Preprints (www.preprints.org) | NOT PEER-REVIEWED | Posted: 5 September 2018 doi:10.20944/preprints201809.0084.v1

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Abstract

This paper discusses corporate taxes and Foreign Direct Investment (FDI) in Nigeria. It is a review of literature that attempts to explore and give a reality on the response of FDI to corporate taxes. This paper shows in its introductory phase a prior discussion of the terms corporate tax and FDI and also elements of both terms and classifications. It follows with issues such as the effects of corporate taxes on FDI. This paper discusses the rhetoric whether reduced corporate taxes and other tax incentives has an effect on the inflow of FDI in Nigeria. To answer this question, the paper utilised information gathered from secondary sources including books, newspapers publications, working papers and research findings from studies. This paper shows that from surveyed empirical studies corporate taxes may have an important role in attracting FDI and have a rising effect on the development of the country, and as such recommends that tax incentives should be employed as a means to attracting FDI, a cost benefit analysis should be employed on the types of corporate taxes to determine the benefit from the perceived FDI inflow, in addition a review of the current tax policies should be carried out as they seem not to respond to the current economic situation.

Keyword: corporate tax, fdi, tax incentives, tax rate, investment

1.0 Introduction

Corporate income tax is a compulsory levy imposed on the chargeable profit of companies at a stipulated rate in a particular location. Though this is seen as a burden, it influences the inflow and location of foreign direct investment (FDI) in a country (Okoi & Edame, 2013). According to Ong, Wong and Teh (2012) corporate tax determines the disposable profit for multinationals. Ong et al. (2012) argued that the burden of corporate tax negates the profit maximisation principle for multinational enterprises in locating FDI for the obvious reasons that it reduces after tax profit, therefore, implying that multinationals can shift their investment from a location to another which appears to be favourable. High tax rate inclines to deter FDI. Thus to attract investment in labour-intensive industries which can be sited in other favorable location a reasonable corporate tax regime will be required (Golpira, Abdolreza, & Rui ,2016). Justman, Thisse, and Van Ypersele (2005) argued that tax policies are fundamental for companies wishing to invest in other countries.

FDI was defined by the United Nations Conference on Trade and Development (UNCTAD) (2017 P3) "as an investment in a long term relationship and reflecting a lasting interest and control by a resident entity in one country (foreign direct investor or parent enterprise) in an enterprise resident in another country other than that of the foreign direct investor". Morriset (2000) further buttressed that it involves the injection of foreign capital into enterprises operating in a different country other than the country of the investor.

FDI can be classified as either Inward FDI or Outward FDI, the former being the injection of foreign funds into local resources and the latter being the direct investment of funds abroad (UNCTAD 2017). FDI also has three components which are equity capital, reinvested earnings and intra-company loans (UNCTAD 2017). However, this excludes investment in stock market. FDI is specifically geared towards the investment of foreign assets into domestic goods and services (Agwu, 2014).

Over the years until 2014, Nigeria has been ranked high amongst the destination for foreign capital inflow. However, there has been a consistent decline in the flow of foreign investment, the world investment report in 2012 revealed that foreign capital inflow fell to $6.1 billion approximately (N933.3 billion) and a decline of 78.1 % in the following year and in the third quarter of 2016 it recorded no foreign capital inflow (UNCTAD 2016).

According to Ioan-Alin and Dragos (2013) companies are seeking multiple ways to reduce cost and this leads to competitive pressure to find new strategies in gaining competitive advantage. Thus, companies are in search of locations where they can achieve their desired competitive advantage which includes cheap labour, exemption from tax payment, tax incentives and low corporate taxes. Easson (1992) opines that the use of tax incentives and tax reductions can stimulate the flow of foreign direct investment. Tomonori (2012) put forward that various economies have implemented policies aimed at reducing corporate taxes in order to stimulate FDI inflows, this includes economies such as Germany where its tax rate was reduced from 26% to 15%, United kingdom from 30% to 19%, Netherland, Finland and Denmark reduced its tax to 25% , Switzerland at 21.2% and recently the United states of America under the leadership of president Donald Trump reduced its taxes company income tax rate from 35% to 21%. This therefore supports the assertion of the tax competition theorist. This theory as opined by Oates (1972) explains that economies are in competition for FDI inflow and they have advanced the use of tax cuts and other tax incentives as a lure for their motive.

However, Arogundade (2005) argued that besides taxation, other factors such as security, currency convertibility, political stability and economic factors acts as fundamental drivers to

 doi:10.20944/preprints201809.0084.v1

attracting FDI. This was in consonance with the study of Haberly and Wojcik (2014) where they found no relation between tax and FDI, supporting this also is the study by Kinda (2014) as he found out that taxation does not affect the inflow of FDI but other variables such as market size, openness, availability of natural resources and development size of the financial sector. Julio, Alves and Tavares (2013) also put forward that corruption is one of the factor that negates the inflow of FDI. It is a known fact that African countries are marred by corruption and Nigeria ranks high on that index as revealed by transparency international.

However, researchers have argued that tax burdens are a negating factor and also an attracting factor (Babatunde & Adepeju ,2012; Gordon & Hines, 2002; Okolo, Okpalaojiego, & Okolo, 2016; Haiyamba ,2013) implying that a high tax burden deters investment, while reduced taxes and incentives endears FDI. Other studies have rejected this assertions stating that that taxes and tax incentives does not affect the flow and pattern of FDI. Van and James (2010); Keen and Mario, (2009), from their observations, they put forward that tax reduction and incentives comes with a cost and therefore results to a loss of government revenue

Therefore, the fundamental question is whether tax incentives are a significant driver of FDI? This therefore calls for a reappraisal of the effectiveness of tax incentives in stimulating FDI inflows. Thus this paper is aimed at evaluating corporate taxation and foreign direct investment in Nigeria.

This study is purely conceptual, thus the remainder of the study is organised as follows, section 2 which discusses concept of corporate taxation and foreign direct investment, section 3 discusses the theories of taxation, section 4 will conclude the paper.

2.0 Review of literature

2.1 Foreign Direct Investment

Foreign direct investment, also known by its acronym as FDI was defined by Voget (2014) as an investment in assets of firms by foreign entities especially by multinationals' but also including individuals or government given the fact that they own a lasting interest. According to the Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) the ownership of at least 10 % of the voting power by the foreign investor is an evidence of such long lasting interest (Walker, 1983). On a closer look Bellak and Leibrecht (2009) posit that it includes plant, property and equipment (P.P.E) which therefore reflects real capital, it also includes a "Greenfield investment"; by Greenfield investment it is meant that a company establishes presence in a foreign market by means of constructing a new factory or facility. It may also include the acquisition of a foreign firm directly or to expand an existing affiliate as well as cross-border merger and acquisition called "Browfield direct" investment (Galeza & Chan, 2015).

2.2 Corporate Taxes and FDI

Corporate income tax applies to corporation, that is, business firms other than individuals (Mark & Molly, 2014) .Corporate income tax is designed as a tax on corporate profit. Broadly defined by Mark and Molly (2014) corporate profit is the total income minus cost associated with generating the profit, these may include expenses such as employee compensation, advertising, general supplies, transportation, interest payment, a decline in the value of property, plant and equipment and other expenses, the statutory tax rate is then deducted from the income.

Company income tax is payable for a year of assessment on the profit of any company accruing in, derived from, brought into or received from a trade, business or investment in Nigeria at a statutory rate of 30% (Ekpung & Wilfred, 2014), the law regulating this tax is the Company income tax Act, CITA CAP C21,L.F.N 2004 as amended 2007, it regulates the taxation of private companies, public companies as well as petroleum operations. The Federal Inland Revenue service is the sole administrator of this tax.

In November 2010, the republic of Ireland was faced with some financial challenges as it was under pressure to push up its corporate tax rate as a rescue for its financial challenge but declined, stating that its corporate tax regime is non- negotiable and a red flag to development, it maintained that its tax base was fundamental to FDI inflow and by extension development, and the country was not willing to mortgage that for anything, at that time its tax rate was 12.5% (Treanor 2010; Kesley, 2011). This assertion was supported Ekpung and Wilffred (2014) when they found out in their study that high corporate tax endangers the economy and it discourages development. Fakile and Adegbile (2011) are of the view that low corporate tax rate are part of the policies employed by developing countries to increase FDI inflow, this is in consonance with the case of Ireland in 2010. Taxes are a very common variable across many studies on FDI location. Moreover supporting their findings is the study by Okoi and Edame (2013) whose result shows that high corporate tax rate is witnessed in Nigeria and may have an adverse effect on FDI inflow, thus hampering the benefit of FDI inflows in the country. Hence high corporate tax may reduce the incentive of foreign investors to invest in both physical and human capital (Okoi & Edame, 2014). According to Haufler, and Wooton (1997) multinationals prefer to be located in larger economies that have larger market, better products and infrastructure; even if the statutory tax rates are higher. Thus for developing countries like Nigeria which on one hand may have the market but on the other hand lack infrastructure, a reduction in the rate of corporate tax may help to balance the equation between other infrastructures which are not present. In essence a reduction in tax rate will help strike a balance between statutory tax chargeable and other amenities which are not present. If a country has not got all the infrastructure and still charges a high tax, it therefore means that it is unconsciously inferring that firms should relocate to countries where infrastructures are available, this is evidenced from the article by Okon (2016) published by the punch newspaper where it was gathered that a Nigerian indigenous firm (Erisco Foods Ltd) threatened to fire over 1500 staff and relocate its operations to China on the grounds that the cost of running business in Nigeria was quite exorbitant. Thus corporate tax should compensate for the unappealing infrastructure, market competition, market size and other factors (Raff & Srinivasan, 1998). This was further corroborated by Altshuler, Grubert, and Newlon (2000) when they posit that the location of FDI by multinationals have been an area of active research in international taxation; therefore taxes are indicated to have a strong influence on the location of FDI.

The imposition of several taxes such as company income tax, sales tax, value added tax, excise tax and many others should be premised on the expectation effect of taxation on investment and economic activity of which the inflow of FDI is a component (Hines, & Desai, 2001).

2.4 Global Perspective of Corporate Tax and FDI

Tax incentives have become a global phenomenon world-over. Government strive to attract multinational companies and enhance the associated technology spill-over as countries employs tax incentives and tax reductions as a tool for stimulating the inflow of FDI (Eason, 1992). This has therefore gained the attention of researchers on globalisation and tax competition, and has led to the premise that the use of tax incentives acts as a stimulant to attracting foreign direct investment inflow with empirical studies supporting the response of FDI to taxes (De-Mooij & Ederveen, 2006; Feld & Heckemeyer, 2009). Moreover, there seems to be a downward trend in the rate of corporate statutory tax in the European union (Olofsdotter & Hansson ,2010).

The United Nations Industrial Development Organisation (UNIDO) reported in 2008 that the flow of FDI globally reached an all time high of USD1.3 trillion during the year 2000. It was also reported that continents such as china, North America, Asia and European economies recorded a high volume of business investment inflows. However, the report revealed that America, Japan and countries in the European Union together accounted for 71% of the worlds FDI due to lucrative tax incentives (UNIDO, 2008). While Asian economies of China recorded high business transaction and celebrated further success in attracting FDI, despite broad skepticism about the benefits of globalisation, majority of U.S. states had offered lucrative tax incentives to attract investment. Consequently, Africa's share of world investment fell from its previous 1% to a further low of a mere 0.67% (UNIDO, 2008). Consequently, African countries were encouraged and supported to set up Investment Promotion Agencies (IPAs) to "market" their attractions and create a one-stop-shop and to smoothen the pathway for incoming investors. As a comparison, in the year 2002, Nigeria with an estimated population of 120 million attracted FDI of USD 22 billion, while Malaysia with much fewer population and far less natural resources attracted FDI that almost tripled the Nigeria's figure of USD 22 billion – and not much has changed since then (UNIDO, 2008).

 doi:10.20944/preprints201809.0084.v1

2.5 Corporate Taxes and FDI in Nigeria

As Africa's most populous country, Nigeria boasts of the continent's second largest oil reserves and has a very promising growth outlook, though Nigeria has been characterised by political instability, corruption, inadequate infrastructure, and poor macroeconomic management which have hindered economic development and growth (Babatunde & Adepeju , 2012). The drive for FDI was emphasized by Nigeria when it joined in the formation of the New Partnership for African Development (NEPAD). In view of the NEPAD initiative, the government is working toward developing stronger public-private partnerships for roads, agriculture, and power through the attraction of FDI among other measures. A National Council on Privatisation was established, and in addition the Nigerian Investment Promotion Council (NIPC) has been strengthened to serve as a one- stop office for clearing all the requirements for investment in Nigeria. This is through the promulgation of Nigerian Investments Promotion Commission Act Cap n.117 (1995), LFN. These incentives can classified as general incentives and specific incentives, the former being incentives that stimulate and attract foreign and domestic investment to all sectors of the economy; the latter being incentives specific to specialized industries. Examples of general incentives includes but not limited to pioneer status, which is a tax incentive exempting qualifying companies from paying taxes in their formative year(it includes up to five to seven years tax holiday for qualifying companies),capital allowance on qualifying equipment such as plants, pipelines, buildings, storage tanks and capital expenditure on drilling activities, tax incentives on research and development as well as export incentive (Fakile, & Adegbile 2011).

The essence of these incentives is to enable these companies make reasonable profit for reinvestment which will therefore have an effect on the flow of investment as well as the level of income receipt in the long run. Modugu, Eragbhe and Izedonmi (2012), opines that taxation goes hand in hand with economic growth and lifeblood for governments to deliver essential services and to make long-term investments in public goods. If this is so, there is need for a trade –off between the level of taxation and development, thus creating an enabling environment for businesses and creating an avenue for these businesses to make profit while developing the economy on the other hand. It is a known fact that the government cannot shoulder all the problems of a country. Thus there is need for partnership at some level, but what is partnership without profitability?

Stapper (2010) is of the view that investors emphasise more on incentives that deal with taxation such as tax-holidays and accelerated depreciation implying therefore that firms that commence business activities in a new country have different preferences about their motives in relevance with firms that expand their motives (Rolfe, Ricks, Pointer & McCarthy, 1993); Attracting FDI is commendable but maintaining and keeping them is what is of utmost important, other tax policies that act as stimulant to attracting FDI may include tax holidays, investment allowance, capital allowance and others but they seem to lose their potency over time as the businesses are also hit by the inflation and other unfavourable factors which tend to lower the effects of this policies.

In effect, the profit of these firms dwindles and they tend to look towards countries having more favourable tax regimes such as reduced statutory taxes on profit. According to Lall (2001) he opines that, in Ghana, investment allowances and tax-deductible R&D expenditures failed to evoke a significant response from the business community, as well as a study carried out by Trela and Whailey (1991) which examined the impact of rebates of direct and indirect taxes on exports, investment allowance, tax holidays and investment tax credits on Korean

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growth performance. Ayanwale (2007) conducted a study on the effect of foreign direct investment on the performance of the manufacturing sector and Nigerian economy and revealed that Nigeria is struggling to attract more foreign investors. Fakile and Adegbile (2011) elaborated on the effectiveness of tax incentives in Nigeria; the effectiveness of tax incentives is likely to vary depending on a firm's activity and its motivations for investing abroad. Growing evidence shows, for example, that tax incentives are a crucial factor for mobile firms and firms operating in multiple markets, such as banks, insurance companies, and Internet-related businesses. This is because these firms can better exploit different tax regimes across countries, tax rates generally have a greater effect on the investment decisions of export oriented companies than on those seeking the domestic market or location-specific advantages, because such firms not only are more mobile but also operate in competitive markets with very slim margins. A study carried out by Basu and Srinvasan (2002) in Lesotho and Swaziland revealed that a generous tax incentive positively influences the inflow of FDI. Akaegbu (2012) also noted that the gap in poor investment growth and low contribution to FDI in Nigeria manufacturing sector is as a result of persistent increase in multiple taxation. He pointed out that multiple taxation has affected the Gross Domestic Product of the country. High tax rate will reduce the incentives of people to invest in both physical and human capital. When tax rates are high foreign investors will look for other places to put their money and domestic investment will look for investment projects abroad were taxes are low (Okoi & Edame,2014). It is pertinent that at some point the government could adjust its policies and waive taxes to an extent consequently to attracting FDI and maintain them as its numerous benefits cannot be undermined.

3.0 Theories of Taxation and FDI

3.1 Tax Discrimination Theory

Tax discrimination is when outsiders are taxed differently from insiders, where "insiders" refers to nationals, resident individuals, and resident companies (Mason & Knoll, 2012). According to Glaeser (2001) who was the proponent of this theory, he postulated that government imposes different tax rates based on regions and investments. The tax rate is determined by demand for firms to locate in a particular location. The government applies tax discrimination to encourage development in the rural areas. Tax holidays and low tax rates are given to investors to locate their businesses to less developed areas from the major cities and towns. According to Mason (2006), tax discrimination subjects the residents and non –residents to different tax regimes in the same jurisdiction. The resident tax payer is usually taxable on all of his or her global income, whereas a non – resident is taxable on income derived in the host state. According to the European court of Justice (ECJ) through Mason (2006) he argues that tax discrimination promotes economic efficiency and integration of the European common market.

3.2 Eclectic Paradigm Theory

The Eclectic theory is demonstrated by Dunning (1980, 2000, 2008) as a combination of three different theories of FDI based on the following advantages (O-L-I). Ownership advantages (O), Location advantages (L) and Internalisation advantages (I). This theory is termed as the OLI theory or framework. All the three factors are important in determining the pattern and extent of FDI. Eclectic theory embraces all existing theories of FDI. The theory is a framework for identifying some determinants of FDI. The OLI theory is relevant to consider the process of establishing why Nigeria has attracted FDI because of tax incentives offered which is the highlight of this study. Countries should attract FDI by reducing inherent costs and derive maximum benefit. Because of this, most countries grant tax incentives to attract FDI. This theory therefore suggests that multinational corporations develop competitive advantages at their home country and then transfer these advantages to specific countries based on the location advantage in that country which also helps to internalize the ownership advantage.

3.3 Tax Competition Theory

Tax competition theory was propounded by Oates (1972) as cited in Rikard (2005), the theory opines that the government lowers fiscal burdens to encourage the inflow of productive resources, often explained as a measure of attracting FDI, the offshoot of this theory has resulted in increase in skilled human capital and financial investment by lowering overall taxation or special tax preferences (Wakaguyu, Mwangi, Kennedy, & George 2017).

This theory further assert that tax competition is an important determinant of investment distribution across countries. This theory has motivated the researcher in asking questions on the impact of reduced corporate taxes, and has given rise to the objectives of this study.

This theory differs from other theory as it explains the reaction of Investment inflow to cut in corporate tax rates. According to Rikard (2005), this theory assumes that an increase in tax rate on capital in a region creates a "fiscal externality" in other region, this is because the tax increase in one region leads to capital inflow in other regions. According to Oleska (2013) tax competition aims at decreasing fiscal burdens in anticipation for an increase inflow of productive resources, in light of this study such as Bénassy-Quéré, ,Fontagné, and Lahrèche-Révil. (2005); Heinemann, Overesch, and Rincke (2010) and Devereux, and Loretz. (2012) have tested the connection between tax competition and FDI, this study follows suit and adopts this theory to underscore the relationship between corporate taxes and FDI in Nigeria

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4.0 Conclusion

This paper provides some observations taken from empirical study. Its purpose was to shed light on the relationship between taxation and FDI in developing countries and conceptually reviewed literature on the subject matter. Most African governments are yearning to improve the livelihoods of their citizenry with the agenda of reducing poverty and fostering economic development. Proponents of economic development have regarded FDI as one of the essential components for securing higher growth rates (Okon, Augustine and Chuku, 2012; Melnyk, Kubatko and Pysarenko, 2014; Pulstova, 2016) There is massive competition by these national governments to acquire as much FDI as possible, thereby using tax incentives to reap the benefits that this FDI may bring with it (Babatunde & Adepeju, 2012). Studies have also shown that corporation taxes has a significant influence on the location of FDI in Nigeria. it is therefore pertinent that a cursory look be given to the subject matter and various policy recommendation should be applied.

However, the study might be limited as it has not tested the variables empirically, as such, this study is limited and suggest further study testing the relevant variables, such as Company income taxes, exchange rate volatility, degree of openness, and corruption.

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