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Effect of Corporate Tax Rate Changes on Foreign Direct Investment in India

Monisha G Reddy[1], Rishika Vittal[2], Riya Dwivedi[3], D.N. Ruchitha[4], Chirag Nandalal Surana[5], Dr Tejaswini S[6]

MBA, CMS Business School, JAIN (Deemed-to-be University), Bangalore, India[1,2,3,4&5]

Assistant Professor – Finance, Faculty of Management Studies, CMS Business School, JAIN (Deemed-to-be University), Bangalore, India[6]

ABSTRACT: India, one of the fastest-growing economies, has always attempted to enhance its appeal as an investment destination. Being one of the key drivers of foreign direct investment (FDI), India's corporate tax rate, its corporate tax reforms, such as the significant reduction in 2019, was aimed at promoting a business-friendly environment. According to recent data, India's corporate tax rate was lowered from 30% to 22% for domestic businesses and to 15% for new manufacturing units with the expectation of boosting FDI inflows.

This study investigates the impact of tax policy reforms by multinationals on FDI in India. The primary objective is to identify whether tax cuts have been effective in increasing foreign investment and to identify other determinants of FDI decisions. The study involves the use of a review of secondary data, empirical studies, and economic data in the analysis of past FDI trends before and after tax reforms. The study emphasizes how, although corporate tax cuts have contributed positively to FDI inflows in the short term, regulatory stability, infrastructure, and international economic conditions also play an important role. It is important in the future that the country has a comprehensive approach that mixes tax incentives with other economic reforms so that it continues to remain competitive in foreign capital inflows, particularly long-term foreign capital.

I. INTRODUCTION

The lack of investible funds is a big setback to economic growth and this is making it increasingly difficult to achieve the Millennium Development Goals (MDGs) by 2015 as set by the United Nations . Foreign direct investment is seen as a major source of getting the required funds for investments, hence most developing countries offer incentives to encourage FDI (United Nations, 2005). Policymakers, especially in developing countries, have come to the conclusion that: foreign direct investment (FDI) is needed to boost the growth in their economy. It is claimed that FDI can create employment, increase technological development in the host country, and improve the economic condition of the country in general.

Financial and monetary policies are the basis for the government's work on macroeconomic management ,sustainable development, and attraction of various foreign direct investments, where fiscal policy covers the government's work on public spending and taxes, and monetary policy in the regulation of money supply in order to stabilize the price level. In order to be able to carry out economic activities such as attracting foreign direct investment, monetary policy and fiscal policy work together. One of the most important tools of fiscal policy is tax revenues and one of the most important tools of monetary policy is money supply. Tax revenues are a major source of funding for the state budget, contributing directly to public expenditure financing.

Taxation is a tool for fiscal policy that has a significant impact on the fiscal policies of many developed and emerging countries, In India tax revenues accounted for 78% of total revenue.

Foreign Direct Investment (FDI) plays a crucial role in the economic development of emerging markets like India. It brings capital inflow, technology transfer, and employment opportunities, fostering overall economic growth. However, the corporate tax structure significantly influences the attractiveness of a country as an FDI destination. The impact of corporate tax on FDI is a widely debated topic, as tax rates, incentives, and regulatory policies can either encourage or deter foreign investors. India has undergone multiple corporate tax reforms to enhance its investment climate, including reducing tax rates and introducing incentives for specific industries. While lower corporate taxes may attract multinational corporations, other factors such as economic stability, market potential, and regulatory transparency also play a crucial role in investment decisions.

II. REVIEW OF LITERATURE

1. **Young, K.H. (1988).** "The Effects of Taxes and Rates of Return on Foreign Direct Investment in the United States." National Tax Journal, 41(1), 109-121**.**

Young (1988) investigates the impact of taxes and rates of return on foreign direct investment (FDI) in the United States between 1953 and 1984. The study reveals that FDI financed through retained earnings is more sensitive to tax changes than FDI funded by new capital inflows. This finding highlights the elasticity of reinvested earnings to tax variations, suggesting that foreign firms operating in the U.S. adjust their reinvestment decisions based on tax policies. When corporate taxes are reduced, retained earnings become a more attractive source of financing for expansion, whereas higher taxes may discourage reinvestment and lead firms to repatriate profits instead. This insight underscores the role of tax policy in influencing corporate reinvestment behavior and overall FDI dynamics.

2. **Devereux, M.P., & Freeman, H. (1995).** "The Impact of Tax on Foreign Direct Investment: Empirical Evidence and the Implications for Tax Integration Schemes." *International Tax and Public Finance*, 2(1), 85-106.

Devereux and Freeman (1995) analyze the impact of taxation on foreign direct investment (FDI) by examining data from seven countries between 1984 and 1989. Their findings indicate that tax policies play a crucial role in determining the location choices of outward FDI. Higher tax rates in a host country can discourage foreign investment, while lower tax rates create a more favorable environment for multinational corporations seeking to expand internationally. This suggests that firms strategically consider tax burdens when deciding where to allocate capital, highlighting the importance of competitive tax policies in attracting cross-border investment. The study also underscores the broader implications for tax integration schemes, as harmonizing tax structures across countries could influence global investment flows and economic growth.

3. **Sudsawasd, S. (2008).** "The Impact of Corporate Income Taxes and Tax Treaties on FDI Inflows to East Asia Countries." Asian Economic Journal, 22(1), 1-23.

Sudsawasd (2008) investigates the impact of corporate income taxes and tax treaties on foreign direct investment (FDI) inflows in ASEAN-5 countries. The study finds that an increase in corporate tax rates leads to a decline in FDI levels, highlighting the sensitivity of foreign investment to regional tax policies. This suggests that higher tax burdens discourage multinational corporations from investing in these economies, as they reduce after-tax returns and make alternative investment destinations more attractive. The research emphasizes the importance of maintaining competitive tax rates and leveraging tax treaties to enhance a country's appeal to foreign investors, ultimately fostering economic growth and regional competitiveness.

III. OBJECTIVES

- Analyze the trends in FDI inflows in India concerning corporate tax policy changes.
- Assess the relationship between corporate tax rates and foreign investment decisions.
- Evaluate the effectiveness of corporate tax reductions in attracting FDI.

IV. RESEARCH METHODOLOGY

This study employs a descriptive and analytical research designed to examine the impact of corporate tax rate changes on foreign direct investment in India. The primary objective is to evaluate whether reducing corporate tax leads to increased foreign investment and to understand public perception regarding recent tax reforms. Data for the study was collected from both primary and secondary sources to ensure a comprehensive analysis, primary data was gathered through structured Google form surveys, distributed among the general public particularly working professionals and business students across India. The questionnaire included multiple choice questions to assess participant's awareness and views on corporate tax policies and their perceived effect on FDI inflows. This allowed the researchers to gain insights into how citizens perceive the relationship between tax reforms and foreign investment attraction. For secondary data reliable sources such as Economic Research Journals, academic Papers, financial news portals and

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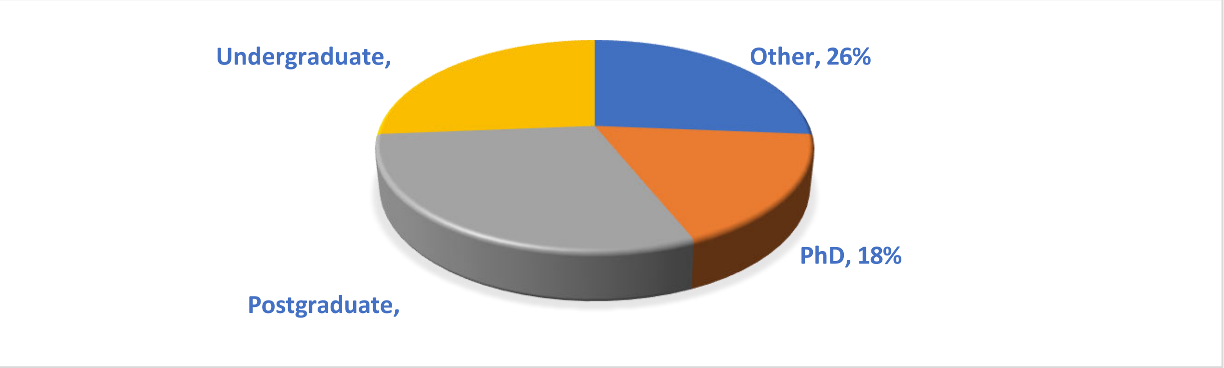
publications from think tanks were used. These sources provided factual data on FDI trends, corporate tax policies and related economic indicators, both before and after major tax change. The study used a convenient sampling method to select respondents which involve targeting participants who were easily accessible through online platforms. One in every three responses was selected to maintain a balance and achieve broad representation. Data analysis techniques included analysis to identify how respondents perceive tax reforms, graphical representation through pie charts to simplify data interpretation and comparative analysis to examine FDI trends before and after- tax policy changes. Additionally, basic correlation analysis was conducted to explore the relationship between tax reductions and FDI inflows. Despite the comprehensive approach, the study has certain limitations. The use of convenience sampling may have introduced bias, as sample may not represent all demographics. Moreover, public opinion was not necessarily aligned with actual investor behavior, and other critical economic factors such as political stability, global market trends and infrastructure development were not deeply explored in the analysis. These limitations highlight the complexity of investment decisions and the need for further in- depth research to support broader policy recommendations.

V. ANALYSIS AND RESULTS

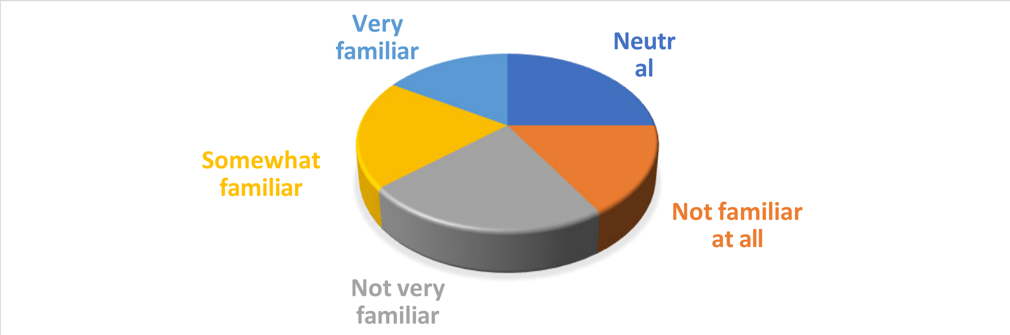
1. Level of study

Level of Study	Count of Level of Study
Other	21
PhD	14
Postgraduate	24
Undergraduate	21
Grand Total	**80**



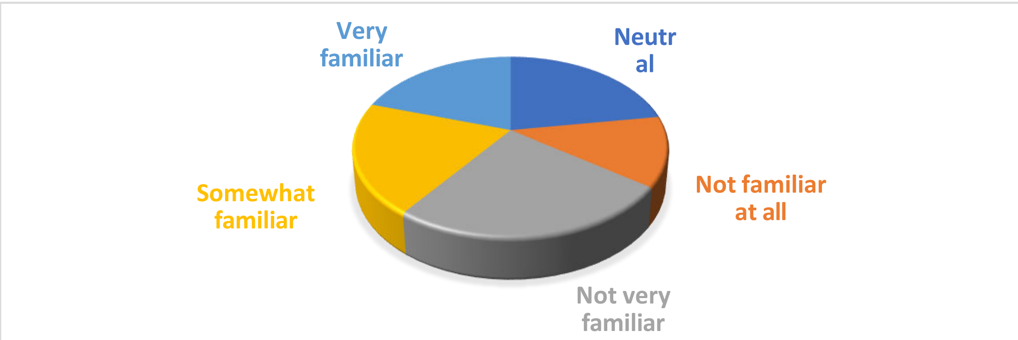
2. FDI Familiarity

FDI Familiarity	Count of FDI Familiarity
Neutral	20
Not familiar at all	13
Not very familiar	18
Somewhat familiar	16
Very familiar	13
Grand Total	**80**



3. Tax Policy Familiarity

Tax Policy Familiarity	Count of Tax Policy Familiarity
Neutral	18
Not familiar at all	10
Not very familiar	20
Somewhat familiar	16
Very familiar	16
Grand Total	**80**



4. Effect on FDI

Effect on FDI	Count of Effect on FDI
Decreases FDI	24
Increases FDI	14
No impact	18
Uncertain	24
Grand Total	**80**

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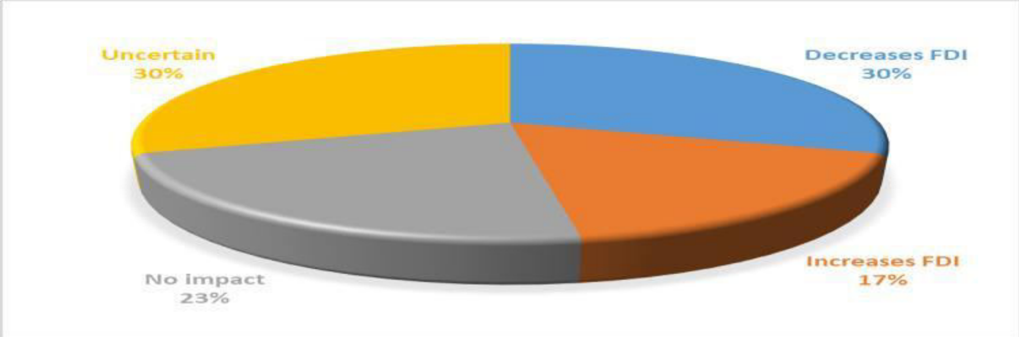
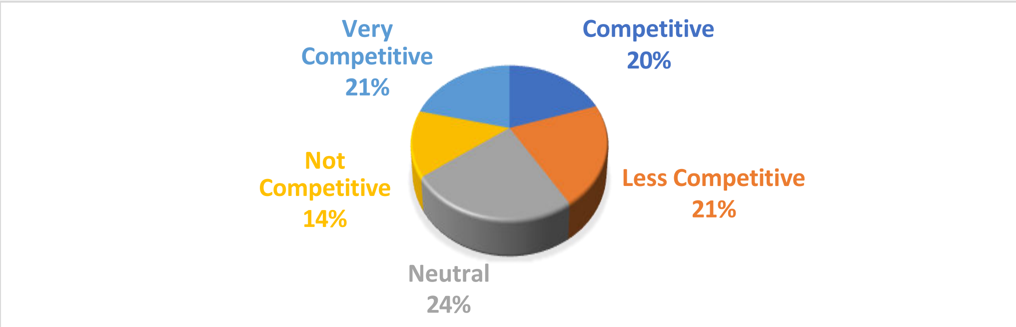


5. Competitiveness Compared to Asia

Competitiveness Compared to Asia	Count of Competitiveness Compared to Asia
Competitive	16
Less Competitive	17
Neutral	19
Not Competitive	11
Very Competitive	17
Grand Total	**80**



6. Key FDI Factors

Key FDI Factors	Count of Key FDI Factors
All of the above	17
Ease of Doing Business	21
Infrastructure Development	14
Political Stability	28
Grand Total	**80**

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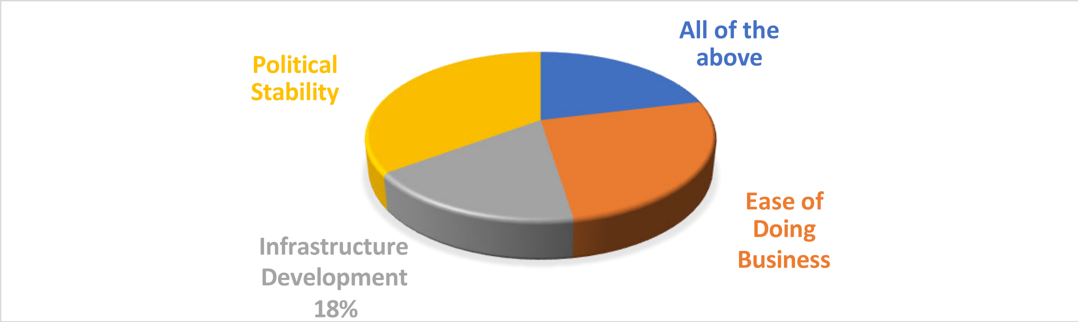
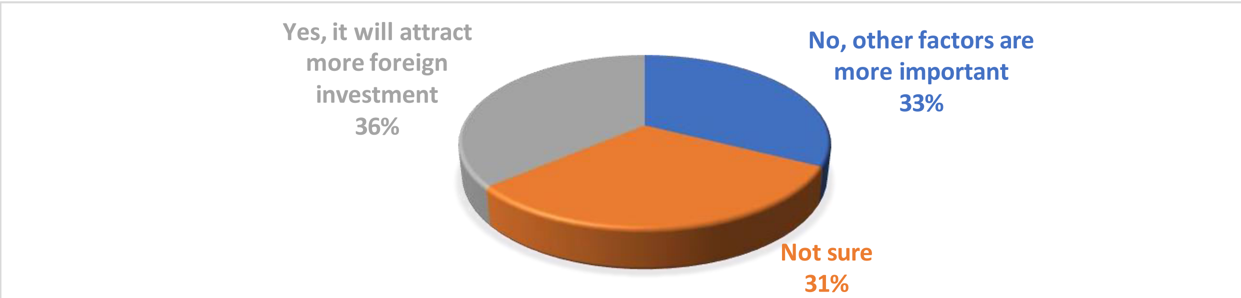


7. Long-Term FDI Impact

Long-Term FDI Impact	Count of Long-Term FDI Impact
No, other factors are more important	26
Not sure	25
Yes, it will attract more foreign investment	29
Grand Total	**80**



VI. DISCUSSIONS

This study aimed to understand how individuals with diverse academic backgrounds perceive foreign direct investment (FDI), tax policies, and India's position in attracting investment compared to other Asian countries. The survey responses from 80 participants reveal some interesting patterns about familiarity levels, opinions on tax reforms, and broader economic perspectives.

To begin with, participants came from a range of educational levels—most had postgraduate (30%) or undergraduate (26.25%) qualifications, while others fell into categories like PhD holders (17.5%) and 'Other' (26.25%). This variety in educational background helps provide a balanced overview of public understanding, drawing insights from both specialized and more general viewpoints.

One of the most noticeable findings was that many respondents admitted they weren't very familiar with FDI. Roughly 38.75% reported being "not very familiar" or "not familiar at all," and only 16.25% said they were "very familiar" with the concept. Similarly, only 20% of participants claimed to have a high level of familiarity with tax policies. These results indicate that while FDI and tax reforms are important national issues, there is still a significant knowledge gap

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among the general public and students alike. Bridging this gap through awareness programs, educational content, and simplified public communication could help citizens better engage in discussions about economic policy.

When asked how tax policies influence FDI, responses were split. A sizeable portion (30%) believed that tax policies can discourage foreign investment, while another 30% were unsure of the impact. Interestingly, only 17.5% felt that lower taxes would lead to increased FDI. This mix of opinions may stem from the complexity of the issue. Although tax cuts can improve a country's investment appeal on paper, other on-ground challenges—like regulatory delays, inconsistent policies, and infrastructure concerns—often play a larger role in shaping investor decisions.

Looking at India's competitiveness compared to other Asian countries, opinions were again varied. While 41.25% of participants described India as competitive or very competitive, 35% felt the country lagged behind. The rest were neutral. This reflects a cautious optimism—India has made significant progress through economic reforms and ease-of-doing-business initiatives, but areas like logistics, legal processes, and transparency still need improvement to match regional leaders like Singapore or South Korea.

Participants were also asked to identify what factors they thought were most important in attracting FDI. The majority highlighted political stability (35%) as the top factor, followed by ease of doing business (26.25%), and infrastructure development (17.5%). Interestingly, 21.25% chose "all of the above," reinforcing the idea that FDI decisions are influenced by a combination of economic, administrative, and political factors. Investors typically seek a stable and predictable environment where policies are consistent and operational hurdles are minimal.

The final part of the study explored whether the recent corporate tax cuts in India would lead to more foreign investment in the long term. Responses were again divided—36.25% believed it would have a positive impact, while 32.5% felt other factors played a more important role. About 31.25% remained unsure. This shows that while tax cuts are seen as a step in the right direction, they are not viewed as a standalone solution. Long-term FDI depends on several complementary factors, including infrastructure, skilled workforce, legal clarity, and the ease of repatriating profits.

Taken together, these findings highlight three major points. First, there's a clear need to increase awareness about FDI and tax policy, especially among students and early-career professionals. Second, people recognize that attracting FDI is not just about lowering taxes—broader systemic improvements are equally important. And third, while reforms like tax cuts may boost India's image in the short term, sustainable investment growth will require deeper, long-term structural changes.

In conclusion, while tax incentives can enhance India's competitiveness, they need to be part of a bigger picture that includes strong institutions, good governance, and transparent regulatory systems. For India to continue attracting meaningful and lasting FDI, policies must not only be investor-friendly on paper but also effective in practice. Future research could explore this topic further by including respondents from different regions or industries to see how perceptions differ based on professional or geographical backgrounds.

VII. CONCLUSION

The study investigated the effect of corporate tax rate changes on FDI in India. Finding indicate that tax reductions can positively influence investment inflows, Making India more competitive in attracting foreign businesses. However, the analysis also highlights that the tax incentives alone are not the primary factor in investment decisions. Stability in business regulations, infrastructure and ease of doing business play a crucial role in sustaining long term FDI growth.

Comparing FDI trends before and after- tax reform suggests that by lower tax rates encourage short term investment surges, long term growth depends on a holistic economic approach. Countries that successfully attract FDI not only after offer tax benefits, but also create a stable investment environment, simplify procedures and promote transparent governance.

While corporate tax reductions help stimulate investment, they should be complemented by broader policy measures to enhance investor confidence. Policy makers should focus on regulatory reforms, infrastructure development and strategic sectoral incentives.

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