“Will Corporate Income Tax Rate Dictate the Ease of Doing Business?”

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Abstract

In today’s competitive world, efficiency plays a significant role in weighing business opportunities. There have been various global assessment tools used to rate and rank countries against one another which may influence important political and economic policies. The Ease of Doing Business ranking is a developed index by the World Bank, a tool primarily used to attract investment. One of the indicators of the Ease of Doing Business Index is paying taxes. Although there were many criticisms on the paying of taxes as an indicator, its significance is recognized by the global tax community. This paper aims to find out if corporate income tax rates dictate the Ease of Doing Business ranking. The data analysis employed data mining strategy. The 114 countries listed in the tradingeconomics.com report are analyzed using the concept of ethnocentrism. Findings showed that lower corporate income tax rate does not result to a better ranking in the ease of doing business and the income level of a country does not influence the ease of doing business. An investor is not so much concerned about how much tax he is going to pay in a particular country but on how simple the processes are in doing businesses. Therefore, government’s tax reform does not necessarily lead to a better ranking in the ease of doing business. Should a country contemplate on improving its ease of doing business, its priorities should be on streamlining processes and not decreasing corporate income tax rates.

Keywords: Corporate income tax; ethnocentrism; income level category; Mahalanobis distance; ranking; rates

Introduction

The business environment is an essential factor in creating an improved economic condition. There have been various global assessment tools used to rate and rank countries against one another which may influence important political and economic policies. One such tool is the Ease of Doing Business Ranking and report jointly created by the World Bank and its private sector arm, The International Finance Corporation (Biron, 2013). The report has become one of the Bank’s most high profile publication pressuring governments around the world to meet the Bank’s expectations. The parameters used to rank countries include starting a business, dealing with permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enhancing contracts and closing a business. Incidentally in 2016, the World Bank released its report presenting the limitations on the calculation
of the ranking. These limitations include but are not limited to corruption, financial security, and infrastructure which are equally important to attract investments.

In 2003, the initial publication of the Ease of Doing Business Report elicited criticism from labor unions and International Labor Organizations because it did not take into consideration the consequences of the deregulation of workers and their working conditions (Kelly, et al, 2016). Further, the authors claimed that the report failed to consider the full range of business transaction costs.

Despite the criticisms, the Ease of Doing Business ranking is a model to achieve developmental objectives. The ranking determines which country have better and less complex business regulations and more robust property right protection. This would measure how easy or how difficult it is for an entrepreneur to create and operate a small to medium size business. Countries aim to have a higher standing on the Ease of Doing Business ranking. A high ease of doing business ranking means the regulatory environment is more conducive to start and operate local and foreign firms. Countries desire to provide an enabling atmosphere where economic growth and prosperity is possible. However, the Ease of Doing Business ranking does not aim to measure the overall economy (World Bank Group, 2014).

According to World Bank, the decision to rank the countries is specifically intended to set competition among countries and to enhance the Bank’s private-led development agenda (Kelly & Simons, 2015). Ease of Doing Business expects countries to reduce costs and time associated in creating businesses. The intention of the report is to measure objectively the quality of business laws in different nations. It also identifies the ‘best practices’ on business regulation which is significant for benchmarking and improving entrepreneurship in each country (Mohando, 2009). The World Bank believes that economic growth and job creation are the results of better and improved quality of business regulations.

Eakin & Gray (2009) said that with greater ease of taxation and other factors being equal, investments would flow to the lowest-taxed country. Sometimes, nations engage in tax competition to draw in capital by offering low tax rates (Hassett & Mathur, 2006). The corporate income tax rate is one of the factors which make a country’s economy attractive for investment (Pomerleau, 2015). Studies have revealed that countries compete with one another in attracting investments by reducing corporate income taxes (Devereux, Lockwood, & Redoano, 2004). From the different studies and literature presented, its authors claimed that corporate income tax rate affects investments in general and higher investment is an effect of lower tax rates. There is no study however, which particularly determines the influence of corporate income tax rate to the ease of doing business ranking in a country, which this paper tries to establish.

**Objectives of the Study**

This paper generally aimed to study the influence of corporate income tax rate to the ease of doing business using 114 countries ranked by the World Bank Group. Specifically, this study attempts to: 1. Explore on the characteristics of countries ranked to recognize patterns from the processed data; 2. Present a cross-country analysis of the influence of corporate income tax rates; and, 3. Create a theory related to corporate income tax rates and the ease of doing business.

**Conceptual Framework**

The basis of this study is the prospect theory of Kahneman and Tversky (1979). Prospect theory is an economic theory centered on the idea that people evaluate gains or losses in the face of risk and uncertainty. The theory is not only applicable in investment decisions but virtually in all experiences. People value
gains and losses differently and as such will base decisions on perceived gains rather than perceived losses. If there are two equal choices, one expressed in possible gains and the other on possible losses, an investor will tend to choose the options with possible gains.

Figure 1 shows a direct and unidirectional relationship between corporate income tax rates and the ease of doing business ranking. The index anchors on the premise that firms are likely to succeed if they operate with lesser regulatory fees and requirements (Kelly, Simmons, & Doshi, 2016). One of the indicators of the Ease of Doing Business Ranking is paying taxes. In the independent panel review on The Ease of Doing Business Report, Manuel (2013) cited that paying taxes is one of the most controversial indicators because it is often subject to country-level political debates. Despite of the criticism on the paying taxes indicator of the ranking, the global tax community recognized its importance. The paying taxes has many sub-indicators, however, this study focuses on corporate tax rates. Other forms of taxations are not within the scope of this study.

The ranking develops first-hand information that can stimulate competition among firms. Eakin and Gray (2009) studied 85 countries and concluded that increasing corporate tax rate results to reduction in the investment rate. Further when all other factors in the Ease of Doing Business Ranking being equal, an investor tends to invest on a lesser taxed country. A previous study of Lee and Gordon (2005) found out that a decrease in corporate tax rate could enhance economic growth rate.

**Methodology**

**Research Design**

The research employed a descriptive method to gather information about the Ease of Doing Business of ranked countries and their corporate taxes. The data taken involved 114 counties using data mining strategy. The sources of data were the websites of Trading Economics for the corporate income tax rates, and World Bank Group for the Ease of Doing Business Ranking.

The data analysis employed several steps. First, the researchers downloaded and matched the Ease of Doing Business Ranking as of October 2016 from World Bank website and the corresponding Corporate Income Tax Rates 2015 from Trading Economics.com. From the downloaded data, 16 countries do not have available corporate income tax rates, hence, excluded from the analysis. Data from 98 countries were processed using statistical software. A scatterplot was generated using the ease of doing business rankings in the “y” axis and the corporate income tax rates in the “x” axis. A scatterplot presentation of the data revealed a circular pattern. To understand
the characteristics of the countries, the researchers divided the circle into four parts; the upper and lower areas, the left and right areas. From the scatterplot, the researchers used the concept of ethnocentrism to locate the central reference point and calculated the radius using statistical software. The radius (0.24960) was computed using the Mahalanobis Distance formula. To identify patterns, increasing the radius was necessary (from point 0.2 to 0.4-0.5). Identification and discussion of all countries lying on the increased radii followed. The same process was done for countries lying on the 0.6-0.8 unit radius, 0.9-1.1 unit radius, and 1.3-1.5 unit radius.

The computed radius is identified through Mahalanobis Distance where it considered the grouped classification of each observation. It measures the distance between the central point and a distribution.

Results and Discussion

Figure 2 shows the scatterplot of the Corporate Income Tax Rate versus Ease of Doing Business. The data presented below is not linear. Hence, regression analysis cannot be used to analyze data. It is evident however that the data cluster in a circular pattern.

From the pattern seen in Figure 2, the analysis used ethnocentric approach. An ethnocentric approach determined a central reference point; a mean country used as basis of comparison.

Characteristics of 114 Countries

Countries below the central reference were highly ranked. These ranks range from 1-50 based on the ease of doing business. There are four countries in Asia, 15 in Europe, one in Central America, and one in South America below the reference point. The World Bank categorized these countries as High Income or Upper Middle Income except for Armenia which is a low-income country. World Bank defined low-income economies as those countries with a Gross National Income (GNI) per capital of $1,025 or less using the World Bank Atlas Method in 2015. Countries with GNI per capital between $1,026 and $4,035 are lower middle-income economies while between $4,036 and $12,475 are upper middle-income economies. Countries with GNI per capita of $12,476 and more are considered high-income economies. Countries below the central reference point, however, have rankings in the ease of doing business ranging from 18 to 50 and their corporate income tax rates from 17 to 32.36%. Most of the countries below the central reference are European. These countries are ranked better in their ease of doing business with the high-income category. Of these 15 European Countries, 11 are members of the European Union. Member countries of the European Union are bounded by laws and treaties that result in uniform economic and fiscal policies and practices.

Table 2 presents the discussion of the countries (ranked 53-113 with corporate income taxes of 15-33%) located above the central reference point. There are 23 countries, of which five are from Asia, five from Europe, five from Africa, six from North America, one from South America, and one from Oceania. The countries’ income category are as follows: 4.3% are considered as low income, 30.43% are considered as lower middle income, 39.13% are classified as upper middle income, and 26.08% as high income. These countries have complexities in the ease of doing business as manifested in the ranking.

The common problems experienced by the countries presented above are widespread, encompassing chronic absolute poverty, rising levels of unemployment and underemployment, growing disparities and distribution of income, inappropriate educational and health system and severe international debt problems. Fiscal policies focused on addressing the above problems rather than on creating an environment
conducive to business development and growth. Countries above the central reference are from different continents without formal economic unions that exercised different fiscal and economic policies (Todaro, 2015).

Mongolia and Vietnam charges almost the same corporate tax rates, however, these countries ranked as 56 and 90 respectively in the Ease of Doing Business index. The European scenario presented a similar finding. Serbia and Ukraine have lower corporate tax rates at 15% and 18% respectively, yet, these nations ranked 59 and 83 respectively in the Ease of Doing Business rank. The result is observably similar to that of the countries in Africa, North America, South America, and Oceania. The observation shows that the corporate income tax rates do not determine the ranking of the countries regarding the ease of doing business. Table 3 illustrates the countries located at the left side of the central point.

Countries on the left side of the central reference point have lesser corporate income tax rates ranging from 8-22.5% and Ease of Doing Business rankings of 1-113. There are 48 countries on this side of which the Word Bank categorized 23 of these countries as high-income, 19 as Upper Middle Income, and 6 Lower Middle Income. High-income countries are highly developed countries where fiscal and economic policies focused on economic growth and development, rather than social issues. Among the 48 countries, 14 have income tax rates of 20%. Ten of these countries are from Europe and four are from Asia. Singapore ranked first in terms of ease of doing business. Seventy-five percent of its GDP came from the service industry. Singapore is a country with the best investment potential. It consistently ranked number one in the Ease of Doing Business from 2008-2014. Last 2015, it ranked third and improved to second in early 2016 and regained its standing as number one in last quarter of 2016. Singapore also has the most conducive environment for business compared to the rest of the world, and the best performing Asian country ahead of Hong Kong, Korea, and Japan. It excels in the pillars of institutions, human capitals and research, infrastructure and business sophistication. Its ease of doing business is influenced by lesser government corruption. It also ranked 4th in the listing of least corrupt countries as of 2016. The result of the Global Competitiveness Report for 2015-2016 showed that Singapore is the most transparent country in Asia which enjoys the most stable business environment. This country has also successfully produced skilled workers who are responsible for the easy access to importation and exportation.

Most countries in these points made several reforms to achieve better Ease Of Doing Business rankings. The United Kingdom, for example, made several reforms to improve their rank in the ease of doing business. One of these is the increase in court fees in filing
claims and reducing the corporate income tax rates. They also increased the wage bracket of employees exempted from social security contributions paid by employers. Jordan, being ranked 113, the lowest in the Ease of Doing Business index imposed a 20% corporate income tax. According to the 2016 index of economic freedom, they incurred a budget deficit; public debt increased to about 90% of Gross Domestic Product (GDP). The Jordanian government implemented more privatization to improve transparency and the rule of law. Table 4 shows the countries located at the right side of the center point.

Apart from corporate income tax rate as factor of the high ranking of New Zealand, a study conducted by World Bank Group in 2016 revealed some significant policy reforms formulated by the New Zealand government. These are: (1) enactment of new district court rules for enforcing user-friendly contracts; (2) improved access to credit information; (3) ensuring speedier and less costly adjudication

Table 1. Countries below the Center Point of 52

<table>
<thead>
<tr>
<th>Country</th>
<th>Ease of Doing Business Ranking</th>
<th>Corporate Income Tax Rates</th>
<th>World Bank Income Category</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASIA</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Malaysia</td>
<td>18</td>
<td>25</td>
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</tr>
<tr>
<td>Japan</td>
<td>34</td>
<td>32.26</td>
<td>High Income</td>
</tr>
<tr>
<td>Thailand</td>
<td>49</td>
<td>20</td>
<td>Upper Middle Income</td>
</tr>
<tr>
<td>Israel</td>
<td>53</td>
<td>26.5</td>
<td>High Income</td>
</tr>
<tr>
<td><strong>EUROPE</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portugal</td>
<td>23</td>
<td>21</td>
<td>High Income</td>
</tr>
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<td>Austria</td>
<td>21</td>
<td>25</td>
<td>High Income</td>
</tr>
<tr>
<td>Switzerland</td>
<td>26</td>
<td>17.92</td>
<td>High Income</td>
</tr>
<tr>
<td>Netherlands</td>
<td>28</td>
<td>25</td>
<td>High Income</td>
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<td>Slovenia</td>
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<td>17</td>
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<td>Mauritius</td>
<td>32</td>
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<td>Upper Middle Income</td>
</tr>
<tr>
<td>Spain</td>
<td>33</td>
<td>28</td>
<td>High Income</td>
</tr>
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<td>Armenia</td>
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<td>Low Middle Income</td>
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<td>Czech Republic</td>
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<td>19</td>
<td>High Income</td>
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<td>Romania</td>
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<td>Croatia</td>
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<td>High Income</td>
</tr>
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<td>Hungary</td>
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<td>19</td>
<td>High Income</td>
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<tr>
<td>Belgium</td>
<td>43</td>
<td>33</td>
<td>High Income</td>
</tr>
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<td>Belarus</td>
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</tr>
<tr>
<td>Italy</td>
<td>45</td>
<td>31.4</td>
<td>High Income</td>
</tr>
<tr>
<td><strong>CENTRAL AMERICA</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>38</td>
<td>30</td>
<td>Upper Middle Income</td>
</tr>
<tr>
<td><strong>SOUTH AMERICA</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Peru</td>
<td>50</td>
<td>30</td>
<td>Upper Middle Income</td>
</tr>
</tbody>
</table>
of cases; and (4) reduction of the time required for getting electricity.

**Influence of Corporate Income Tax Rates**

At a radius of 0.24960, the center point is Colombia, country number 52, the coordinates of which are (25, 54). The “x” axis represents the corporate taxes, and the “y” axis is the rank in the ease of doing business. Colombia’s corporate income tax rate for 2015 was 25%, and ranked 54 in the Ease of Doing Business for October 2016. At 0.4 to 0.5 unit radius, corporate income tax rates of the countries found on the left side decreased to 20%, on the other hand, corporate income tax rate of countries on the right side increased to 26.5%. The rankings on the ease of doing business of countries on the lower side improved from 54 to 40 while those found on the upper side declined to 69. When the range of radius increased to 0.6-0.8, rankings of the Ease of Doing Business of the countries lying in the upper portion went down to 8, but tax rates on the right side increased to 30%. The same observation happened when the range of radius increased to 0.9 to 1.1. The distance of the tax rates and rankings on the ease of doing business became farther from the central reference: Colombia. Increasing the radius range further to 1.3 to 1.5 unit, tax rates on the left side decreased, but the ease of doing business varies from rank 3-109. The tax rates of the countries found on the right side increased to 32.26%. In general, it is observed that an increasing radius does not necessarily increase the ranking in the ease of doing business nor the corporate income tax.
These means that the larger the radius, the more distinct the country is from Colombia. Those countries found on the upper portion tend to have a lower ranking which means that their ease of doing business for investors are not favorable even if corporate income tax rates are lower. Likewise, those countries found on the lower portion have better rankings on the ease of doing business which is favorable for investors. Countries found on the right portion imposed higher corporate income tax rates. Those countries on the left side have lower corporate income tax rates, but these do not dictate their ranking in the Ease of Doing Business.

Table 3. Countries located at the left side of the center point

<table>
<thead>
<tr>
<th>Country</th>
<th>Ease of Doing Business Ranking</th>
<th>Corporate Income Tax Rates</th>
<th>World Bank Income Category</th>
<th>Continent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kosovo</td>
<td>66</td>
<td>10</td>
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<td>Europe</td>
</tr>
<tr>
<td>Qatar</td>
<td>68</td>
<td>10</td>
<td>High Income</td>
<td>Asia (Middle East)</td>
</tr>
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<td>Moldova</td>
<td>52</td>
<td>12</td>
<td>Lower Middle Income</td>
<td>Europe</td>
</tr>
<tr>
<td>Oman</td>
<td>70</td>
<td>12</td>
<td>High Income</td>
<td>Asia (Middle East)</td>
</tr>
<tr>
<td>Cyprus</td>
<td>47</td>
<td>12.5</td>
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<td>Europe</td>
</tr>
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<td>Lithuania</td>
<td>20</td>
<td>15</td>
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<td>Europe</td>
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<td>High Income</td>
<td>Europe</td>
</tr>
<tr>
<td>Georgia</td>
<td>24</td>
<td>15</td>
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<td>Europe</td>
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<td>Mauritius</td>
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<td>Sub Saharan Africa</td>
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<td>Europe</td>
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<td>101</td>
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<td>Iceland</td>
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<td>Turkey</td>
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<td>Saudi Arabia</td>
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<td>Fiji</td>
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<td>Jordan</td>
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</tr>
<tr>
<td>Vietnam</td>
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</tr>
<tr>
<td>Chile</td>
<td>48</td>
<td>22.5</td>
<td>High Income</td>
<td>South America</td>
</tr>
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</table>

The corporate income tax in the Philippines increased from 32% to 35% in 2005 (Ballada, 2015). In 2008, the Ease of Doing Business ranking was at 144 when the tax rate was at 35%. In 2009, the tax rate decreased to 32% without corresponding change in the ranking in the Ease of Doing Business. Until today, corporate income tax rates remain at 32% while the Ease of Doing Business ranking averaged 121.22. The lowest rank recorded by World Bank for the Philippines was 97 in 2014. In 2016, ranking went low to 99.

The location of Philippines in the circle
illustrated in Figure 3 is above the central point with the furthest radius. The characteristics of the Philippines regarding corporate income tax rates and rankings became very dissimilar with Colombia. The Philippines ranked 99 has a comparable tax rate to Japan, Italy, and Mozambique which ranked 34, 45 and 138 respectively in the 2016 Ease of Doing Business ranking.

### Theory on Corporate Income Tax Rate and Ease of Doing Business

With this observation, lowering the corporate income tax rate of the country, which the Philippine government is thinking of in order to attract investment, will not guarantee a better Ease of Doing Business ranking. If the government wants to improve the business climate, increasing or decreasing tax rates do not necessarily attract investors or entrepreneurs.

### Conclusion

This paper generally aimed to study the influence of corporate income tax rate to the ease of doing business using 114 countries ranked by the World Bank Group. Specifically, this study attempted to explore the characteristics of countries ranked to recognize patterns from the processed data, present a cross-country analysis of the influence of corporate income tax rates, and

<table>
<thead>
<tr>
<th>Country</th>
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<th>Corporate Income Tax Rate</th>
<th>World Bank Income Category</th>
<th>Continent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Israel</td>
<td>53</td>
<td>26.5</td>
<td>High Income</td>
<td>Asia</td>
</tr>
<tr>
<td>Canada</td>
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<td>North America</td>
</tr>
<tr>
<td>Samoa</td>
<td>96</td>
<td>27</td>
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create a theory related to corporate income tax rates and the ease of doing business. The findings revealed that lower corporate income tax rate does not result to a better ranking in the Ease of Doing Business index and the income level of a country does not influence the ease of doing business. Countries with better rankings have varied income tax rates and not all countries having lesser corporate income tax rates are in the top ranks of the Ease of Doing Business index. The created theory is useful to supplement the present literature on the ease of doing business ranking and the controversy over whether corporate income taxes are an indicator of a better business environment.

The study also shows that the country’s income level is not dependent on the corporate income tax rate. An investor is not so much concerned about how much tax he is going to pay in a particular country but on how simple the processes are in doing businesses. These processes include but are not limited to dealing with construction permits, registration of property, filing taxes, enforcing contracts, getting electricity, trading and getting credit. Therefore, government’s tax reform does not necessarily lead to a better ranking in the ease of doing business. Should a country contemplate on improving its ease of doing business, its priorities should be streamlining processes and not decreasing corporate income tax rates.

References Cited


