HOW TO NOTES

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Abstract:
Special economic zones (SEZs) are widely used to attract investment, promote exports, and support industrialization, yet their performance is uneven and often uncertain. This How To Note reviews global experience with SEZs—their rapid expansion, diverse design, and mixed economic impact—and highlights that many operate as enclaves with limited spillovers and high fiscal costs. While generous tax incentives are common, evidence suggests they are rarely decisive drivers of investment and can lead to significant revenue losses, distortions, and opportunities for profit shifting. The note provides practical guidance for policymakers on how to design and tax SEZs effectively. It emphasizes that taxation should generally remain neutral relative to the domestic economy, with any incentives closely aligned to clear policy objectives, time-bound, and subject to regular evaluation. Priority should be given to well-designed indirect tax regimes and to cost-based investment incentives rather than profit-based tax holidays. Ultimately, the success of SEZs depends far more on fundamentals—such as infrastructure, governance, regulatory efficiency, and integration with the domestic economy—than on tax breaks alone.

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Abbreviations

CIT	corporate income tax
EPZ	export promotion zone
FDI	foreign direct investment
FTZ	free trade zone
GMT	global minimum tax
MNE	multinational enterprise
SEZ	special economic zone
VAT	value-added tax

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Introduction

Special economic zones (SEZs) are geographically delimited areas with economic regulations that differ from the rest of the jurisdiction in which they are located. SEZs offer a variety of services such as infrastructure, facilities, and utilities, as well as a range of incentives, including tax breaks, streamlined customs procedures, and light regulatory frameworks (IMF 2024a). Their main aim is to promote a conducive business environment to attract foreign and domestic investments, create jobs, promote exports, and generate positive spillovers such as skills, innovation, and technology transfers (Akinci and Crittle 2008). They can take various forms, such as specialized or diversified free zones, free trade zones (FTZs), export promotion zones (EPZs), revitalization zones, or charter cities, each designed to foster specific types of economic activity.

The popularity of SEZs has soared since the late 1980s. Traditionally established as rare trans-shipment ports on key international trade routes (for instance, Gibraltar, Hong Kong, and Singapore), SEZs now exist in almost every country (Akinci and Crittle 2008). The number of SEZs has exploded from only 79 in 1975 to over 6,000 today (UNCTAD 2023)—over 2,000 new SEZs were established globally between 1997 and 2002. Their increasing popularity can be attributed to their perceived role as a quick solution for countries seeking industrialization and economic transformation. They are viewed as tools to facilitate participation in global value chains, attract foreign direct investment (FDI), and address immediate market challenges without necessitating comprehensive structural reforms.

Despite their expansion, the benefits of SEZs are uncertain, and they come with high sunken costs. Many SEZs operate as isolated enclaves, with limited integration into the broader domestic economy, providing temporary economic gains rather than achieving sustainable growth (Akinci and Crittle 2008; Ghazanchyan, Klemm, and Zhou 2018; UNCTAD 2021). This disconnection frequently results in underperformance, particularly in regions such as sub-Saharan Africa, where SEZs have struggled to meet their objectives of attracting FDI, generating exports, and creating jobs (UNCTAD 2021). In addition, the reliance on generous tax incentives can yield short-term benefits but fails to establish long-term global competitiveness (Ndubai-Ngigi, Readhead, and Nikièma 2024).

This note discusses the tax and tariff aspects of SEZs. It reviews the experience of SEZ companies and provides practical guidance on how they should be taxed to minimize the tax revenue forgone to public finances. It also addresses the undesirable distortions that tax incentives in SEZs can create relative to the domestic economy. In many ways, taxation and tax incentives in SEZs should be subject to the same principles of policy evaluation and implementation applied to the wider economy—the difference is that they are provided to a group of firms located in small areas relative to the size of a country. They also create tax issues like those for cross-border transactions, such as transfer pricing and value-added tax (VAT) border adjustment—with the exception that they are under the laws of one country instead of two. In this sense, it is useful to read this note together with the six principles described in the Platform for Collaboration on Tax (2025), which covers the justification, design, international consideration, legislation, implementation, and evaluation. The tax administration principles and practices outlined in the IMF's how-to note on strengthening international tax administration frameworks can also be useful (Betts and others 2008).

Features and Taxation of Special Economic Zones

Number, Size, and Location

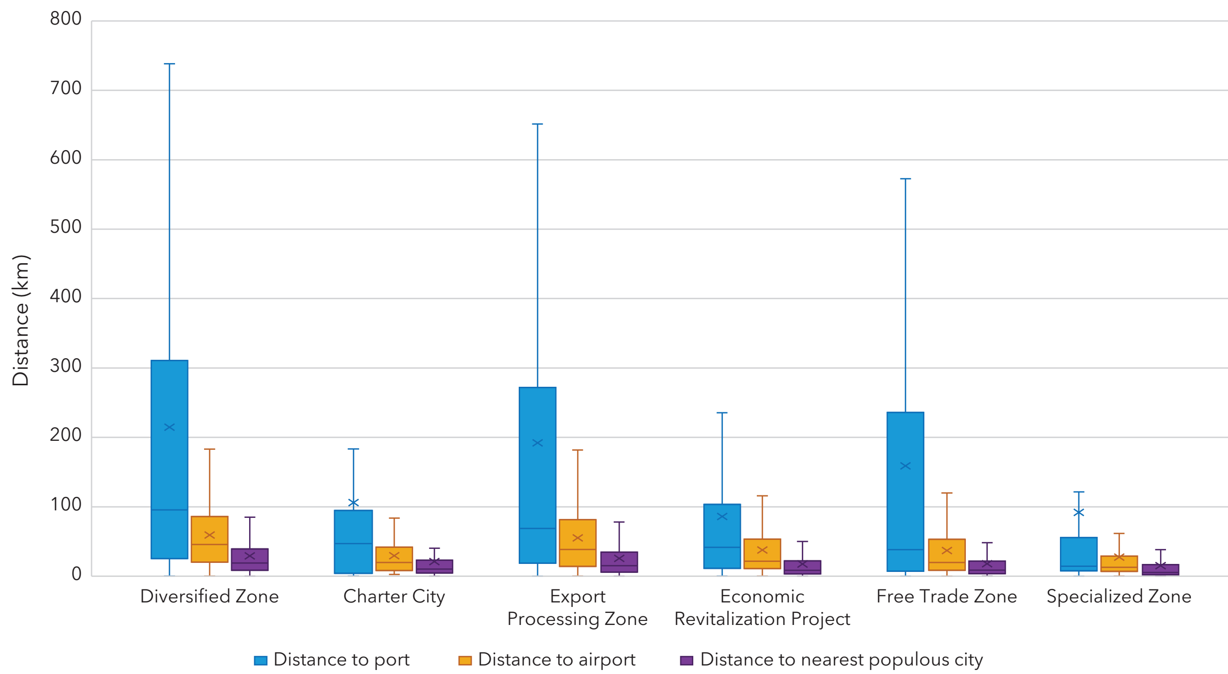
SEZs often share the common goals of attracting investment, promoting exports, creating jobs, and shielding companies, especially foreign companies, from inefficient domestic regulations. They employ different approaches to achieve these objectives. Diversified zones—large SEZs offering multiple types of incentives for firms in multiple industries—make up 31 percent of all zones worldwide. Specialized zones (SEZs offering direct and indirect tax incentives for a certain industry), EPZs focusing on trade tax incentives seeking to promote exports, and FTZs established to facilitate free trade together make up 64 percent of global SEZs. Lastly, economic revitalization projects, which aim to improve distressed areas through various tax incentives, and charter cities, which function as both commercial and residential districts with comprehensive incentives, account for about 5 percent of global SEZs.

The number and composition of SEZs vary considerably across and within regions. Asia and the Pacific account for the highest number of SEZs globally, approximately 66 percent of the total. The median SEZ is relatively large, with an area of 186 hectares, and is only 48 kilometers away from a port. Worldwide, SEZs greatly vary in size. The largest SEZs, such as the Sarawak Corridor of Renewable Energy and the Energy Sabah Development Corridor in Malaysia, exceed 7 million hectares. By contrast, 308 zones are no larger than 1 hectare and are primarily classified as specialized zones. This wide range demonstrates the diverse approaches countries take in establishing SEZs—and perhaps space constraints. In terms of accessibility, most SEZs are located close to key transportation hubs and labor markets, whereas some diversified zones, EPZs, and FTZs are surprisingly remote (Figure 1). Across the entire sample, 51 percent of SEZs are within 50 kilometers of ports, 66 percent are located at a similar distance from airports, and 87 percent are close to urban centers.

The Open Zone map broad classification identifies 1,305 SEZs in China and 832 in the Philippines.[1] Other countries with significant numbers are the United States (250), India (205), and Vietnam (175). Different types of SEZs are more prevalent in certain regions (Figure 2). For instance, revitalization zones are predominantly found in Europe, EPZs are most popular in sub-Saharan Africa, FTZs thrive in the Western Hemisphere and Middle East and Central Asia, and specialized zones are common in Asia and the Pacific (Adrianople Group 2021). Within regions, countries often focus on different types of SEZs: China primarily relies on diversified zones and EPZs, whereas the Philippines favors specialized zones. FTZs are popular in the United States, Saudi Arabia, and Colombia, whereas EPZs are prevalent in the Dominican Republic, Vietnam, and Thailand. Specialized zones also find traction in India and Korea, whereas economic revitalization projects are commonly seen in Egypt, France, Italy, and the United Kingdom.

1 The Open Zone Map uses a broad SEZ definition, covering geographically defined development, industrial, export-processing, free-trade, and other specialized zones, even where these are classified under different legal or administrative categories in national classification systems.

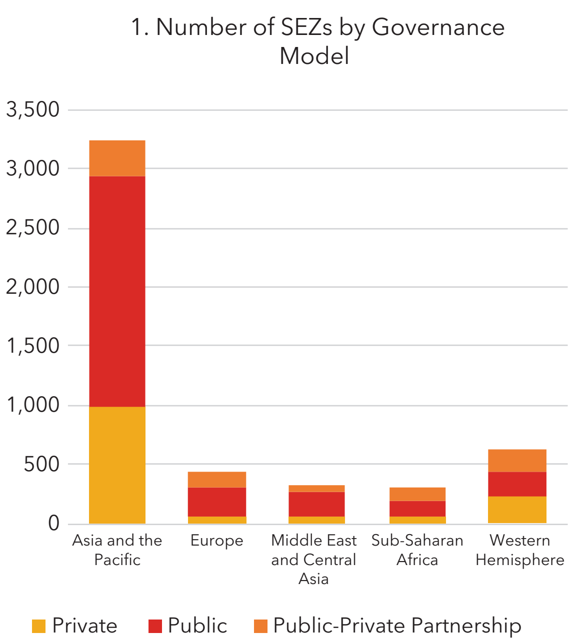
Figure 1. Special Economic Zones: Distances to Ports, Airports, and the Nearest Populous City

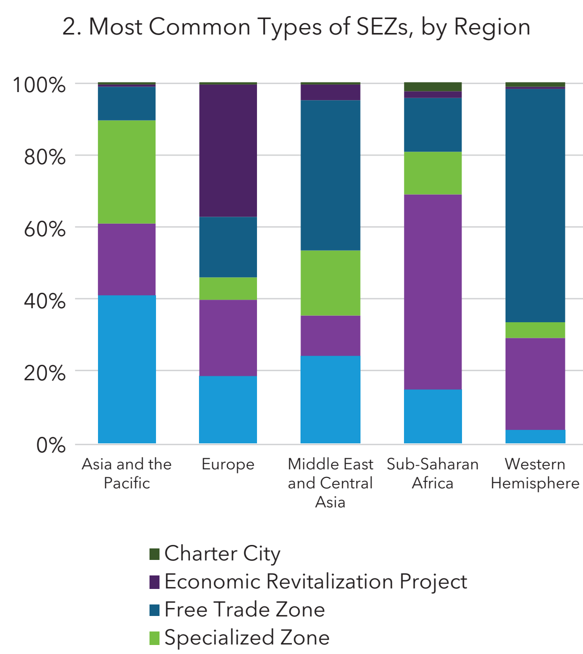


Source: Adrianople Group 2021.

Note: EPZ = Export Promotion Zone; ERP = Economic Revitalization Project; FTZ = Free Trade Zone

Figure 2. Special Economic Zones: Regional Breakdown by Type and Governance Model





Source: Adrianople Group 2021.

Note: SEZ = special economic zone.

Governance and Management

Slightly more than half of SEZs are managed by a public entity, and a similar share are in countries with a dedicated law on SEZ. SEZs can be fully controlled by the government, but they can also be developed, operated, and owned by a private corporation or through a public-private partnership. Governments increasingly rely on the private sector to construct zone facilities and manage the daily operations of zones, but they often provide tax incentives for zone developers. Approximately 44 percent of SEZs are privately owned and managed worldwide. Excluding China, Vietnam, and Korea, which have many publicly managed SEZs, this share jumps to 63 percent. Of course, even in the case of privately owned and operated SEZs, the government approves and regulates the zones. However, there are key differences between countries. Although about 51 percent of countries with SEZs have dedicated legislation governing their development and operation, others rely on broader legislation and presidential decrees that govern only certain aspects or types of SEZs. In China, legal and governance arrangements vary across different types of zones, with significant responsibilities often assigned to local governments.

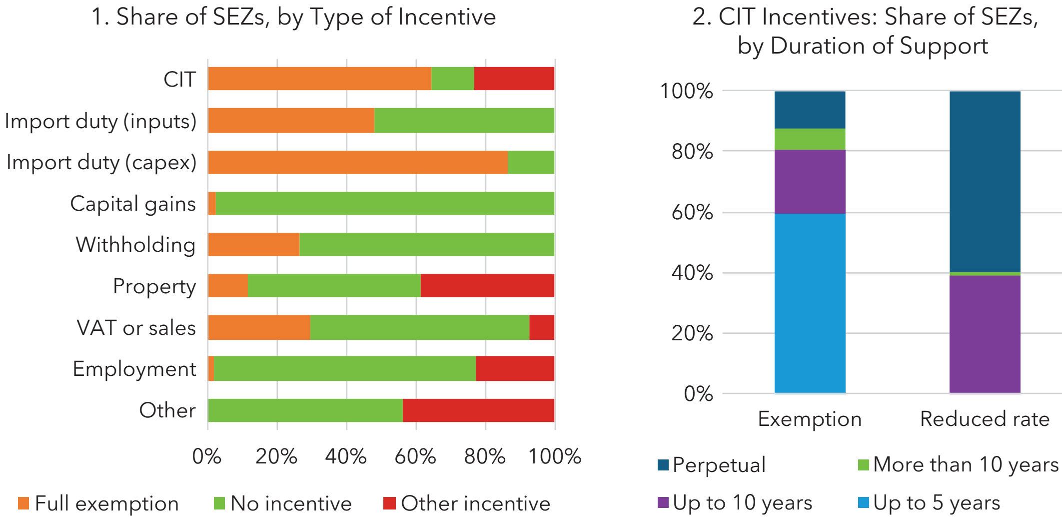
Most SEZs provide considerable regulatory relief to facilitate business operations, despite certain restrictions. Many seek to enable efficient business operations. A survey by the World Free Zone Organization (2020) found that over 70 percent of SEZs facilitate the registration of new businesses within the zone in fewer than 10 days and most provide on-site customs clearance within one day for both exports and imports. In addition, more than half of these zones have special mechanisms to protect investors and facilitate access to credit. They also impose very limited restrictions on foreign exchange operations and the repatriation of capital and profits. However, about one-third of free zones do impose restrictions on the types of legal entities that can be established (for example, only allowing certain types of business structures), and one-fourth limit the number of visas that firms can apply for to hire foreign employees (World Free Zone Organization 2020).

Common Tax Incentives

Almost all SEZs provide corporate income tax (CIT) and customs duty incentives, with some heterogeneity in their design. When analyzing individual SEZs, slightly less than two-thirds (64 percent) offer full CIT exemptions or tax holidays for all firms within the zone. By contrast, about 24 percent provide full exemptions to some firms while offering partial exemptions or reduced rates to others, leaving around 11 percent of SEZs without any CIT incentives (Figure 3, panel 1). Some offer full CIT exemptions but charge a tax on firm turnover (for example, 1 percent in Egypt, collected and kept by the zone authority). In lieu of full exemptions, some countries opt for reduced rates that are nearly equivalent to full exemptions. For example, the Aqaba SEZ in Jordan offers firms a reduced CIT rate of 5 percent, while SEZs in Belize offer rates between 0 and 8 percent, depending on employment and firm income levels. Other countries, including China, Colombia, Jamaica, and South Africa, provide reduced CIT rates ranging from 12.5 percent to 20 percent. Furthermore, nearly 90 percent of SEZs grant full customs duty exemptions for capital expenditures, although less than half extend this incentive to production inputs. However, SEZs offering only limited customs duty exemptions are concentrated in a few countries, since 90 percent of countries offer exemptions for both input and capital imports.

CIT incentives in SEZs are often time bound and have specific eligibility criteria. Although about two-thirds of countries provide full exemptions for CITs, only 11 of them offer perpetual exemptions. By contrast, 27 countries impose limits ranging from 2 to 20 years, often followed by reduced incentives (Figure 3, panel 2). Moreover, approximately 70 percent of countries offering full exemptions make these contingent on factors such as investment size, export turnover, foreign or domestic ownership, and minimum job creation. Some countries also tailor the size of their incentives to specific qualifications; for example, Türkiye offers exemptions ranging from 30 percent to 90 percent based on the size, location, and sector of the investment.

Figure 3. Tax Incentives in Special Economic Zones



Source: Competitive Industries and Innovation SEZ Database.
Note: CIT = corporate income tax; SEZ = special economic zone; VAT = value-added tax.

In Russia and Angola, exemptions range from 10 to 100 percent, contingent on factors such as job creation, export turnover, or local value added. In Russia, the full CIT exemption lasts only one year, but in Angola, it ranges from 4 to 10 years.

Other types of tax incentives offered are also heterogenous across countries. Most SEZs do not provide incentives for taxes on capital gains or dividends. Incentives are more common for employees' personal income taxes, or other employment-related taxes (such as payroll taxes), VAT, and sales taxes. Approximately 40 percent of SEZs offer outright VAT exemptions on inputs, including those from local suppliers, as well as utilities and capital goods. About 50 percent of SEZs provide property tax incentives, typically for a duration of 10–15 years rather than on a perpetual basis. About 60 percent of SEZs offer additional incentives for various other taxes, including local and municipal taxes, export taxes, transaction taxes, and stamp duties. However, the exact combination of all incentives offered in a SEZ varies considerably by country. Only one country in the sample, Nigeria, offers a 100 percent exemption from any government tax for firms in its SEZs (World Bank 2017).

The incentives provided by SEZs can result in large amounts of forgone tax revenue. It is difficult to provide overarching figures of revenue forgone because of differing benchmark tax systems between countries, different setups, varying sizes of SEZs, and the lack of transparency and publicly available data about SEZ operations. Available data show that some of the largest SEZs result in billions of US$ of revenue forgone (Redonda, von Haldenwang, and Aliu 2024). The revenue forgone from CIT deductions of export profits of firms located in Indian SEZs was estimated at $3 billion in 2022, close to 3 percent of CIT revenue for that year. In Poland, the CIT tax holiday for SEZ firms cost the government $750 million in revenue forgone (more than 6 percent of total CIT collection) in 2018.[2] Looking at other taxes, capital gain tax deferrals and exclusions for Opportunity Zone investments in the United States were estimated to result in $3.1 billion in revenue forgone in 2025. In Russia, SEZ-related tax expenditures were estimated at $74 billion or 4 percent

[2] The estimate for India is from the *Government of India Receipt Budget for 2024–25* (Table 5, page 32). The estimate for Poland is from the *Preferencje podatkowe w Polsce Nr 8* (page 133).

of GDP in 2021.[3] Since these are all yearly figures and most SEZ incentives last for multiple years, the overall cost of SEZs across time is much higher. Furthermore, the marginal cost of public funds[4] in developing countries is typically higher than that in developed countries, which makes these tax incentives particularly expensive and exacerbates fiscal constraints. This is consistent with broader evidence on industrial policies, which highlights that such interventions can entail significant fiscal costs and distortions, particularly in environments with limited administrative and fiscal capacity (EBRD 2024).

Effectiveness of Special Economic Zones

Estimating the overall contribution of SEZs to national economies is challenging. Estimates of SEZs' contributions to GDP are rarely publicly available, but when they are available, they often focus on the most successful SEZs or countries, making generalization difficult. One estimate found that major state-level zones, broadly defined, accounted for about 22 percent of China's GDP in 2007 (ADB 2015). In the Dominican Republic, SEZs represented about 7.5 percent of GDP at their peak (UNCTAD 2021). In Africa, the average SEZ hosts about 60 firms, with larger zones such as the Tanger SEZ in Morocco housing 750 firms (UNCTAD 2021). SEZs are typically populated by multinational enterprises (MNEs) that benefit from favorable conditions and incentives (ADB 2015). The World Investment Report by UNCTAD (2019) estimates that SEZs employ approximately 90–100 million people directly worldwide—less than 3 percent of worldwide employment. Using publicly available information and internal information from IMF reports, a back-of-the-envelope estimate based on a limited number of countries suggests that SEZs account for 1–3 percent of GDP on average in value added. This would imply CIT revenue forgone on the order of roughly 0.2–0.8 percent of GDP annually (assuming standard rates between 15 and 25 percent), depending on the design and generosity of incentives.

Establishing a causal relationship between SEZs and these economic figures is complex, particularly because estimating the additionality of SEZs is difficult. It can be challenging to determine whether firms are simply relocating to SEZs to take advantage of incentives or are genuinely new investments. Moreover, estimates of their contribution to GDP could be inflated by domestic profit shifting into the zone. This highlights the need for further empirical research to determine the real contribution of SEZs to national economies and their effectiveness—and more importantly, for countries to regularly monitor the cost-benefit of SEZs.

Existing empirical evidence on the effectiveness of SEZs in achieving their policy objectives is scarce, typically based on case studies, and often yielding mixed results. Most empirical research has concentrated on the most successful SEZs, raising questions about the validity of generalizing the factors behind their success, which are often tied to specific economic, social, political, and legal contexts. Moreover, cross-country data on SEZs are limited, with few empirical studies examining their effectiveness across multiple countries, usually within specific regions (Aggarwal 2005; Farole 2011; Frick and Rodriguez-Pose 2023), and even fewer adopting a global perspective—Buba and Wong (2017) being an exception. Even within a single country, establishing causality between SEZs and outcome variables is difficult. A significant concern is whether SEZs provide any additionality to the economy or merely divert resources from the broader economy into

[3] The US estimate is from Table 1 in Tax Expenditures Fiscal Year 2027, and the Russia estimate is from Table 1 in the Налоговые расходы Российской Федерации 2021–23 ("Tax Expenditures of the Russian Federation 2021–23").

[4] The marginal cost of public funds is the direct and indirect costs of raising one additional dollar of public revenue as a share of the value of private income.

the zone, thus benefiting firms within the zone at the expense of those outside, while potentially hindering necessary reforms in the wider economy.

Most of the empirical evidence of SEZs' effectiveness in attracting FDI comes from China. There, SEZs accounted for approximately 50 percent of the national FDI in 2012 (ADB 2015), supported by the fact that the country has over 1,300 SEZs. These zones have a positive effect on FDI per capita, facilitating both resource reallocation and new investments without crowding out domestic investment (Wang 2013). Cheng and Kwan (2000) found that SEZs are 4–8 times more effective than other place-based policies in attracting FDI in China, while Lu, Wang, and Zhu (2019) found that the net benefit of SEZs to the Chinese economy exceeds $5 billion annually. There are notable success stories in other countries as well. For example, SEZs in Poland have proven effective in attracting local and international investments, particularly in the automotive and high-tech sectors (Ambroziak and Hartwell 2018; Kinelski and others 2023). In addition, SEZs in The Dominican Republic, Malaysia, Mauritius, Morocco, Panama, and Vietnam, among others, have also been credited with attracting FDI, though to varying degrees (Hausmann, Obach, and Santos 2016; Duranton and Ventables 2018; UNCTAD 2021).

For most other countries, the empirical evidence indicates a more nuanced effect of SEZs on FDI, with some studies suggesting little to no effect. For example, Intel's decision to open a large manufacturing plant in Costa Rica is often seen as a transformative event for the country's economy, signaling to other firms that it is a viable investment destination (Larrain, Lopez-Calva, and Rodriguez-Clare 2000). Although the existing tax incentives under the free zone plan played a role, the key factors attracting Intel were Costa Rica's political stability, low corruption levels, credible legal institutions, and a highly educated and suitable labor force (Larrain, Lopez-Calva, and Rodriguez-Clare 2000; Monge-Gonzalez, Rosales-Tijerino, and Arce-Alpizar 2005). Labor conditions also played a role in Bangladesh, where the initial aim was to establish SEZs in the high-technology sector, but success came after shifting their focus to labor-intensive garment manufacturing, which better matched the country's labor pool (Duranton and Ventables 2018). Similarly, India's experience with SEZs is also mixed. Some evidence suggests that they have supported investment, generated regional spillovers, and contributed to structural transformation (Aggarwal 2010; Hyun and Ravi 2018; Gallé and others 2022). However, other evidence suggests that factors such as inconsistent policy frameworks, inadequate infrastructure, and governance challenges have hindered the competitiveness of Indian SEZs and limited the creation of a conducive environment necessary for sustained investment (Aggarwal 2005; Alkon 2018).

Some evidence suggests that SEZs boost exports. SEZs in some Asian countries account for significant national exports, with firms in these zones often exporting more than those outside. Notable shares of national exports from SEZs include 44 percent in China (2012), 49 percent in the Philippines (2011), 17 percent in Bangladesh (2013), and as high as 67 percent in Sri Lanka (2007) (ADB 2015). These figures are also high in some Latin American countries—around 50 percent of exports in the Dominican Republic, Costa Rica, and Nicaragua, 31 percent in Mexico, and 13 percent in Colombia (UNCTAD 2019). However, many SEZs in Africa, particularly EPZs, have struggled to achieve substantial export growth, often operating below capacity, and have been unsuccessful in reaching global markets. Countries such as Nigeria, Tanzania, and Rwanda have experienced relative success by targeting regional markets instead (Farole 2011; UNCTAD 2021). The effects of export diversification are less clear. For instance, looking at Bangladesh, India, and Sri Lanka, Aggarwal (2005) found that the degree of diversification depends on the country and sector, with some sectors benefiting more than others.

There is little evidence that SEZs generate substantial additional employment. The most successful zones at attracting investment and promoting exports typically create some jobs; however, in most cases, this employment is concentrated in the firms within the zones (UNCTAD 2021). As a result, there are minimal spillovers into surrounding regions and almost no observable effects on overall employment levels of entire countries (Ambroziak and Hartwell 2018; Frick and Rodriguez-Pose 2023). In certain instances, SEZ firms provide jobs with better labor conditions (Larrain, Lopez-Calva, and Rodriguez-Clare 2000; Hausmann, Obach, and Santos 2016) and higher wages (Wang 2013), or they employ more women than firms outside the zones (Aggarwal 2007; Brussevich 2023). However, many SEZs create very few new jobs and simply displace economic activity from other regions (Neumark and Simpson 2014; Alkon 2018) or generate low-skill positions with low wages and limited opportunities for advancement (Brussevich 2023). Furthermore, some SEZs can exacerbate existing inequalities within countries (Farole 2011) or encourage students to drop out of high school to join the labor force (Brussevich 2023).

Large SEZs, with strong governance, high-quality infrastructure, and proximity to major markets, have proven most successful in attracting FDI and promoting exports.[5] Although the ideal size of SEZs is country dependent, larger SEZs tend to attract a more diverse array of businesses and leverage agglomeration benefits, such as shared resources and labor pools (Buba and Wong 2017). Regardless of the size of SEZs, effective governance, marked by streamlined administrative processes and independence of SEZ regulators, is essential for enhancing their operational efficiency. High-quality infrastructure, including transportation, utilities, and digital connectivity, plays a pivotal role in fostering economic activity. Proximity to transport hubs, such as ports and airports, and availability of large and trained labor pools are also crucial (Akinci and Crittle 2008). Although a focus on high-tech industries can enhance economic performance in some countries, SEZs in low-tech, labor-intensive sectors have shown greater dynamism in many emerging markets (Buba and Wong 2017; Frick and Rodriguez-Pose 2023). SEZs also perform better in countries with a history of industrialization and access to major markets (UNCTAD 2021). Hence, strategic design of SEZs, with an emphasis on choosing the right location and selecting industries best matching a country's labor conditions, is key.

Integration with local supply chains is important for generating positive spillovers. SEZs that are large, located near major markets, and well connected to local supply chains are most likely to generate spillover effects and serve as engines of local economic growth. Using a global dataset of SEZs and nightlights data, Buba and Wong (2017) found that these spillovers are generally concentrated within proximity of the zones and diminish sharply beyond a 20-kilometer radius. Evidence from African SEZs also shows localized household wealth gains and improved access to services within 10–20 kilometers of zones, whereas evidence from SEZs in European and Central Asian countries points to increases in economic activity concentrated within a similar radius (EBRD 2024; Abagna, Hornok, and Mulyukova 2025). Together, these findings suggest that spillovers are highly localized and tend to decay rapidly with distance, limiting their economywide effect. In addition, SEZs with joint ventures between foreign and local firms, as well as those focused on low-tech manufacturing, generate greater spillovers since they tend to source more of their inputs and labor locally (Aggarwal 2005; Frick and Rodriguez-Pose 2023). By contrast, high-tech SEZs can provide higher-quality jobs within the zone but contribute less to indirect job creation outside of it. Such SEZs interact less with local suppliers because the latter often lack the necessary specialized capabilities. This results in low skill and technology transfers from the SEZ to the local economy (Buba and Wong 2017; Frick and Rodriguez-Pose 2023).

[5] Recent empirical results also lend support to the effectiveness of SEZs only in a wider economic context, where fiscal discipline and the quality of institutions are good in general, and not just in SEZs (IMF 2026).

Corporate tax incentives do not play a major role in SEZs' success. Despite the extensive use of tax incentives in SEZs, and outside of them, evidence shows that they are not a key factor in investment decisions (Klemm and Van Parys 2012; Buba and Wong 2017). This is particularly true in the case of SEZs that offer many other (often more desirable) benefits to investors (Frick and Rodriguez-Pose 2023). Tax incentives only play a role if they are a key differentiating factor between otherwise similarly attractive investment locations. Looking at CIT incentives broadly (not within the context of SEZs), Klemm and Van Parys (2012), for example, found that CIT holidays are effective in attracting FDI in Latin America and the Caribbean, but not in Africa. The overall investment climate was a critical factor enabling tax incentive effectiveness. Looking at tax incentives within SEZs, Buba and Wong (2017) found that they only attract investment in more advanced economies, rather than developing ones. Crucially, they also found that overly generous incentives do not make up for poor SEZ locations or facilities. Other fiscal incentives such as subsidies for infrastructure, duty exemptions on imports, and financial support for training programs can help offset operational costs but should be applied selectively to meet specific zone needs (Buba and Wong 2017).

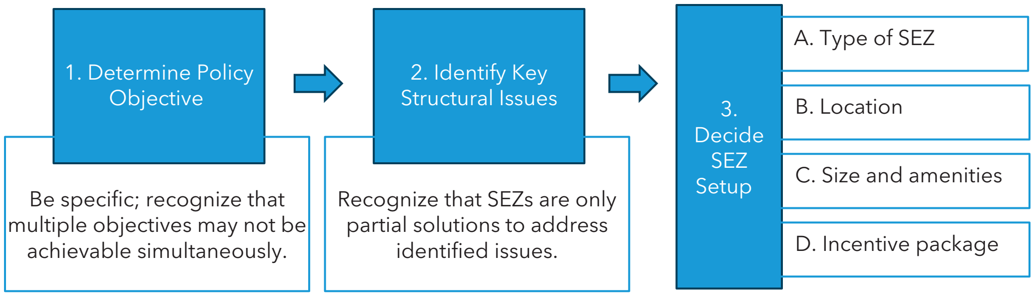
Corporate profit tax incentives will play an even smaller role moving forward because of the implications of the global minimum tax (GMT), agreed among members of the G20-OECD Inclusive Framework. As an increasing number of countries implement the GMT, requiring large MNEs to pay a minimum effective tax rate of 15 percent wherever they operate, the attractiveness of traditional tax incentives in SEZs is expected to diminish (IMF 2024a). Tax holidays and profit-based incentives will be most affected by the GMT, whereas cost-based incentives may remain relatively unaffected or become more popular because of the substance-based income exclusion rules (Ndubai-Ngigi, Readhead, and Nikièma 2024). Customs duty and indirect tax incentives are not directly affected by the GMT. Consequently, SEZs will need to enhance nonfiscal incentives, such as improving infrastructure and administrative support, to attract foreign investment. This shift presents a valuable opportunity for countries to revisit their SEZ incentive structures and assess their effectiveness in achieving desired economic outcomes. With potentially less competitive pressure to offer extensive tax incentives, countries can focus on aligning these regimes with evolving international practices.

How Should Governments Tax in Special Economic Zones?

From the tax policy perspective, the primary lesson from the earlier analysis is that unless there are compelling and tested reasons to differentiate the taxation of firms in SEZs from that in the domestic economy, neutrality relative to domestic taxation should be the guiding principle in policy design. Figure 4 broadly sets out three steps in how to structure the design of an SEZ. The first step is to decide on the type of zone to meet certain policy objectives. As described earlier, these can go from simple, such as free ports where the main purpose is transit and perhaps light assembly, to more complex structures, where the regime is not geographically limited and is intended to develop pockets of zones in the country or even whole regions. The latter are more complex from the design perspective and more likely to connect with local markets, raising both tax design and implementation issues—for instance, customs control is difficult to exercise within borders and coordination between customs and tax administration is more problematic.

Any incentives, including tax incentives, should be decided as the final step in the SEZ design process and should support the overall policy objectives of SEZs set out in step 1. For instance, if the primary objective is to promote exports, the tax part of an incentive package should include reduced (potentially to zero) tariffs

Figure 4. Step-by-Step Approach to Designing a Special Economic Zone



Source: Authors.
Note: SEZ = special economic zone.

on imported production inputs, full VAT refunds, and administrative procedures to ensure that indirect taxes on inputs have a minimal effect on a firm's cash flow or cost of finance. Conversely, if the goal is to revitalize a region within the country, the focus should be on encouraging investors to create activities in that region, which from the tax perspective implies reducing the after-tax cost of investing there relative to elsewhere in the country. Therefore, in addition to the indirect tax incentives just noted, governments may consider accelerated tax depreciation for investment located in the region or employment tax credits. Note that in both cases, the incentives, even if they contribute to the strategic objective sought, may not be cost effective and will create allocative distortions in the economy. Both export and locational incentives could come at the expense of other activities that have higher returns and effects on growth, leaving the country less well-off.

This section discusses how taxes should be designed for SEZs. It assumes that the decision to set up an SEZ is taken for a variety of reasons, and that taxation should be neutral or supportive of that decision. Annex III provides a summary of the analysis together with minimum requirements for the legal tax governance of and reporting by SEZ firms.

Indirect Taxes

In principle, indirect taxes should not be imposed on production inputs to preserve neutrality and production efficiency. This is true more generally, but it may not be feasible economy wide, especially in countries where certain indirect taxes, such as external tariffs, are still important revenue sources, and where their replacement by less inefficient taxes is not entirely possible (Baunsgaard and Keen 2010)—for instance, in sub-Saharan Africa and South Asia, where tariffs still strongly contribute to revenue, despite the wide adoption of VATs.[6] Preferential treatment of indirect taxes for SEZs is also less contentious than that of income taxes.

External Tariffs

Customs duty reductions or exemptions play a crucial role in enhancing the operational efficiency of SEZs and increasing their attractiveness to investors (Akinci and Crittle 2008), irrespective of SEZs' objectives. Countries should ensure compliance with the World Trade Organization's rules, including that tariff exemptions or remissions should be nondiscriminatory and transparent, and can only be made contingent on export if they do not exceed the amount of duty otherwise due on imported goods that are used in producing

[6] Data from the IMF's World Revenue Longitudinal Database show that trade taxes accounted for about 12 percent of the total revenue in sub-Saharan Africa and more than 10 percent in South Asia between 2017 and 2021. This is compared to about 8 percent in Latin America, about 4 percent in East Asia, and below 3 percent in other regions (IMF 2024b).

those exports. Otherwise, such measures may amount to prohibited export subsidies.[7] Furthermore, and unless they are part of a general reform of tariffs, tariff rate reductions or exemptions should be time limited, supported by clear legislative frameworks and centralized oversight, and reviewed periodically to ensure they continue to align with economic goals and deliver desired outcomes. Policymakers should recognize that customs exemptions create opportunities for tax arbitrage and fraud, and complicate compliance (Pérez Azcárraga and others 2022).

Tariff reductions or exemptions are not always useful without efficient customs procedures. Merchandise entering SEZs from elsewhere in the jurisdiction should require only a simple registration rather than a full export declaration to reduce administrative burdens, while still allowing for effective customs control further up the value chain. Merchandise leaving SEZs to the domestic economy should be taxed at a standard tariff rate and using standard valuation rules. Integrating SEZ firms into a single window can streamline customs processes electronically, allowing for all necessary documentation to be submitted through one platform. Implementing on-site customs clearance within SEZs can expedite the clearance process, reduce delays, and enhance operational efficiency (Pérez Azcárraga and others 2022). Moreover, establishing a uniform customs regime across all SEZs can minimize confusion and further reinforce their appeal for investors. To ensure compliance and operational integrity, customs and tax authorities should maintain regular oversight, conduct audits, and enforce bookkeeping and reporting requirements for all firms operating within SEZs, even for firms benefiting from tax holidays or operating in privately managed zones.

Sales and Production Taxes

Unlike external tariffs, VAT-type sales taxes are not discriminatory and are intended as taxes on consumption. SEZ firms should not be exempted from VATs as a matter of principle, irrespective of the SEZ objectives, and including transactions between SEZ firms and the domestic economy—which should be treated as exports when entering the zone, and imports when leaving the zone for the domestic market. The only relevant element for them in relation to VAT is production neutrality, which makes VAT input tax credits and refunds most important.[8] Experience shows that in many developing countries, weak refund administration erodes neutrality by creating cash-flow constraints for exporters (Pessoa and others 2021). Hence, credits and refunds in relation to imported inputs in SEZs, from other countries or from the domestic economy, can be more efficiently provided through VAT suspension mechanisms, which are subject to ex post customs verification. This alleviates SEZ firms' cash-flow constraints from outstanding VAT credits and refunds but would not confer on them an absolute tax benefit. This can be especially efficient for export-oriented SEZs that cannot sell into the domestic economy but is more difficult to enforce in other types of zones where firms operate in the domestic economy. In all cases, VAT registration should be mandatory for all SEZ firms and subject to regular filing and oversight by the tax administration.

Excises on consumption and forms of production taxes typically have nonrevenue objectives, such as reflecting in market prices the harm they inflict on individuals or the environment (Cnossen 2005). To the extent that the harm is borne by the domestic economy, such taxes should apply normally to SEZ firms. For example, domestic consumption of alcohol, sugary drinks, and tobacco produced in SEZs should be fully subject to excises, but are typically levied at the point of production or wholesale. Similarly, consumption of fuel products by producers should be subject to standard fuel excises applied in the domestic economy,

[7] Similarly, countries should avoid making incentives subject to local content requirements (for instance, to enhance SEZ integration with the local economy), as these may also amount to illegal export subsidies—as well as create economic distortions and inefficiencies.

[8] By design, SEZs may be more frequently in refund situations if their primary purpose is to produce for or serve export markets.

given that it is their use that leads to the emission of greenhouse gases and release of other toxins. If a country exempts the use of fuel from excises for competitive reasons—for instance, fuel used in the production of construction materials such as tiles and porcelain—it bears alone the entire consequences of pollution, instead of sharing it with foreign consumers. It also encourages firms located in other countries to move their pollution activities to SEZs (Farid and others 2016). As a result, the country could gain some export activities, but at the cost of potentially significant health consequences to its population in the medium to long term.

Direct Taxes

Direct taxes apply to the income derived from capital and labor. As such, they increase the required rate of return on capital and labor in various ways, depending on how cost items are treated. For example, immediate expensing, rather than gradual depreciation, of capital outlays renders the corporate tax neutral to investment decisions—the deductibility of the entire amount invested means that the firm bears no tax on such amount. The key income taxes generally deployed in most countries are the CIT on corporate profits, the personal income tax on labor income, and (in countries with dual income tax systems) separate income taxes on passive investment income of individuals.

Corporate Income Tax

As noted earlier, CIT incentives are more effective (and cost efficient) when they target capital and labor costs, rather than when they exempt or reduce profit taxation (Klemm and Van Parys 2012; IMF and others 2015; Pecho and others 2024). This result generally holds whether firms are in SEZs or outside, and whether they are foreign or domestically owned.[9] It follows that providing CIT incentives only to firms in SEZs has risks and costs to the domestic economy. For example, SEZs could become more attractive to domestic investors who are eligible directly or indirectly to locate in the zone. Such incentives also create transfer pricing and other profit-shifting opportunities between SEZ firms and domestic firms (Akinci and Crittle 2008; Farole 2011; Hausmann, Obach, and Santos 2016). Unless investment in the zone is entirely incremental, taxation would have to increase in the domestic economy to make up for revenue loss. Even if investment is incremental, the government forgoes tax revenue in the long term, since future taxation after the incentives have expired will be hard to achieve politically as expectations of renewal build up (IMF and others 2015).

The recently agreed changes to the taxation of the profits of large MNEs within the G20-OECD Inclusive Framework could make profit-based incentives even less effective. In particular, the GMT of Pillar 2 of the Inclusive Framework, under which a large number of countries agreed to apply a global effective tax rate of 15 percent on large MNEs and their subsidiaries in each tax jurisdiction, allows for expense-related incentives to lower the effective tax rate below 15 percent—but not profit-based incentives (Ndubai-Ngigi, Readhead, and Nikièma 2024).[10] This means that a source country that provides (temporary or permanent) exemptions or tax rate reductions from the CIT applicable to a large MNE could lose the revenue forgone to foreign jurisdictions allowed to impose top-up taxes, and not the MNE. Profit-based incentives could also run afoul of countries' obligations under regional agreements, such as under the European Union's State aid rules and its Code of Conduct for Business Taxation, and the World Trade Organization's prohibition of export-contingent tax subsidies. These international trends and standards offer an opportunity for countries to

[9] Foreign-owned companies may be more attracted by SEZs if their regulatory frameworks shield them from compliance with domestic regulations. In that sense, some foreign firms may be more sensitive to the incentives provided in SEZs—in general and not just tax incentives.

[10] The 2026 "side-by-side" agreement—effectively carving out the United States from the GMT by recognizing its own minimum tax as being equivalent—has expanded the scope of favorably treated "qualified" tax incentives to also include production-based incentives, albeit with a cap based on a share of local payroll and assets.

revisit their CIT and make it more investment-friendly across the board (for instance, by allowing companies to expense, rather than depreciate, some capital outlays), obviating the need for dedicated and potentially more distortionary SEZ CIT incentives.

Wage Taxes

Wage-related incentives in SEZs have shown limited effectiveness in raising wages in the zone or attracting more skilled labor to the zone. Given that the supply of low-skilled labor is rarely a constraint in countries where SEZs are used extensively, the benefit of reducing taxes on wages is likely to accrue to the companies located in the zone, rather than to individuals (Almeida, Orr, and Robalino 2014); however, individuals working in the zone would still benefit from public services and government transfers. In case of a supply constraint—say of skilled labor in digital technologies—a positive effect on wages from tax reductions in the SEZ will raise wages in the domestic economy as well and make the SEZ less competitive (OECD 2011). Country authorities must carefully study the possible implications of reducing wage taxes in SEZs, since if there are compelling reasons to adopt such a measure, it is highly likely that it should be done for both the SEZs and the domestic economy.

Dividends, Interest, Royalties, and Capital Gains

Similar to profit-related tax incentives under the CIT, exemptions or rate reductions from income tax (often withholding taxes in domestic law or tax treaties) on investment income—interest, dividends, and royalties—are costly and ineffective in attracting FDI. Such taxes represent the last chance for a country to tax income accruing (ultimately) to foreign equity and debt holders who are likely taxable in their country of residence, at the company or individual level.

Capital gains are increasingly likely to arise from the sale of know-how and other forms of movable assets. This could include, for instance, transfer of rights and licenses by MNEs that derive their value from real property in a source country. For instance, in an offshore indirect transfer, a subsidiary of an MNE located in an SEZ to exploit a local asset, such as a mining or telecommunication license, can sell such an asset (indirectly) through its parent company to another company located in a foreign jurisdiction. Capital gains derived from such a transfer of a local asset should in principle be taxed in the source country (Platform for Collaboration on Tax 2025), as the country of residence of the parent company may not include the gain in its CIT tax base. If the subsidiary is exempt from the CIT or enjoys a tax holiday, the source country could entirely forgo the capital gains tax—this is another risk of tax holidays, where even if the country wanted to tax capital gains, it may not be able to do so legally, unless capital gains are taxed separately from profits.

Property Taxes

Recurrent property taxes are an important source of revenue to finance infrastructure and services in and around SEZs. These taxes, typically related to the value of real property, its size, or a combination, have the primary purpose of funding local public services that the properties located in the SEZ benefit from—for instance, physical infrastructure, water and sanitation, streetlights, and digital infrastructure, all necessary inputs for operations in the zone. A challenge in SEZs is that real properties are not as marketable as property in general in the domestic economy, since potential buyers are limited—by the function of the zone—to companies eligible to set up in the zone. Thus, it is difficult to establish market value for the application of property taxes. A combination of book values and size is a more feasible approach. The rate can be set such that sufficient revenues are generated to fund public services and management of the zone—zone management being equivalent in this respect to community councils in the domestic economy.

In some zones, infrastructure costs are covered by fees paid by companies to the zone authority or management body (Buba and Wong 2017). This reduces the need for property taxes within the zone, but removing property taxes altogether also removes the possibility that SEZ properties contribute to financing broader infrastructure and spillover benefits in the surrounding areas. If the property tax is waived in the zone and there is no obvious source of revenue from the zone to fund public infrastructure and services in the zone, such cost will be borne by residents and businesses in the domestic economy. Not only is this inefficient, but it is also unfair (IMF 2024a).

Other Common Issues

Tax incentives in SEZs, like those provided generally in the domestic economy, should be subject to sunset clauses and mandatory evaluation. The purpose of enacting policies that deviate from the norm or a benchmark is to achieve objectives that cannot be achieved under the benchmark. It then follows that evaluating such policies against their intended objectives should be standard practice. Sunset clauses with an evaluation requirement provide visibility and accountability for policymakers and companies benefiting from tax incentives to reconsider the cost-benefit implications of tax incentives after a period of implementation. Unless incentives are designed to respond to unanticipated shocks, a period of five years usually provides a good balance between giving companies ample stability to make investment and employment decisions, and the authorities time to assess whether policy objectives have been met.

The cost of tax incentives in SEZs should be estimated annually and included in a tax expenditures report.[11] Since SEZs are clearly identified by law, tax incentives that they benefit from, either specifically in nontax laws or generally in tax laws, should be estimated and reported annually. This allows tracking the evolution of the revenue cost of SEZ incentives relative to that of tax incentives provided to companies outside SEZs. Such reporting promotes fiscal transparency and enables an informed debate about the cost-benefit of SEZs.

Maintaining tax reporting by SEZ firms to the tax and customs authorities is key for policy monitoring, evaluation, and design. Such reporting should be mandatory even when companies are exempt from taxation. The information reported on income tax and VAT returns, for instance, is valuable not only for tax purposes but also for understanding the wider economic implications of SEZs, and whether they are achieving their objectives.

Beyond fiscal considerations, SEZs also carry broader risks that should not be overlooked. A common source of concern is the mistaken perception of "extra-territoriality," which can weaken the enforcement of national laws, complicate statistical reporting, and reduce the transparency needed for sound policy evaluation (GFI 2022). Weak regulatory oversight and secrecy provisions have, in some jurisdictions, created vulnerabilities to illicit activities, including trade misreporting, sanctions circumvention, and money laundering, with some also used for high-value asset storage (GFI 2022; U.S. Department of the Treasury 2022). Moreover, SEZs that operate under looser labor, environmental, or social rules risk exacerbating negative externalities—such as undermining labor rights, contributing to environmental degradation, or reinforcing gender inequalities (Farole 2011; Cotula and Mouan 2021). Although this note primarily aimed to address taxation, policymakers should be mindful that these broader risks can undermine the credibility and long-term sustainability of SEZs.

11 Guidance on tax expenditures reporting and assessment can be found in Heady and Mansour (2019) and Beer and others (2022).

Conclusion

SEZs are used extensively around the world as tools of economic development. They differ in three key characteristics, namely, size, economic purpose, and location. SEZs are no longer oriented toward light manufacturing for exports. They cover almost the entire spectrum of economic and industrial development, from light manufacturing oriented toward exports to technological development and specialized business services.

Experience with SEZs suggests that many do not generate substantial or long-lasting benefits to economic development. However, the small number of successful SEZs has had a disproportionate effect on their popularity as a development instrument. This suggests that SEZs are not fit for all countries or for every stage of development. For developing countries, a narrow sector-focused approach to SEZs that builds on domestic comparative advantages and development strategy can be their best chance at using SEZs as sources of growth, but even successful SEZs may entail fiscal costs and economic distortions that should be assessed carefully.

Tax incentives are not the primary driver of the success of SEZs. Tax incentives that directly reduce the cost of inputs for SEZ companies can be cost effective. These include reducing or removing tariffs on inputs (primary and intermediate) and accelerated depreciation or expensing (instead of depreciating) capital outlays for tax purposes. Exemptions (especially permanent ones) from taxes on profits and wages are unlikely to affect investment in SEZs, are very costly, and are more vulnerable to abuse. Property taxes are efficient tools to finance public infrastructure and services in SEZs; not applying them imposes a high and unfair cost on the domestic economy.

The primary drivers of successful SEZs remain nonfiscal. Reliable infrastructure and utilities; efficient logistics and customs processes; clear and predictable legal frameworks; competent, independent, and accountable zone management; streamlined regulatory frameworks; skilled and trainable labor; proximity to markets and suppliers; and strong linkages with the domestic economy do more to attract and retain productive investment than tax breaks. Tax incentives cannot compensate for weak fundamentals.

Governance and transparency are important in understanding whether and how SEZs contribute to economic development. For this, standard tax reporting and tax oversight by customs and tax administrations should not be waived for SEZ firms, irrespective of the tax treatment. Publishing SEZ-related tax expenditures in national tax expenditure reports fosters public finance accountability and encourages policymakers to undertake regular evaluation of such tax expenditures.

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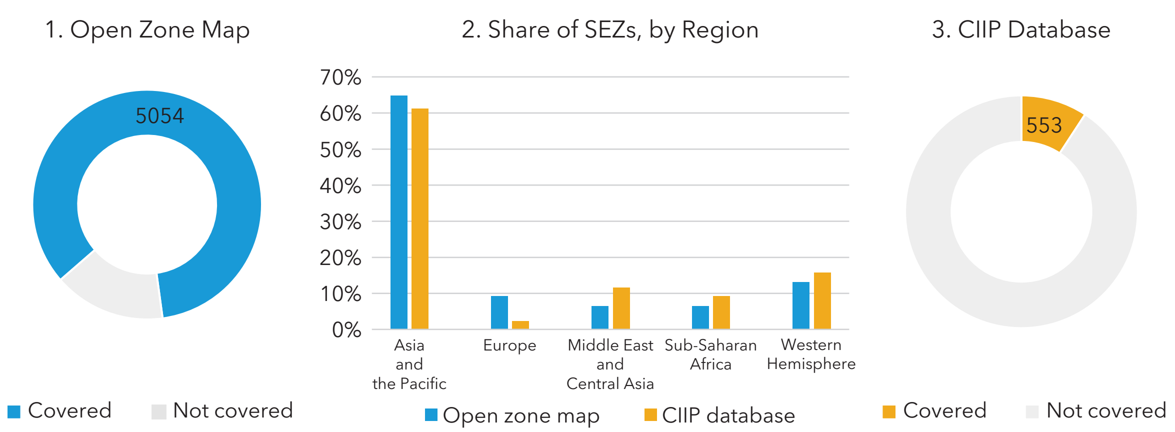
Annex I. Data Sources

For descriptive data on special economic zones (SEZs), this note relies on Open Zone Map (Adrianople Group 2021), a comprehensive global database mapping 5,054 SEZs across 169 countries. The platform provides essential information on zone types (for example, free trade zones, export processing zones, industrial parks), specializations (for example, manufacturing, logistics, technology), management structures (for example, private, public-private partnership, public), zone sizes (in hectares), and the legal framework governing the zones (for example, whether a single law is dedicated to SEZs or multiple pieces of legislation apply). It also includes information about the distance of each SEZ to key infrastructure, such as airports and ports, and to the national capital and the nearest populous city. Open Zone Map reflects data as of 2021, sourced from government publications, SEZ authorities, and publicly available reports. Despite the challenges in SEZ data collection because of varying transparency levels, Open Zone Map is the most extensive and reliable resource currently available.

For more detailed information on the economic frameworks of SEZs, this note uses the Competitive Industries and Innovation Program SEZ Database. Covering 553 SEZs across 51 countries, this database provides a deeper analysis of management structures, institutional setups, and fiscal incentives. It details corporate tax exemptions, including types (for example, absolute exemptions, reduced tax rates, conditional exemptions based on firm characteristics), duration, grace periods, and additional requirements such as minimum investment or export levels. The database also addresses fiscal incentives for tenant firms, such as exemptions on import duties (for example, capital equipment only or both capital equipment and inputs), value-added tax, property taxes, and employment-related taxes. Furthermore, it characterizes incentives for zone developers, including exemptions from repatriation and capital gains taxes. Although its coverage is much smaller, the Competitive Industries and Innovation Program database provides a representative sample of SEZs globally, with a very similar regional breakdown of SEZs to the Open Zone Map (Figure A.I.1).

Other sources also complement the analysis. The Global Tax Expenditures Database provides data on tax incentives offered within some SEZs and the associated revenue forgone. Information on investment, economic activity, and employment within the zones, as well as exports from the zones, was taken from various reports and studies of SEZs. Internal IMF reports were also used as complementary data sources.

Figure A.I.1. Coverage of Different Datasets among an Estimated 6,000 Special Economic Zones Worldwide



Source: Authors.

Note: Regions are defined according to the IMF's regional organizational structure. CIIP = Competitive Industries and Innovation Program; SEZ = special economic zone.

Annex II. Mapping Structural Policies to the Objectives of Special Economic Zones

Table A.II.1 summarizes the policies that, according to the literature, are the most effective in contributing to the key objectives of special economic zones (SEZs). The row titles represent the key objectives, and the column titles represent the key structural policy issues that governments may consider. For example, if the primary objective of the SEZ is to attract foreign direct investment, corporate tax incentives are typically shown to matter only if they are a differentiating factor—that is, if the other structural policies are not in place, corporate tax incentives are likely to be a waste of public revenues, with little or no effect on foreign direct investment.

Table A.II.1. Policy Objectives and Structural Issues of Special Economic Zones

Objective	Overregulation	Inadequate Infrastructure	Weak Public Services	SEZ Type and Size	Role of Taxation
Attract foreign direct investment	Simplify regulatory frameworks; establish one-stop shops Risks: dual regulatory systems	Provide access to facilities and utilities within zone and connectivity to ports and logistics hubs outside; develop SEZs near transport hubs; use public-private partnerships Risks: high upfront costs; increased regional inequalities	Fast-track investor services (for example, permits, utilities) Risks: two-speed economy	Large diversified zones	Corporate tax incentives only shown to matter if they are a key differentiating factor of investment locations
Promote exports	Streamline customs processes and export documentation Risks: limited integration with domestic economy; smuggling opportunities			Small and fenced-in export promotion zones; small specialized zones	Customs and value-added tax exemptions may provide real value to exporters
Revitalize areas	Simplify land-use and business licensing procedures to encourage new firms Risks: risk of creating enclaves that bypass, rather than reform, local governance	Use economic revitalization projects as anchors for regional infrastructure upgrades (transport, utilities) Risks: infrastructure concentrated in SEZs may not revitalize surrounding areas	Integrate training and social facilities with local communities Risks: SEZ-led initiatives may substitute for, rather than strengthen, local service provision	Economic revitalization projects	Targeted, temporary tax incentives may help attract pioneer investors, but sustained revitalization depends on broader structural reforms
Generate spillovers	Pilot regulatory reforms that could be scaled nationally Risks: increased regional inequalities	Establish large SEZs with connectivity to local supply chains Risks: revenue leakages if incentives provided	Strengthen vocational training and local service delivery to enable linkages between SEZ firms and the domestic economy Risks: weak public services may prevent spillovers regardless of SEZ efforts	Large diversified zones; large export promotion zones	Neutral corporate income tax treatment supports fair competition and encourages links with the domestic economy

Source: Authors.

Note: Job creation is also an often-cited policy objective of SEZs, but it was not included in this table because it is an overarching objective that may be achieved if any of the other objectives are achieved. SEZ = special economic zone.

Annex III. Tax Policy Considerations of Special Economic Zones

Table A.III.1 summarizes the key tax considerations in special economic zones (SEZs): their rationale, pros and cons, and suggested treatment that preserves as much as possible neutrality with the domestic economy while reducing as much as possible distortions to SEZ firms and limiting the revenue cost of tax incentives. Table A.III.2 summarizes minimum legal and reporting requirements for SEZ firms.

Table A.III.1. Key Tax Considerations

Tax	Rationale and Risks of Tax Incentives	Suggested Tax Treatment
Indirect Taxes		
Customs duties	Tax incentives may lower input costs, improve SEZ efficiency, and attract investors. However, they reduce tariff revenues, create risks of fraud and arbitrage, and complicate compliance if not paired with efficient procedures.	• Limit exemptions to capital goods and production inputs. Make those exemptions time bound, legislated, and subject to periodic review. • Introduce on-site customs clearance and integrate SEZs into single window systems. • Ensure uniform customs regimes across SEZs, with regular oversight, audits, and reporting.
VAT and sales taxes	Tax incentives may reduce cash-flow burdens for SEZ firms and support exporters. However, exemptions undermine neutrality and create revenue leakages, while refund delays discourage local sourcing.	• Ensure neutrality through input VAT credits. • Consider VAT suspension with ex post customs checks for export-oriented SEZs. • Require mandatory VAT registration and reporting for all SEZ firms, and fully tax domestic sales.
Excises and production taxes	Tax incentives may lower production costs and support exports. However, exemptions shift health and environmental costs to the domestic economy and encourage relocation of polluting activities.	• Apply excises (for example, alcohol, tobacco, fuel) fully to SEZ firms.
Direct Taxes		
CIT	Tax incentives may be used to signal competitiveness. However, overreliance on CIT holidays could lead to revenue loss and profit shifting. Similarly, long-term CIT exemptions can create dependence.	• Maintain neutrality with domestic firms. • If justified, implement cost-based incentives (accelerated depreciation, investment credits). • Use sunset clauses and mandate regular policy evaluation. • Require reporting for all firms, including exempt ones.
Wage taxes	Tax incentives may lower labor costs for firms. However, benefits often accrue to firms rather than workers. Tax incentives can distort labor markets and reduce the overall competitiveness.	• Avoid wage tax incentives. • If justified, apply them broadly, not in SEZs only.
Dividends, interest, royalties, and capital gains	Tax incentives may reduce the cost of capital for investors. However, exemptions are costly and generally ineffective at attracting foreign direct investment. They also erode source-country taxing rights and can allow multinational enterprises to shift gains on domestic assets abroad.	• Do not exempt. Maintain normal withholding or income taxation, subject to generally applicable treaty limitations. • Tax capital gains on direct and indirect transfers of domestic assets, licenses, and rights.
Property taxes	Tax incentives may lower firms' operating costs and make the zone more attractive. However, exemptions deprive local services of revenue and shift infrastructure costs to the wider economy.	• Do not exempt recurrent property taxes. • Ensure regular valuations (using book values or size where markets are thin).

Source: Authors.

Note: CIT = corporate income tax; SEZ = special economic zone; VAT = value-added tax.

Table A.III.2. Minimum Requirements for Tax Regimes in Special Economic Zones

Issue	Description
Is there a clear legal basis for all SEZ incentives?	Eligibility criteria, duration, and conditions should be explicitly defined in law, avoiding discretionary or ad hoc arrangements.
Are all SEZ incentives time bound and subject to evaluation?	Incentives should include sunset clauses (five years is typical) and require periodic review against stated objectives.
Are the costs of SEZ tax incentives estimated and reported annually?	Revenue forgone should be quantified and included in official tax expenditure reports to support transparency and policy assessment.
Are all SEZ firms required to file tax returns and maintain accounts?	Filing and bookkeeping obligations should apply to all firms, including those benefiting from exemptions or tax holidays.
Is there coordination between tax and customs authorities?	Authorities should share information and coordinate oversight, particularly for monitoring transactions involving SEZ firms.

Source: Authors.

Note: SEZ = special economic zone.

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