The Effect of Tax on Foreign Direct Investments: A Comparative Analysis of India and Albenia

Sriragahi

Abstract: This research paper provides a complete insight of the Foreign Direct Investments, made by India, as in the recent years, India has achieved one of the top-ranking countries in the world, in terms of FDI’s. It provides an idea, to the stakeholders, as to under what sectors the firms can and cannot invest. Also, this paper provides a complete comparative analysis, between two developing countries, that is, India and Albania, to analyse and understand about the various dimensions, as to how a firm can vary, in terms of Foreign Direct Investments.

Keywords: Foreign Direct Investment, Tax, Policy, Sector, Segment

1. Introduction

Currently, in an era of a very high level of interaction between various nations, corporations and agencies, there is an antagonistic and cut-throat competition, arising among various nations. There is a gradual visual rise, seen explicitly in the investment of FDI’s, by various countries, since the early 1980’s. The liberalisation of trade, commerce and industry, has made firms increasingly to expand and develop and also enter into new markets. Unlatched, Crystal-Clear and Unambiguous Buying and Selling of Goods, Favourable conditions for local businesses, Adroitness and Dexterity for labour markets, Adequate and Proficient infrastructure, are some of the key major significant factors, for establishing an efficient FDI market.

Sectors under which FDI can be invested:

1) Non-Designated Air Transport Services [All the information provided, is in extent with FDI Policy, issued by DPIIT].
2) Rotorcraft and Sea-plane services, requiring the approval of DGCA (Directorate of General Civil Aviation).
3) Aviation Services, which includes domestic flights, Scheduled Passenger Airlines, Autogiro’s and Sea Plane Services.
4) Foreign Airlines are allowed to take part in equity of firms, operating Cargo airlines, Gyro and Sea-Planes, as per the limits mentioned [In sectors not mentioned above, FDI investments are allowed].

Foreign Airlines:
1) It must be made under the acquiescence of the Government.
2) If a foreign company invests in India, then it must strictly comply with the provisions of SEBI, ICDR (Issue of Capital Disclosure requirements) and SAST (Substantial Acquisition of Shares and Takeovers) and other regulations as mentioned.

A result of such investment shall be viewed from the Security viewpoint, before deployment. [A Non-resident entity, is subject to FDI policy, except in those sectors, which are prohibited]

Prohibited Sectors:

1) Lottery Business, including Government, Private and Online Lotteries etc.;
2) Gambling and Betting, including Casino’s;
3) Chit Funds and Nidhi Company;
4) Real estate Business or Construction of Farm Houses; [Real estate business shall not include development of town shops, construction of residential/ commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations, 2014.]
4) Manufacturing of Cigars, Cigarillos, Cheroots, Cigarettes, Tobacco and other Tobacco Substitutes.

Foreign Exchange Management Act:

<table>
<thead>
<tr>
<th>Category</th>
<th>Authorised Dealer – Category 1</th>
<th>Authorised Dealer – Category 2</th>
<th>Authorised Dealer – Category 3</th>
<th>Full- Fledged Money Lenders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entities</td>
<td>Commercial Banks, State and Urban Co-operative Banks.</td>
<td>Upgraded FFMC’s, Co-operative Banks and Regional Rural Banks (RRB’s) and other banks.</td>
<td>Selected Financial and other Institutions.</td>
<td>Department of Co-operative Banks and Other FFMCs’.</td>
</tr>
<tr>
<td>Activities allowed</td>
<td>As per the RBI guidelines, all current and capital account transactions.</td>
<td>All activities permitted to FFMC and specified non-trade related current account transactions.</td>
<td>Foreign exchange transactions.</td>
<td>Purchase of foreign exchange and sale for private and business visits abroad.</td>
</tr>
</tbody>
</table>

Main Features of the Act:

All financial transactions of foreign board, requires the approval of FEMA, whereby all transactions must be carried through authorised persons.

It gives strengths to the Central Govt., and also standardise and regularise flow of payments, to a person is situated in abroad or to a person, who is situated outside the country. Provides authority to RBI and also places diminution on transactions, from the capital account, even though it is provided by an individual.

Indian Citizens residing in India, have permission to conduct foreign exchange, right to hold immovable property and securities deposited etc.,
India and Its Current Landscape:
In the FY 2020-21, India was recorded as the fifth largest investor of FDI investments according to the World Investment Report, followed by the FY 2022-23, where India was recorded as the third largest investor, as per the reports, released in 2021. Total FDI inflows, including equity inflows, re-invested earnings and other capitals, was US $ 81.97 billion (in 2020-21) and $83.57 billion in 2022-23, respectively. Most regions had a rapid growth, due to the greenfield projects. However, the following inflows were recorded, in the Growth sector, Services (US $ 8.7 billion), Telecommunications (US $ 713 million), Pharmaceuticals (US $ 8.7 billion) and Chemicals (US $ 1.85 billion) were recorded, during the FY 2022-23.

State-wise, though Maharashtra has received the highest inflows, ofUS $ 14.8 billion, followed by the inflows in Karnataka which amounted to US $ 10.42 billion in 2022-23 as compared to US $ 22 billion in 2021-22. Other states and Union Territories, where FDI was maximum in 2022-23 includes Delhi, Tamil Nadu, Haryana, Telangana, and West Bengal.

On the other hand, FDI in Gujarat has increased to US $ 4.71 billion in 2022-23 as against US $ 2.7 billion in 2021-22. FDI has also reported a significant growth in Rajasthan.

FDI inflows, from APRIL 2012 Till March 2022*:

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI Inflows (In Rs.)</th>
<th>% of GDP (in %)**</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>28,15303</td>
<td>1.52</td>
</tr>
<tr>
<td>2014</td>
<td>34,57664</td>
<td>1.70</td>
</tr>
<tr>
<td>2015</td>
<td>2,0921</td>
<td>2.09</td>
</tr>
<tr>
<td>2016</td>
<td>44,45857</td>
<td>1.94</td>
</tr>
<tr>
<td>2017</td>
<td>39,9609</td>
<td>1.51</td>
</tr>
<tr>
<td>2018</td>
<td>42,11745</td>
<td>1.56</td>
</tr>
<tr>
<td>2019</td>
<td>51,61065</td>
<td>1.78</td>
</tr>
<tr>
<td>2020</td>
<td>64,36236</td>
<td>2.41</td>
</tr>
<tr>
<td>2021</td>
<td>44,72728</td>
<td>1.42</td>
</tr>
<tr>
<td>2022</td>
<td>49,91551</td>
<td>1.47</td>
</tr>
</tbody>
</table>

*Data taken from, www.macrotrends.net, as on March 23, 2023. ** Data taken from https://www.macrotrends.net/countries/IND/india/foreign-direct-investment, is purely for research purposes only.

Link between Taxes and FDI:
If a country’s tax burden, is out of hand, then there are also chances that, the burden might even move on, to other regimes. In fact, most of the evidences and resources, suggest that, firms always try to reduce taxes, so that, they can improve the GDP of the Economy. Also, they spend resources on Transfer Pricing and Other tax evasion Techniques. Domestic Taxes, matter more for Outflows of the Country, because the firm can Escape Domestic Taxes, by paying abroad. But in sharp contrast, Territories investing in FDIs’, have to pay domestic taxes, so that, the Surplus and Profits that they get, is evenly repatriated.¹

Transfer Pricing:
Consider a State, having low and high tax. The MNC has to overstate the price of inputs, the firm has an incentive to overstate the price of inputs, as the Profits surge in a Low-Tax country as compared to the profits in a High-Tax country, whereby the tax reduces, thus minimizing worldwide tax liabilities.

Tax Harmonisation:
It is the process of increasing the compatibility of various systems, so that, there are no big differences in the taxes and also, it paves an easy way for the firms, to pay their taxes and also avoids confusions. In response, a research that was conducted by the EU in 1990, suggested and drew that, the countries with High-Tax rates, would gain revenue from harmonisation, whereas countries with Lower-Tax rates, would have to witness a reduction in revenue. But, in contrast, if there is an increase in FDIs’, then automatically, the GDP will increase.


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How will the Countries React to Taxes on Lower Fdis?:
The first step that they will take is, reduce the statutory income tax rate, which also improves Tax-Efficiency and also, sometimes reduces Tax Rate. But, as reducing tax rates is a bit is a very heinous task, some countries explicitly prefer Tax Belief. But decisions to completely waive off taxes or FDIS’s, is morally not possible, unless there is an emergency declared by law, in any state.

Policy Considerations:
Tax impartiality, between House-Tax and Outbound Investment, is still a Big Goal, for many economies. Thus, many countries, choose the Dividend Credit Option, where both House-Bound taxes and Outbound Investments, more or less, come up to the same level that is, more or less, both taxes will be of Equivalent Rates.

Tax Planning:
Most of the reformers today, ignore Tax-Planning, which is a very grave mistake. Stakeholders, must properly plan, so that, they can pay taxes accordingly. If the Domestic country, provides FDI, under Dividend Credit System, is measured by Average Effective Tax Rate System (AETR) System. Therefore, when dividends are exempted, AETR also reduces, making a reduction in tax rates. Thus, tax planning is of utmost important for a stakeholder.

FDIs’ Inbounds:
It is not visible that whether Tax reduction, is always required to seek to attract FDIs’, but, where a Higher Corporate Tax Burden is matched by well-developed Infrastructure, Public Services and other host country attributes are attractive to business, including its Market Size, Labour and Infrastructure, Not only that, Payrolls, Energy and Business taxes, must also be taken into consideration. Investors, always look for Consistency, Kindliness, Certainty and Credibility, in the payment of taxes. The Tax environment and need for the authorities, to introduce anti-abuse measures, to have a healthy tax environment, is utmost required.

India’s Industrial Policies:
While everybody would have at least heard about the LPG (Liberalisation, Globalisation and Privatisation) Policies, which was happened in 1991. Well, there were four more industrial movements, that has happened before that, so that India could be relieved from the Restrictive Trade Practices. Those are:

Industrial Policy Resolution, 1948:
This policy declared India, as a mixed economy, whereby more significance was given to Cottage, Home-Business and Small-scale Industries. There were restrictions on Foreign Trade Investment Policies. Industries were categorized into four:
1) Exclusive Cartel of the Central Government. (Directing, Controlling and Handling of Railways, Manufacturing of Weapons, Arms and other required Ammunitions and Production of Nuclear Power).
2) New Agreement undertaken by the State (Navy and Cargo Building, Telephone and Telegraph, Manufacturing of Iron, Coal, Steel and Airflight manufacturing etc..)
3) Industries are to be monitored and regulated by the Government.
4) Transparent to public, individuals and stakeholders.

Industrial Policy Resolution, 1956:
The IPR (Industrial Policy Resolution), also known as The Economic Institution of India, has laid down the basic industrial policies and guidelines, that needs to be followed for imports and exports. The sectors were divided into three categories.
Schedule A- Covers only Public Sector.
Schedule B- Covers Mixed (Both Public and Private) Sectors.
Schedule C- Covers only Private Sectors.

The Industrial Policy Statement, 1977:
Main objective of this policy is to Create Employment Opportunities for the poor. It also focused on Small Scale Industries and proposed to the creation of a new unit, called as The Tiny Unit.

The Industrial Policy Statement, 1980:
This Industrial Policy, inscribed the need for a Healthy Competition, Liberalisation, Globalisation, Domestic Markets and Technological Upgradation. Firms were Granted Licenses and Liberalisation Polices, were slowly introduced. This Policy, has laid a basis for a highly competitive export markets, upcoming in the future.

Effect on GDP:
India’s trade and its’ liberalisation policies, to expand and re-enforce FDIs’, has a very good impact on GDP growth. Also, strengthening Human Capital and Financial Resources, are value added components associated with FDI, which would even further improve and bring a further rise, in the percent of GDP.

Activities of MNC’s:

Agreement with Local Firms For Sale:
An inter-continental firm, can enter into an accordance, with the local firms. In this case, an MNC, allows a foreign firm, to sell its products into foreign markets and controls, all aspect of operation of sales.

Subdivisions of a Branch:
Second mode of Investment, is an investment made in abroad, in a foreign country. If an MNC, has a complete control over its business operations, from its production, then its ultimate goal, is sale to the consumers. However, the firm also enjoys, some freedom, over the parent company, whereby the firm can perform, without any Hassle.

Collaboration or Joint Ventures:
MNCs’ collaborate joint ventures, for the sale of goods, from abroad. An MNC, sets up a business operation, by associating other firms so that it could get its unprocessed material at a much lower cost. Also, it minimizes the overall cost of production.
**Whereithal Concerted Techniques:** Countries from abroad, bring in the up-to-date technology to their countries, in turn brings up a capital potence economy, which is the main reason for extension of employment opportunities.

**Foreign Direct Investment in Albania**

**Why Albania:**
Firstly, India and Albania, both are developing realms and also, a proper analysis, must be drawn between two developing countries.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Albania</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial taxes</td>
<td>36.60%</td>
<td>49.70%</td>
</tr>
<tr>
<td>Average Income</td>
<td>6,770 US$</td>
<td>2,380 US$</td>
</tr>
<tr>
<td>Central government debt (% of GDP)</td>
<td>73.17%</td>
<td>54.27%</td>
</tr>
</tbody>
</table>

**Legal Framework**
Albanian Legislation requires Declaration of Rules, on Establishment, Continuation, Alteration and Merging of Capitalization of Firms, Shareholders’ Cracks and other Governing Principles. The Law on Accounting and Financial Statements includes reporting provisions related to international financial reporting standards (IFRS) for large companies, and National Financial Reporting Standards for small and medium enterprises. Albania meets minimum standards on fiscal transparency, and debt obligations are published by the Ministry of Finance and Economy.

The Legal Framework, makes sure that, pellucidity, glassiness and straight-forwardness is strictly followed which ascends, the ultimate benefit of the owners. If the owners, either directly or indirectly, if own 25% of the shares, then they are ultimately entitled to voting and registration rights, according to the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures.

Authorities and regulatory agencies develop forward regulatory plans, that include any changes or proposals that is intended to be adopted within the given lapse of time. The law on notification and public consultation requires, Albania to publish draft laws and regulations for public consultation and sets clear timeframes for these processes.

**Funds and Embankment System:**
In the recent few years, there is a consistent reduction in non-performing loans and it has allowed commercial banks, to increase in their overall lending, especially when the economy has been recovering from the severe pandemic in 2020. Non-Performing Loans (NPL) at the end of 2022 dropped to 5%, as compared to 5.65%, in 2019. Overall lending has gradually increased over the recent few years and by the end of 2022, it has reached about US$6.3 billion, marking an extra-ordinary 7% of increase, as compared in 2021. The credit market is competitive, as local banks began to compete due to an increase, in the share of their market. Most of the mortgage and commercial loans are pre-denominated in euros as the rate differentials between local and foreign currency average is 2%. Average interest rates for new loans in domestic currency for the private sector, has reached up to 7% and at the end of the last quarter of 2022 up from 5.7 percent during the first half. In contrast, interest rate for new loans in euro reached 5.4 percent from 4.6 percent in the first half.

On the other Hand, Commercial banks in Albania have improved the quality and quantity of services they provide, including a large variety of credit instruments, traditional lines of credit, and bank drafts, etc. Reacting to the significant increase of inflation during 2022, Bank of Albania (BoA) has brought up a tightened monetary policy increasing the base interest rate to 2.75% in November 2022, as compared to just 0.5%, at the beginning of the year.

Albania’s Nominal GDP, From Apr’12013 Upto March 31’2022
[Data collected from https://www.ceicdata.com/en/indicator/albania/foreign-direct-investment, is for illustrative purposes only.]
Investments of Albania, from 2013 Till 2021[Data collected from https://apps.bea.gov/international/factsheet/factsheet.html#350, is purely for informative purposes only]

<table>
<thead>
<tr>
<th>Year</th>
<th>U.S. MNEs: Majority-Owned Affiliates in Albania</th>
<th>Albania MNEs: Majority-Owned Affiliates in the United States</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Thousands of employees (D)</td>
<td>Sales, millions of dollars (D)</td>
</tr>
<tr>
<td>2013</td>
<td>0.3</td>
<td>35</td>
</tr>
<tr>
<td>2014</td>
<td>0.3</td>
<td>34</td>
</tr>
<tr>
<td>2015</td>
<td>A</td>
<td>59</td>
</tr>
<tr>
<td>2016</td>
<td>A</td>
<td>58</td>
</tr>
<tr>
<td>2017</td>
<td>0.3</td>
<td>56</td>
</tr>
<tr>
<td>2018</td>
<td>0.2</td>
<td>53</td>
</tr>
<tr>
<td>2019</td>
<td>0.2</td>
<td>94</td>
</tr>
<tr>
<td>2020</td>
<td>0.2</td>
<td>92</td>
</tr>
<tr>
<td>2021</td>
<td>0.2</td>
<td>106</td>
</tr>
</tbody>
</table>

FDIs' in Albania, from 2012 TO 2020
[Taken from chrome-extension://efaidnbmnnibpcajpcglclefindmkaj/file:///C:/Users/S%20Sriraghavi/Downloads/EJBMR_1542.pdf is only for illustrative purposes only]

US, has done the most foreign exchange FDIs’, in Albania. In 2022, U.S. Direct Investment Position with Albania was $-69.0 million, a decrease of 20.7 percent, from 2021.

Albania’s percentage of GDP, of FDI inflows, from 2012-2020
[Taken from the same above mentioned link, is only used for informational purposes]

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI net inflows (BoP, current US$)</th>
<th>FDI net inflows (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>0.9</td>
<td>4.1</td>
</tr>
<tr>
<td>2013</td>
<td>4.56</td>
<td>2.7</td>
</tr>
<tr>
<td>2014</td>
<td>4.98</td>
<td>2.7</td>
</tr>
<tr>
<td>2015</td>
<td>5.67</td>
<td>2.7</td>
</tr>
<tr>
<td>2016</td>
<td>6.65</td>
<td>2.7</td>
</tr>
<tr>
<td>2017</td>
<td>7.45</td>
<td>2.7</td>
</tr>
<tr>
<td>2018</td>
<td>8.14</td>
<td>2.7</td>
</tr>
<tr>
<td>2019</td>
<td>8.74</td>
<td>2.7</td>
</tr>
<tr>
<td>2020</td>
<td>8.82</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Strategic Investments
Albania has given an acquiesce in, for the approval of a new that is, Law on Strategic Investments, whereby the country can boost its’ investments. A strategic investment, is defined as the investments of inhabitants and electorates, including the proportion of investment, including its’ value, cadence and fecundity.

Strategic Sectors:
Strategic sectors are those, where the investment is done in large. For e.g., The sectors like Mining, Energy, Transportation and Communication, Agriculture, Tourism, Fishing, are the main priority areas, in Albania. The sectors may obtain both assisted and selected procedure, which depends upon the level of investment.

Mining, Transport, Communication and Infrastructure:
Authorities have offered, Power Purchasing Agreements (PPA) for 15 years for the electricity produced from hydroelectric plants with a sufficient installed capacity. The government also offers feed-in-premium tariff for solar installations with Exemptions from Custom Duties and VAT is there for the manufacturing of solar panel systems for the
production of hot water. Certain machinery and equipment, is imported for the construction of hydropower plants are VAT exempt.

**Agro-Tourism:**
Investments of EUR Five million or more, enjoy the status of assisted procedure, whereas Investments greater than 50 million or more, enjoys the status of special procedure. These facilities are exempt from the infrastructure impact tax.

**Development Priority Areas:**
Investments, larger than 1 million, creates at least new jobs, for which, Assisted Procedure is given.

**Corporate Income Tax Exemption:** Film Studios, Motion Pictures, Cinematograph’s and which are those licensed by the Cinematograph Centre, are an exempt from the Corporate Tax.

**Technological Development Areas (TED):**
Law on Economic and Development areas, provides for a fifty percent exemption in tax, for the users. Exemption from Infrastructure Impact Tax and Real Estate Tax, for five years.

**Incentives for Manufacturing Sector:** Manufacturing Sector, is actually exempted from 20 percent VAT, on machinery and equipment. Government offers rent, for Government Owned Property and Buildings, if investments exceed US $ 2.7 million. Also, no vat is charged for re-exports. Employers are also exempted from paying security tax, for one year. Also, the sector immediately obtains VAT refunds, in case of Zero-Risk exporters. Apparel producers, are exempted from 20 percent VAT on exports. Thus, these are some of the Industrial Policies of Albania.

Thus, the returns through FDI, in terms of GDP were higher.
- For Albania, GDP has been higher in 2015, because of the shrugging impact of floods, that they have faced in 2014. Despite damage in Agriculture, the economy has grown up to 2.5%, in the first quarter of 2015. Also, the country has imported more than 6 lakh migrant workers, from Greece and also, the growth went up to 13.5%, while manufacturing water and energies, went 7.64% higher.\(^2\)
- Major countries, that invest in India are Mauritius (26%), Singapore (23%) and USA (9%), according to 2022-23.
- While for Albania, the major investors are Switzerland, Netherlands, Canada, Turkey and Austria.
- Therefore clearly, the level of tax-rates, is one of the main determinants of GDP and Revenue. Other factors like skill, infrastructure, labour also play a major role, whereby the policy makers, have to constantly witness the fiscal position of the firms.

Thus, these are some of the major observations, drawn from this research.

### 3. Conclusion

Thus, as compared to Albania, India has emerged and has gone far beyond in Investments, but, my personal suggestion is, if India could liberalise more, that is, expand all its’ sectors to FDI, then India would definitely emerge as the top country, as an Investor, in Foreign Direct Investments.

### References


### Bibliography