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Abstract

Governments need to put in more effort in attracting investors into their country through tax reforms if it wants to achieve economic growth and enhance standards of living. The research considered certain variables that affect investor's decision as to where to invest. These included the location, type of activity and time variables, which were very important due to the fact that, the laws pertaining to each one of them concerning the tax rate to be paid, incentives, exemptions, relief and holidays to be enjoyed varies.

The data for the research were obtained from both primary and secondary data. To obtain first hand information on whether investors in the country did consider the tax system in their investment decision, the study used questionnaires and interviews

CHAPTER ONE

INTRODUCTION

Background of the study

Every government and most especially those in the developing economies are concerned about the economic growth of their nation. As a result, they put in much effort to achieve higher rate of economic growth and raise the standard of living of its citizens. The critical issue has been how to attract investors and generate the needed resources domestically using tax instruments that are least harmful to both the government and the investors. This will obviously involve reforming the tax system to ensure efficiency by widening the tax net without necessarily increasing the tax rate. Governments continue to encourage foreign investment as an integral part of its economic policy. Ghana embarked on a privatization program in the early 1990s. The government at one point controlled more than 350 state-owned enterprises but nearly 300 were privatized by the end of 2000 and as at December 31st 2005, 351 had been privatized leaving just a handful of state-owned enterprises. For example, the government's, stated priority privatization in the 2007 budget included Ghana Telecom, Western Wireless (Westel), Tema Oil Refinery, Ghana Oil Company and State Insurance Company. They also pursued privatization through selling of State-owned shares on the Ghana Stock Exchange (GSE). The government recognizes attracting foreign direct investment requires an enabling legal environment and has passed laws that encourage foreign investment and repeated some that has previously stifled it. In the United States for example, there was a decline in investment some years ago. In order to stimulate investment, a new tax Act was introduced in 2002 and 2003. This helped the economy to regain its stand by the late 2003, investment returned to its pre-recession trend and the economy expanded at a healthy rate of 3.9% and despite the dislocations that was as a result of the hurricanes and steep rise in energy prices, registered 3.2%. A research conducted in United States by a Joint Economic Committee presented a case that, "lowering the cost of capital through tax legislation can be both timely and effective in stimulating economic growth".Governments need to put in more effort in attracting investors into their country through tax reforms if it wants to achieve economic growth and enhance standards of living. The most important source of government revenue is from tax. According to the 2006 budget, the government introduced some tax incentives for venture capital investment and reduced tax rate on personal and corporate income in order to strengthen the private sector and enhance the disposable income of householders. Tax rate for companies in categories A and B were lowered, and rate for other categories were abolished with regard to the National Reconstruction Levy.

Various studies have shown that changes in the tax system have great impact in investment decisions. Feldstein (1982) observed that “adverse changes in the tax variables since 1965 have depressed investment by more than 40%” Hassett and Hubbard “recent empirical studies appear to have reached a consensus that the elasticity of investment with respect to the tax-adjusted user cost of capital is between -0.5 and -1.0” Hassett and Hubbard cited other studies that concluded that tax over the last forty years have had a large effect on investment. A research by House and Shapiro showed that temporary investment tax incentives did stimulate investment. In my study, I will consider certain variables that affect investor’s decision as to where to invest. These, which include the location, type of activity and time variables, are very important because the tax laws pertaining to each one of them concerning the tax rate to be paid, incentives, exemptions, relief and holidays to be enjoyed varies. Due to these continuous changes in the tax law, there is the need for such information to be publicized since it goes a long way to determine the growth of the economy, divert resources to a particular sector of the economy and also protect the local industries, at the same time attracting foreign investors. This is what Ghana has embarked on in recent times and my study will try to analyze the budget from January 2010 to April 2012 and see the various attempts by the government to generate more revenue by attracting investors into the country. Analyses of the budget in recent times had indicated that the government continually decreases the tax rate to widen the tax net. Even though in terms of tax revenue composition, our main source of revenue is derived from indirect taxes (VAT especially), these are indirect taxes paid by consumers on some goods and services to the state through registered individuals or businesses. It has been realized that revenue from direct taxes continues to rise. In 2010, it constituted 38.71% of total tax revenue and increased to 42.84% in 2011 and this can be attributed to the persistent reduction of the corporate tax rate by the government as part of its efforts to improve the environment for private sector businesses.

These few changes and many others that have not been mentioned here brought to the fore the need to observe how decision on where to invest, what to invest in and when to invest changes as the tax system pertaining to these changes. These are serious issues which must be considered because the transition of developing countries into developed countries depend largely on the extent to which people invest their resources to promote economic growth

STATEMENT OF THE PROBLEM

In every thriving economy, investors' main aim is to invest scarce resources to yield maximum returns on them. The government also needs to cater for its expenditure and development of the country. It has therefore become necessary to generate the needed resources from domestic economy using tax instruments that are least harmful to both the investor and the government

In Ghana, there have been several policies to attract investors into the country but it is not clear whether investors utilize these policies which have been put in place to benefit both the Government and investors in all.

It is in light of this, that this research tries to investigate into the following issues:

- How the changes in the tax system affects investment decision in the country.
- Whether tax reliefs, incentives, exemptions and holidays have an impact on investment decisions on a particular location.

OBJECTIVE OF THE STUDY

The objectives of the study are;

- To find out the extent to which the various tax reforms affect investment decision in the country.
- To evaluate the various tax reforms in the formal sector over the past few years.
- To explore the impact of corporate tax on firm location decision in Ghana.

RESEARCH HYPOTHESES

For the successful completion of the study, the following research hypotheses were formulated by the researcher;

H0: there are no various tax reforms in the formal sector over the past few years

H1: there are various tax reforms in the formal sector over the past few years

H02: there is no impact of corporate tax on firm location decision in Ghana

H2: there is impact of corporate tax on firm location decision in Ghana

SIGNIFICANCE OF THE STUDY

The study will be useful in the following ways:

Firstly is that, it will educate prospective investors on the best alternative business to invest in, based on the tax law for that particular sector. Secondly, it will also encourage existing investors to expand their investments to other sectors of the economy as well.

SCOPE AND LIMITATION OF THE STUDY

The scope of the study covers the implication of taxation on investment decision making. The researcher encounters some constrain which limited the scope of the study;

a) **AVAILABILITY OF RESEARCH MATERIAL:** The research material available to the researcher is insufficient, thereby limiting the study

b) **TIME:** The time frame allocated to the study does not enhance wider coverage as the researcher has to combine other academic activities and examinations with the study.

c) **Organizational privacy**: Limited Access to the selected auditing firm makes it difficult to get all the necessary and required information concerning the activities

1.7 DEFINITION OF TERMS

IMPLICATION: the conclusion that can be drawn from something although it is not explicitly stated.

TAXATION: A means by which governments finance their expenditure by imposing charges on citizens and corporate entities. Governments use *taxation* to encourage or discourage certain economic decisions.

INVESTMENT: In general, to *invest* is to allocate money (or sometimes another resource, such as time) in the expectation of some benefit in the future – for example, *investment* in durable goods, in real estate by the service industry, in factories for manufacturing, in product development, and in research and development.

DECISION MAKING: In psychology, decision-making is regarded as the cognitive process resulting in the selection of a belief or a course of action among several alternative possibilities.

THE IMPLICATION OF TAXATION ON INVESTMENT DECISION MAKING