IMPLICATIONS OF CORPORATE TAX ON FOREIGN INVESTMENTS

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Abstract

This paper tries to focus on the link between corporate taxation rates and policies and foreign direct investments. As direct corporate tax is an important source of revenue for collection of taxes for the government, the government needs to analyse the loss of return in order to sustain if the expected amount of foreign investments aren't met. This paper makes an attempt to understand how successful the countries have been by reducing the corporate tax rates and whether they have resulted in the expected manner. The reasons for changes in foreign investments aren't only corporate taxation and so even if the corporate tax rates and policies are the same, still the foreign investments vary from year to year. Using statistical tools like correlation and observing data year on year basis, even if the corporate taxation rates aren't changed the investments vary due to other factors and corporate taxation also plays a vital role among them. So the countries look into reducing corporate taxation as one of the methods to increase the foreign investments if they already consist of favourable consists for business.

Keywords: Corporate Tax, FDI, Government, Investments

I. Introduction

Since the time of Liberalisation and Globalisation, Companies are not thinking of only manufacturing in their own country, but also in other countries where the overall cost of operations would be reduced as compared to its competitors and expand its business making it a Global leader. But while considering the overall cost, the impact of taxation which could also lead to double taxation is not a subject to omit as then the returns expected by the investors may not be reached. There are various policies and regulations to restrict and invite foreign trade into a country. One of the major ways to attract a company to invest in a country is by reducing the corporate tax rates and providing them adequate deductions and reliefs in order to improve their net return. Even though there are various other factors such as Manpower, Resources, Societal Behaviour, Politics, etc., Taxation has been a key factor in motivating countries. Countries considered as Tax havens for example,have aLow rate of taxation and yet have not been able to attract sufficient FDI's. This is due to a fact that the countries have not been to up-to the mark in providing various facilities. Few countries with similar or almost equal rates of tax and deductions have major differences when it comes to the foreign investments that have been poured into the country.

II. Review of Literature

(OECD, 2008). The research conveys that studies examining cross border flows suggest that on average, FDI decreases nearly by 3.7% if there is 1% increase in the tax rate on FDI. They also mention how different countries have responded to pressures to lower tax on FDI. They conclude by saying that increased caution by countries may also be exercised to limit false fluctuating of tax base to low tax havens to avoid differences in the global tax system.

(Devereux & Griffith, 2002) The research paper has been restricted only on the studies that include some measure of taxation as a possible factor in determining the flow of foreign direct investments. This research incorporates every stages of the decision-making process into simplified form and attempt to evaluate the impact of tax on the level of the foreign owned capital stock or investment in each country. This paper concludes by saying that there is some evidence that taxes affect firm’s location and investment decisions, although they don’t have a clear idea on the quantum of the effect.

(Jadea & Basir, 2017)Based on Saudi Arabia’s planned investment for 2030, there will be more business opportunity for foreign investors, thus the potential and opportunities of FDI in Saudi Arabia are reviewed as well as the laws itself been reviewed as legal protection to the investors. This paper examines legal regime of FDI in the Kingdom of Saudi Arabia, by analysing the provision of the current Foreign Direct Investment law and finding the solution to the gaps and challenges that the law has not yet deliberately covered, for the implementation of FDI regulations in KSA which will be more attractive to the local and foreign investors.

(NUŢĂ, 2012)The article is on how the countries taxation incentives play a major role in bringing FDI to its country. But still many supervisors started to analyse that tax incentives are not the most powerful tool on influencing the FDI, but it is infrastructure, political stability, and cost and availability of labor.so tax incentives taken such a position that the government of different countries have started biding to attract FDI. In this paper the researcher has specified tax and non-tax factors influencing FDI.

(Prime, 2012)The article is on how cans a small country like Singapore which depends on global markets can do so well in FDI. As per author the for success is that Singapore has its government policies have been made hyper-sensitive to attract foreign companies and investors to their country. The other reasons are that they have study government since 1959, And they did not leave market to face decision alone. As the author the main attraction for FDI is the country’s infrastructure, education, pre-development institutions.

III. Research Design

Scope of study: We have considered the net inflow of FDI into the following countries for the period 2008 to 2017:

INDIA
SINGAPORE
CHINA

SAUDI ARABIA
JAPAN

Statement of Problem: Identifying whether the changes in FDI are due to effects of taxation is very difficult. There are always other external factors also influencing the FDI in a country. Thus in this paper we are trying to identify if taxation is a factor that affects the FDI of various countries and if it has a similar effect among all of them.

Objective of the study: To establish a relationship between Taxation policies in a country and foreign direct investment inflow in a country.

Source of Data: Secondary Data has been obtained for the purpose of this research Paper.

Hypothesis:

H_0: Change in taxation does not have an impact on the FDI in a country

H_1: Change in taxation has impact on the FDI in a country

Expected Outcome: The change in taxation has an impact on the foreign investments in a country.

Limitations of the Study:

1. Only Five Selected countries are taken into Consideration.
2. The data collected is based on an external source and its reliability is subject to the data provided.
3. The time frame of the historical data is only 10 years and does not include all the previous data.
4. The quantitative effect of deductions availed by the companies is not accurately measurable.
5. The results are likelihood of trends and possibilities and not certain.
6. Since only 2 countries under study have changed the taxation rates, the correlation between taxation and FDI may not be very accurate.

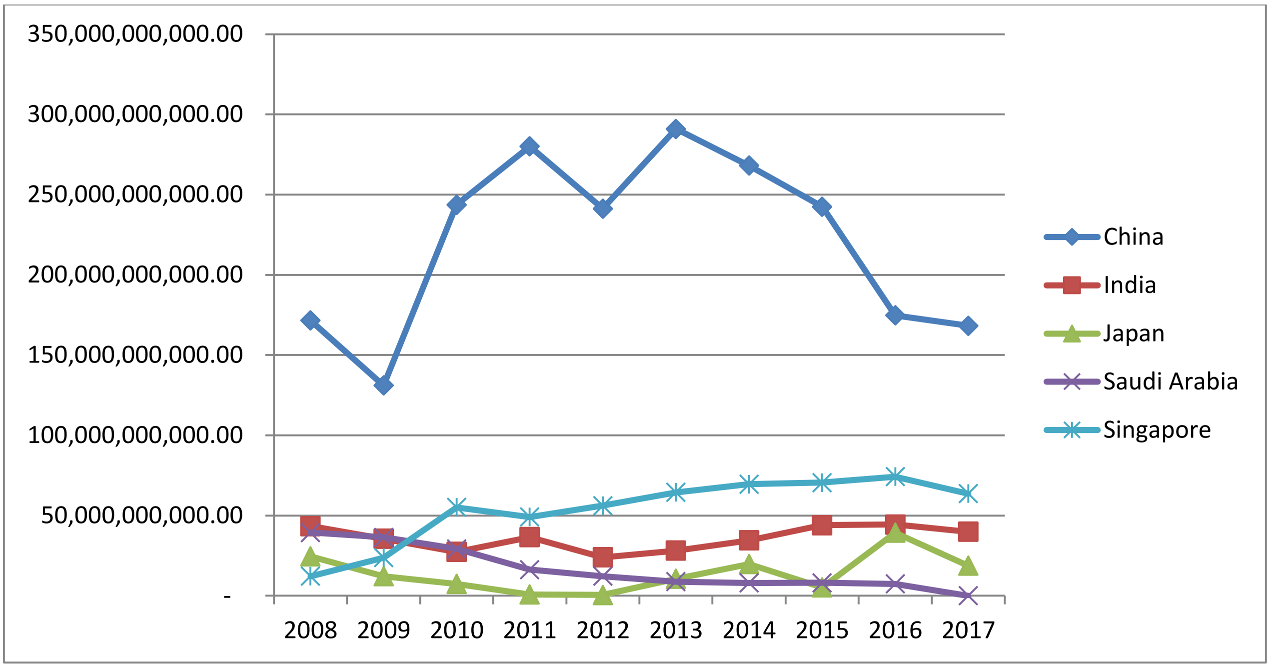
IV. Data Analysis and Interpretation:

Countries	China			India		
Year	FDI	Taxation Rate	YOY increase	FDI	Taxation Rate	YOY increase
2008	1,71,53,46,50,311.57	25.00%	-	43,40,62,77,075.81	30.00%	-
2009	1,31,05,70,52,869.50	25.00%	-24%	35,58,13,72,929.66	30.00%	-18%
2010	2,43,70,34,34,558.18	25.00%	86%	27,39,68,85,033.78	30.00%	-23%
2011	2,80,07,22,19,149.94	25.00%	15%	36,49,86,54,597.86	30.00%	33%
2012	2,41,21,38,68,161.42	25.00%	-14%	23,99,56,85,014.21	30.00%	-34%
2013	2,90,92,84,31,467.00	25.00%	21%	28,15,30,31,270.32	30.00%	17%
2014	2,68,09,71,81,064.34	25.00%	-8%	34,57,66,43,694.14	30.00%	23%
2015	2,42,48,93,31,627.40	25.00%	-10%	44,00,94,92,129.53	30.00%	27%
2016	1,74,74,95,84,584.05	25.00%	-28%	44,45,85,71,545.80	30.00%	1%
2017	1,68,22,35,83,736.79	25.00%	-4%	39,97,83,94,934.56	30.00%	-10%

Countries	Japan			Saudi Arabia		
Year	FDI	Taxation Rate	YOY increase	FDI	Taxation Rate	YOY increase
2008	24,62,48,45,329.56	40.69%	-	39,45,58,63,929.33	20%	-
2009	12,22,64,71,578.74	40.69%	-0.50	36,45,76,66,666.67	20%	-8%
2010	7,44,09,79,284.16	40.69%	-0.39	29,23,27,06,666.67	20%	-20%
2011	85,07,17,035.07	40.69%	-0.89	16,30,82,80,000.00	20%	-44%
2012	54,69,62,692.19	38.01%	-0.36	12,18,23,73,333.33	20%	-25%
2013	10,64,84,41,636.21	38.01%	18.47	8,86,46,93,333.33	20%	-27%
2014	19,75,22,49,424.09	35.64%	0.85	8,01,17,86,666.67	20%	-10%
2015	5,25,22,18,412.39	33.86%	-0.73	8,14,10,26,666.67	20%	2%
2016	39,32,33,65,428.38	30.86%	6.49	7,45,25,33,333.33	20%	-8%
2017	18,83,75,24,124.65	30.86%	-0.52	-	20%	-

Countries	Singapore		
Year	FDI	Taxation Rate	YOY increase
2008	12,20,07,05,251.93	17.00%	-
2009	23,82,12,09,699.62	17.00%	0.95
2010	55,07,58,64,345.04	18.00%	1.31
2011	49,15,56,57,316.29	14.40%	-0.11
2012	56,18,93,55,124.06	18.00%	0.14
2013	64,48,17,38,991.45	12.60%	0.15
2014	69,54,26,38,412.06	12.60%	0.08
2015	70,59,53,84,867.16	12.60%	0.02
2016	74,25,30,27,404.73	9.00%	0.05
2017	63,63,34,34,111.19	9.00%	-0.14

Chart showing FDI inflows for 10 years (Amount in $ US)



The above tables represent the taxation rates and foreign investments inflow for the last 10 years. This data shows the increase and decrease on foreign investments and taxation rates for all these years.

Taxation and deductions available for the period:

Singapore: The taxation in Singapore had been going on at 18% for the year of assessment for the year 2008 and 2009. Since 2010,the taxation rate in Singapore has dropped down to 17% making it more feasible for companies to invest in. For YA 2011, companies were granted a 20% Corporate Income Tax Rebate or 5% SME Cash Grant, whichever is the higher amount. For the YA 2012, companies were granted a one-off 5% SME Cash Grant. For YA 2013-2015, Companies were granted a 30% Corporate Income Tax Rebatecapped at $30,000 for each YA. In the YA 2016, Companies were granted a 50% Corporate Income Tax Rebate capped at $20,000. In The YA gave the Companies a grant of 50% Corporate Income Tax Rebate capped at $25,000. Over and above these, partial exemption from tax has also been provided to companies based on their chargeable income.

Saudi Arabia: In case of Saudi Arabia it has been following the rate of corporate taxes at 20% of net adjusted profits throughout the period of study which is slightly higher than the taxation of Singapore. Businesses involved in production of oil and hydrocarbons have a different rate of taxation at 85% (for investments up to USD 60 billion), 75% (for investments between USD 60 and 80 billion), 65% (for investments between USD 80 and 100 billion), 50% (for investments exceeding USD 100 billion). (source:https://en.portal.santandertrade.com/establish-overseas/saudi-arabia/tax-system)

China: Generally, foreign companies may only engage in indirect business activities through a representative office (RO) in China. ROs are similarly taxed as Chinese companies but are not allowed to sign contracts with Chinese customers or engage in direct business operations. The standard rate of taxation is 25% and varies between 10%-15% based on other services that are provided by them. There are also various other taxes like VAT, Business tax, real estate tax, Land appreciation tax, Deed tax, consumption tax, etc which hamper the rate of return for the investors.

India: Taxation factors are a bit complex in India as compared to other countries. The taxation varies from 30% to 40% to domestic and foreign companies and adds up surcharge when the income exceeds a value of

Rs.1Cr to which education cess is also added. The aspect of Minimum Alternate Tax ensures that the company pays a minimum amount of tax based on book profits computed under the sections of the act rather than the actual profit.

Japan: Japan has been continuously reducing taxation in their country to attract foreign investments. For the years 2008-2011, Japan had a corporate tax rate of 40.49%. For 2012and 2013, they reduced the corporate taxation to 38.01%. Further in the year 2014, they reduced the taxation rate to 35.64%. For the year 2015, the taxation rate for companies had been changed to 33.86%. From 2016, the taxation rate in Japan has been changed to 30.86%. Apart from these companies also have to social security tax for companies and employees.

Data Analysis:

Singapore Correlation:

Correlations

		FDI	Rates
FDI	Pearson Correlation	1	-.676*
	Sig. (2-tailed)		.032
	N	10	10
Rates	Pearson Correlation	-.676*	1
	Sig. (2-tailed)	.032	
	N	10	10

*. Correlation is significant at the 0.05 level (2-tailed).

India Correlation:

Correlations

		FDI	Rates
FDI	Pearson Correlation	1	.[a]
	Sig. (2-tailed)		.
	N	10	10
Rates	Pearson Correlation	.[a]	.[a]
	Sig. (2-tailed)	.	
	N	10	10

a. Cannot be computed because at least one of the variables is constant.

China Correlation:

Correlations

		FDI	Rates
FDI	Pearson Correlation	1	.[a]
	Sig. (2-tailed)		.
	N	10	10
Rates	Pearson Correlation	.[a]	.[a]
	Sig. (2-tailed)	.	
	N	10	10

a. Cannot be computed because at least one of the variables is constant.

Saudi correlation:

Correlations

		FDI	Rates
FDI	Pearson Correlation	1	.[a]
	Sig. (2-tailed)		.
	N	9	9
Rates	Pearson Correlation	.[a]	.[a]
	Sig. (2-tailed)	.	
	N	9	9

a. Cannot be computed because at least one of the variables is constant.

Japan Correlation:

Correlations

		FDI	Rates
FDI	Pearson Correlation	1	-.515
	Sig. (2-tailed)		.127
	N	10	10
Rates	Pearson Correlation	-.515	1
	Sig. (2-tailed)	.127	
	N	10	10

V. Findings and Suggestion:

The correlation betweenforeign direct investments and taxation rates show a negative sign. This implies that with decrease in direct taxation rates the foreign direct investments increase. But, the significance level of correlation in case of Japan is higher than 10% which is considered to be a low level of significance. Moreover the normality graphs show a deviation for the Normal Line which throws a light that an accurate relationship cannot be established between these two variables. Yet we can still say that there will be significant impact on the foreign investments whenever there are changes in direct taxes in a nation. For the other countries namely, India, Saudi Arabia and China do not have a correlation between them which implies that there is no relation between taxation rates and foreign investments. But based on the deductions and exemptions provided by the laws of these each countries we could identify that any change of policy would effect the investments in the same or the upcoming year.

The reasons for decline of FDI in Saudi Arabia are that the economic social reforms had reverse effect and when Houthis from Yemen infiltrated Jazan nearly 140 soldiers and had to spend more than 6 billion riyals to rehabilitation nearly 6000 families. And also Arab Spring caused huge chaos in Arab world in researchers point of view the reason mostly be the in adequate policy reforms,saudization, and failing to create favourable and lucrative market for investors.

Therefore whenever a country is in need of foreign investments, then a country go ahead and reduce their corporate taxation rates. But this does not ensure success if all the factors that affect foreign investments aren't taken care of. Therefore it advisable for countries to reduce taxation rate only if all the other determinants are favourable to the working of foreign companies.

Implication of Major events including taxation on foreign investments inflow into the countries:

Country	Year	Significant events	Impact on Foreign Direct Investments
All countries	2009	The economic recession all over the world.	Due to this, the foreign investments in all the countries had a severe effect.
China	2010-2011	FDI policies being decentralised and making taxation for Foreign investments easier	The Foreign inward investments grew heavily cause the economic recession in 2009 and the commutated direct tax policies reduction since years
	2012	The possible change of Government	This caused the investors to think before they invest the new government may or may not be favourable to the foreign investors

	2013	The new Taxation policies brought in by the new governments for motivation foreign investments on Capital gains and certain business incomes	Foreign investments grew rapidly taking advantage of the tax benefits on capital gains and other exemptions from business income
	2014-2016	The Chinese government started to provide more benefits to the Domestic companies than the foreign invested companies	Domestic companies out bid the foreign companies to win the market at a cheaper rate.
	2017	China's government announced plans to cut restrictions on foreign companies operating in the country, in an effort to curb both falling FDI and to increase flow of outward investment	Thus Foreign investments fell even more
India	2010	-	India was still recovering from the recession that took place in 2008 and was not such favourable country to attract foreign investments
	2011	The government had taken several policy decisions, which included allowing FDI in multi brand retail and civil aviation sectors	There was major increase in foreign investments due to such policies taken up by the government
	2012	The government to tried to focus on increasing Foreign investments in insurance and pension sectors by allowing them deductions	There wasn't good environment for working conditions in the country to attract foreign investments
	2013-16	Make in India, Overhauled provisions in sectors like construction, development, insurance, and pension for attracting foreign investments, raising the FIPB approval limit were the major policies taken by the new government in India	The Foreign investments never saw a down side in these years due to all the favourable initiatives relating to tax taken by the government
	2017	The government reduced quantum of deductions on profits to be transferred abroad to reduce the inflows of investments, in order to revive the domestic market and also to do further ease of doing business in the country, the Effects of demonetisation also led to a cash crunch in the country	This had a both side effect, but ultimately the taxation on profits of the company played a higher role and the foreign investments went down for the first time in 4 years

VI. Conclusion:

In the above study we are able to see that wherever there are any changes in taxation rates or there are any provisions that provide benefits to foreign investments, there has always been an increase in foreign investments. The accurate percentage of growth cannot be ascertained. There is an inverse relationship between taxation policies and the foreign investments in a country.

But even though taxation rates have an impact on the foreign investments, they are solely not enough to increase the foreign investments. Other factors like politics, environmental human culture, societal factors, etc. also have a major impact on the foreign investments inflows in a country. Thus even though there is a change in taxation rate the increase may not be same. It can also be seen that reduction of taxation in one year may have animpact on the inflow of foreign investments in the next year.

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