 1994 on special economic zones (Journal of Laws of 1994 No. 123 item 600 as amended)-(over the years of the functioning of special economic zones there have been introduced a lot of significant legal changes in the general provisions as well as in the ones regulating the activity of individual zones).The Act defines the special economic zone as “a separated, in accordance with the provisions of the Act, uninhabited part of the territory of the Republic of Poland, in the area of which a business activity may be conducted under the terms of the Act”. In Poland, there are 14 special economic zones which, according to the regulations in force, will operate by the end of 2026. In their area, entrepreneurs may conduct a business activity on preferential terms, on the basis of the permit in the form of public aid

(Gwizdała 2016).In SEZ, entrepreneurs may be granted the following privileges: tax exemption (CIT or PIT),a plot fully prepared for investment at a competitive price, free assistance in completing the formalities related to the investment, exemption from property tax (in the area of some municipalities).

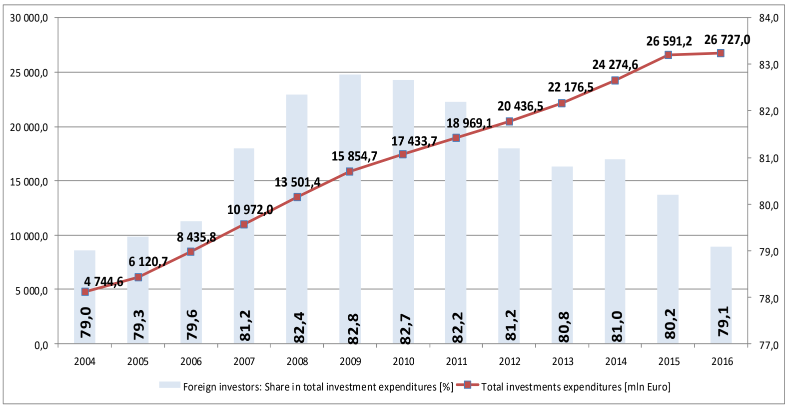
Exemptions from property tax granted in SEZ constitute the so called *Regional state aid*(the Communication from the European Commission 2013), which is to accelerate the development of the least developed regions of the EU by supporting new investments and creating new jobs related to those investments. The permissible amount of regional aid that can be granted to the entrepreneur is dependent on the location of the investment, investment volume or the costs of hiring new employees, and also the size of the company applying for tax exemption.

The costs eligible for regional aid in SEZ, i.e. the costs constituting the grounds for calculating the maximum amount of tax exemption can be the costs of a new investment *or* the costs of labor of newly recruited staff, depending on whether tax exemption is to be due to a new investment or due to creation of new jobs. It is also possible to take advantage of both of the above forms of aid simultaneously when respecting the limitations specified in the Act (1994).

Therefore, while referring to capital expenditures incurred in all SEZ in Poland in the research period, there can be observed a significant advantage of foreign capital invested in these zones (Fig.1).

The reason for limiting the time horizon of the analysis of the development of investments incurred by foreign investors in the areas of SEZ against the level of all foreign direct investments coming into Poland to the years 2004-2016is the lack of data on the structure of the origin of the capital invested in the zones before 2004. Also, in order to maintain an appropriate symmetry, the accompanying issues associated with the problem of SEZ will be concentrated on the analogical period, i.e. the years 2004-2016.

The value of capital expenditures increased annually and in 2017 the value of expenditures exceeded six times the amount invested in 2004. On the other hand, the geographical structure of the expenditures remained nearly unchanged in that period, varying by a few percentage points. For foreign investments, that was the range of 79.0% to 82.78%.



*the value in Euro was calculated based on exchange rate Euro=4.2 PLN

Figure 1. The value of capital expenditures incurred in SEZ in years 2004-2016, taking into account the geographical structure

(Source: Own study based on the reports: Informacje… o realizacji Ustawy o specjalnych strefach ekonomicznych, 2004-2016*)*

The objective of the further/more detailed research was to determine the strength of interaction between specific economic indicators which included capital expenditures, level of employment and financial aid. In the first place, there were presented the characteristics of individual factors and used the values of descriptive statistics.

Table 2. The values of descriptive statistics

		Capital expenditures	Public aid	Employment
N	Valid	14	12	14
	No data	0	2	0
Mean		17679	354	228432
Standard error of the mean		2188	48	21571
Median		18201	326	232403
Mode		4745	140	74554
Standard deviation		8187	168	80711
Skewness		-.085	,380	-.378
Standard error of skewness		.597	,637	.597
Kurtosis		-.980	-1.118	-.475
Standard error of kurtosis		1.15	1.23	1.15

(Source: Own elaboration*)*

The analyzed statistics indicate that the average amount of capital expenditures in the research period is at the level of EUR 17 679 million. For more than half of the research period the level of capital expenditures was equal or lower than EUR 18 201 million, for the remaining period, the expenditures were higher. At the same time, the expenditures were at the level of EUR 4 745 million. Negative skewness (-0.085) indicates slight skewness to the left, which signifies slightly higher values of expenditures after 2010. Negative kurtosis (-0.980) indicates a large number of extremes in the data set and, at the same time, a high diversity in expenditures in the research period. Negative values of skewness (-0.378) and kurtosis (-0.475) also accompany the level of employment in subsequent years, also indicating skewness to the left and a diversity in the level of employment between 2003 and 2017. In turn, the data concerning public aid take different values, indicating positive skewness (0.380) and negative kurtosis (-1.118) and the related extreme values.

Due to the fact that the mean and median are similar to each other in each case, one may assume the symmetry of their distribution. The data distribution can be observed in the histograms along with their curves in Figure 2.

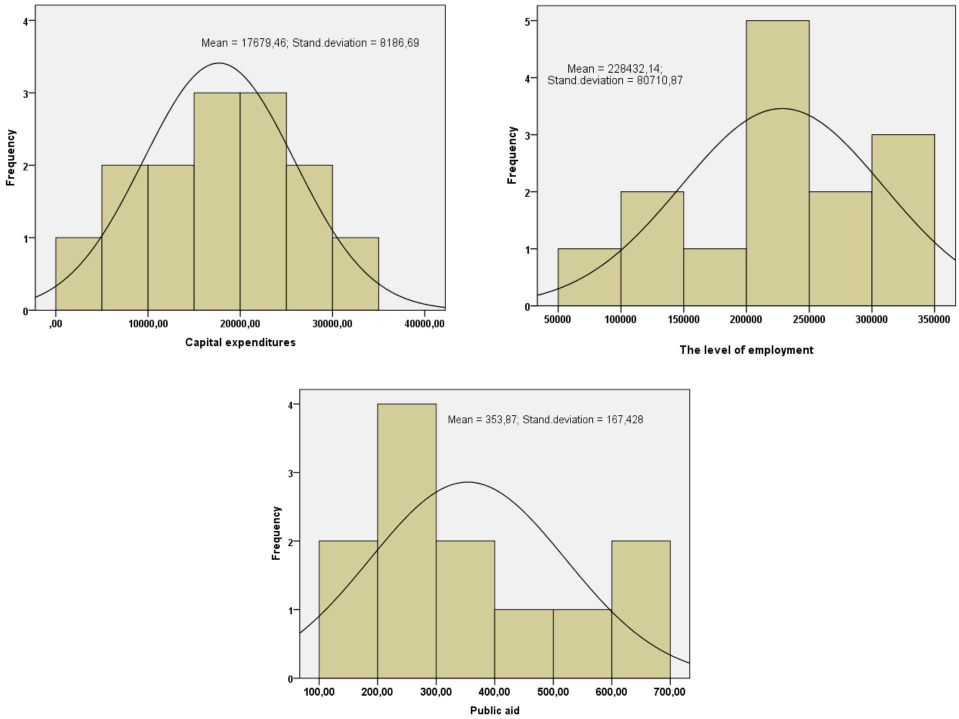


Figure2. The histograms with the distribution curve for capital expenditures, the level of employment and public aid
(Source: Own elaboration*)*

On the basis of the figures it is observed that the difference between the empirical and theoretical distribution is significant in the case of public aid and the level of employment. Therefore, for both factors, the distribution does not take the value of the normal distribution. In order to check the correlation between the variables, in the first place, there was used the scatter diagram. For the confidence interval of $\alpha = 0.95$ there was examined the linear correlation for the pairs of variables.

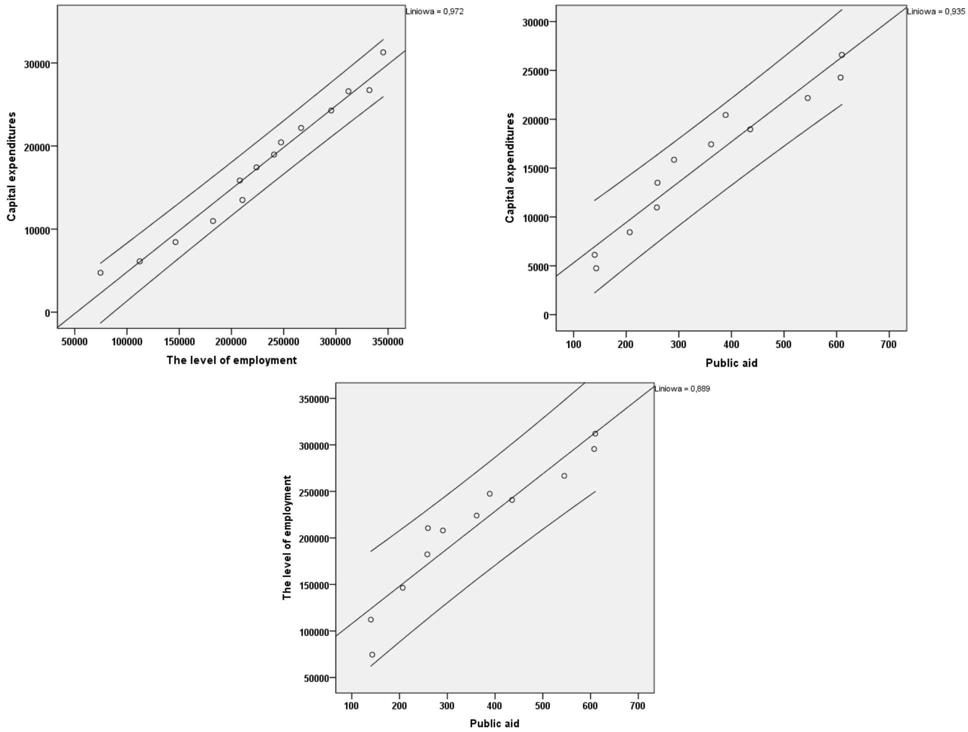


Figure3. Scatterplots for the tested variable pairs
(Source: Own elaboration*)*

For all the examined pairs of variables the correlation is linear regression, therefore, it may be assumed that there is a strong statistical relationship between these variables. Due to the linear correlation between the variables, in order to verify the strength of the impact, there was conducted the analysis of the Pearson's correlation, i.e. linear correlation (Table 3).

Table 2. The values of descriptive statistics

		Capital expenditures	Public aid	Employment
Capital expenditures	Pearson's correlation	1	.986**	.967**
	Significance (two-tailed)		.000	.000
	N	14	14	12
Public aid	Pearson's correlation	.986**	1	.943**
	Significance (two-tailed)	.000		.000
	N	14	14	12
Employment	Pearson's correlation	.967**	.943**	1
	Significance (two-tailed)	.000	.000	
	N	12	12	12

**. The correlation is significant at the level of 0.01 (two-tailed)
(Source: Own elaboration*)*

For n=14, as a result of the Chi-Square correlation, there was observed two-tailed statistical relationship at the level of $p < 0.01$ between all the pairs of variables. The Pearson's coefficient value close to 1 shows a strong positive relationship, indicating that:

• along with increased expenditures there is an increase in the level of employment,

• along with increased aid there is an increase in the level of expenditures.

Two strong relationships determine the correlation between public aid and the level of employment. An increase in public aid has a positive impact on the creation of new jobs.

Unfortunately, the data presented in the reports: *Information on the implementation of the Act on special economic zones* did not allow to specify the value of the support transferred to foreign investors since the revealed value of the aid includes all the investors along with the companies managing the zones.

However, the table shows a definitely growing interest of investors in the possibilities of receiving public aid in the form of tax exemption, thus, taking into account the previously presented values concerning the capital expenditures, it can be assumed that foreign companies undoubtedly use the aid adequately for the capital invested. The decrease in the value of the public aid used noticeable in 2012 was the result of the uncertainty of investors related to the period in which SEZ initially were to be ceased (2020). This is confirmed by the survey carried out by the experts of Ernst & Young (2011).According to them, more than half of the previous investors declared that they were not planning the implementation of new investment projects in the area of SEZ in the case of their functioning only until2020 but as much as 81% of the respondents declared the readiness for implementing new investments if these zones operated longer. The fact of extending the activity of SEZ was therefore the direct factor determining the attractiveness of the zones. The extension of the period of the functioning of the zones by 2026 and even the covering of the entire country with the conditions preferential for investors would be definitely a significant argument. The surveyreferred to also indicated that as much as 96.7% of the respondents recognized tax exemption as the main advantage of conducting a business activity in the zones.

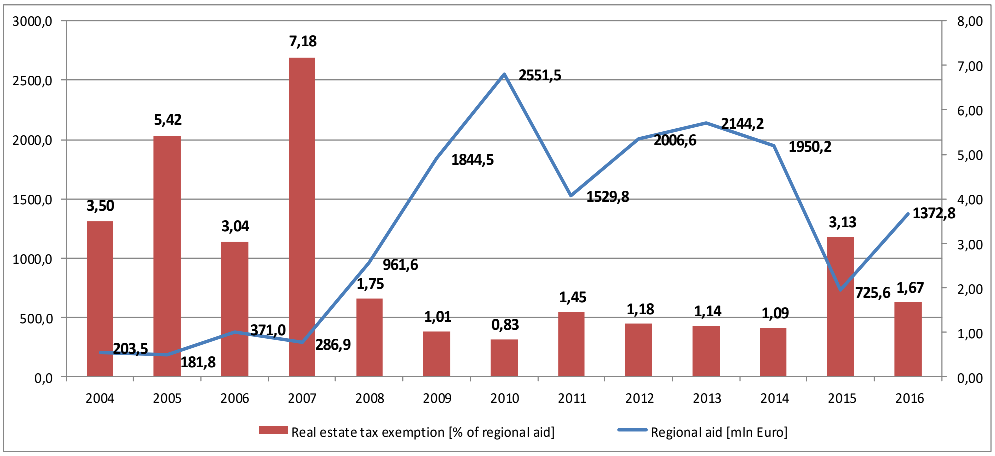
2.3 Investment incentives in municipalities – exemption from property tax

One of the basic investment incentives available in municipalities is exemption from taxes and local fees (The Act of 12 January 1991 on Taxes and Local Fees (Journal of Laws of 2017,item 1785), however, the most significant for entrepreneurs is exemption from property tax. The aid arising when using this form of support corresponds with the value of tax exemption and is the so-called "automatic aid", which means that the exemption is by virtue of law itself after fulfilling, by the entrepreneur, the conditions established in the resolution of the municipal council.

The value of state aid for investors in the form of exemption from property tax is possible to know on the basis of the published annual Reports on State aid in Poland granted to entrepreneurs.

Mayors of cities and commune heads, in the period of 2004 – 2016, granted regional aid of 262.8 million euro, 242.7 million euro of which was the aid in the form of exemptions from taxes and local fees. In Figure 5, there is presented the value of regional aid granted in Poland in total in the analyzed period and the percentage of exemption in the form of exemption from property tax in that amount of regional aid.

The largest percentage of exemption from property tax in the total value of regional aid was recorded in 2007, whereas the smallest in 2010. However, this does not mean that the value of exemptions in those periods was subjected to rapid changes. As it can be seen, it was rather the value of regional aid that underwent strong fluctuations (in 2007, its value was almost the lowest, whereas in 2010 it was the highest in the whole analyzed period). The support from local municipalities each year remained at a similar level – from 16.8 million euro in 2008 to 22.9 million euro in 2016. The exception was the years 2004-2006, when the value of exemptions from property tax did not exceed 11.3 million euro.



*the value in Euro was calculated based on exchange rate Euro=4.2 PLN

Figure4. The value of regional aid granted in Poland in total in years 2004-2016 and the percentage of exemption in the form of exemption from property tax in the amount of regional aid

(Source: Own elaboration based on: Reports On Public Aid In Poland Granted To Entrepreneurs In The Years 2004-2016,UOKiK, Warsaw*)*

Unfortunately, in the most reliable presentation of the value of the support granted by the State in the form of exemption from property tax, the problem is the lack of continuity in a uniform presentation of the data in the Reports. Moreover, this form of investment incentives for investors is also often indicated in the case of other data, e.g. tax exemptions in Special Economic Zones. Therefore, the given figures are approximate values. However, they prove the considerable interest of investors in the support provided by the host country as well as the efforts of the Polish government to encourage foreign investments in the country.

3. Conclusions

The inflow of foreign direct investment (FDI) is one of the most important stimuli boosting the economy of host countries. No wonder, therefore, that the governments of the countries show a great interest in the inflow of foreign capital and create favorable conditions for investors. Investment incentives take different forms and are offered within the framework of target programs, and also regulated by laws. In the paper, there are presented two most significant examples of the support for FDI using tax incentives. The result of the conducted considerations meets the expected conclusions that foreign investors frequently and substantially benefit from the incentives offered by the Polish government. The presented results certainly do not fully reflect the total value and all available forms of tax incentives for FDI in Poland. The constraint is definitely the lack of access to current data and, in the case of public aid, often the lack of the separation of specific support for FDI, which has already been mentioned when commenting the results.

However, in spite of the fact that the use of investment incentives seems to be very beneficial for attracting foreign investments, in numerous scientific studies, there is held the discussion concerning this issue(among others: Baltaci and Sahin 2016, Kamińska and Babula, 2014, Hansson and Li 2016, Greblikaite, et al., 2015, Olofsdotter 2008, Morisset 2003). Supporters of fiscal incentives for FDI argue that they are needed to increase investment which, in turn, create jobs and generate economic and social benefits such as positive externalities or spillovers conveyed by foreign firms. (Kurowska-Pysz, and Szczepańska-Woszczyna, 2017, Madièsi Dethier, 2010). Investment incentives may also provide higher income from a possible increase in investments from other countries. The aforementioned authors, Madiè sand Dethier, also noted a few arguments negating the legitimacy of tax incentives: they may cause corruption or seeking profits. Excessive competition may lead to this, in the opinion of domestic businesses, governments of countries favor foreign companies. Finally, tax incentives may bring about economic disruptions since companies attempt to transfer as many transactions as possible to the sector with the lowest taxation or build new companies shortly before the expiry of the current tax preferences (Revilla and Laarni, 2016).

Although investment-related incentive policies have tended to proliferate in all corners of the world, over the past decade, such policies have been used most intensively by countries in Asia and Africa. According to the Asian Development Bank, the investment incentives used by Asian host economies are chiefly targeted in character and often relate to the establishment of special economic zones — in part to bypass the prohibition of tax incentives for exporters established by the

World Trade Organization (WTO) subsidy rules. Asian incentive programs often pursue a specific approach, with incentives resulting from discretionary deals between host country governments and multinational investors (Sauvé and Soprana, 2016).The countries of Southeast Asia were the subject of the research conducted by Revilla and Laarni (2016), which confirmed the use of tax incentives in the field of attracting and increasing foreign direct investments.

The disputable nature of the use of tax incentives is not favorable for the formulation of a uniform opinion on this issue. On the other hand, tax exemptions offered by the Polish government in the form of exemption from income tax and property tax definitely constitute an important factor determining the inflow of FDI, which is confirmed by the cited values of investments incurred in the analyzed period of 2004-2016.

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