THE RATE OF CORPORATE INCOME TAX AND THE INVESTMENT ATTRACTIVENESS OF THE VISEGRAD GROUP COUNTRIES

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Abstract:
Despite geographical proximity and the European Union membership, the diversity of the Visegrad Group countries still largely continues. An excellent example of this trend are their rates of Corporate Income Tax. In spite of the Value Added Tax rates harmonization within the European Union, the particular member states still have a considerable degree of autonomy in terms of imposing Corporate Income Tax rates. This diversity leads to a specific tax competition between countries. On more than one occasion this influenced significantly the investment location decisions of the investors from other countries. Hence, it is worth investigating the Corporate Income Tax rates of the Visegrad Group countries in relation to the countries investment attractiveness. The article has a form of a research paper. The objective of the article is to compare the Corporate Income Tax rates imposed in each of the Visegrad Group countries in relation to the foreign investment levels in those countries as measured by foreign direct investment. The conclusion of the article is that the Corporate Income Tax rates in the countries of the Visegrad Group have not an impact on the value of foreign investment in these countries.

Keywords: corporate income tax, Visegrad group, investment attractiveness, rates

1. INTRODUCTION

The Visegrad Group was established in 1991 as an informal association of four neighbouring states located in Central and Eastern Europe: Poland, Hungary, the Czech Republic and Slovakia. These countries play an important economic role in the region. They can be seen as a bridge between the "old" European Union member states and Easter Europe. The total area of those countries amounts to more than 12% of the entire European Union and they are inhabited by nearly 13% of the EU population.

Since the political transformation that was initiated in 1989 the attractiveness of investing in the Visegrad Group countries has increased significantly. Another accelerator in this respect was their accession to the European Union in 2004 (Onufer, 2011). It is to underline that, according to a study by Ernst & Young undertaken in 2009, in the opinion of investors, Central and Eastern Europe would become the most attractive region for investment (Ernst & Young, 2009). However, after five consecutive years, the situation has changed. The region's appeal was lost in the eyes of investors and it was given the fourth place in the ranking of the most attractive regions for establishing operations, after Western Europe, North America and China. In spite of that, the countries of the Visegrad Group are maintaining their leading positions among the countries of Central and Eastern Europe in terms of the attractiveness of investment (EY, 2014).

Despite their geographical proximity and the European Union membership, the diversity of the Visegrad Group countries still largely continues. The same can be said about the economies. An excellent example of this trend are the tax regulations and practices. In spite of the Value Added Tax harmonization within the European Union, the particular member states still have a considerable degree of autonomy in terms of imposing Corporate Income Tax. Different rates and statutory definitions lead to a certain tax competition between countries. Repeatedly this has significantly influenced the choice of investment location by investors from other countries. All of the above makes it worthwhile to have a closer look at the topic of Corporate Income Tax in relation to the investment attractiveness and significance for the European Union countries of the Visegrad Group.

This article is an attempt to compare the rates of the Corporate Income Tax in force in various countries of the Visegrad Group in relation to their investment attractiveness as measured by the inflow of foreign direct investment. The first part of the article will be devoted to issues related to the Corporate Income Tax, with particular focus on rates of this tax. In the second part foreign direct investment will be further analyzed. The third part of the article will have a value added – it will be an attempt to identify the relationship between tax rates of the Corporate Income Tax in the Visegrad countries and foreign direct investment in the said countries.

2. TAX RATE OF THE CORPORATE INCOME TAX

The concept of income tax found a practical application relatively recently. It was first used in England in 1799. Originally, the emphasis was on the taxation of natural persons. But over the years its range has been extended also to legal persons. At the beginning of the 20th century there a specific separation of the Personal Income Tax and the Corporate Income Tax took place. The first such cases occurred in the United States and Germany in 1920. After World War II, this solution has become popular in many other European countries (Kalinowski, 1996).

Despite the similarities in the characteristics of the tax systems of different countries, it is always possible to discern larger or smaller discrepancies in regards to the regulations concerning specific taxes. The European Union from the 1960s sought to harmonize taxes among the member states. However, the effects of these measures varied. While this process underwent more effectively in the case of indirect taxes, it was difficult to look for significant strike forward in relation to the Corporate Income Tax. Here the progress was limited to three directives in the field of corporate taxation:1) Council Directive 90/434/EEC of 23.07.1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States; 2) Council Directive 2003/123/EC of 22.12.2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States; 3) Council Directive 2003/49/EC of 3.06.2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member

States. At the same time a highly advanced work has been undertaken with regards to the concept of Common Consolidated Corporate Tax Base (CCCTB).

It is important to bear in mind the fact that the progress on the harmonization of the Corporate Income Tax has been and still is being hampered by the actions of the opponents. They continue to argue against the unification of this tax. Vast variations between countries in terms of the redistribution of income or their fiscal policy have been pointed out in this regard (Gaetan, 2006).

The lack of harmonization in terms of the Corporate Income Tax results in the existence of tax competition between countries of the European Union. Here we ought to quote the words of Milton Friedman: „Competition among national governments in the public services they provide and in the taxes they impose is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices at which they offer them." (Biswas, 2002, p.3). States can compete against each other in terms of the Corporate Income Tax on several levels. On the one hand, there may be exclusions and exemptions. On the other hand, various kinds of legal definitions can be used. Repeatedly, it can also affect the tax rate itself.

The tax rates is a changeable element of the tax structure. It is defined as a ratio of the tax amount to the tax base (Mastalski, 2009). In other words, it is the percentage of income paid as tax. The rates of the Corporate Income Tax in the European Union are clearly differentiated. Currently, they are in the range between 10% in Bulgaria to almost 34% in Belgium.

Table 1: CIT rates in the countries of the Visegrad Group

	2007	2008	2009	2010	2011	2012	2013
the Czech Republic	24%	21%	20%	19%	19%	19%	19%
Hungary	20%	20%	20%	19%	19%	19%	19%
Poland	19%	19%	19%	19%	19%	19%	19%
Slovakia	19%	19%	19%	19%	19%	19%	23%
the European Union average	23.97%	23.17%	23.11%	22.93%	22.70%	22.51%	22.75%

Source: www.oecd.org and www.kpmg.com

In the Visegrad Group countries is it worth looking at the Corporate Income Tax rates in a longer time frame. A good reference point may be the recent economic crisis. Therefore, Table 1 shows the data for Visegrad Group countries for 2007-2013 (2007 - just before the crisis; 2010 - during the crisis; 2013 - current data). In 2007 we see a difference in the rate of the Corporate Income Tax between Poland and Slovakia – 19%, Hungary – 20% and the Czech Republic – 24%. The economic crisis has forced the countries of the region to embark on a greater competition for investments. A manifestation of this tax competition could be seen, for example, in a clear standardization of tax rates.

In 2010 in all countries of the Visegrad Group the rate of the Corporate Income Tax were already at the level of 19%. During the three following years only one change appeared in this regard – in 2013 Slovakia increased the tax rate by 4 percentage points to 23%. The rationale for this change was to move away from the flat tax rate and the necessity to seek ways to increase revenues to the budget related to the excessive deficit of the public finance sector. It is worth noticing that during the same time the average rate of the Corporate Income Tax in countries belonging to the European Union was higher and moved in the range between 23,97% in 2007 and 22,51% in 2012.

Therefore, it becomes apparent that the rates of the Corporate Income Tax in the Visegrad Group countries are relatively homogeneous. Moreover, in the recent years an additional unification has been under way.

3. INVESTMENT ATTRACTIVENESS

Contemporary economies are immersed in a global economy and need sustained growth and development. Economic development is influenced by multiple factors, both domestic and foreign. Nowadays, the source of support for economic development are international capital flows, regardless of all foreign direct investment. Foreign direct investment (FDI) is one of key factors supporting the host country economic development and international economic integration.

Foreign direct investment (FDI) is defined as an investment made by a resident of one economy in another economy, and it is of a long-term nature or of lasting interest. Moreover, the investor has a significant degree of influence on the management of the enterprise. A significant degree of influence on the management of the enterprise is determined as 10 per cent of the voting shares or voting power (UNCTAD, 2009b).

Foreign direct investment consists of an investment in or the acquisition of foreign assets with the intent to control and manage them. Companies can make a FDI in several ways:

- purchasing the assets of a foreign company;
- investing in the company or in new property;
- investing in plants or equipment;
- participating in a joint venture.

Flows of FDI include capital provided by a foreign direct investor to an enterprise or capital received from an investing enterprise by a foreign direct investor. FDI has three components (Miroux, 2007):

- equity capital – that is the foreign direct investor's purchase of shares of an enterprise in a country other than its own;
- reinvested earnings – that comprises the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor;
- intra-company loans or intra-company debt transactions – that refers to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

Flows of FDI in global economy are strongly dependent on the level of economic activity and trade cycle. The flows of FDI reached their peak in 2007 and afterwards during the global economic and financial crisis the FDI flows have declined. The fall in global FDI in 2008–2009 was the result of two major factors affecting domestic and international investments. On one hand, the capability of firms to invest has been reduced by declining access to financial resources, both internally – due to a decline in corporate profits – and externally – due to a lower availability and higher cost of financing. On the other hand, the propensity to invest has been affected negatively by economic prospects, especially in developed countries that were hit by the most severe recession of the post-war era (UNCTAD, 2009a).

Table 2: Inward foreign direct investment flows

	2007	2008	2009	2010	2011	2012	2013	2007-2013
US Dollars at current prices and current exchange rates in millions								
Czech Republic	10444	6451	2927	6141	2318	7984	4990	41255
Hungary	3951	6325	1995	2202	6290	13983	3091	37837
Poland	23561	14 839	12932	13876	20616	6059	-6038	85845
Slovakia	4017	4868	-6	1770	3491	2826	591	17557
European Union	864045	551413	363133	383703	490427	216012	246207	3114940
Euro area	556140	364393	243406	317496	376712	116845	190651	2165643
World	2001987	1818834	1221840	1422255	1700082	1330273	1451965	10947236
US Dollars at current prices and current exchange rates per capita								
Czech Republic	1010	620	279	582	218	749	466	3924
Hungary	393	630	199	220	629	1402	311	3784
Poland	617	389	339	363	540	159	-158	2249
Slovakia	743	899	-1	326	642	519	108	3236
European Union	1718	1093	717	755	963	423	481	6150
Euro area	1679	1095	729	947	1120	346	564	6480
World	301	270	179	206	243	189	203	1591

Source: UNCTADSTAT

Turbulences in global economy triggered by economic and financial crisis hit Europe, the Euro area countries and the Visegrad Group countries. The aggregate volume of FDI flows in 2007-2013 for the Visegrad Group was 182.494 mln USD – nearly 6 percent of total EU inward flows. The European Union is the largest investor and recipient of FDI. The structure of inward flows for the Visegrad Group is not homogeneous. 47% of total the Visegrad Group FDI flows is directed at Poland, 23% at the Czech Republic, 21% at Hungary and only 10% at Slovakia. The distribution of FDI flows among the Visegrad Group is significantly different when FDI flows per capita is concerned. The highest volume of FDI flows per capita is recorded by the Czech Republic (3924 USD). Both Hungary and Slovakia have reached high level of FDI flows per capita (appropriately 6784 and 3236 USD), whereas Poland has been placed in the last place in that 'capital race' reaching only 2249 USD per capita. The highest level of FDI flows as percentage of GDP has been achieved by Hungary (4 pp), whereas other countries are marked by similar levels of FDI flows in relation to Gross Domestic Product.

Table 3: Inward foreign direct investment flows (percentage of total world)

	2007	2008	2009	2010	2011	2012	2013	Average
In percentage of total world								
Czech Republic	0.52	0.35	0.24	0.43	0.14	0.6	0.34	0.37
Hungary	0.2	0.35	0.16	0.15	0.37	1.05	0.21	0.36
Poland	1.18	0.82	1.06	0.98	1.21	0.46	-0.42	0.76
Slovakia	0.2	0.27	0	0.12	0.21	0.21	0.04	0.15
European Union	43.16	30.32	29.72	26.98	28.85	16.24	16.96	27.46
Euro area	27.78	20.03	19.92	22.32	22.16	8.78	13.13	19.16
In percentage of Gross Domestic Product								
Czech Republic	5.79	2.86	1.48	3.09	1.07	4.06	2.52	2.98
Hungary	2.9	4.1	1.57	1.73	4.58	11.22	2.38	4.07
Poland	5.54	2.8	3	2.95	4	1.24	-1.17	2.62
Slovakia	5.36	5.16	-0.01	2.03	3.64	3.09	0.62	2.84
European Union	5.06	3	2.21	2.35	2.77	1.3	1.42	2.59
Euro area	4.49	2.68	1.96	2.61	2.87	0.96	1.5	2.44

Source: UNCTADSTAT

The global financial and economic crisis caused a serious change in the investment attractiveness of all regions. For example, Europe's share in global FDI inflows has declined significantly and Europe has lost its long-lasting leadership. Europe captured over 50% of global FDI inflows in 2002 whereas in 2013 it was only 20%. Moreover, investment patterns have changed – an increase in sales and marketing projects and a decrease in the size of investment and in average job creation by FDI inflows were recorded. In 2013 the top European host countries with regard to FDI inflows were Germany and United Kingdom. There was an increase in FDI projects focusing on services to more than two-thirds of all inflows and a decrease in FDI projects in manufacturing from more than half of FDI inflows (EY's attractiveness survey. Europe 2014 – Back in the game, 2015).

Poland and the Czech Republic are in top 15 European countries by FDI projects and Poland has achieved the third place in top 15 European countries by FDI job creation. Poland and the Czech Republic are two top central European destinations of FDI inwards flows, but they are facing different competitors. The majority of investments is in automotive, plastic and rubber sectors and R&D driven by international software companies (EY's attractiveness survey. Europe 2014 – Back in the game, 2015).

4. IMPACT OF THE INCOME TAX RATE ON THE INVESTMENT ATTRACTIVENESS OF THE VISEGRAD GROUP COUNTRIES

A set of empirical studies focused on the identification of the factors that determine investors' decisions regarding the location of investments. Those studies pointed out various significant factors associated with FDI inflows. The most compelling factor, identified by the majority of the studies, is associated with FDI business opportunities reflected in the size and growth potential of host country market. Also, the investment climate and taxation seem to matter. The largest economies attract the

most FDI – the example here are the United States (Battat, Hornberger and Kusek, 2011) and Poland, the largest economy in the Visegrad Group, which also records the highest volume of FDI inflows. The size of the domestic market and the perspectives of growth are what matters most.

The literature indicates a number of factors affecting foreign direct investment. Among them we distinguish (Wawrzyniak, 2010): the size of the market and its growth rates, the cost and quality of the workforce, the degree of openess of the economy, its geographical distance, risk, the level of corruption and taxes. The size of the market takes on a particular significance for foreign direct investment aiming to acquire ownership shares in the local market. Greater or dynamically growing market also encourages increased investment. The cost and quality of the workforce play a key role. Investors are often interested, although it is not a rule, in lower costs associated with a cheap labor force. However, we must remember that in sectors where companies use advanced technologies the presence of the skilled workers will be more important for the inflow of FDI. The degree of openness of the economy comes down to an objective that investors put in front of them. On the one hand, they may prefer to start operations in a country due to the difficulties in importing manufactured goods or services. On the other hand, an orientation towards exports of manufactured products may encourage companies to invest in economies characterized by high openness. An interesting factor in FDI is geographical distance. It is understood as an element which is reflected in transport costs. Higher transport costs encourage investments in the country of destination. Another determinant of the location of foreign investment is risk. It is analyzed from two perspectives: the macroeconomic and the political. In both cases, the higher the risk the less positive the influence on the propensity to invest. The case of corruption, which is not welcomed by investors, is similar. The final factor affecting FDI are the taxes. We take here into account mainly the rate of the Corporate Income Tax. As a rule, it is considered that with increasing taxation the propensity to invest lowers. The research carried out partially confirmed this thesis. This has been demonstrated in the studies by (Wawrzyniak, 2010): Billington in 1999, Wei in 2000, Cartensen and Toubal in 2004, Bellak and Leibrecht in 2005 and in 2007, Bellak, Leibracht and Riedl in 2008 and Leibrecht and Stehrer in 2008. At the same time, several other studies have shown the insignificant influence taxes have in relation to FDI. This has been demonstrated by: Kirkpatrick, Parker and Zhang in 2006, Torrisi, Delaunay, Kocia and Lubieniecka in 2008 and Lada, Tchorek in 2008. A small impact of taxes on foreign investment was also indicates in EY's report from 2014 (EY, 2014), where the Corporate Income Tax has taken just the 8th positions among 10 factors that companies take into account when deciding on a location to establish operations.

In the recent years three of the Visegrad Group countries has lowered and unified the Corporate Income Tax rate on the level of 19 per cent. Slovakia has increased the Corporate Income Tax rate from 19% to 23%. In this study, no statistical correlation between the Corporate Income Tax rate and the investment attractiveness has been shown. Three groups factors can be identify to clarify the lack of correlation: the impact of global financial and economic crisis that triggered FDI inflows, the role of more significant markets drivers on FDI and taxation more long-run incentive than short-run.

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