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Tax incentives to encourage migration of skilled labour: another tax expenditure or a failure of tax residence?

Andrew Halkyard*

Abstract

In a world of increasing labour mobility, is it good tax policy to use tax incentives to encourage migration to meet shortages of skilled labour? Countries as diverse as Australia, New Zealand, Singapore, Denmark and China, to name but a few,¹ think so. But is this the best response? This article seeks to answer these questions, first by analysing the taxation regimes of various countries which have encouraged migration of skilled labour by providing tax incentives and asking why they did so (Part I). It then examines empirical studies and related literature with a view to determining whether occupational or residence decisions really are responsive to the taxation of labour (Part II). There is a wealth of literature on tax incentives to promote foreign direct investment. But comparatively little analysis has critiqued tax incentive regimes designed to attract labour. This article aims to fill this gap and goes on to consider whether such regimes may best be viewed, not as tax expenditures, but as curing the failure whereby many countries adopt an over-embracing concept as to when an individual becomes a tax resident (Part III). It will be argued that, although the case for enacting a tax incentive regime as the best way to encourage migration of skilled labour is problematic and has not been made out, it would be unrealistic to expect countries to refrain from doing so. Accordingly, the article proceeds to set out the design elements such a regime should contain to ensure that the policy goals identified can best be satisfied (Part IV). Finally, the article explains the lessons learned from the analyses undertaken and answers the questions posed above (Part V).

1. A COMPARATIVE STUDY OF TAX INCENTIVE REGIMES AIMED TO ATTRACT MIGRATION OF SKILLED LABOUR

As indicated above, many countries have enacted taxation incentive regimes to attract migration of skilled labour. This article will examine five of these, namely, those in Australia, China, Denmark, New Zealand and Singapore. For comparative purposes, the experience of Israel will also be analysed – since its taxation incentive is directed at encouraging immigration generally. Most of these incentives provide an exemption to qualified persons for foreign source income and, where relevant, offshore capital gains. They are generally aimed at attracting foreign, non-resident skilled workers to relocate (and often to encourage expatriates to return) and virtually all are time limited

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¹ An OECD study found that as of 2010 15 OECD countries had introduced targeted income tax concessions to attract migration of highly-skilled workers: see *OECD Tax Policy Studies: Taxation and Employment (No 21)* (2011), p 124. Some of those countries, such as the United Kingdom and Switzerland, go further. They use tax incentives to encourage wealth migration.

(i.e. incentives expire after a stated period or when the relevant person becomes a permanent resident). Table 1 summarises the main features of these regimes.

TABLE 1

Country	Qualifying person	Form of incentive and type of income covered	Compliance obligations and qualification conditions	Time period
Australia ²	Temporary resident – a person who is a tax resident but who does not hold a permanent visa ³ or citizenship and does not have an Australian spouse	Exemption for foreign source income that is not part of the person's Australian employment income [Notes – a temporary resident is also exempt from capital gains tax unless the asset is 'taxable Australian property'. Special rules apply to tax capital gains on shares and rights acquired under employee share schemes.]	Normal compliance obligations apply, except that interest paid to foreign lenders is not subject to withholding tax	Exemption ceases when the person is no longer a temporary resident
China ⁴	A person who is not domiciled in China and who has resided in China for less than 5 years ⁵ [Note – even where a non-Chinese domiciliary (expatriate) stays in China for more than 5 years, it is relatively easy for that person to avoid becoming a resident taxpayer under the Individual Income Tax Law. To achieve this result, the person must stay outside China for more than 90 days cumulatively, or 30 days consecutively, within the relevant calendar year. ⁶]	Exemption for all non-Chinese source income and gains, except where it is paid or borne by a Chinese entity or individual	Normal compliance obligations apply	Exemption applies for 5 years [Note – see, however, Note contained in the first substantive column of this table which shows that, for an expatriate, non-resident tax status is relatively easy to achieve.]

² Income Tax Assessment Act 1997 (Cth), s 768-910. The rules came into effect on 1 July 2006. See generally, <http://www.ato.gov.au/individuals/content.aspx?doc=/content/76537.htm> (accessed 18 February 2013).

³ Under the Migration Act 1958 (Cth) a temporary visa allows a person to remain in Australia during a specified period or until a specified event happens or while the person has a specified status. A permanent visa allows a person to remain in Australia indefinitely.

⁴ Individual Income Tax Law of the People's Republic of China, art 1 and the Regulations Implementing the Individual Income Tax Law of the People's Republic of China, arts 2, 3 and 6. The law and regulations came into operation on 1 January 1994. They can be found at http://www.chinatax.gov.cn/n6669073/n6669088/index_3.html (accessed 18 February 2013).

⁵ For this category, the exemption described in the next column of this table is available only with the approval of China's State Administration of Taxation: see Regulations Implementing the Individual Income Tax Law of the People's Republic of China, art 6.

⁶ Regulations Implementing the Individual Income Tax Law of the People's Republic of China, arts 2 and 3.

Denmark ⁷	Overseas researchers (scientists) and high income earners ⁸ employed in other professions. The person must have been recruited abroad and not been liable to tax in Denmark in the prior 10 years. Danish citizens living abroad can apply for the incentive	Flat rate of income tax of 26% (no deductions from income allowed), instead of the normal progressive income tax with a top marginal rate (including labour market contributions) of around 56% (2012). The incentive only applies to earnings from the qualifying employment; all other income is taxed at normal rates	The foreign national must apply for a tax and social security number within 3 months of arriving in Denmark and at the same time make a formal application for the tax incentive	The incentive expires after 60 months ⁹
Israel ¹⁰	New immigrants and returning residents – the latter category refers to an individual who resided overseas for at least 10 years from the date he or she left Israel or was a foreign resident on 1 January 2007	Exemption for foreign source income, including income from professional work, salary and capital gains. New immigrants are also entitled to additional tax deductions (known as ‘tax credit points’)	New immigrants and returning residents should complete an application form. Offshore income need not be reported in the individual’s tax return ¹¹	The exemption applies for 10 years. New immigrants are exempted from tax on offshore pension income without time limit. Interest income earned by new immigrants on foreign currency deposits is exempt for 20 years, provided the funds deposited were owned prior to immigration and were deposited in an Israeli banking institution

⁷ Danish Withholding Tax Act, s 48E. The rules came into effect in 1991. See generally, Guide published by the Danish tax authority (SKAT), ‘Tax Scheme for Foreign Researchers and Key Employees’ www.skat.dk/SKAT.aspx?thisId=97319.205905 (accessed 18 February 2013).

⁸ The income threshold for the scheme to apply to non-researchers is around €10,000 per year (as of 2011). The threshold only applies to earnings from the relevant employment to which the incentive applies. In other words, other sources of income are not counted when considering this condition of eligibility.

⁹ Between 2008 and 2011, a qualified person could chose between the then standard incentive tax rate of 25% for 36 months or a higher rate of 33% for 60 months.

¹⁰ Income Tax Ordinance [New Version] 5721–1961, s 14. The exemption commenced in 2002 when Israel moved from a territorial to a worldwide tax system. The exemption was expanded in 2008 to provide enhanced incentives as well as to cover returning residents (in addition to the original category of new immigrants). The law can be found at [www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/legislation/FiscalIssues/5721-1961_Income_Tax_Ordinance_\[New_Version\].pdf](http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/legislation/FiscalIssues/5721-1961_Income_Tax_Ordinance_[New_Version].pdf) (accessed 18 February 2013). As indicated above, it is important to appreciate that Israel’s exemption regime is not directed at encouraging skilled labour migration as such; rather, it is meant to encourage immigration generally (see Table 2).

¹¹ Income Tax Ordinance [New Version] 5721–1961, s 134B.

New Zealand ¹²	Transitional resident – a person (who may or may not be a citizen) who was not a tax resident for the previous 10 years	Exemption for foreign source income (except employment income from overseas employment performed while living in New Zealand and business income relating to services performed offshore)	The exemption applies automatically to a qualified person. The normal compliance obligations apply	The exemption applies for 4 years from the first calendar day of the month the person qualifies as a tax resident in New Zealand
Singapore ¹³	Not ordinarily resident – a person (who may or may not be a citizen or permanent resident) who was not a tax resident for at least 3 years prior to becoming a tax resident in Singapore	Exemption for a portion (that corresponds with the number of days spent outside Singapore for business reasons in a year) of the person's Singapore source employment income [Notes – Singapore's jurisdiction to tax is based on source and, to a limited degree, remittance. However, except in a very limited manner, the remittance jurisdiction does not apply to resident individuals. ¹⁴ The source of employment income is determined by where the employment is exercised, and not simply by where the employment duties are performed. ¹⁵]	To qualify, a person must spend a minimum of 90 days outside Singapore for business purposes pursuant to his or her employment in the year of assessment and have a minimum employment income of S\$160,000. In addition, where the tax on the apportioned income is below 10% of the person's total Singapore employment income, the person must pay a tax rate of 10% on his or her total Singapore employment income. A one-time election, using a special form, must be submitted to the IRAS on an annual basis no later than 15 April in each Year of Assessment	The incentive ceases after 5 years

Given the popularity of these regimes, what prompted the surveyed countries to adopt them? Table 2 answers this question. As will become apparent two broad rationales are generally advanced when introducing tax incentives to promote migration of skilled workers – to remove taxation barriers for migration decisions and to attract and/or retain skilled workers.

¹² Income Tax Act 2007 (New Zealand), CW 27 and HR 8. The rules came into effect on 1 April 2006 and were enacted by the Taxation (Depreciation, Payment Due Dates Alignment, FBT and Miscellaneous Provisions) Act 2006. See generally, www.ird.govt.nz/yoursituation-nonres/move-nz/temp-tax-empt-foreign-inc.html (accessed 18 February 2013).

¹³ Income Tax Act (Cap 134, 2008 Rev Ed) ('ITA'), s 13N. The rules came into effect in the Year of Assessment 2003. See generally, IRAS Circular, 'Not Ordinarily Resident Scheme' (7 July 2008) (updated on 29 August 2008), at www.overseasingaporean.sg/userfiles/blog/files/NOR%20Circular_07_07_08%20.pdf (accessed 18 February 2013).

¹⁴ ITA, s 13(7A).

¹⁵ See Pok, Ng and Timms (Eds), *The Law and Practice of Singapore Income Tax* (Singapore: LexisNexis, 2011), chap 19.

TABLE 2

Australia ¹⁶	China	Denmark	Israel	New Zealand	Singapore
To attract internationally mobile skilled labour, and to ease the cost pressures for Australian business of employing skilled foreign workers ¹⁷ ¹⁸	To distinguish between ordinary residents and non-permanent or short-term residents. China's rules are similar in concept to those of Japan. ¹⁹ The tax policies underpinning China's rules emanated from the 1980s and were designed to complement China's numerous tax incentives to increase foreign direct investment. They were thus intended to attract skilled expatriates, experts and scholars to work in China and are not represented by China to be a labour migration incentive, even though they should have some incentive effect ²⁰	To strengthen the competitiveness of Danish companies and research institutions by facilitating research and product development. The incentive also addressed concerns about the high costs borne by Danish companies and research institutions of employing researchers and skilled professional staff ²¹	Essentially this is an immigration policy aimed specifically to increase the number of people who choose to return or to come and live in Israel. The reform is described by the Ministry of Finance as "one more benefit the Ministry of Immigrant Absorption initiated for Israel's 60th anniversary, all intended to ease the return of Israelis living abroad and the absorption of new immigrants." ²²	To help New Zealand businesses recruit highly skilled individuals from overseas, resulting in positive effects for the New Zealand economy. ²³ This incentive also addressed concerns that had been expressed relating to the additional costs borne by New Zealand businesses in recruiting overseas talent by virtue of New Zealand's wide jurisdiction to tax foreign income earned by all residents	To attract talent to relocate to Singapore ²⁴

¹⁶The temporary resident tax incentive was based on recommendation 22.18 of the *Review of Business Taxation* (known as the Ralph Review, 1999) that, inter alia, considered what reforms should be made to Australia's international tax regime: see www.rbt.treasury.gov.au/ (accessed 18 February 2013).

¹⁷ Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No 1) Bill 2006 (Cth).

¹⁸ Australian Government, Budget Paper No 1: Budget Strategy and Outlook 2005-06 (2005) 'Part 1: Fiscal Outlook and Budget Priorities', pp 1-15: see www.budget.gov.au/2005-06/bp1/html/bst1-05.htm (accessed 18 February 2013). Some highly paid expatriates, prior to relocation overseas, negotiate so-called 'equalisation' payments as part of their Australian remuneration package (so that they are no worse off in tax terms by becoming an Australian tax resident). This was considered an added cost to Australian business which may make it more expensive to recruit and retain skilled foreign workers.

¹⁹ See <http://www.nta.go.jp/tetsuzuki/shinkoku/shotoku/tebiki2011/pdf/43.pdf> (accessed 18 February 2013). Specifically, a non-permanent resident is one who meets the normal residence test but is not a Japanese national and has not maintained a residence in Japan for an aggregate of 5 years during a 10 year period. A non-permanent resident is taxed only on domestic source income and foreign-source income which is remitted to Japan.

²⁰ The author is grateful to Professor Cui Wei, China University of Political Science and Law for this comparison and to Dr Ren Linghui, Ernst & Young Tax Services Ltd (Hong Kong) for placing this 'incentive' in its historical perspective.

²¹ See www.eatlp.org/uploads/Members/Denmark02.pdf (accessed 18 February 2013), sourcing material from the SKAT homepage; see further, *OECD Tax Policy Study* (2011), n 1 above, p 132.

²² See <http://www.gov.il/FirstGov/TopNavEng/PageReturnHomeEng> (accessed 18 February 2013).

In addition to the publicly stated reasons explaining why each of these countries enacted tax incentive regimes to attract skilled labour, other rationales should not be discounted. These include tax competition (many other countries, including Japan,²⁵ the United Kingdom and several other European Union nations, have similar incentives to those examined) and equity considerations (reflecting the view that temporary residents should be taxed on a concessional basis since they do not obtain the same long term advantages from tax funded public spending as ordinary residents on matters such as social welfare and pension benefits).²⁶

To complete this introduction, the OECD Tax Policy Study Taxation and Employment (No 21)²⁷ has usefully summarised the arguments for introducing tax concessions to promote skilled labour migration. The following list provides an overview of why a country may wish to proceed along the tax incentive path:

- To reduce the effect of tax on the migration decisions of foreign high-skilled workers
- Increasing the attractiveness of high-tax jurisdictions as a residence and work location for high-skilled mobile workers
- Reducing the barriers to migration created by domestic tax rules, including the reach and complexity of rules for taxing foreign source income and gains
- Responding to the introduction of tax concessions in other countries
- Using the tax system to attract and retain mobile high-skilled workers (where more direct means to obtain these outcomes are not feasible) so as to:
 - capture knowledge-related spillovers
 - address skill shortages
 - derive a fiscal gain
 - complement other government policies.

²³ See <http://www.ird.govt.nz/technical-tax/legislation/2006/2006-3/2006-3-temp-exemption-from-tax/leg-2006-3-temp-exempt-tax-migrants.html> (accessed 18 February 2013). Concerns with the previous law, under which all residents were taxed on foreign source income and which was seen as a barrier to migration, were highlighted by the *Final Report of the Tax Review 2001* (see www.treasury.govt.nz/publications/reviews-consultation/taxreview2001, accessed 18 February 2013) as well as by the government discussion document, *Reducing Tax Barriers to International Recruitment to New Zealand*, released in November 2003 (see <http://taxpolicy.ird.govt.nz/sites/default/files/2003-dd-international-recruitment.pdf>, accessed 18 February 2013).

²⁴ See Pok, Ng and Timms (Eds), *The Law and Practice of Singapore Income Tax* (Singapore: LexisNexis, 2011), chap 19, p 1021.

²⁵ See n 19 above.

²⁶ See, e.g., Invest: Sweden, *Tax Relief for Foreign Employees* (Fact Sheet: Running a Business; January 2012): see www.investsweden.se/Global/Global/Downloads/Fact_Sheets/Tax-relief-for-key-foreign-employees.pdf (accessed 26 November 2012). This concern was also acknowledged in Denmark: see the comments by the Danish Minister for Taxation on Bill L 158 of 10 December 1991, cited in www.eatlp.org/uploads/Members/Denmark02.pdf (accessed 18 February 2013).

²⁷ Note 1 above, pp 131–135. At p 132 the Study notes that: “Tax Systems across the OECD have typically been designed with *immobile* permanent residents in mind.” (emphasis added).

2. ARE OCCUPATIONAL OR RESIDENCE DECISIONS REALLY RESPONSIVE TO THE TAXATION OF SKILLED LABOUR?

Published studies on this question relating to mobile highly skilled workers, who are the target of the analysis in this article, are fairly uniform in concluding that the empirical evidence available does not suggest that migration decisions are highly responsive to taxation.²⁸

However, the OECD Tax Policy Study which supports this conclusion cautions that:

“While the literature is to an extent mixed, it suggests that tax can affect migration decisions, especially for the high-skilled, but that this effect is likely to be relatively small. This is unsurprising given the number of other factors that affect the migration decision. However, as mobility continues to increase it is likely that the influence of tax on migration decisions will also increase. This poses a number of issues for tax policy.”²⁹ (emphasis added)

Other studies express similar reservations:

“More empirical research is needed to determine which [labor mobility] benchmark is most important. We do not yet know whether locational, leisure, occupational, or residence decisions are most responsive to the taxation of labor, but as labor mobility becomes more important in the global economy, the need for answers to these questions will become more pressing.”^{30 31}

In relation to domestic patterns of migration, tax elasticities may be more pronounced:³²

“Tax – along with potential for professional development and better career options – is a major influence on people’s decision to migrate. Looking specifically at tax as a motivator for migration, Richard Vedder from Ohio University has been looking at domestic migration patterns within the US. Vedder has found indications that Americans by and large choose to migrate into low tax states and that this tendency has been consistent over the last 20 years.³³ Kathleen Day has also found that regional fiscal policies including taxation to some degree influences inter provincial migration in Canada.”³⁴

Finally, given the longevity of the Danish tax incentive for foreign researchers and skilled workers, initiated more than two decades ago, it is not surprising that several

²⁸ Ibid, p 11.

²⁹ Ibid, p 129.

³⁰ Mason, ‘Tax Expenditures and Global Labor Mobility’ (2009) 84 NYU Law Review 1540, p 1622.

³¹ Tangentially, the *OECD Tax Policy Study* (2011), n 1 above, p 10 also concluded that: “Empirical evidence suggests that low-income earners, single parents, second earners and older workers are relatively responsive to changes in labour income taxation, particularly at the participation margin. In addition, taxable income elasticities suggest that higher-income individuals are more responsive to taxes than middle- and lower-income workers.”

³² Ulrich, ‘Taxing Talent’ Adam Smith Institute Policy Paper (2010), available at www.adamsmith.org/sites/default/files/resources/ASI_Immigration_AW.pdf (accessed 18 February 2013).

³³ Citing Vedder, The Heartland Institute (2005).

³⁴ Citing Day, ‘Interprovincial Migration and Local Public-Goods’, (1992) 25(1) Canadian Journal of Economics-*Revue Canadienne D’Economie* 123–144.

studies have analysed its efficacy. The main conclusions reached can be summarised as follows:

- The tax incentive has increased in popularity since it was introduced – from 229 people in 1992, to more than 2,800 in 2009. Although 2,800 may seem a small figure, it is not insignificant in a labour force of 3,000,000 people.³⁵
- From these statistics, it is arguable that the tax incentive has shown that highly skilled workers are responsive to lower taxes and that it is a viable way to attract qualified people to Denmark.
- However, it is important to appreciate that this conclusion focuses upon the short term – since it reflects figures based on attracting highly skilled workers, but ignores statistics on permanently retaining them. Indeed, only 50 qualified workers chose the longer, higher tax, five year option under the Danish scheme, which would more likely lead to long-term residency. [Note: as indicated in Table 2 and note 9 above, from 2008 to 2011 a qualified person could choose to be taxed at the standard incentive rate of 25% for 36 months or a higher rate of 33% for 60 months]. These statistics show that the incentive seemingly has not been effective in retaining highly qualified workers in Denmark.³⁶
- On the basis of a study using population wide Danish administrative tax data, the tax incentive doubled the number of highly paid foreigners in Denmark relative to slightly less paid ineligible foreigners. These statistics show a very large elasticity of migration with respect to after tax earnings. The study also showed evidence of sharp bunching of durations of stay at the pre-2012 three-year limit before the incentive expired (compare note 36 above and related text). This illustrates a significant but quantitatively small intensive duration response.³⁷

To summarise, the thrust of these studies, particularly the more recent ones, and the cautions expressed therein, reveal clear tensions relevant to enacting and evaluating tax incentives to attract the migration of highly skilled workers. Although most deny that labour migration is significantly influenced by tax considerations, it appears that the full ramifications of the increasing mobility of skilled labour and its responsiveness to tax incentives may not be fully appreciated. In today's more fluid economic and social environments, there is an arguable case that tax incentives targeted at attracting migration of mobile skilled workers is worthy of consideration and analysis.³⁸ Indeed, as indicated above, it is no coincidence that this path has been

³⁵ Note 32 above, citing Danish Treasury Department, 18-5-2009, SKAT.dk.

³⁶ Ibid, citing C.K. Jessen, (21-7-2010), www.business.dk.

³⁷ See Kleven, Landais, Saez and Schultz, 'Taxation and International Migration of Top Earners: Evidence from the Foreigner Tax Scheme in Denmark' (Draft, November 2011), p 1, available at http://ceg.berkeley.edu/visitors_31_4127414159.pdf (accessed 18 February 2013).

³⁸ A survey carried out by KPMG, *Tax, Demographics and Corporate Location* (March 2009) supports this conclusion. The survey involved 260 senior human resources managers from 11 countries and was intended to test the views of business on the desirability and practicability of greater labour mobility, as well as the role that governments should play in influencing the movement of labour. Respondents were virtually unanimous in the view that the greatest barrier to employing more foreign workers is restrictions on immigration. However, 79% of respondents also supported government action being taken to remove fiscal barriers for individual employees and their employers, particularly in relation to

taken by several countries (including those surveyed in this article), particularly those imposing higher than average effective tax rates on employment income and high and/or complex taxation on foreign source income.³⁹ The question remains, however, whether this is the best policy response and how can we evaluate it?

3. A CRITIQUE OF TAX INCENTIVES TO ATTRACT MIGRATION OF SKILLED LABOUR

If, as seems to be well accepted, (1) a highly skilled workforce adds real value to a country's economy, (2) countries' responses to labour shortages will change as labour becomes increasingly mobile, (3) tax incentives to promote migration of skilled labour are increasing and (4) as a practical reality, countries will not simply refrain from enacting those incentives, a crucial question must be considered, namely, what design features should be incorporated into the incentive so as to best promote its objective? Before answering this question, we must first set out an appropriate framework to critique and justify such incentives.

To provide background for this analysis, the OECD Tax Policy Studies: Taxation and Employment (No 21)⁴⁰ has summarised the arguments against introducing tax incentives to attract labour migration. They are as follows:

- Incentives may not be necessary due to an already highly attractive labour market
- Incentives may not work, e.g. because of limited labour mobility or tax concession design difficulties
- Even if they do work, there may be other more efficient policy measures available
- Incentives may not be justifiable on broader equity grounds, since they discriminate against resident workers with similar skills
- Scheme design can become complex due to the need to target the incentive by reference to a particular policy goal. This may lead to possible uncertainty and impose substantial compliance and administrative costs relative to the potential benefits sought.

In addition, the main argument advanced against Denmark's researcher tax incentive scheme bears repetition – namely, the available evidence supports the conclusion that whilst this incentive encourages highly skilled workers to locate in Denmark, it does not encourage them to permanently remain there.

Confining our analysis initially to a critique of 'tax incentives', there is a deep and rich literature on their use and efficacy to attract foreign direct investment (FDI).⁴¹

the cross-border portability and harmonisation of the tax treatment of pension schemes. 70% were even prepared to support harmonised personal income tax rates, to reduce what they considered to be arbitrage distorting labour markets, especially in the Asia-Pacific region.

³⁹See *OECD Tax Policy Study* (2011), n 1 above, pp 10, 12 and 44. See also, Kleven, Landais, Saez and Schultz, n 37 above, who conclude that tax incentives for highly paid workers could generate very harmful tax competition in European countries.

⁴⁰ *Ibid*, pp 135–137.

However, comparatively little attention has been paid to evaluating tax incentives designed to encourage migration of skilled labour.⁴² As indicated above, it is necessary to establish a framework to perform this task with a view to ultimately determining how the policy goals sought to be met by such tax incentives can best be attained. A classic framework involves an examination of their effectiveness, efficiency (cost), fairness and transparency. In addition, the utility of tax incentives needs to be understood in the context of the prevailing historical, social and economic circumstances of the country providing them.

(a) Tax Holidays

Table 1 above shows that all the surveyed countries except Denmark provide tax holidays (exemptions) to qualified taxpayers, albeit for foreign source income only. At face value, this seems troublesome since, at least in the FDI context, tax holidays have been widely criticised as being the least effective and efficient form of tax incentive.⁴³ In that context, tax holidays have been described as serving no specific purpose and for being unfocused.

In the context of our current study, the major pitfalls of tax exemptions are: they result in revenue loss that cannot be predicted in advance; the costs are not directly related to the benefits that are envisaged will accrue to the country granting the incentive; studies do not appear to have distinguished which segments of the skilled labour force are more responsive to tax incentives than others; and they are rarely effective in retaining skilled workers on a more permanent basis. In addition, a tax exemption discriminates against domestic workers having the same skills, thus highlighting the potential for negative unforeseen consequences. Adopting this analysis, a tax exemption appears hard to justify and should be evaluated with circumspection.

(b) Reduced Tax Rate

By and large, the criticisms directed at tax holidays also apply to the reduced tax rate provided by Denmark (the remaining country surveyed in Table 1) for relevant domestic employment income, although instinctively one may be tempted to conclude that from a tax policy perspective a tax reduction for a limited period of time is not as egregious as a tax holiday.

(c) General Comments

Notwithstanding the criticisms above, if a country's policy goal is to attract migration of highly skilled workers on a short-term basis *and* the incentive chosen is finely focused upon those segments of the skilled workforce that are more highly mobile and responsive to the level of taxation on their income, the empirical studies discussed in Part II above show that an incentive can be effective in promoting (although not

⁴¹The seminal work of Alex Easson, *Tax Incentives for Foreign Direct Investment* (The Hague: Kluwer Law International, 2003) and the OECD, *Checklist for Foreign Direct Investment Policies* (Paris: OECD, 2003) provide an excellent starting point for researching this area.

⁴²The framework for the following analysis first appeared in Cockfield (Ed), *Globalization and Its Tax Discontents* (Toronto: University of Toronto Press, 2010), chap 3, Halkyard and Ren, 'Evaluating China's Tax Incentives for Foreign Direct Investment: An Eassonian Analysis'. The analysis contained in this article is comparative in nature and deals solely with tax incentives to encourage migration of skilled labour; the earlier work dealt solely with the corporate tax incentive regimes in China.

⁴³Easson, n 41 above, pp 140–141.

necessarily retaining) this goal. Furthermore, subject to the comments below relating to evaluating the cost of enacting an incentive, the ancillary benefits flowing to a country from the influx of skilled labour should not be insignificant.

However, this argument begs the question of whether a tax incentive is the most effective, efficient (in terms of a cost-benefit analysis), fair and transparent means of pursuing the economic goal of a country to develop a skilled labour force? At this juncture two matters could be noted. First, just because the tax system can be used to treat a perceived problem does not mean that it should be so used. Second, as a general matter a market failure (the shortage of skilled labour) may be better handled by addressing that failure directly rather than indirectly through the tax system.

Furthermore, even if we confine our analysis to taxation options,⁴⁴ would enhanced deductions for employing skilled workers or tax credits for employers developing employee work skills be a preferable way to meet the policy goal? In terms of tax policy generally and tax incentive design specifically, and bearing in mind what activity is being incentivised and the issues of equity which arise if only limited areas of economic activity would benefit from the availability of enhanced deductions or tax credits, the answer is probably 'no'. Yet this is only one of many questions that could be put. And, as indicated in the previous paragraph, the analysis does not adequately address systemic concerns expressed in many countries (particularly developing countries) by skilled workers and their employers – for instance, would it not be preferable to tackle problems of skills shortage by improving overall education standards, economic wellbeing, environmental quality and quality of life for workers and their families?

The real difficulty with the analyses attempted above, and with a country's decision to grant tax incentives to attract migration of skilled labour in the first place, is that it simply has not been proven that they produce the best result. Indeed, there does not seem to have been a thorough debate or empirical study on this issue. Although it might be countered that tax incentives in this area create a modestly incentivised tax environment which is justifiable from a tax policy perspective, the fact remains that Part II above indicates that there is a paucity of hard evidence to show that the activities targeted for tax exemptions and reductions are those which are particularly, as distinct from generally, sensitive to taxation (in the sense that they focus upon attracting skilled labour which would not migrate without the chosen tax incentive).⁴⁵ Without such evidence, how can we confidently answer the question that the tax

⁴⁴See further, Jogarajan, 'Bring them Home – The Case for Tax Concessions for Returning Australians' (2006) 16(1) Revenue Law Journal 1, pp 17–18 who argues that the main alternative to tax concessions for skilled labour migration, namely a direct subsidy, grant or provision of services (such as housing), is not justifiable and is thus not a "substitutable tax expenditure". The author recognises however that such a conclusion should not preclude us from considering generally whether using direct methods of support and assistance (as distinct from a tax incentive), including migration regulation and a focused public spending program on education, may better meet a country's desire to address shortages of skilled labour.

⁴⁵The *OECD Tax Policy Study* (2011), n 1 above, p 10 puts it thus: "The variation in empirical estimates [relating to the responsiveness of workers to income tax changes] highlights the need for tax policy makers to be aware of the groups likely to be affected by a tax change, and their likely response to the change, in order to understand the overall impact of the reform on employment, tax revenue and the income distribution."

incentive chosen is the most effective option for a country to attract highly skilled labour of the type it wishes to increase?⁴⁶

Even if the answer to this question is assumed, or answered positively, we must proceed to examine whether the incentive chosen is the most efficient (least costly) and whether, and to what extent, considerations of equity and fairness between taxpayers⁴⁷ and the community interest and transparency indicate any contrary conclusion.

At the risk of repetition, it would be remiss not to acknowledge the difficulties and limitations faced in evaluating the tax incentive regimes set out in Table 1. In short, there are major problems in obtaining relevant data that could provide a statistical and empirical basis to support a typical tax incentive analysis. Specifically, as illustrated by Part II above, the surveys relating to the influence of taxation upon migration of skilled labour (effectiveness) in today's environment are not comprehensive and in many ways are incomplete and outdated. Moreover, the cost of the incentive (efficiency) seems difficult to estimate with any degree of confidence.⁴⁸ And, as shown by Israel's experience in Table 2, the social and economic conditions influencing the introduction of a tax incentive (reflecting the government's desire to encourage immigration and Israelis to return) may itself provide the justification for a country to proceed in this way, regardless perhaps of tax incentive policy considerations.

Criticism may sometimes be directed at countries for being complacent and not reacting quickly enough in terms of granting tax incentives to encourage skilled labour migration, particularly given the continuing level of tax competition worldwide. This article does not tackle this argument directly, but instead cautions that a country should be wary in changing its tax policy on incentives by introducing what many commentators would view as 'yet another tax expenditure'. Notwithstanding an environment of arguably increasing tax competition to attract skilled labour, many countries have not sought to shape their economic development by relying upon tax incentives. And, in this regard, it is by no means clear that the economies of these countries have suffered by not going down the tax incentive path.

⁴⁶Interestingly, the most comprehensive of the policy papers published, the *OECD Tax Policy Study* (2011), n 1 above, p 139, concludes that where countries enact a broad tax incentive which is not dependent upon the worker having a narrowly legislated skill set (such as the temporary tax exemption for qualified persons on foreign source income in Australia and New Zealand) it can be expected that the take-up (effectiveness) will be more substantial.

⁴⁷See Jogarajan, n 44 above, p 20, who argues that a tax concession exempting for a limited period foreign source income of skilled workers returning to their country of origin would not be perceived in the same light as reducing their tax liability on domestic source income (which the author considers would be unfair).

⁴⁸For instance, both Australia and New Zealand treat their respective temporary resident tax incentive provisions as "tax expenditures" for the purpose of their tax expenditure budgets. In Australia, the cost thereof was estimated at A\$45 million for each of the years 2011/12 and 2012/13, but the reliability of these figures was acknowledged as "low": see *Australia Tax Expenditure Statement 2011*, available at www.treasury.gov.au/PublicationsAndMedia/Publications/2012/Tax-Expenditures-Statement-2011/TES/Tax-Expenditures (accessed 18 February 2013). In New Zealand, the amount of the expenditure was "not quantified": see *New Zealand – Tax Expenditure Statement 2011*, available at www.treasury.govt.nz/budget/2011/taxexpenditure/b11-taxexpstmt.pdf (accessed 18 February 2013).

What does seem clear in this context is that, whether tax incentives are introduced or not in response to the increasing calls for them, the debate should not be focused upon doomsday stories from self-interested parties. Rather, to the extent that tax incentive analysis is engaged, this debate should not be divorced from benchmarking the policy goals sought to be achieved with considerations of effectiveness, efficiency, fairness, clarity and transparency – concepts which have been the subject of numerous policy and empirical studies, albeit in other fields. It is the desirability for a measured and principled approach to granting tax incentives which this article advocates.

(d) A Different Analysis Focusing Upon Tax Residence

What often seems lacking in tax incentives analysis is a detailed consideration of the role they play within the context of a country's income taxation system as a whole – and this leads us to another way to analyse 'tax incentives' to attract migration of highly skilled labour. Rather than evaluate them by reference to the classic benchmarks generally applied to tax incentives, a more satisfying justification for their existence is to consider such provisions as reflecting a key element of most tax systems (including most of those surveyed in Part I above) – whereby non-residents are taxed on a different basis (tax on domestic source income only) to residents (tax on a worldwide basis).

If one accepts that these provisions are often designed to remove taxation barriers for highly skilled workers to migrate by exempting foreign source income for a relatively short period of time (a conclusion supported by Table 2 above, with the possible exception of Denmark), then it might be argued that they only benefit workers who in a more perfect tax world should be treated as non-residents. In the absence of such provisions, an individual normally becomes subject to worldwide taxation in the host country simply by staying in that country for a fairly limited period of time. After satisfying what is typically a low threshold (which, depending on individual facts and circumstances, may be evidenced by physical presence of much less than 183 days in any year), that person becomes a tax resident, at a very minimum for that year, regardless of (1) the total time she actually remains in the country and (2) the extent to which she benefits from the tax-funded public spending available to the long-term or 'domiciled' resident. Accordingly, in the case of skilled mobile workers these provisions may best be viewed, not as tax expenditures, but as curing the failure whereby most countries adopt an over-embracing concept as to when an individual becomes a tax resident.

4. DESIGN ANALYSIS

To paraphrase Alex Easson, albeit in a different context, there is a disconnect between conventional thinking that casts doubt on the efficacy of tax incentives (which is reflected in Parts II and III of this article) and the reality in many countries where they are extensively adopted.⁴⁹ Accordingly, notwithstanding the criticisms, doubts and queries raised above, it is unrealistic to expect the wholesale abolition of the tax incentives similar to those detailed in Table 1. Indeed, some will argue that properly designed incentives can be simpler and more cost-effective than the alternative that might be advocated – a direct spending program involving grants to encourage such

⁴⁹ Easson, n 41 above, Preface and p 12; and, to underline this point in the present context, see n 1 above.

migration or increased public expenditure on education and quality of life for a country's residents.

In this Part, we will consider the design of the types of incentives surveyed in Table 1 above in order to see whether they match the goals sought to be achieved. It is also necessary to appreciate the role that good administration plays in their realisation, for lack of transparency and certainty ultimately comes at a cost.

- The policy goal sought to be achieved must clearly inform the type of tax incentive adopted.
 - If the main goal is to address perceived tax barriers to migration of skilled labour generally (e.g., a country having a worldwide tax system which is complex and / or has high rates of personal tax), then a tax exemption for foreign source non-employment related income and gains seems appropriate (all countries surveyed except Denmark took this approach). In this case the skill requirements targeted by the incentive may be (but often are not) fairly general and can be controlled through rules regulating immigration (as in Australia, New Zealand and Singapore). In this regard, the tax exemption is a critical design feature since, notwithstanding the traditional arguments directed against tax holidays, it provides the best justification for taxing migrating skilled workers differently from the longer-term resident during the period when it all too easy under modern tax systems for such a person to be treated as a resident taxpayer and thus typically taxed on a worldwide basis.
 - However, if the goal is to address market failure by seeking to fill skill shortages in certain identified industries, then a reduction of tax on labour income (as in Denmark and arguably China⁵⁰) may be considered. In this case, to the extent achievable, analyses should be undertaken showing that the tax incentive proposed will be effective, efficient and provide overall benefit to the host country (bearing in mind, however, the very difficult problems of undertaking such assessments, as illustrated by Part III). The skill requirements need to be very carefully targeted and restricted in their application to promote the type of skilled labour sought to be encouraged and focused upon the most mobile forms of skilled labour required.
- The incentive should be drafted in sufficient detail and clarity so that there is no doubt as to who will benefit, what that benefit will consist of, and how it is calculated (all countries surveyed seem to satisfy this requirement).
- Ideally, the exercise of discretion to determine whether a person qualifies for the incentive should be kept to a minimum (all countries surveyed seem to

⁵⁰China has a higher tax free threshold (which takes the form of a standard monthly deduction) for expatriates than for nationals: see n 4 above.

satisfy this requirement).⁵¹ Any lack of transparency would doubtless affect the efficacy of the incentive.

- The incentive should be of a limited duration (all countries surveyed except China) and expire after a period when there is no doubt that the beneficiary is both legally and substantively a tax ‘resident’ of the host country. A time limitation also reduces the cost of the incentive and allays equity concerns.
- Although a case can be made for minimum income threshold before the incentive applies (as is the case in Denmark),⁵² selectivity should not depend upon levels of income and marginal tax rates but rather upon the types of skills sought.
- It does not seem necessary to restrict the incentive to non-citizens (as is the case in Australia), provided the intended beneficiary has not been a tax resident for a minimum number of (say) five years. This would particularly be the case where a country wished to retain skilled workers and wanted to avoid providing a ‘free’ incentive for those citizens who would return in the normal course, after a short-term stay abroad (as is the case in Denmark, New Zealand and Singapore).
- Finally, the incentive should be periodically reviewed to see whether its continued existence is justifiable (changes to the relevant incentive have, since their inception, been made in Australia, Denmark and Australia, as well as Israel). By way of contrast, China’s tax incentives in this area are long outdated since many expatriates now coming and staying are not necessarily those that the Chinese government initially wanted to attract (foreign experts and highly skilled workers). Those benefitting from the incentive now include many short-term residents staying in China for non-skilled work.⁵³

5. CONCLUSIONS

This article has analysed the tax incentive regimes adopted by various countries to attract migration of skilled labour. In each case the incentive chosen sought to address perceived tax barriers to such migration or cure market failure indicated by skilled labour shortages in specific industries (Part I). However, applying a classic tax incentive analysis to the regimes enacted in those countries, the question whether this response is the most appropriate appears highly contentious. Specifically, we have seen that limited data is available to show whether the incentives adopted are effective

⁵¹It is apparent that, at least at face value, the terms of many of the incentives surveyed in Table 1 are sufficiently clear and detailed and do not rely upon the exercise of discretion before they can be availed of. Generally speaking, those incentives appear to be appropriately selective to match the policy goals set for them in Table 2. All these matters produce a healthy result from a tax policy perspective, since certainty, transparency and accountability in administering tax incentives is necessary to maintain the integrity of the taxation system. This is important, since it does not appear to be in anyone’s interest to instigate another round of tax competition or, to use Alex Easson’s analogy, escalate a “race to the bottom”.

⁵²Compare Jogarajan, n 44 above, p 22.

⁵³See n 20 and related text. It is understood that suggestions have been made to remove this ‘tax incentive’ from China’s Individual Income Tax Law and to treat expatriates on the same basis as Chinese nationals, but China’s State Administration of Taxation has not decided whether to propose this to the Standing Committee of the National People’s Congress.

(Part II) and, in terms of cost, efficient; and they are clearly inequitable since they are not available to domestic workers who possess the same skills as those who do benefit. It is clear that the difficulties in applying such an analysis abound and cannot be lightly dismissed (Part III).

Nonetheless, tax incentives directed at promoting the migration of skilled labour show no signs of abating and, as unfortunate as some may consider this to be, this trend may be pragmatically justified by an increasingly competitive global market for skilled workers and the appreciation that there is much still to learn about the impact of taxation upon the elasticities of labour migration (Part II). Notwithstanding the criticisms directed at tax incentives in this area, it would be foolish to think they will disappear.

In the event, our focus turned to design issues (Part IV) so as to best ensure that the incentive adopted by a particular country is the most effective, efficient and equitable tax response to combat the skills shortages identified. All the countries surveyed remind us that design must be dictated by the goals sought to be achieved; that the political and social circumstances of a country may trump all other factors (Israel); that economic factors, including skills shortages resulting from market failure and the barriers that a domestic tax system poses to the migration of skilled labour, informs not only the existence of the incentive but also the form it takes (contrast the experience of Denmark with that of Australia, New Zealand and Singapore); and that each incentive should be reviewed periodically to revalidate its continued operation (which has not been the case in China).

Rather than evaluate tax concessions to attract the migration of skilled labour by reference to the benchmarks classically applied to tax incentives, Part III also shows that a more satisfying justification for their existence is to consider such provisions as reflecting the need to cure the failure whereby many countries adopt an over-embracing concept as to when an individual becomes a tax resident. Such an approach best validates the stance taken by all the countries surveyed (except Denmark) whereby foreign source non-employment income and gains of the skilled worker is generally exempted for a limited period of time, upon the expiry of which the relevant person under virtually every tax system would become a resident of the country providing the 'incentive'.

As we have seen, special measures designed to encourage migration of skilled labour are contained in tax expenditure budgets of various countries (including Australia and New Zealand)⁵⁴. They are usually called "concessions". But perhaps they are not concessions at all. Rather, they are the norm and the real problem is not one of concessionary treatment but of over-taxation in countries that have not enacted such rules. In other words, they are only concessions because they deviate from the rules applied to 'normal' residents and, as explained in Part III (d), skilled workers to whom they apply may become tax residents in a host country virtually immediately upon arrival. The definition of a tax "resident" was developed a century ago before the days of labour mobility. It is thus arguable that the baseline rule for tax residence is the problem and that special rules for temporary residents might be the correct rule, not a concessional rule, for temporary residents. If we assume that the logic of taxing on a residence basis remains compelling, we should then ask whether the definition of

⁵⁴ See n 48 above.

resident developed in a very different era makes sense today or whether it is more logical to refine the definition for today's world.

Finally, the theme of this article illustrates the broader problem that global taxation of personal services income is far from perfect. In addition to widely held concerns regarding the threshold and criteria for tax residence of an individual, the difficulty in distinguishing between dependent and independent services and why these are taxed differently, and why under double tax treaty agreements (DTAs) employees are treated differently from directors and sportsmen and artistes are treated differently still, clearly show the necessity for reform both domestically and under DTAs. Given that service provision is increasingly important in our world economy, it seems a shame to end with the observation that in many ways taxation of personal services income is confusing – but it is a mess⁵⁵ and, notwithstanding the difficulty, it is important to clean it up.

⁵⁵The author gratefully acknowledges the analogy provided by Brian Arnold, 'The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess' (2011) *Bulletin for International Taxation* 59.