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Cross Jurisdictional Study of Corporate Income Tax

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ABSTRACT

Corporate Income Tax has been of very high significance especially in the developing countries and not only because it contributes to the country's economy but also because of the impact that it creates on the income flows and world trade because of various tax competition. the Corporate taxation system for the developing countries is rather difficult because on one hand the corporate taxation provides them with a revenue that none of the other taxation system provides and it is also far more feasible than income tax as Income tax is levied on every member of the country whereas this corporate tax is only placed on a few companies and most of the revenue is also coming from a few companies.

This paper looks at CIT from a theoretical as well as empirical perspective. Some principles of CIT are similar for all countries but the problem arises that the position/characteristic of the developing countries yields different tradeoffs. Moreover, the main aim of this paper is to study the main differences in CIT between developing and advanced countries and even go beyond the analysis and look at the changes that these developing countries need to incorporate.

I. INTRODUCTION

Corporate Income Tax has been of very high significance especially in the developing countries and not only because it contributes to the country's economy but also because of the impact that it creates on the income flows and world trade because of various tax competitions.[2] Though CIT is also based on certain broad principles but global crises/developments effects developing and advanced countries in their own way, therefore it becomes necessary to gauge CIT in both developing and developed economies so that all possible reform can be made to make CIT a better tax system.

This paper looks at CIT from a theoretical as well as empirical perspective. Some principles of CIT are similar for all countries but the problem arises that the position/characteristic of

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[2] ELKE ESSEN, "CORPORATE TAX RATES AROUND THE WORLD, 2020, TAX FOUNDATION", 09TH DECEMBER, 2020.

the developing countries yields different tradeoffs. For example, less administrative capacity, CIT developments which can be easily seen in developed countries whereas reliance on tax incentives, narrowing of tax bases could be easily seen in developing countries. Moreover, the main aim of this paper is to study the main differences in CIT between developing and advanced countries and even go beyond the analysis and look at the changes that these developing countries need to incorporate.

II. CORPORATE TAX RATES AROUND THE WORLD

According to the survey of 2019 most of the countries have a tax rate below 25% while a few may have between 20-30%.[3] The US being one of the top ranking developing countries have been ranked 84th with a CIT of 26%.[4] Now important point to consider is that out of top 20 countries for the highest CIT 10 of them belong to the Africa and 4 from Asia, which clearly shows that the developing countries have a high tendency of charging high Corporate Income tax rather than developed countries and one of the main reasons behind this assertion can be revenue generation.

III. GLOBAL DEVELOPMENTS

Tax Competition could be one of the possible reasons for lower CIT rates in many countries across the world. Information economy has been another common development in this context. CIT systems are facing a tough time due to increased production of tangible goods and assets. The primary reason behind this can be due to distribution of costs to different countries wherein companies strongly influence patent fees. The "Controlled Foreign Company" (CFC) rules will play a significant role in preventing the shifting of profits to other countries.[5] Until recently, CIT have fetched returns not only in the developing but advanced economies as well. Because of increased corporate profits in GDP, CITs have been increasing as well.

IV. DECLINE OF CORPORATE TAX RATES SINCE 1980

The Corporate tax rates have shown a considerable decline of 40% in the last 39 years. As compared to 40.38% in 1980, the statutory rate stand is 24.18% in 2019.[6]

On similar lines, the weighted average statutory rate has depicted a sharp downward surge of

[3] Mr. NISHANT RAVINDRA, Dr. VIVEK VASANTRAO, "A Comparative Study of Tax Structure of India with respect to other countries", IJETT Journal ISSN:2231-5381, 2016.
[4] *Supra Note 2.*
[5] R. SINHA, "An International Comparison of Tax Regimes," Centre for Budget and Governance Accountability, 2010.
[6] KARI JAHNSEN and KYLE POMERLEAU, "Corporate Income Tax Rates around the World, 2017," Tax Foundation, September 7, 2017

44% i.e. from 46.67% in 1980 to 26.30% in 2019.[7] Till 2017, the United States was primarily responsible for such high weighted rate owing to its high tax rate.[8] The significant contribution of the U.S. GDP to the global GDP can also be one of the reasons for this higher weighted rate.

There has been inconsistent distribution of tax rates in most countries. The United States showed the way in 2017, wherein it started taxing corporations @ 30% or even lower. A whopping 77% countries across the globe imposed a statutory rate of less than 30% between 2000 and 2010 whereas only 41% had tax rates lower than 30% in 2000.[9]

The average statutory rates declined during the period 1980-2019.There was a maximum rate reduction of 55% in Europe as compared to South America where this reduction was minimum at 27.63%. Countries like Africa, Oceania and South America witnessed an increase in average statutory rates over small periods whereas the overall effect was decreased if the entire period is considered.

V. Issues in developing countries

The problem with the developing economies in implementation of such taxes is that the tax structure is such economies is weak and the enforcement systems are not up to the mark, therefore there is a possibility of a lot of tax evasion. Therefore, these countries would give primacy to those tax structures that would less evasion opportunities and their enforcement is comparatively easier. Corporate Income Tax is a very complex phenomenon with a lot of exceptions and loopholes and there is also a possibility of transfer-pricing rules and other regimes which makes its enforcement also a complex process.[10] But developing countries still prefer CIT over income tax structure, as ITS would have to be administered to all the citizens and the collection mechanism would involve a lot of people whereas Corporate Income Tax would be administered to a few large corporations which would generate most of the revenue.[11] Therefore, this presents the view that the because of the difficulty in monitoring the income tax structure the revenue collected by it is comparatively lesser than the CIT. We also need to consider that developing countries also need good amount of FDI from advanced counties in order to access their technologies and even capital markets are less advanced, and because these developing countries have less resourceful economies and locational rents are

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[7] *Ibid.*
[8] *Supra Note 3*.
[9] "World Tax Database," the University of Michigan – Ross School of Business,http://www.oecd.org/tax/tax-policy/tax-database.htm#C_CorporateCaptial.
[10] ARMSTRONG, CHRISTOPHER S., JENNIFER L., and DAVID F. LARCKER, 2011. "The Incentives for Tax Planning." Journal of Accounting and Economics.
[11] *Ibid.*

also not up to the mark it basically leads to disadvantages in these tax structure. Therefore, developing countries at the same time also wants to adopt the CIT that would attract FDI so that they could achieve better developments therefore they start their journey from complex Corporate Income Tax Systems but there would notable differences in the tax structure.

VI. DO THE ETRS ESTIMATED FROM THE REGRESSION COEFFICIENTS DIFFER FROM THE ACTUAL ETRS?

In reality there is very less difference between the estimated ETRs and Actual ETRs. The correlation between the two values is more than 94% most of the times OR in other words the difference between the two values is never more than 6%.[12] This helps us to draw inference that control variables like industry, year and size have no or negligible impact on coefficients of interest. Hence, it would not be out of place to mention that regression estimated ETRs can also be satisfactorily used in place of ETRs derived from financial statements, if there is a need. But the problem arises when the estimated ETR is used in the developing countries as actual ATRs because though it can be used the result that estimated ETR gives when used in advanced countries if much closed to the Actual ATR tan when used in developing countries.[13] Now this difference arises because of the tax incentives that developing countries offer attract Foreign Direct Investment as these developing countries lack behind advanced countries in terms of technologies and capital markets therefore they come up with such variable tax incentives which could attract businessman, and because ETR are calculated by the earnings before tax and developed countries do not offer such high incentives therefore there arises a difference in ETR when used in developing countries as oppose to advanced countries like USA.[14]

VII. DO ETRS DIFFER BETWEEN DOMESTICS AND MULTINATIONALS?

A study of firms of Australia, Canada, Malaysia, United Kingdom, United States, Asia, Europe, and Latin America clearly depict that the difference between estimated domestic cash ETRs and multinational ETRs is not more than 5%.[15] On the other hand the correlation between these two estimates is about 84%.[16]

The few things that we need take into consideration when we talk about taxation on domestic

[12] S. MARKLE and DOUGLAS A. SHACKELFORD, “CROSS-COUNTRY COMPARISONS OF CORPORATE INCOME TAXES”.
[13] J. G. GRAVELLE, "International Corporate Tax Rate Comparisons and Policy Implications," Congressional Research Service, 2015.
[14] Carroll, Robert, 2010. The Importance of Tax Deferral and A Lower Corporate Tax Rate. Special Report No. 174. Tax Foundation, Washington, DC.
[15] *Supra note 6.*
[16] FULLERTON, DON, “Which Effective Tax Rate?” National Tax Journal 37 (1), 23–41,1984.

and multinational companies is that which tax system is being followed in these countries whether it is territorial or worldwide, because if it is territorial then every multinational company won't become a part taxation as taxation would only happen in terms of GDP (gross domestic product) which means that only those companies would be taxed who are performing all the task within the country otherwise if we refer to the world wide taxation then the taxes would calculated according to the GNP (Gross national Product) which means not only the companies that are working in the country would be included but also the companies who are outside the country but are being run by citizens of that country would also be included. And therefore in developing countries there may arise a situation in which domestic ETR may vary from multinational ETR because FDI is high in these developing countries whereas in advanced countries that might not be scenario as the FDI is less therefore the difference between ETR in domestic and multinational almost remains same.[17]

Some other studies suggest that domestic ETRs are statistically different from multinational ETRs, however the direction of difference is not consistent i.e. sometimes the domestic ETR is greater than the multinational ETR and vice-versa.[18] As a result, it can be inferred that neither do multinationals pay lesser taxes in comparison to their domestic counterparts nor they are at a tax disadvantage as compared to their domestic counterparts.

VIII. Do ETRs vary across industries?

A study involving various industries depicts that retail trade has the highest ETR at 27% whereas mining is on the lowest side with 11%.[19] Retail trade requires extensive fixed assets like buildings, inventory, etc hence more likely to be heavily taxed. Further it's sales locations are easily identifiable, barring online sales. As a result, retail trade lies under the banner of high tax jurisdiction as compared to other industries which operate on intangible assets.

France, India, and Sweden have finance as their highest ETR. Manufacturing, Mining, and Real Estate are some of the industries with low ETRs in many countries. Even in US the mining ETR is around 6%. India with a variation of 34% in ETR is one of the countries whose variation is on higher side, whereas Bermuda is on the lowest side with a variation of only 12%.

Though it is true that the ETR definitely varies across industries, but the evolution of these

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[17] DEVEREUX, MICHAEL P., and RACHEL GRIFFITH, "The Taxation of Discrete Investment Choices.", Institute for Fiscal Studies, London, UK, 1998.

[18] *Ibid.*

[19] *Supra note 16.*

industries in developing countries would also be an important consideration because the advanced countries would have technology to pull of any sector demands but the same cannot be said for the developing countries, and if they indulging in FDI for increasing demand in for example Retail sector then they would have to give tax incentives to the companies who would want to invest in their country whereas the advanced economies does not have to indulge in any such practices because they already have the technology and capital market to meet the demand of such sectors and at the same time they don't have to give any tax incentives to the companies to want to invest in their country, hence the revenue collected from them would be higher.

IX. TAX HOLIDAYS AND TAX SPARING

A number of developing countries provide tax holidays to its multinational companies so that they could get some incentives to invest with their trade. A tax holiday can be construes as a time period where that company does not have to pay any type of taxes during that period of time.[20] Now as mentioned above these tax holidays/incentives are provided with the sole reason to these multinational companies to seek investment in developing countries, but what the author generally fails to consider is that these tax incentives would only matter if the country to which this multinational corporation belong will have a home country taxes because if that country follow worldwide taxation then that multinational corporation would be taxed irrespective by the home country and the taxation incentive would be of no value.[21]

Therefore, a new concept of tax sparing is used a few developed countries which allow these multinational corporate to have a type of credit for all the taxes that they haven't paid.[22] Tax sparing is generally entered in the form of treaties that are signed between developing and advanced countries but some the countries like US does not enter into such agreements. And there is certain limitation of this phenomenon of tax sparing like it does not benefit any of the startup companies as most startup companies have losses in the initial years. In the current business world innovative ideas can be said to the backbone of economic growth and this principle of tax sparing would encourage pricing abuse and therefore even if it increases investment in developing countries it is reducing the CIT of its own host country.[23]

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[20] TIMOTHY J. GODSPEED," Taxation and FDI in Developed and Developing Countries".
[21] *Ibid.*
[22] M. P. RAIKER, "Simplification of Tax Structure," 17 April 2015.
[23] DYRENG, SCCOTT D., MICHELLE HANLON, and EDWARD L. MAYDEW, "Long-Run Corporate Tax Avoidance." The Accounting Review 83 (1), 2008.

X. SHIFTING OF CORPORATE RESIDENCE

Another important question that needs to be answered is that what is the criteria for determining the home of a multinational corporation because these multinational corporations operate in a lot of countries and have offices in almost all countries and are listed on stock exchange of many countries so how will we determine the host country.[24] Now this somewhat differs from country to country but few things that are generally considered are place of incorporate, place of headquarters and pace where the whole management and control relies. Now this is sometimes problematic because a few multinational corporations often try to change their origin in order to obtain tax benefits for example this was done by Stanley which announced their residence as Bermuda in first instance but changed it automatically when find out that the problems raised by country's policies and shareholders.[25] Now this is very problematic for developing countries as their revenue would keep on fluctuating that comes from Corporate Income Tax if such multinational corporations keep changing their host country as it would lead to change in their tax structure.

XI. THEORETICAL ISSUES AND REFORMS

Evolutionary reforms

There seems to be a relationship of direct proportionality between tax rates and revenue. There will be reduced revenues because of continuously falling tax rates, in the absence of basic fundamental changes.[26] If preferential treatment is given to tax differentiation it can disfigure investment decisions differently in various sectors. For example, it can lead to over investment in export facing sectors and on the other hand domestic consumption can face under investment. There is a fair chance of reduced efficiency as investments would be targeted towards sectors that yield high after-tax returns. There would be escalated high administration costs by implementing these schemes which might lead to significant abuse and corruption. Weaker Tax administration systems, in developing countries create limiting opportunities for tax evasions, thereby resulting in shifting profits towards preferentially treated segments of different businesses. Tax holidays are one of the major reasons which encourage short term investments.[27] Government offered incentives and private contracts with corporations often lead to corruption. In developing countries there is a positive correlation between foreign direct investment and CIT incentives, but the link of CIT with

[24] *Supra note 10.*
[25] J. O. A. R. PARRY, "Why Tax Matters for development," 2009.
[26] *Supra Note 21.*
[27] HANLON, MICHELLE, and SHANE HEITZMAN, "A Review of Tax Research." Journal of Accounting and Economics", 2010.

economic growth or total fixed capital formation is absent. As a result, tax incentives is a primary choice for kicking off CIT reforms in developing countries. Primarily, the incentives that result in high economic costs need to be reduced. The administrative and revenue costs should be covered in cost-benefit analysis.[28] The discretionary incentives granted by executives escalate corruption and hence should be reduced as well. Regional coordination could be used as a tool to decrease the granted incentives on the basis of earned region specific economic rents.

XII. CONCLUSION

Now the Corporate taxation system for the developing countries is rather difficult because on one hand the corporate taxation provides them with a revenue that none of the other taxation system provides and it is also far more feasible than income tax as Income tax is levied on every member of the country whereas this corporate tax is only placed on a few companies and most of the revenue is also coming from a few companies but the problem arises with the tax incentives and the holidays that have to be provided to these multinational corporation in order to invest in these developing countries.

Though CIT revenues have been throughout the developing countries even after the tax incentives that are provided to these multinational corporations. But there are certain problems with these tax incentives also because factually lower tax rates on these modes of production would fine for developing countries as it would create a lot of administrative inefficiency if these modes of production had to be determined and taxed and this is specially for developing countries, but this would exactly lead to transfer pricing, hence to blatantly say that providing tax incentives would be fine for a developing economy is not a good assumption.

At the end this is clear that Corporate Income Tax definitely has its pros for the developing countries but a very high rate of such taxes might backfire the developing economies, therefore such developing countries should keep cap on their CIT's and should try to compensate the amount by using VAT's and such other taxes on services. There should also be a cap on the tax incentives that developing countries provide else it will lead to price transfer pricing.

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[28] *Ibid.*