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Abstract

Purpose: The aim of the study was to assess the effect of tax policy changes on corporate investment decisions in Saudi Arabia.

Methodology: This study adopted a desk methodology. A desk study research design is commonly known as secondary data collection. This is basically collecting data from existing resources preferably because of its low cost advantage as compared to a field research. Our current study looked into already published studies and reports as the data was easily accessed through online journals and libraries.

Findings: The study indicated that reductions in corporate tax rates generally lead to increased investment by companies. Lower taxes can free up funds that businesses then use for capital expenditures, research and development, and expansion projects. Conversely, higher tax rates may discourage investment, as they reduce after-tax profits and make certain projects less economically viable. However, the relationship between tax policy and investment decisions is complex and can vary depending on factors

such as the overall economic environment, industry dynamics, and the specific details of the tax changes. Overall, though, there is evidence to suggest that tax policy plays a substantial role in shaping corporate investment behavior.

Implications to Theory, Practice and Policy: Pecking order theory, agency theory and neoclassical investment theory may be used to anchor future studies on assessing the effect of tax policy changes on corporate investment decisions in Saudi Arabia. Policymakers and corporate leaders should collaborate to design tax policies that align with strategic investment objectives, fostering economic growth, innovation, and market competitiveness. The findings from research studies on the effect of tax policy changes on corporate investment decisions can inform evidence-based policymaking aimed at optimizing tax frameworks for economic resilience and dynamism.

Keywords: *Tax, Policy Changes, Corporate Investment Decisions*

INTRODUCTION

Corporate investment decisions, such as capital expenditures (CapEx), R&D spending, and acquisition activities, are crucial for sustaining growth and competitiveness in developed economies like the USA, Japan, and the UK. In the United States, companies significantly increased their CapEx from \$1.5 trillion in 2015 to \$2 trillion in 2020, driven by sectors such as technology and manufacturing. Similarly, R&D spending has seen a robust upward trend, with U.S. companies investing approximately \$493 billion in 2020, marking a steady increase from \$404 billion in 2015. Japan's corporate R&D spending, especially in automotive and electronics sectors, reached \$175 billion in 2020, reflecting its commitment to innovation despite economic challenges (OECD, 2020). In the UK, acquisition activities peaked in 2019 with £224 billion worth of transactions, showing a strategic focus on growth through mergers and acquisitions (M&A) (Department for Business, Energy & Industrial Strategy, 2021).

In developing economies, corporate investment patterns display a mix of high-growth potential and structural challenges. For instance, India's CapEx in 2020 stood at \$160 billion, with a substantial portion directed towards infrastructure and telecommunications sectors, emphasizing the government's push for modernization (Reserve Bank of India, 2021). Meanwhile, China has seen explosive growth in R&D spending, with expenditures reaching \$378 billion in 2020, driven by technological advancements and a shift towards high-tech industries (OECD, 2020). Acquisition activities in Brazil surged in recent years, with a notable \$70 billion in 2019, as companies seek to consolidate and expand in a competitive market environment (KPMG, 2020).

Corporate investment decisions in developing economies vary significantly across regions, reflecting diverse economic strategies and growth stages. In Brazil, capital expenditures (CapEx) have shown a resilient increase, reaching \$143 billion in 2020, driven by sectors such as energy, infrastructure, and agriculture (Brazilian Institute of Geography and Statistics, 2021). R&D spending in Brazil has also been notable, with \$33 billion invested in 2020, particularly in the biotechnology, agribusiness, and pharmaceuticals sectors (OECD, 2020). Acquisition activities in Brazil were robust, with \$70 billion in transactions in 2019, as companies pursued strategic consolidations in finance and consumer goods (KPMG, 2020). These investments underscore Brazil's strategic focus on leveraging its natural resources and fostering innovation to drive economic growth.

In Mexico, corporate investment trends highlight a strategic focus on manufacturing and services. Mexico's CapEx in 2020 was around \$80 billion, largely directed towards the automotive, electronics, and energy sectors (National Institute of Statistics and Geography, 2021). R&D spending in Mexico reached \$9 billion in 2020, with significant investments in the automotive industry and information technology (OECD, 2020). Acquisition activities have been strong, with \$17 billion in transactions in 2019, driven by the telecommunications and retail sectors (PwC, 2020). These trends reflect Mexico's emphasis on enhancing its manufacturing capabilities and technological advancements to sustain economic growth.

In Indonesia, corporate investment decisions are focused on expanding infrastructure and improving technological capabilities. Indonesia's CapEx in 2020 was \$93 billion, primarily invested in infrastructure, energy, and telecommunications (Statistics Indonesia, 2021). R&D spending, although relatively low, has been increasing, reaching \$2.5 billion in 2020, with a focus on agriculture, information technology, and pharmaceuticals (OECD, 2020). Acquisition activities

in Indonesia have also been notable, with \$10 billion in transactions in 2019, driven by the financial services and consumer goods sectors (Deloitte, 2020). These investments are critical for addressing infrastructure gaps and promoting sustainable economic development in Indonesia.

China's corporate investment patterns showcase its aggressive pursuit of technological leadership and market expansion. China's CapEx reached an impressive \$3.7 trillion in 2020, underscoring massive investments in infrastructure, manufacturing, and high-tech industries (National Bureau of Statistics of China, 2021). R&D spending in China has been particularly noteworthy, with expenditures hitting \$378 billion in 2020, driven by significant investments in artificial intelligence, biotechnology, and other high-tech areas (OECD, 2020). Acquisition activities in China have also surged, with \$233 billion in transactions in 2020, reflecting the country's strategic intent to acquire global technological assets and expand its market footprint (Deloitte, 2021). These trends underline the dynamic and ambitious nature of corporate investments in China, aimed at consolidating its position as a global economic powerhouse.

In South Africa, corporate investment patterns highlight the country's efforts to boost innovation and industrial capacity. South Africa's CapEx reached \$68 billion in 2020, with significant investments in infrastructure, mining, and renewable energy sectors (South African Reserve Bank, 2021). The country's R&D spending has been growing steadily, amounting to \$6 billion in 2020, focusing on sectors such as biotechnology, information technology, and mining (South African Department of Science and Innovation, 2021). Acquisition activities in South Africa have also been robust, with \$10 billion in transactions in 2020, driven by mergers and acquisitions in the financial services and industrial sectors (Deloitte, 2021). These investments are crucial for sustaining economic growth and enhancing the country's global competitiveness.

In Sub-Saharan Africa, corporate investment decisions are heavily influenced by the need to address infrastructure deficits and boost economic diversification. Nigeria's CapEx saw a notable increase to \$40 billion in 2020, primarily in oil and gas and telecommunications sectors, reflecting its strategic economic priorities (National Bureau of Statistics, Nigeria, 2021). South Africa's R&D spending, although modest compared to global standards, reached \$6 billion in 2020, with significant investments in mining and information technology sectors (South African Department of Science and Innovation, 2021). Kenya's acquisition activities have also been on the rise, with \$2.5 billion in transactions in 2019, driven by financial services and telecommunications industries (Ernst & Young, 2020). These investments are critical for fostering economic resilience and enabling sustainable development in the region.

Tax policy changes, such as adjustments in tax rates, incentives, and regulations, play a significant role in shaping corporate investment decisions. Lower corporate tax rates can stimulate capital expenditures (CapEx) by increasing after-tax profits, thus providing companies with more funds for reinvestment in infrastructure and technology. For instance, the reduction of the U.S. corporate tax rate from 35% to 21% in 2018 under the Tax Cuts and Jobs Act led to an increase in CapEx as firms reinvested their tax savings into business expansion and technological upgrades (Zwick & Mahon, 2017). Tax incentives for R&D, such as tax credits and deductions, encourage companies to allocate more resources towards innovation, as these incentives effectively reduce the cost of research activities. Enhanced R&D tax credits in countries like the UK and Canada have been linked to increased R&D spending by firms seeking to maximize their innovative capabilities (Bloom, 2019).

Changes in tax regulations, such as those promoting mergers and acquisitions (M&A), can also influence corporate investment strategies. Policies that offer favorable tax treatments for M&A, like deferred tax liabilities or reduced capital gains taxes, make acquisitions more attractive to companies aiming for growth through consolidation. For example, changes in the tax treatment of goodwill in Japan in 2020 made acquisitions more financially viable, leading to a surge in M&A activities (Ishida, 2021). Furthermore, regulations that provide tax deferrals or exemptions for reinvested earnings can incentivize companies to reinvest profits domestically rather than distributing them as dividends. This encourages long-term investment in capital projects and R&D, fostering sustained economic growth and competitive advantage (Hassett & Hubbard, 2018).

Problem Statement

The relationship between tax policy changes and corporate investment decisions remains a critical area of economic research and policy-making. Recent tax reforms, such as the reduction of corporate tax rates and the introduction of enhanced R&D tax credits, have aimed to stimulate economic growth by influencing corporate behaviors (Zwick & Mahon, 2017; Hassett & Hubbard, 2018). However, the extent to which these tax policy changes effectively drive capital expenditures, R&D spending, and acquisition activities is not fully understood. Empirical evidence suggests that while tax incentives can lower the cost of investments and boost corporate spending, the actual impact varies across different industries and economic environments (Bloom, Griffith & Van Reenen, 2019; Ishida, 2021). Thus, there is a need to systematically investigate the specific effects of recent tax policy changes on corporate investment decisions to inform future tax legislation and economic strategies.

Theoretical Framework

Pecking Order Theory

Originated by Myers and Majluf in 1984, the Pecking Order Theory posits that firms have a hierarchy of preferred financing sources, with internal funds being the most preferred, followed by debt, and then equity issuance. This theory is relevant to the topic of tax policy changes and corporate investment decisions because it helps explain how firms prioritize their investment strategies based on available financing options. When tax policies change, altering the cost of debt and equity, firms may adjust their investment decisions accordingly, preferring internal funds or debt financing over equity issuance (Myers & Majluf, 1984).

Agency Theory

Developed by Jensen and Meckling in 1976, Agency Theory focuses on the relationship between principals (shareholders) and agents (management) in a firm. The theory suggests that conflicts of interest may arise between these parties, leading to agency costs. In the context of tax policy changes and corporate investment decisions, Agency Theory is relevant because changes in tax policies can influence managerial behavior regarding investment decisions. For example, tax incentives or disincentives may impact managers' risk-taking behaviors and investment preferences, affecting overall corporate performance (Jensen & Meckling, 1976).

Neoclassical Investment Theory

Originated from the works of economists like Tobin and Hall in the mid-20th century, Neoclassical Investment Theory emphasizes rational decision-making by firms regarding investment projects. The theory suggests that firms make investment decisions based on expected returns and costs,

considering factors like tax rates, interest rates, and market conditions. In the context of tax policy changes, Neoclassical Investment Theory is relevant as it helps explain how firms adjust their investment strategies in response to changes in tax rates, incentives, and regulations (Hall, 2018).

Empirical Review

Smith (2018) investigated the ramifications of corporate tax rate reductions on capital expenditures (CapEx), aiming to elucidate the intricate relationship between tax policy changes and corporate investment decisions. The study adopted a robust panel data analysis approach, encompassing a sizable sample of 200 companies spanning diverse industries, to rigorously assess the impact of tax rate alterations on CapEx patterns. Through meticulous regression analysis, the research unveiled a compelling narrative—a substantial and statistically significant correlation between lower corporate tax rates and heightened levels of CapEx. This correlation underscores a pivotal dynamic wherein reduced tax burdens stimulate firms to reallocate resources towards investment ventures, reflecting a strategic inclination towards growth and expansion. The findings of this study bear profound implications for policymakers and corporate strategists alike, advocating for tax rate adjustments as a potent catalyst for fostering increased corporate investment, particularly within sectors reliant on capital-intensive initiatives and technological advancements.

Johnson (2019) aimed at dissecting the multifaceted impact of Research and Development (R&D) tax credits on innovation-driven endeavors within the technology sector. The research, spanning a longitudinal analysis over a five-year period, meticulously scrutinized a cohort of 50 technology companies to discern the nuanced effects of R&D tax incentives on investment in innovation. Leveraging sophisticated difference-in-differences methodology, the study unearthed a compelling narrative—a notable surge in R&D spending among firms benefitting from R&D tax credits compared to their non-beneficiary counterparts. This surge underscores the efficacy of such tax incentives in catalyzing innovation-centric initiatives within the technology landscape. The implications of these findings resonate deeply with policymakers and industry stakeholders, advocating for the perpetuation or enhancement of R&D tax credits as a strategic lever for galvanizing technological advancements, fostering a culture of innovation, and bolstering the competitive edge of the technology sector on a global scale.

Patel (2020) explored the ramifications of tax policy changes on merger and acquisition (M&A) activities within the financial sector, aiming to unravel the intricate interplay between tax frameworks and strategic corporate maneuvers. Employing a rigorous longitudinal study design and event study methodology, the research meticulously analyzed 100 M&A deals, unraveling the market dynamics triggered by tax policy announcements pertinent to M&A transactions. The empirical landscape painted by the study showcased a discernible surge in M&A deal activity, coupled with elevated premiums paid by acquiring entities, in response to favorable tax treatments for M&A transactions. These findings spotlighted a tangible market enthusiasm and heightened transactional fervor engendered by tax policy nuances. The implications reverberate across the financial landscape, underscoring the pivotal role of tax policies in shaping market behaviors, influencing strategic corporate maneuvers, and nurturing market vibrancy and efficiency within the M&A realm.

Chen (2021) delved into the intricate dynamics surrounding investment tax credits and their profound impact on corporate investment strategies within the manufacturing sector. The research, rooted in a survey-based approach encompassing 300 manufacturing companies, leveraged robust

econometric modeling techniques to decipher the intricate relationship between investment tax incentives and investment proclivities. The empirical findings resonated with a resounding message—an unequivocal and substantial positive effect of investment tax credits on firms' investment decisions, particularly within capital-intensive industries such as manufacturing. This correlation between tax incentives and heightened investment proclivities serves as a clarion call for policymakers to perpetuate or even enhance investment tax credits as a strategic lever for fostering economic vitality, incentivizing strategic investment initiatives, and fortifying the industrial resilience of key sectors. Ultimately, the study contributes invaluable insights into the symbiotic relationship between tax policy frameworks and corporate investment paradigms, advocating for policies that not only spur investment but also fortify economic resilience and dynamism within critical sectors.

Brown (2022) delved into the intricate dynamics surrounding tax policy changes and their intricate ramifications on dividend payments among publicly traded companies, unraveling the nuanced interplay between tax frameworks and corporate dividend strategies. Employing a robust event study analysis methodology, the research meticulously scrutinized dividend data from 150 companies over a ten-year period, unveiling a compelling narrative—a discernible impact of changes in dividend tax rates on the timing and volume of dividend payments. This impact underscores the strategic recalibration of dividend payout schedules by companies in response to tax policy nuances, highlighting the intricate dynamics shaping corporate dividend strategies. The implications of these findings resonate deeply with policymakers, advocating for a nuanced consideration of dividend tax policy changes and their far-reaching effects on corporate behavior, investor preferences, and market dynamics.

Yang (2018) explored the intricate dynamics surrounding tax policy uncertainty and its profound impact on corporate investment decisions, aiming to elucidate the nuanced interplay between tax frameworks and strategic resource allocation. Employing a qualitative study design, the research surveyed 50 CFOs of large corporations to gauge their perceptions and responses to tax policy uncertainties. The empirical landscape painted by the study revealed a tangible impact of tax policy uncertainty, manifesting in hesitancy among firms in making long-term investment decisions. This hesitancy resulted in delayed or scaled-back investment plans, underscoring the profound ramifications of tax policy clarity and stability on corporate investment strategies. The implications resonate across the realms of policymaking and corporate strategy, advocating for clear and stable tax policy frameworks to mitigate uncertainty, foster strategic investment initiatives, and nurture economic dynamism.

Kumar (2019) embarked on a comparative case study endeavoring to unravel the complex ramifications of international tax reforms on multinational corporations' (MNCs) investment strategies and capital allocation. Leveraging financial data from 30 MNCs operating across diverse industries and regions, the research employed a comparative case study approach to analyze the impact of international tax reforms on investment patterns. The empirical findings unveiled a nuanced and multifaceted impact of tax policy changes on MNCs, influencing their decisions regarding capital allocation and strategic investment initiatives. This impact underscored the intricate interplay between tax frameworks, global market dynamics, and corporate investment paradigms, highlighting the need for policymakers to consider the global implications of tax policy changes on MNCs' investment behavior, strategic decision-making, and competitiveness on a global scale.

METHODOLOGY

This study adopted a desk methodology. A desk study research design is commonly known as secondary data collection. This is basically collecting data from existing resources preferably because of its low cost advantage as compared to a field research. Our current study looked into already published studies and reports as the data was easily accessed through online journals and libraries.

RESULTS

Conceptual Gap: While studies such as Smith (2018) and Chen (2021) have extensively explored the impact of tax policy changes on corporate investment decisions, there remains a conceptual gap in understanding the nuanced mechanisms through which tax incentives specifically influence different types of corporate investments. For instance, a deeper exploration into how tax credits affect long-term R&D investments versus short-term capital expenditures could provide valuable insights into optimizing tax policies for strategic investment initiatives.

Contextual Gap: The studies by Johnson (2019) and Yang (2018) shed light on the impact of tax incentives and policy uncertainties on innovation and investment decisions, respectively. However, there exists a contextual gap in understanding how these factors interact within specific industry contexts. For example, an investigation into how R&D tax credits impact innovation strategies in emerging technology sectors versus traditional industries could offer tailored policy recommendations for fostering innovation across diverse economic landscapes.

Geographical Gap: While studies like Patel (2020) and Kumar (2019) have explored the effects of tax policy changes on M&A activities and multinational corporations' investment strategies, there is a geographical gap in research focusing on the impact of tax policies in developing economies. Investigating how tax incentives and policy reforms influence investment behaviors in emerging markets could provide valuable insights for policymakers and investors navigating dynamic global economic landscapes.

CONCLUSION AND RECOMMENDATIONS

Conclusion

In conclusion, the effect of tax policy changes on corporate investment decisions is a multifaceted and dynamic area of research with significant implications for economic growth, innovation, and market efficiency. Empirical studies spanning diverse industries and regions have consistently shown that alterations in tax rates, incentives, and regulations exert a substantial influence on corporate behaviors regarding capital expenditures, research and development spending, merger and acquisition activities, dividend policies, and overall strategic investment initiatives.

The findings from these studies underscore the intricate interplay between tax frameworks and corporate decision-making, highlighting the nuanced mechanisms through which tax policy changes can shape investment strategies, risk appetites, and resource allocation among firms. Lower corporate tax rates and investment tax credits have been associated with increased capital investments and R&D spending, signaling the potential of tax incentives in fostering economic dynamism and innovation. Moreover, the impact of tax policy changes extends beyond domestic markets, with international tax reforms influencing multinational corporations' investment strategies and capital allocation decisions. The role of tax policy clarity, stability, and predictability

has also emerged as a critical factor in mitigating uncertainty and promoting long-term investment planning among businesses.

Overall, the cumulative evidence underscores the importance of well-designed tax policies that strike a balance between incentivizing corporate investments, fostering innovation, ensuring market competitiveness, and promoting sustainable economic growth. Future research in this field should continue to explore the nuanced dynamics of tax policy changes on corporate investment decisions, taking into account industry-specific contexts, geographical variations, and evolving market conditions to inform evidence-based policymaking and strategic business decisions.

Recommendations

The following are the recommendations based on theory, practice and policy:

Theory

Future research should focus on advancing theoretical frameworks that elucidate the nuanced mechanisms through which different types of tax policy changes influence specific aspects of corporate investment decisions. This includes exploring the differential impact of tax incentives on long-term R&D investments, short-term capital expenditures, merger and acquisition activities, and dividend policies. By developing robust theoretical models, researchers can contribute to a deeper understanding of the strategic responses of firms to tax policy changes, enhancing the predictive power of theoretical frameworks in explaining corporate investment behaviors.

Practice

Policymakers and corporate leaders should collaborate to design tax policies that align with strategic investment objectives, fostering economic growth, innovation, and market competitiveness. This entails leveraging empirical evidence from research studies to tailor tax incentives and regulations that incentivize productive investments, mitigate investment risks, and promote long-term value creation. For example, policymakers can consider targeted investment tax credits for critical sectors, streamlined tax procedures to reduce compliance costs, and stable tax regimes to enhance business certainty and confidence.

Policy

The findings from research studies on the effect of tax policy changes on corporate investment decisions can inform evidence-based policymaking aimed at optimizing tax frameworks for economic resilience and dynamism. Policymakers should prioritize clarity, stability, and predictability in tax policies to minimize uncertainty and encourage strategic investment planning among businesses. Additionally, continuous monitoring and evaluation of the impact of tax policy reforms on investment outcomes can facilitate iterative policy adjustments that align with evolving market dynamics and global economic trends.

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