THE IMPACT OF THE TAX STRATEGY ON TAX COMPETITION AND INVESTMENTS

Sargsyan Surik Nairi

Institute of Economics, National Academy of Sciences, Armenia

suriksargsyan@gmail.com

ABSTRACT

The international tax competition is an integral component of the modern world economy. The tax policy pursued by various states to attract foreign investment, tax base and other opportunities to increase tax revenues often goes beyond rationality and leads to unfair competition. The implementation of effective tax strategy aimed at attracting effective investments is one of the most important tasks of Armenia's current economic routine, which successfully depends on future economic stability and tax competitiveness in the international economic field.

1. INTRODUCTION

Financial-economic crisis of 2008 revealed that Armenian economy structural peculiarities were critical by their type. At the present stage of economic development taxation strategy importance becomes more significant. The high level of poverty, public debt dramatic increase and a number of socio-economic indicators continues increase prove that for state policy realization, serious financial resources are required for overcoming them. Due to free market economy basic sub-provisions adoption by Republic of Armenia, almost all infrastructure facilities have been privatized; hence the state revenue most important source was and will be the tax revenue. In such circumstances, taxation strategy enhancement for rational tax system formation purposes is the demand of time.

In parallel with integration and intensification processes activation in the whole world, the efforts of various countries of attracting investments being the main factors of economic growth are also enhanced. It is obvious, that in any competition there are winners and losers so this field is not an exception. In investments involving process, the tax system plays a significant role, as a rule. Tax code various tools usage improves investments environment, affecting on capital international flows volumes and directions, and as a result in the countries ignoring this and indifferent to taking appropriate measures just opposite development tendencies are being observed.

2. TAX COMPETITION

Foreign investments attracting strategy exists in international taxation competition doctrine. From a broader perspective, in various countries international tax competition is characterized as taxes elements confining any non agreed manifestation[1]. Tax legislation obligatory or substantial elements refer to:

- the subject of the taxation (taxpayer), represents legal individuals and entities framework who are liable for paying taxes;
- an object of tax, which represents the turnover, goods and services deals; wealth and property accumulation, which entails the obligation to pay taxes;
- taxation database representing the quantitative estimation of objects, which are subject to taxation;
- Tax rates which can be rough (some fixed amount, for example, a license fee charged for dealing with a particular type of activity): interest (as a fixed rate in relation to a taxable object),

or mixed as a combination of above stated rough and mixed usage. In addition to the roughness interest and mixed characteristics, tax rates are also characterized by progressivism, regression and equalization.

- Terms of tax payment that stipulates the period during which the taxpayer must meet it.
- Tax payment procedure that defines taxes paying method, thus in person or through the third party (via a tax agent) as well as tax commitments occurrence, linking taxpaying commitment with monitory funds de facto accomplishment or obtaining the right of making it.

In addition to the substantial elements, national tax code may also confine tax additional elements which can significantly affect on taxation relations logics and volumes too. Extra elements are:

- Tax privileges system that confines a certain privileged status for an individual taxpayer aimed to resolve the priorities established in the tax strategy;
- Responsibility for violation of tax legislation that punishes unfair taxpayers in the event of tax obligations improper performance.
- The levy of taxes, returning the overpaid taxes and clearing procedures, as well as a more specific set of other elements specific only to certain types of taxes.

In narrower definitions, the authors focus on individual manifestations of international tax competition. For example, according to a view, the essence of international tax competition is to attract "global taxpayers" to the national tax area in order to levy taxation of taxable turnover outside the national economy (Pogorleckiy, 2005).

International tax competition is characterized by the following criteria:

1. Tax competition is related to the non agreed actions of the sovereign state in the strategic field, which leave their impact on their taxpayers.

2. Tax competition reflects individual elements of taxation in such differences, that in that case they basically meet the specific needs of a particular group of taxpayers and influence to the tax decision they make.

3. Tax competition objects, taxpayers of the outside world whose taxable facilities are flexible enough and can be moved to another tax competence field.

We can separate short-term and long-term objectives of tax competition. The short-term goal of tax competition is to provide additional tax revenues, while the long-term goal is the economic development and growth. As a result of tax competition, it is possible to achieve a high level of development of the financial and physical infrastructure, technological clusters formation, and increasing population income to reduce the unemployment. The ultimate goal of tax competition is to attract more taxable objects to the field of tax jurisdiction. Naturally, it is necessary to distinguish the natural differences of separate elements of the tax systems in different countries from the differences in the above-mentioned functions.

First of all, tax competition becomes apparent in the elements of taxation, such as tax rate, privileges for each or a separate group of taxpayers, as well as manipulation of the taxable object, base, period, terms of payment and methods. Practically there are also mechanisms not related to elements of taxation: the process of easy registration of taxpayers, simplified classification of privileged groups, etc. However, the main direction of tax competition is fees objective taxation, tax rates and privileges, and the other aspects have a secondary importance (OECD, 2004).

3. DISCUSSION

It is natural to suppose that, despite tax rates, the complexity and complication of the tax system also affects to the foreign investment volume. This impact is linked with the cost of attracting additional human and material resources for following tax possesses, with possible defaults and temporary losses. However, the empirical analysis made it possible to estimate that the effect is about 10 times less than the change in tax rates that means that reducing the complexity of the tax system up to 10% for foreign investment has the same impact as reducing taxes on corporate taxes (Martina, 2013).

Each country should develop and implement its own tax strategy, which must comply with the priorities and superiorities of the country. In this case, Armenia is not an exception, and the priorities of reforming the taxation strategy should be based on the type of development that the country owns and the logics for current issues solution. Tax system is known to affect the decisions of making investment, but the increase of foreign and immediate investment through the tax system cannot be a sole aim by itself. Researches have shown that corporate taxes reduction leads to an increase in such investments, leading to their quality characteristics worsening. The increase in such taxes leads to a more significant extra value and investment orientation, which is the preferred direction of economic growth. In this sense, taxation strategy directed to foreign investment promotion should balance the investment qualitative and quantitative specifications (Johannes et al, 2012).

In these conditions, one of the main goals of the state economic strategy is to involve highly qualified investments, in which it is also important to accomplish the corresponding taxation strategy.

At first, it seems that tax competition between different countries as a type of free market competition, is a positive phenomenon that in a global sense, leads to positive changes in the global economy. Indeed, international tax competition has several advantages. First, as a type of competition, tax race leads to a straitjacket of authorities' actions in the tax field.

In the absence of competition, the authorities have more opportunities to adjust the tax system with the interests of a specific group, while its existence gives the private sector greater flexibility and disobedience to the provocations of unjust authorities. Moreover, tax competition is a unique tool that allows disclosing public demands, priorities of economic and tax reform promotes innovative solutions and optimal management of limited public resources and furthers social progress. Meanwhile, a study of professional literature shows that positive opinions and approaches to tax competition are typical for professionals from developed countries, while views in the positive development of tax competition in transitional and underdeveloped countries are more restrictive and even negative.

First, on the base of the positive approach, the starting point is that both private entrepreneurship and the public usually require high-quality public services and welfare, including the tax service. Paid taxes are often associated with the use of public goods, and therefore receiving more public goods for the same or smaller tax payments is perceived as a higher indicator of the effectiveness of the government. So a high level of tax profitability, including tax competitive advantages, creates basis for increasing capital inflows and enhancing opportunities for progress.

But in real life, not everything is so clear. Practically it is possible and often there are situations when taxpayers demand poor-quality public goods. Among them, there may be gaps and imperfections in tax legislation, lack of transparency in financial data, lack of cooperation and exchange of information with tax authorities of states, lack of environmental protection and a corresponding tax, which ultimately leads to loss of publicity and leads to tax advantages. This picture is typical for small, offshore as well as unsuccessful political institutions.

According to these developments, many researchers are concerned that in recent decades more and more countries have resorted to destructive methods of taxation (OECD, 1998).

In order to resist the "tax heaven", many countries have to make similar non prospectus reforms, which can lead to a situation where the fiscal function of the tax system is terminated, which will lead to deepening of debt relations and a steady increase of public debt. To counteract such anxiety, various international organizations have developed and implemented mechanisms to prevent unfair tax competition. Over the past decade, OECD experts have submitted annual reports analyzing manifestations of unscrupulous tax competition (OECD, 2017).

It is also important to add that the studies show that tax policies are characterized by diversity and different approaches mainly in developing countries, which not only contradict the practical solutions used in developed countries, but also the landmarks in the professional literature (Gordon et al, 2009). This shows that in the field of tax strategy these countries are trying to overcome certain ways of development by creating tax exemplary systems. Moreover, the impact of the tax on economic growth in real life is less than in the case of corruption. R. Fisman and J. Svensson have research the dependence of organizations on the growth of taxes and corruption. The analysis led to the conclusion that a 1% increase in corruption leads to a 3% decrease in the growth rate of the organization, which is three times more than the effect of tax increases. This means that in the state economic strategy in the fight against corruption should be allocated an equally important part as the tax cuts and economic stimulation strategy with tax privileges (Fisman et al, 2007).

Therefore, tax policy and corruption are the key factors that influence the adoption of business decisions. Studies have shown that high tax rates and high levels of corruption negatively affect on business decisions making. However, the presence of the impact on high tax rates in the case of corruption led to unexpected results in the case that higher tax rates have a slight negative impact on entrepreneurial activity than without the corruption scenario (Belitski et al., 2016).

According to the authors' assessment, corruption exists to avoid paying taxes, which means that corruption can compensate for the negative impact on high taxes. Naturally, such a statement is impossible to use to assess corruption as a positive phenomenon, as it promotes fraud or crime (tax evasion) and impunity.

It is required a certain amount of tax revenue to implement the fiscal function of taxation. Naturally, varying the rates of different types of taxes, the same taxable income can be collected in completely different proportions of different types of taxes in equal conditions. It is possible to assert theoretically and practically that different types of taxes have a different effect on economic activity and, consequently, the rates of economic growth. For example, empirical studies have shown that the impact of corporate taxes on economic growth is more evident than individual taxes. It is estimated that an increase in the tax rates by 10 percentage points leads to a decrease in annual economic growth by 1-2 percentage points (Lee et al., 2005).

4. CONCLUSION

In the Republic of Armenia, the reduction of investment flows in recent years is one of the most discussed and anxious topics in society. Not surprisingly, the priority of all governments without exception was the attraction of large-scale foreign investment, which, unfortunately, had not been achieved. Moreover, taking into account the rapid growth of public debt during previous years the burden of services will grow during next years. In all long-term stress tests of sustainability of public debt, the most important indicators of economic growth and foreign investment are the fact that, in the event of their failure, the value of the public debt burden goes beyond the safe level of control. Therefore, the development of a tax strategy aimed at forming a competitive tax system in the international arena is a laborious task that should become the basis for the formation of a competitive investment environment.

Reference:

Погорлецкий, А.И. Принципы международного налогообложения и международного налогового планирования. - СПб. : Изд-во С.- Пе- терб. Гос. ун-та, 2005.- С. 123.

The OECD's Project on Harmful Tax Practices: The 2004 Progress Report. Paris: OECD, 2004.

L.Martina, "Do complicated tax systems prevent foreign direct investment?" Economica, Volume 80, Issue 317, January 2013, Pages 1-22,

B. Johannes, F.Clemens, R.Nadine, "Corporate tax effects on the quality and quantity of FDI". European Economic Review, Volume 56, Issue 8, Pages 1495-1511 , November 2012.

Harmful Tax Competition: An Emerging Global Issue. – Paris: OECD, 1998.

OECD (2017), Harmful Tax Practices - 2017 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264283954-en

R.Gordon, W.Li, "Tax structures in developing countries: many puzzles and a possible explanation". Journal of Public Economics, Volume 93, Issues 7-8, August 2009, Pages 855-866

R.Fisman, J.Svensson, "Are corruption and taxation really harmful to growth? Firm level evidence.". Journal of Development Economics, Volume 83, Issue 1, May 2007, Pages 63-75

M.Belitski, F. Chowdhury, S.Desai, "Taxes, corruption, and entry". Small Business Economics, 2016, vol. 47, issue 1, 201-216

Y. Lee, R. H. Gordon, "Tax structure and economic growth". Journal of Public Economics, Volume 89, Issues 5-6, June 2005, Pages 1027-1043.