

Exploring the Impact of Global Economic Factors on Corporate Income Tax: Evidence from OECD Countries

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Abstract

Corporate income tax is a cornerstone of fiscal policy, with far-reaching implications for economic development and business operations. As governments seek to fund public expenditures and achieve socio-economic goals, the design and implementation of corporate tax regimes are at the center of government policy agendas. On the other hand, companies navigate tax considerations when making decisions in terms of investing, managing operations, and optimizing financial performance. This study aims to examine the factors that affect corporate tax revenue in OECD countries from 2006-2021 using a quantitative approach and the Generalized Method of Moments (GMM) method. As for the findings in this study, foreign direct investment has no effect on corporate tax revenue. Manufacturing value added and trade openness have a positive influence on corporate tax revenue.

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1. INTRODUCTION

In the modern tax system, one of the important players in tax collection is the company. Tax payments by companies include not only taxes on corporate profits, but also personal income taxes, payroll taxes, taxes on sales, taxes on business property, as well as value-added taxes and excise taxes. However, when it comes to business taxation, the public debate focuses on corporate income tax. Corporations are widely seen as powerful actors with a significant impact on the economy, owned and controlled by wealthy individuals. Therefore, many people think that taxing corporate profits is important to achieve a fair distribution of the tax burden (Fuest & Neumeier, 2023).

In terms of competition for the tax base moving in a “race to the bottom”, countries are forced to compete with the widening trade openness, especially in corporate income tax rates (Genschel & Schwarz, 2011; Van Ganzen, 2023). Back in 2021, the European Commission issued a council directive ensuring a minimum effective tax rate for the global activities of large multinational groups. The proposal includes some general rules relating to the calculation of effective tax rates, so that they can be applied correctly and consistently across the European Union (EU). The existence of such rules can protect the level playing field for European businesses, ensuring that they all pay their fair share of corporation tax (Biondi, 2023).

The 137 participating countries that have signed up to the OECD's inclusive framework for a global minimum tax of 15% can choose whether they want to adopt the OECD's Pillar Two Model Rules or have to accept the adoption of Pillar Two Rules by other countries. This agreement establishes Global Anti-Base Erosion (GloBE) rules designed to ensure that

large multinationals with consolidated revenues of more than 750 million Euros pay a minimum effective tax rate of 15% on “excess profits” arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum rate. A Group with an effective tax rate below the minimum rate in a particular jurisdiction will be required to pay additional tax, either to its head office location or to a jurisdiction with a low tax rate. The global minimum tax seeks to limit tax competition on investment capital and profit shifting by introducing a globally uniform base for corporate tax (Schjelderup & Stähler, 2024).

Tax authorities around the world have introduced corporate tax compliance approaches. These approaches open up the possibility for tax authorities and corporate taxpayers to move away from an adversarial and often harmful relationship, and instead establish a more constructive and cooperative *modus operandi*. This new way of working can take the form of formal participation in so-called cooperative compliance programs as introduced, for example, by the tax authorities of Australia, the Netherlands, South Africa, the United Kingdom, and the United States, but cooperative relationships can also exist without formal participation in such programs (Siglé et al., 2022).

Concerns over worsening government budget deficits and rising government debt have sparked renewed interest in the macroeconomic impact of fiscal policy. The emerging consensus is that tax-based fiscal consolidation is generally associated with large output declines, but its composition also matters. In particular, policymakers often suggest that base broadening measures, such as limiting exemptions, closing loopholes, or reducing tax expenditures, can raise revenues and be less harmful to economic activity than tax rate increases. However, there is little empirical evidence to support this assumption (Dabla-Norris & Lima, 2023).

However, corporate taxes have proven to be quite beneficial to innovation in both categories of countries as they fund research and development, which is crucial in promoting innovation. Among the most prominent barriers to fostering innovation is the quality of governance (Balsalobre-Lorente et al., 2021).

In recent years, a key issue in this debate has been the claim that multinational corporations (MNCs) do not pay their fair share of taxes because they can avoid taxes by shifting profits to tax havens. This has led to calls for international tax coordination with the aim of combating tax evasion (Fuest & Neumeier, 2023).

This paper examines several indicators that can affect corporate tax revenue in OECD countries. The analysis focuses on how corporate indicators can affect corporate tax revenue in OECD countries in recent years, including how trade, outside companies, and manufacturing production can increase corporate tax revenue in OECD countries.

2. LITERATURE REVIEW

Tax Revenue Theory

Tax revenue or tax income is the revenue generated by the government through taxes in the country, it includes taxes collected on income and profits, social security contributions, taxes levied on goods and services, payroll taxes, taxes on ownership and transfer of property, and other taxes. Total tax revenue as a percentage of Gross Domestic Product (GDP) indicates the share of a country's output that is collected by the government through taxes. It can be considered as one measure of the extent to which the government controls economic resources. The tax burden is measured by taking total tax revenue received as a percentage of GDP (OECD, 2024).

Taxing is a keyway for countries to generate public revenue that allows them to finance investments in human capital, infrastructure, and the provision of services to their people and businesses. However, various crises have had the effect of reducing developing

countries' revenues while increasing their expenditures in recent years. The need to improve revenue collection is particularly urgent in countries that until recently collected less than 15 percent of their GDP in taxes. This level of taxation is an important tipping point for a country to survive and stay on a growth path. To continue economic growth, reduce poverty, and support climate action, countries need to improve tax collection and create fairer and more efficient tax systems. Governments need to balance objectives such as increased revenue mobilization, sustainable growth, and reduced compliance costs with ensuring that tax systems are fair and equitable. Fairness considerations include relatively equal taxation of the poor and the rich, corporate and individual taxpayers, urban and rural areas, formal and informal sectors, labor and investment income, and older and younger generations. A more efficient tax system can also enable the private sector to play an important role in job creation (World Bank, 2024).

Corporate Income Tax (CIT)

Corporate income tax is a cornerstone of fiscal policy, with far-reaching implications for economic development and business operations (Sureth-Sloane & Langeleh, 2007). As governments seek to fund public expenditure and achieve socio-economic goals, the design and implementation of corporate tax regimes are at the center of the government's policy agenda. On the other hand, companies navigate tax considerations when making decisions on investing, managing operations, and optimizing financial performance (S. Gupta et al., 2009).

Corporate income tax is a very important source of revenue for governments, allowing them to finance public goods, social programs, and infrastructure development. By taxing corporate profits, governments seek to redistribute wealth, address income inequality and improve social welfare (Auerbach, 2002; S. Gupta et al., 2009). In addition, corporate taxes play an important role in macroeconomic stabilization, as policymakers adjust tax rates and incentives to manage inflation, stimulate aggregate demand, and counteract economic downturns. Through fiscal policy measures, governments aim to achieve a balance between revenue generation, economic growth, and equitable distribution of resources (Jesus et al., 2024).

In reality, taxation of corporate income is a powerful tool that can directly impact corporate profitability, in addition to being used to influence economic behavior and compensate for inequalities in income distribution. Strategically, this taxation can be used to stimulate investment and protect national companies from foreign competition. While taxes on corporate income can provide state revenue and stimulate economic behavior, corporate taxation has negative impacts as well. Therefore, it is imperative to establish a balanced taxation that considers its impact on the economy and society, ensures corporate competitiveness and tax fairness (Jesus et al., 2024).

Foreign Direct Investment (FDI)

Multinational Corporations (MNCs) are seen as having a greater opportunity to engage in income tax avoidance in the host country. MNCs involved in tax avoidance will use aggressive tax planning techniques such as exploiting loopholes in tax regulations to gain tax advantages from mismatches between countries' tax rules to minimize their tax burden and subsequently, avoid paying their fair share of taxes. This is achieved by several means such as locating and shifting business operations to lower tax jurisdictions, exploiting differences in tax rules across countries, and utilizing tax incentives provided by the host country (Kasim & Saad, 2019; Zimmerman, 1983).

On the other hand, FDI inflows through the entry of new firms or increased new investments by foreign investors, may enlarge the corporate income tax base. An increase

in FDI inflows may translate into an increase in MNC profits in the host country, and will ultimately lead to an increase in corporate income tax receipts (Gnangnon, 2017, 2020). Some previous studies that have conducted research related to FDI on corporate income tax have been conducted by Gnangnon, (2020) which states that FDI can increase the volatility of corporate income tax revenues in less developed countries, but reduce it in relatively developed countries. Surbakti & Wijaya, (2023) stated that the positive effect of FDI on corporate tax revenue is generated through the impact of FDI which is able to encourage business development, human capital, and transactions that have a domino effect on tax revenue.

H1: Foreign Direct Investment (FDI) has a positive effect on Corporate Income Tax Revenue.

Manufacturing Value Added (MVA)

Industry is a sector that has an important role in a country's economy, this is because industry can create jobs and national income, as well as being a sector with rapid growth compared to other sectors. Industry can be divided into several sectors such as manufacturing, agriculture, mining and so on (Tricahyono & Wijaya, 2023).

The manufacturing industry sector has been able to drive an increase in the rate of economic growth and has become a driver of economic development. Industrialization contributes to economic growth by increasing production capacity, creating jobs, innovation, and optimal use of resources. Progress in the quality of the manufacturing industry sector plays a major role in the national economy, as shown by the large tax contribution compared to other sectors. In addition, the development of downstream industries is able to provide added value to national natural resources, and the distribution of industrial development is more equitable in various regions (Prabowo & Wijaya, 2023).

Prabowo & Wijaya, (2023) in his research states that the industrial sector including manufacturing has a positive impact on tax revenue from goods and services, this is because manufacturing is one of the largest tax contributing sectors, so that when the production of this sector increases, it will result in additional tax revenue in the country.

H2: Manufacturing Value Added has a positive effect on Corporate Income Tax Revenue

Trade Openness (TO)

Revenues from international trade taxes still constitute an important part of a country's total public revenues. Thus, one of the fundamental reasons for adopting restrictive trade policy measures by policymakers in developing countries is the fear of losing this revenue. (Gnangnon, 2019).

De facto measures of trade openness are outcomes that include price-based indicators, and quantity-based indicators such as trade shares (the ratio of exports plus imports of goods and services as a percentage of GDP), which are commonly used in some empirical studies. Squalli & Wilson, (2011) highlighted the limits of traditional measures of trade openness and proposed another de facto trade openness indicator, calculated as a trade share indicator adjusted by the proportion of a country's trade level relative to the world trade average. This indicator has the advantage of providing a good indication of a country's level of integration into the global trade market (Gnangnon, 2019). For robustness checks, we use a standard trade openness measure (i.e., the ratio of exports plus imports of goods and services as a percentage of GDP).

H3: Trade Openness has a positive effect on Corporate Income Tax Revenue

3. METHODOLOGY

This study uses a quantitative approach using the Generalized Method of Moments (GMM) method. The population taken in this study are all countries that are members of the OECD, but the population used is 33 countries that have complete data related to Corporate Income Tax (CIT), Foreign Direct Investment (FDI), Manufacturing Value Added (MVA) and Trade Openness (TO) from 2006 to 2021.

Before conducting the main test, this study first conducted descriptive analysis testing to see the characteristics of each variable used. This test includes the mean, median, maximum, minimum and std. deviation values.

Furthermore, this study uses the Generalized Method of Moments (GMM) method. With the following estimation model:

$$CIT = \beta_1 CIT_{it-1} + \beta_2 FDI_{it} + \beta_3 MVA_{it} + \beta_4 TO_{it} + \varepsilon_{it}$$

Where CIT is Corporate Income Tax for year t. Subscripts i and t represent the number of countries and period covered in the study. FDI, MVA and TO are Foreign Direct Investment, Manufacturing Value Added, and Trade Openness and ε_{it} is a random variable.

Furthermore, to determine the validity of the use of instrument variables exceeding the number of estimated parameters and also to test the consistency of estimates obtained from the data processing process using the GMM test, this study conducted Arellano-Bond testing and Sargan testing.

The mathematical function of the Arellano-Bond test is described in the formula below:

$$m(2) = \frac{\Delta \tilde{V}_{i,t} - 2\Delta \tilde{V}^*}{(\Delta \tilde{V}) \frac{1}{2}}$$

Decision making from the above test if the AR value is greater than α 5% (>0.05). Thus, the consistency of the GMM results is illustrated by the insignificant statistical value at m2.

While the mathematical function of the Sargan test is written in the equation below:

$$S = \tilde{V}' Z \left(\sum_{i=1}^N Z' \tilde{V}_i \tilde{V}_i' Z_i \right)^{n-1} \quad Z' \tilde{V}_i \sim X_{L-(k+1)}^2$$

The decision of the sargan test results is if the p-value $> \alpha$ 5%. However, in this study, the sargan test has been attached to the GMM test results which are indicated by the Prob J-Statistic.

Table 1. Definition of Variables

No.	Variables	Operational Definitions	Measurements	Source
1.	Corporate Income Tax (CIT) (Y)	Taxes on income, profits, and capital gains are levied on the actual or estimated net income of individuals, on the profits of companies and business entities, and on capital gains, whether realized or unrealized, on land, securities, and other assets.	% of Revenue	World Bank

Intragovernmental payments are eliminated in consolidation.				
2.	Foreign Direct Investment (FDI) (X1)	Foreign direct investment is the net inflow of investment to acquire a continuing management interest (10 percent or more of voting shares) in an enterprise operating in an economy other than the investor's economy. It is the sum of equity capital, profit reinvestment, other long-term capital, and short-term capital as shown in the balance of payments. This series shows the net inflows (inflows of new investment minus divestments) in the reporting economy from foreign investors, and is divided by GDP.	% of GDP	World Bank
3.	Manufacturing Value Added (MVA) (X2)	Manufacturing refers to industries that fall under ISIC divisions 15-37. Value-added is the net output of a sector after summing all outputs and subtracting intermediate inputs. Value-added is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources. The origin of value added is determined by the International Standard Industrial Classification (ISIC), revision 3.	% of GDP	World Bank
4.	Trade Openness (TO) (X3)	Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product.	% of GDP	World Bank

Source: Processed, 2024

4. RESULTS AND DISCUSSION

Descriptive Analytics

The analysis in this study begins by looking at the characteristics of the data using Descriptive Analysis of the data, while the results of the descriptive analysis are shown in the table below:

Table 2. Descriptive Analytics

	CIT	FDI	MVA	TO
Mean	35.05357	5.569549	2.003347	103.5189
Median	32.74844	2.969131	2.240241	85.98768
Maximum	86.25267	234.2487	85.32347	393.1412

Minimum	6.865055	-117.3747	-23.21424	23.10475
Std. Dev.	15.38543	17.34818	7.806261	59.89177
Observations	528	528	528	528

Source: Eviews, 2024

Table 2 above shows the results of descriptive analysis in the form of mean, median, maximum, minimum, standard deviation, and number of observations. CIT data shows an average of 35.05357 while the standard deviation value shows a value of 15.38543, smaller than the average value which indicates that the CIT data type does not vary with a maximum value of 86.25267 and a minimum value of 6.865055 from each sample.

The FDI variable shows an average value of 5.569549 and a standard deviation data of 17.34818, greater than the average value which indicates the type of FDI variable data varies with a maximum value of 234.2487 and a minimum value of -117.3747 from each sample.

The MVA variable shows an average value of 2.003347 and a standard deviation data of 7.806261, greater than the average value which indicates the type of MVA variable data varies with a maximum value of 85.32347 and a minimum value of -23.21424 from each sample.

The TO variable shows an average value of 103.5189 and standard deviation data of 59.89177, smaller than the average value which indicates that the TO variable data type does not vary with a maximum value of 393.1412 and a minimum value of 23.10475 from each sample.

Generalized Method of Moments (GMM)

The results of the First Differences Generalized Method of Moments (FD-GMM) estimation are shown in the table below:

Table 3. GMM Analysis Results

Variable	FD-GMM (CIT)
CIT(-1)	0.0000* (0.773521)
FDI	0.7920 (0.002681)
MVA	0.0005* (0.034274)
TO	0.0000* (0.083634)
Obeservasi	462
Instrumen	33

Source: Eviews, 2024

To see the accuracy of the regression results above, several tests are required in testing with the GMM method, including the Instrument Validity test, Arellano-Bond test, and Unbiased test.

Instrument Validity Test

Table 4. Instrument Validity Test Results

Observations	Instrument	Prob(J-Statistic)
462	33	0.386973

Source: Eviews, 2024

From the table above, it is known that the Prob(J-Statistic) value is 0.386973, greater than 0.05, which means that the data in this study includes valid data.

Arellano-Bond Test

Table 5. Arellano-Bond Test Results

Test Order	m-Statistic	Prob.
AR(1)	-3.499527	0.0005
AR(2)	-0.155403	0.8765

Source: Eviews, 2024

Prob. AR (2) in the table above shows a value of $0.8765 > 0.05$, this means that the data in this study does not contain correlation.

Unbiasedness Test

This test is carried out by looking at the coefficient value of the FD-GMM which must exceed the coefficient value of the Fixed Effect Model (FEM) and is smaller than the Common Effect Model (CEM), the results can be seen in the table below:

Table 6. Sargan Test

	FEM	FD-GMM	CEM
Coefficient	0.734919	0.773521	0.996774

Source: Eviews, 2024

Foreign Direct Investment (FDI) on Corporate Income Tax (CIT)

In this study, FDI has no effect on corporate income tax, this is shown in table 3 above which explains the probability value of FDI of $0.7920 > 0.05$. The impact of FDI on tax revenue depends on competition and technology spillover from multinational companies (MNCs), both factors can stimulate productivity (Nguyen-Huu et al., 2014). FDI as one of the country's capital sources plays a crucial role, as FDI needs to implement some appropriate management related to the implementation and regulation in some countries that have complicated economic conditions. As explained by Jemiluyi & Jeke, (2023) in his research states that the absence or even negative effect of FDI on state tax revenues occurs as a result of government regulations that are willing to do various ways so that FDI can enter the country, these regulations such as tax exemptions, providing incentives, and others.

The absence of the effect of FDI on tax revenue can be caused by several factors such as government policies related to incentives, reduction, or even tax exemptions with low potential tax revenue (Jemiluyi & Jeke, 2023). Countries may lose potential and realized corporate tax revenues if tax incentives for MNCs continue to be provided over a long period of time or when transfer pricing issues (including other tax minimization strategies) are discovered. Such incentives may result in no tax revenue for the country, thus resulting in no effect of FDI on the country's corporate tax revenue (Faeth, 2005; Gaspareniene et al., 2022).

In an attempt to avoid higher taxes in the host country, MNCs have through various means shifted profits to countries with lower tax rates commonly known as tax havens, which has led to a significant reduction in taxes (Janský & Palanský, 2019; Reynolds &

Wier, 2016). Tax competition for FDI could potentially have an adverse impact on corporate tax revenue (Gropp & Kostial, 2001).

The results of this study are in line with research from Bayar & Ozturk, (2018) which states that there is no significant effect of FDI on tax revenue at the panel level in OECD countries.

Manufacturing Value Added (MVA) on Corporate Income Tax (CIT)

In this study, value-added output from the manufacturing sector has a positive impact on corporate tax revenue. The manufacturing sector is one of the sectors that allows businesses to generate a lot of profits in addition to value-added products. The manufacturing sector is also considered as the main driver of economic growth, especially in developing countries. These conditions result in the manufacturing sector being easier to tax than other sectors (Minh Ha et al., 2022; Su & Yao, 2017; Wulandari & Wijaya, 2023).

Manufacturing can be a driver of economic growth through the manufacturing sector itself or through its contribution to other sectors because the manufacturing sector has a function as basic capital in the creation of raw materials which will then be processed into finished products that allow it to generate profits (Wulandari & Wijaya, 2023). Because the manufacturing sector is highly dynamic and specialized, with large businesses generating large revenues. As such, corporate tax on manufacturing can be imposed in several tax levies such as direct tax from corporate income tax and indirect tax from sales tax as well as special consumption tax on domestic products (A. Sen Gupta, 2007; Minh Ha et al., 2022).

Increased tax revenue through the manufacturing sector can occur as a result of increased profits that occur in manufacturing companies. The larger the size of a manufacturing company will result in an increase in production output and an increase in company profits, so that the tax burden or tax that must be issued will also be greater. Under these conditions, there is a positive influence of manufacturing companies on corporate tax revenue (Riny, 2024). Companies that have a relatively large size can also be a concern of the government. The government will increasingly supervise companies with a relatively large size to ensure tax compliance of these companies, so that large manufacturing companies contribute to corporate tax revenues (Berliana et al., 2024).

The results of this study are in line with several previous studies which state that the manufacturing sector has a positive influence on state tax revenue, such as research conducted by Minh Ha et al., (2022) dan Wulandari & Wijaya (2023).

Trade Openness (TO) on Corporate Income Tax (CIT)

According to the findings in this study, Trade Openness has a positive relationship with corporate tax revenue. Trade Openness is considered to have a relationship with state tax revenue, especially on trade taxes conducted by companies. The replacement of trade barriers with import duties is one of the primitive measures often taken in trade openness that causes an increase in state tax revenue through companies depending on the amount of import duty tariffs set and changes in the volume of imports (Arif & Rawat, 2018).

According to Gaalya et al., (2017) Trade openness leads to an increase in total factor productivity. More trade openness will further boost a country's productivity level, either at the firm or industry level which in the future will provide an opportunity for low-income countries to raise their level with high-income countries.

Trade openness tends to expand the country's tax base due to the expansion of exports that can improve economic performance. Trade to GDP ratio can have a positive impact on tax revenue because as trade volume, formulation, and economic competitiveness increase, the output of firms to trade will increase, which will indirectly increase corporate assets and profits, which in turn will increase corporate tax collection (Saptono & Mahmud, 2021).

The results of this study are in line with several previous studies which state that there is a positive effect of trade openness on tax revenue, including research from Gaalya et al., (2017) dan Saptono & Mahmud, (2021)

5. CONCLUSIONS, IMPLICATIONS, AND SUGGESTIONS

Conclusions

Foreign direct investment (FDI) shows no effect on corporate tax revenue in OECD countries. This may result from the unexpected consensus of excessive liberal investment policies to increase FDI inflows. In terms of competition for FDI inflows, countries often offer competitive incentives such as tax reductions, tax exemptions, and tax holidays with potentially low tax revenue consequences. The tax avoidance efforts of multinational corporations through various means such as profit shifting to low-tax countries known as tax havens have resulted in significant tax revenue losses, especially in developing countries that do not have the expertise to overcome such challenges.

Manufacturing value added (MVA) has a positive influence, because the added value of manufacturing companies will increase the selling power of the company and in line with this, will increase company profits, so that the tax burden to be paid increases. The condition of increasing corporate tax revenue in this case also depends on the size of the company, the larger the size of the company will attract the attention of the state government to further tighten the supervision of tax payments, so that companies with a large size will be difficult to practice tax avoidance.

Trade openness (TO) has a positive influence on corporate tax revenue. This can happen because wider trade openness will lead to an increase in the export value of domestic companies. Trade openness will provide a high market expansion opportunity, this benefits companies to export. So that with the expansion of the market, companies will experience an increase in output and profits, which will later be taxed with an impact on trade taxes, income taxes, import duties, sales taxes, and so on.

Implications

The results of this study lead to several policy implications. First, existing state revenues should be optimally utilized to improve the quality of public services, which is expected to encourage an increase in revenue, thereby increasing tax revenues. Second, the development agenda should be prioritized for the structural transformation of the economy towards industry, given the significant positive effects of manufacturing on tax revenues and efforts. Third, policies related to foreign investment rules should be further tightened, to avoid undesirable practices from foreign companies, the state government is also expected to be able to consider more efficient policies related to foreign investment by prioritizing public benefits. Fourth, policies related to trade liberalization need to be improved to increase the volume of import and export transactions. Thus, it is expected that international trade tax revenues can be increased. In addition, some efforts should also be directed at expanding the taxation efforts of revenue agencies, especially for countries with low tax efforts. This can be done, for example, through capacity building and the provision of adequate resources. Thus, tax reform should start with reform of the structure, processes and administrative procedures of revenue authorities.

Suggestions

This research can still be expanded by adding several other variables related to corporate tax revenue. Moreover, adding research focus on other tax sectors. So that the researcher's suggestion for further research, adding several more detailed variables related to factors that can affect state tax revenue specifically on corporate taxes such as the addition of company

asset variables, company size, tax avoidance rate, tax ratio, sales tax rate, trade tax rate and others.

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