

Review Article

A STUDY ON THE USES OF TAXATION IN DEVELOPING COUNTRIES

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ABSTRACT

The paper is intended to study the basic trends and the uses in the distribution of the total tax burden in the developing countries. The comparative analysis is focused on the cross-country differences in terms of total tax burden, measured by the tax-to-GDP ratio and design of tax structure, presented by the breakdown of the total tax revenues into standard components such as direct taxes, indirect taxes and social contributions. The relationship is investigated by the means of the regression analysis. The conclusion is that tax structure based on direct taxes is more efficient in terms of supporting the economic growth. Taxation is the process of a government claiming money from the general population for the purpose of using that money to run the country. Ideally, a government will only spend the amount it gains in taxation, although in the Western world it usually spends far more and runs a budget deficit.

Keywords: Purpose of Taxation, The Highest and Lowest Corporate Tax Rates in the World

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INTRODUCTION AND THE PURPOSE OF TAXATION

Generally, taxes provide the funds for public goods and services that cannot be adequately produced by the competitive market. Examples include schools, roads, and national defense. Additionally, taxes can be added to transactions such as sales. Governments can also tax events, such as death via an estate tax also known as an inheritance tax. Taxes can also be used to push consumers away from goods or services that are deemed harmful. This type of tax is known as a "sin tax". This is usually a state tax on tobacco, alcohol, or gambling. In some societies, taxes have also been used to redistribute wealth to create a more equitable society. All in all, the effective use of tax dollars is the center of a long-standing economic debate.

Increasing the amount of tax collected in developing countries is crucial for development. Tax revenue has a wide array of benefits: spurring infrastructure, strengthening the social contract, and encouraging good governance.

Tax tends to be a rather technical and niche issue. Due to its niche status, it can easily be considered to be obscure or unimportant in the larger debates on humanitarian aid and development. Yet this is a mistake because development requires money to finance it, and money must be acquisitioned from somewhere. Hence there needs to be increasing discussion of the role of tax revenue in international development because it is a vital, yet often absent, component of advancement.

The current situation shows that low-income countries typically collect taxes of between 10-20 percent of GDP, while the average for high-income countries is more like 40 percent. Clearly there needs to be an organized effort to help developing countries increase their tax revenue to match a similar level as developed nations. The current problem we have in the global tax system, which affects the developing world particularly acutely, is one of chronic unfairness as businesses that can afford to pay are failing

to do so. The issue can be outlined by the findings from a report commissioned by Concord. Concord, the European NGO confederation for relief and development, found that in tax revenue alone, at least \$100bn was lost from developing countries through insufficient international tax policies. One example study found that if corporations paid fair amounts of tax, Honduras could "increase healthcare or education spending by 10-15 percent if the practice of profit shifting by US multinationals was stopped". Multinational companies are evading social responsibility through their failure to contribute little or no tax. Corporate tax evasion strategies, referred to as 'base erosion and profit shifting' (BEPS), can be done through measures such as transfer pricing manipulation. Global Financial Integrity in Washington estimates the amount at several hundred billion dollars lost annually due to transfer mispricing.

There are various methods and types of taxation both for individuals and businesses and corporation tax is not the only potential avenue. The Africa Research Institute produced a paper arguing that property tax would benefit the African economy in raising revenue. They write that, "property taxation is widely regarded as highly progressive and equitable because the sum due is determined by wealth rather than being a percentage on transactions." This 'wealth' tax is another potential strategy in which those that can afford to pay more, do so, and hence can help to build national infrastructure such as social housing through tier tax contributions.

There are several reasons for wanting to encourage global taxation. First of all, the implementation of domestic taxation allows developing countries to begin to finance their own infrastructure and hence to take control of their national development. In theory at least, higher tax revenues should mean that the state is able to invest and deliver a comprehensive range of public services such as schools, hospitals, the police force and

social security. This allows country to move from dependence on foreign aid and to a more sustainable and long-term approach to development. Moreover, the 17 Sustainable Development Goals set as part of the 2030 Agenda require a huge amount of financial investment. In order to fund the ambitious targets of the SDGs, developing countries can contribute through raising tax revenue at home.

There is also a deeper sociological reason behind taxation. Taxes establishes a certain social bond between the individual and the state. With the notion of the citizen and the state engaged in a 'social contract' comes the responsibility of the individual and the government to cooperate and participate in good governance. This issue of good governance, in the form of Government transparency and accountability in handling tax revenue and spending it in the benefit of its citizens, must also be a priority in addressing the economic situation of developing countries. Establishing a process of taxation could help stimulate and regulate good governance in developing countries. One practical way in which developed nations can empower the developing world to take charge of their own welfare is through such things as training and equipping tax inspectors, investing in institutional infrastructure, ensuring tight legal regulations, and supporting civil society groups.

Global tax justice is an issue which deserves much more consideration than it currently receives. By setting up a

collaboration between Governments, tax experts and NGOs and adopting practical strategies around domestic taxation, the developing world can make progress in steering their own development in the international community.

THE HIGHEST AND LOWEST CORPORATE TAX RATES IN THE WORLD

The majority of the 208 separate jurisdictions surveyed have corporate tax rates below 25 percent and 103 have tax rates between 20 and 30 percent. The average tax rate among these jurisdictions is 23.03 percent,[3] or 26.47 percent weighted by GDP. The United States has the 83rd highest corporate tax rate with a combined statutory rate of 25.84 percent.

The twenty countries with the highest statutory corporate income tax rates span every region, albeit unequally. While nine of the top twenty countries are in Africa, Europe and Asia appear in the top twenty only twice each. Of the remaining jurisdictions, one is in Oceania, and six are in the Americas.

The only other countries with large economies in the top twenty are India (35 percent), France (34.43 percent) and Brazil (34 percent). India holds the ninth spot, while France holds the 16th, and Brazil holds the 17th.

Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.

| Country | Rate | Region |
|---------------------------------------|--------|---------------|
| United Arab Emirates[4] | 55% | Asia |
| Comoros | 50% | Africa |
| Puerto Rico | 39% | North America |
| Suriname | 36% | South America |
| Chad | 35% | Africa |
| Congo, The Democratic Republic of the | 35% | Africa |
| Equatorial Guinea | 35% | Africa |
| Guinea | 35% | Africa |
| India | 35% | Asia |
| Kiribati | 35% | Oceania |
| Malta | 35% | Europe |
| Saint Maarten | 35% | North America |
| Sudan | 35% | Africa |
| Zambia | 35% | Africa |
| Sint Maarten (Dutch part) | 35% | North America |
| France | 34.43% | Europe |

| | | |
|-------------------------------------|--------|---------------|
| Brazil | 34% | South America |
| Venezuela | 34% | South America |
| Reunion | 33.33% | Africa |
| Cameroon | 33% | Africa |
| Worldwide Average | 23.03% | N/A |
| Worldwide weighted average (by GDP) | 26.47% | N/A |

Table 1: Twenty Highest Corporate Income Tax Rates in the World

On the other end of the spectrum, the twenty countries with the lowest non-zero statutory corporate tax rates all charge rates lower than 15 percent. Eleven countries have statutory rates of 10 percent, six being small European nations (Andorra, Bosnia and Herzegovina, Bulgaria, Gibraltar, Kosovo, and Macedonia).

The only two major industrialized nations^[5] represented among the bottom twenty countries are Ireland and Hungary. Ireland is known for its low 12.5 percent rate, which has been in place since 2003. Hungary reduced its corporate income tax rate from 19 to 9 percent in 2017.

Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.

| (Excluding Countries Without a Corporate Income Tax) | | |
|------------------------------------------------------|-------|---------------|
| Country | Rate | Region |
| Cyprus | 12.5% | Europe |
| Ireland | 12.5% | Europe |
| Liechtenstein | 12.5% | Europe |
| Macao | 12% | Asia |
| Moldova, Republic of | 12% | Europe |
| Andorra | 10% | Europe |
| Bosnia and Herzegovina | 10% | Europe |
| Bulgaria | 10% | Europe |
| Gibraltar | 10% | Europe |
| Kyrgyzstan | 10% | Asia |
| Macedonia, The Former Yugoslav Republic of | 10% | Europe |
| Nauru | 10% | Oceania |
| Paraguay | 10% | South America |
| Qatar | 10% | Asia |
| Timor-Leste | 10% | Asia |
| Kosovo, Republic of | 10% | Europe |
| Hungary | 9% | Europe |
| Montenegro | 9% | Europe |

| | | |
|-------------------------------------|--------|------|
| Turkmenistan | 8% | Asia |
| Uzbekistan | 7.5% | Asia |
| Worldwide Average | 23.03% | N/A |
| Worldwide weighted average (by GDP) | 26.47% | N/A |

Table 2. Twenty Lowest Corporate Income Tax Rates in the World

Of the 208 jurisdictions surveyed, twelve currently do not impose a general corporate income tax. Most of these countries are small, island nations. A handful, such as the Cayman Islands

and Bermuda, are well-known for their lack of corporate taxes. Bahrain has no general corporate income tax but has a targeted corporate income tax on oil companies.[6]

Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.

| Country | Region |
|--------------------------|---------------|
| Anguilla | North America |
| Bahamas | North America |
| Bahrain | Asia |
| Bermuda | North America |
| Cayman Islands | North America |
| Guernsey | Europe |
| Isle of Man | Europe |
| Jersey | Europe |
| Palau | Oceania |
| Turks and Caicos Islands | North America |
| Vanuatu | Oceania |
| Virgin Islands, British | North America |

Table 3. Countries Without General Corporate Income Tax

REGIONAL VARIATION IN CORPORATE TAX RATES

Corporate tax rates can vary significantly by region. Africa has the highest average statutory tax rate among all regions, at 28.81 percent. Europe has the lowest average statutory corporate tax rate among all regions, at 18.38 percent.

When weighted by GDP, South America has the highest average statutory corporate tax rate at 32.2 percent. Europe has the lowest weighted average statutory corporate income tax, with a rate of 25.43 percent.

In general, larger and more industrialized nations tend to have higher corporate income tax rates than smaller or less developed nations. These rates are usually above the worldwide average. The G7, which is comprised of the seven wealthiest nations in the world, has an average statutory corporate income tax rate of 27.63 percent, and a weighted average rate of 27.21 percent. OECD member states have an average statutory corporate tax rate of 23.93 percent and a rate of 26.58 percent when weighted by GDP. The BRICS[7] have an average statutory rate of 28.40 percent and a weighted average statutory corporate income tax rate of 27.33 percent.

| Region or Group | Average Rate | Weighted Average Rate | Number of Countries |
|-------------------------------------------------------------------------------------------------------------------------------------|--------------|-----------------------|---------------------|
| Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture. | | | |
| Africa | 28.81% | 28.39% | 50 |
| Asia | 20.65% | 26.42% | 46 |
| Europe | 18.38% | 25.43% | 49 |
| North America | 23.01% | 26.22% | 33 |
| Oceania | 22.00% | 27.04% | 17 |
| South America | 28.08% | 32.20% | 13 |
| BRICS | 28.40% | 27.33% | 5 |
| EU | 21.86% | 26.03% | 28 |
| G20 | 27.37% | 27.18% | 19 |
| G7 | 27.63% | 27.21% | 7 |
| OECD | 23.93% | 26.58% | 36 |
| World | 23.03% | 26.47% | 208 |

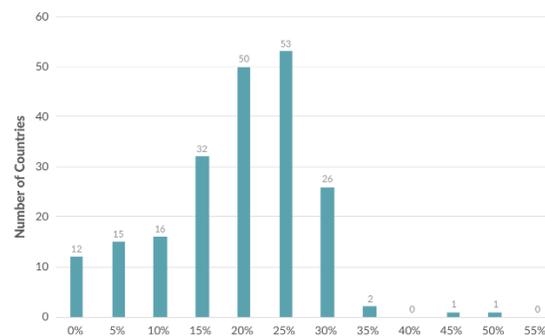
Table 4. Average Corporate Tax Rate by Region or Group

Distribution of Corporate Tax Rates

Very few tax jurisdictions impose a corporate income tax at statutory rates greater than 35 percent. The following chart shows a distribution of corporate income tax rates among 208 jurisdictions in 2018. A plurality of countries (103 total) impose

a rate between 20 and 30 percent. Twenty-eight countries have a statutory corporate tax rate between 30 and 35 percent. Seventy-five countries have a statutory corporate tax rate lower than 20 percent and 178 countries have a corporate tax rate below 30 percent.

Distribution of Worldwide Corporate Tax Rates, 2018



Source: Tax Foundation. Data compiled from numerous sources including: PwC, KPMG, Deloitte, and the U.S. Department of Agriculture.
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The Decline of Corporate Tax Rates Since 1980

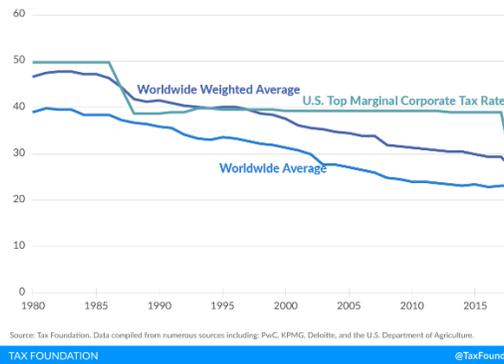
Over the past 38 years, the corporate tax rate has consistently declined on a global basis.[8] In 1980, the unweighted average worldwide statutory tax rate was 38.84 percent. Today, the average statutory rate stands at 23.03 percent, representing a 41 percent reduction over the 38 years surveyed.

The weighted average statutory rate has remained higher than the simple average over this period. Prior to tax reform, the

United States was largely responsible for keeping the weighted average so high, given its relatively high tax rate, as well as its significant contribution to global GDP. Figure 2 shows the significant shift in both the corporate tax rate in the United States in 2018 as well as the impact that change had on the worldwide weighted average. The weighted average statutory corporate income tax rate has declined from 46.63 percent in 1980 to 26.47

percent in 2018, representing a 43 percent reduction over the 38 years surveyed.

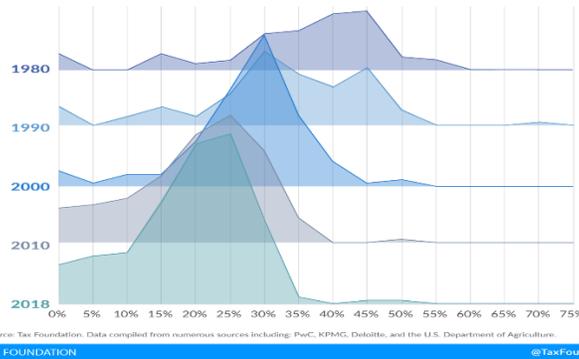
Top Marginal Corporate Tax Rates Have Declined Since 1980



Over time, more countries have shifted to taxing corporations at rates lower than 30 percent, with the United States following this trend with its tax changes at the end of 2017. This changing distribution of corporate tax rates has been far from consistent.

The largest shift occurred between 2000 and 2010, with 77 percent of countries imposing a statutory rate below 30 percent in 2010 and only 42 percent of countries imposing a statutory rate below 30 percent in 2000.

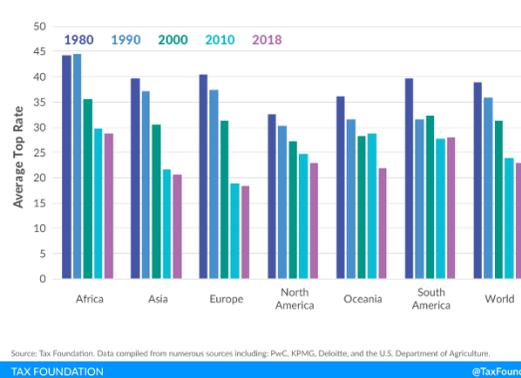
The Worldwide Distribution of Statutory Corporate Income Tax Rates, 1980-2018



All regions saw a net decline in average statutory rates between 1980 and 2018. The average declined the most in Europe, with the 1980 average of 40.5 percent dropping to 18.38 percent, representing almost a 55 percent rate reduction. South America has seen the smallest decline, with the average only decreasing by 29 percent from 39.66 percent in 1980 to 28.08 percent in 2018.

Africa, Oceania, and South America all saw periods where the average statutory rate increased, although the average rates decreased in all regions over the full period. In each instance of an average rate increase, the change was relatively small, with the absolute change being less than 1 percentage point between decades.

Average Top Corporate Income Tax Rate by Region and Decade



CONCLUSION

Average top corporate tax rates continue to fall across the world, and the recent change to the corporate taxes in the United States is a continuation of that trend. Several countries are planning to reduce their corporate tax rates in the coming years.[9] Today, the United States' statutory corporate tax rate is closer to the middle of the distribution and closer to the worldwide average. Countries considering cutting their corporate tax rates could look to potential benefits of attracting business investment and a more competitive tax environment.

Developing countries would benefit from improved tax collection.

The ability to raise revenues from taxes – called “fiscal capacity” – is a crucial aspect for the functioning of any state. Being able to tax citizens, and collect revenues efficiently, is a cornerstone of state formation and survival. Secondly, greater fiscal capacity implies greater access of the state to resources needed to provide public goods and services.

Developing countries are only able to raise a small share of taxes. Typically, they collect between 10% to 20% of GDP. The average in high-income countries is double this, at 40%. These low rates are the consequence of many problems. First, the large size of the informal economy. Second, a lack of investment in tax collection – most developing countries rely on sales taxes, which are easier to administrate than personal taxes, but entail lower revenues.

Low tax collection rates have devastating consequences on development. They mean that governments aren't able to invest in public goods such as health, infrastructure and education. Even the Sustainable Development Goals, which aim, among other things, to build effective, accountable and inclusive institutions at all levels, have set mobilising revenues as a goal on its own.

In our paper on taxation in developing economies we focus on the question: why do they tax so little? We focus particularly on the role of the state in creating an environment conducive to collecting taxes. And we also try to offer some solutions. We posit that political systems that place strong constraints on executive power would be more likely to lead to taxation systems that have a higher degree of accountability and transparency than heavy handed measures to enforce compliance.

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5. The United Arab Emirates is a federation of seven separate emirates. Since 1960, each emirate has the discretion to levy up to a 55 percent corporate tax rate on any business. In practice, this tax is mostly levied on foreign banks and petroleum companies. For more information on the taxation system in United Arab Emirates see PwC, “Worldwide Tax Summaries – Corporate income tax (CIT) rates.” Major industrialized nations are those who are members of the OECD.
6. This tax rate can be as high as 46%. See Deloitte, “Tax guides and highlights.”
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