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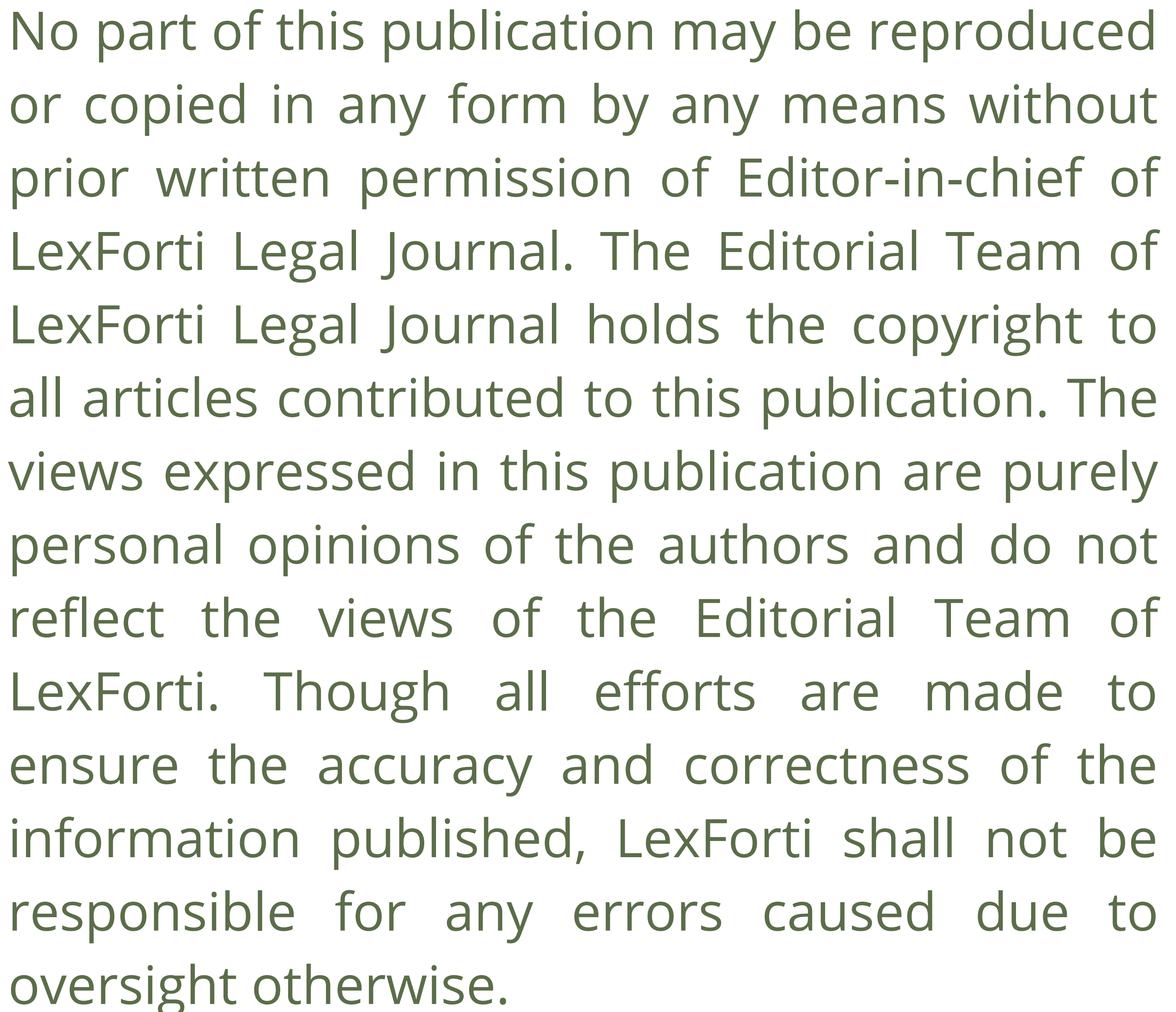

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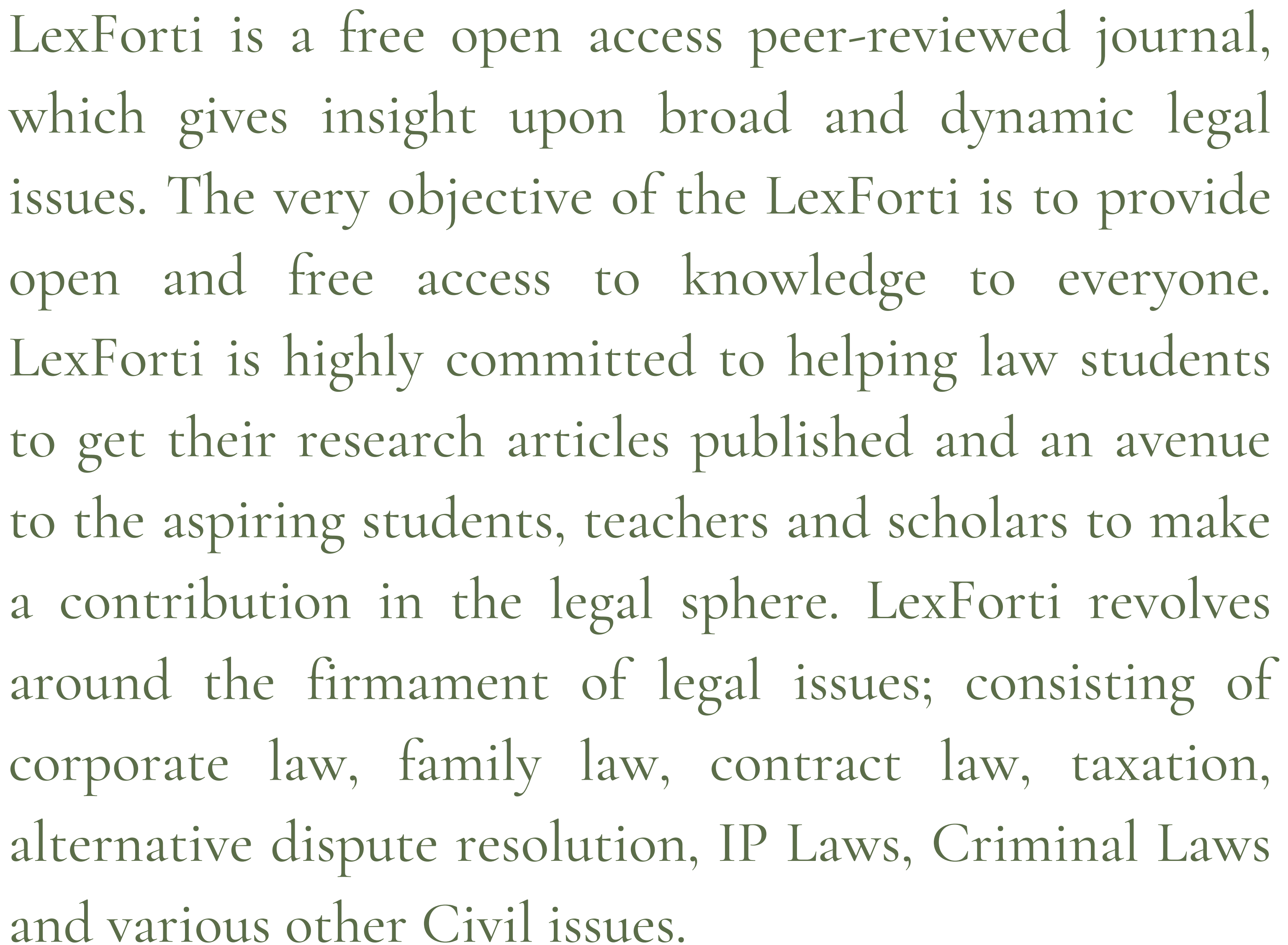

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Consequential Impacts of Corporate Tax Cut in India

Stuti Modi

ABSTRACT

Corporate tax refers to the tax paid by the companies on the profits earned. The tax imposed on companies in India, prior to this rate cut was the highest in Asia. The Corporate Tax Rate Cut has been an attempt to revive the growth of the stagnant economy. This is being done at the cost of foregoing $ 20 Billion in annual revenue, which will widen the government's fiscal deficit. The reduced tax is expected to increase the company's profit, further boosting the investment and circulation of funds in the economy. It can also be seen as an incentive to attract foreign investments in the country. The intent is to promote the 'Make in India' scheme and increase the job opportunities. However, the benefits reaped will not be the same across each sector and some are likely to benefit more than the others. This paper mainly aims at highlighting the rationale and the intended outcomes of the new taxation regime and comparing and contrasting it with immediate and possible result. The extent to which this pursuit is likely to be successful is also discussed.

INTRODUCTION

Corporate tax is a form of tax levied on profits earned by businessmen in a particular period of time. Various rates of corporate taxes are levied for different levels of profits earned by business houses. Corporate tax is generally levied on the revenues of a company after deductions such as depreciation, Cost of goods sold and Selling general and administrative expenses have been taken into account.

Corporate tax or company tax can be assumed as an Income Tax for income earned by businesses. Many countries levy corporate tax in order to smooth out the tax process for enterprises. Different countries have different rules that apply to taxing of income.

Corporate tax in India is levied on both domestic as well as foreign companies. Like all individuals earning income are supposed to pay a tax on their income, business houses too are supposed to pay as tax a certain portion of their income earned. This tax is known as corporate tax, corporation tax or company tax.

On September 20, 2019 the Government has brought Taxation Laws (Amendment) Ordinance 2019 to make certain amendments in the Income-tax Act, 1961 and the Finance Act, 2019. Through insertion of Section 115BAA to the Income Tax Act, 1961 an option for concessional taxation is provided whereby the country's effective corporate tax rate from around 35% to 25.17 per cent.[1] For companies that do not avail of any other incentive or commission, the effective tax rate would be just 22 per cent. Manufacturing companies set up after October 1,

[1] Section 115BAA to the Income Tax Act, 1961.

2019 to get option to pay 15 per cent tax. Effective tax rate for new manufacturing firms to be 17.01 per cent inclusive of surcharge & tax.[2] The new tax rate will be applicable from the current fiscal year which began on April 1, 2020.

The rationale behind such a concessional scheme is that it will incentivise the private sector to invest more, as companies can now expect higher profits. This will eventually lead to, it is hoped, an economic revival and facilitate economic growth.

RATIONALE BEHIND TAX CUT

The GDP growth in April-June 2019 slowed to 5 per cent year-on-year, the weakest pace of growth since 2013.[3] The pace of manufacturing output growth has also stalled, heavily impacted by weakening auto sector sales. The auto industry has slumped into a crisis.

India has cut its corporate tax rates in an effort to spur investment and boost growth in the country's faltering economy. The decision to implement the sweeping corporate tax reform measures reflects the slowdown in economic growth momentum in recent quarters.

Furthermore, India's Corporate Tax Rate before the cut was among the highest, making it less attractive for investment. The rate cut reflects the need to improve India's international competitiveness as a manufacturing hub and corporate investment.

Moreover, the 'Make in India' scheme launched in 2014, had set a target of increasing the contribution of manufacturing to GDP to 25 per cent.[4] However, by 2018 the manufacturing sector share of GDP was still at 18 per cent, which still leaves a substantial gap to bridge in order to achieve this vision.[5] Continuing to drive the transformation of India's industrial sector through 'Make in India' is a key strategic priority for the government, in order to improve manufacturing sector output growth and generate stronger employment growth. Catalysing more dynamic growth in the manufacturing sector will, therefore, be very important as a key pillar to achieving India's objective of becoming an upper-middle-income economy by 2025. Additionally, the New Tax Regime is also likely to improve Ease of Doing Business in India. The current rank of India in the Ease of Doing Business Ranking is as low as 63 out of 190 nations across the world.[6]

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[2] Section 115BAB, the Income Tax Act, 1961.
[3] Trading Economics: *India GDP Annual Growth Rate, 1951-2019.*
[4] Make in India, September 2014.
[5] Statistics Times: *Sector wise contribution of GDP of India.*
[6] The World Bank: *Ease of Doing Business Ranking, 2019.*

The additional income earned due to the tax cuts is expected to be invested in company, which would further boost employment and growth.

IMMEDIATE OUTCOME

Corporate taxes form a major portion of the Government Revenue. It is believed that the move, which involves forgoing Rs 1.45 lakh crore ($20 billion) in annual revenue, will widen the government's fiscal deficit, which is the difference between revenue and expenditure from the current target of 3.3 per cent, to 4 per cent of GDP this financial year.[7] The move is a lift for facing increasing pressure to relight once-stellar economy after five consecutive quarters of slowing growth saw India this year lose its status as the fastest-expanding major economy to China. On a positive note, India's government total revenues increased 4.2 percent to INR 11.78 trillion in April-December 2019-20 from INR 11.31 trillion in the same period last year.[8]

The new rates would be comparable with the lowest tax rates in South Asian region and in South East Asia. The announcement sent shares soaring more than five percent in Mumbai the biggest jump in 10 years while the rupee and firmed against the dollar. Indian stock markets have been on course for the biggest quarterly exodus since at least 1999, with foreign funds having dumped a net $4.9 billion worth of stocks since June.[9]

While India's equity markets cheered the decision, the bond markets tanked on fears that the government may now have to borrow more to meet its expenses.

POSSIBLE IMPACTS OF CORPORATE TAX RATE CUT ON DIFFERENT SECTORS OF INDIA

The Corporate Tax Statistics database released by OECD in January 2019, dealing with the analysis of corporate tax rate across the world reflects a falling corporate tax rate globally. The data reveals that the average combined statutory tax fell from 28.6 per cent in 2000 to 21.4 per cent in 2018.[10] Moreover, the effective corporate tax rate of countries like China, Russia, ranges between 20 to 25 per cent. With a reduction in the corporate tax rates, India aspires to be in sync

[7] Budget 2019: *Fiscal Deficit target revised to 3.3 per cent for FY 2020.*
[8] Trading Economics: *India Government Revenue, 1997-2019.*
[9] BusinessLine: *Nifty, Sensex clock best day in 10 years after sharp cuts in Corporate Taxes.*
[10] Organisation for Economic Co-operation and Development, *The Corporate Tax Statistics database*, January 2019.

with the global economy and the OECD analysis. It has been implemented at a time when the economy needs an impetus. Profitability of firms will immediately improve. Analysts have accordingly revised earnings estimates upwards from 16% to 25% for 2019-20.[11] Moreover, under the old tax regime more than half of the Nifty companies were paying in excess of 30% effective tax rate. This number will drop to three.[12]

Companies operating in the **Industrial Space** are also expected to benefit from the government's decision as increased cash flows will alleviate some of the working capital issues faced over the past few years. The move would benefit "short-cycle industrial companies such as ABB India Ltd., Siemens India Ltd. and Cummins Ltd. in the near term and Larsen & Toubro Ltd. in the long term".[13]

The step will also contribute positively for growth of **Construction Companies** as most of them are paying full tax rate. All these companies will move to 25 percent tax regime, boosting their EPS by 7-12 per cent, according to Phillip Capital. Reduction in tax rate will also enhance cash flow, and hence ease the working-capital situation.

The **financial sector,** initially having an average tax rate of 32.5 percent will be a primary beneficiary of the corporate tax rate cuts. Some of the biggest beneficiaries among banks would be State Bank of India, HDFC Bank Ltd., IndusInd Bank Ltd., DCB Bank Ltd. Among non-bank lenders, Bajaj Finance Ltd., Bajaj Finserv Ltd., M&M Financial Ltd. and Cholamandalam Investment and Finance Company Ltd. will benefit the most.[14]

The **Oil and Gas Sector** will be one of the major beneficiaries of lower tax rate as the average tax rate for the sector in financial year ended March 2019 was close to 33.4 percent. Lower tax rate would result into higher cash flows which could be used by these companies for debt reduction and capex funding.

Automakers may witness a 6 percent increase in earnings per share or net profit on an average due to the corporate tax rate cut, according to Edelweiss. But it's to be seen if the companies retain the benefits of the tax cut or pass them to consumers by lowering prices at a time Indians are buying less cars and GST Council offered no relief.

[11] Motilal Oswal Financial Services.

[12] Motilal Oswal Financial Services.

[13] Credit Suisse, Impact of Corporate tax rate cut.

[14] Edelweiss: *Fiscal Stimulus at the right time.*

Furthermore, the concessional tax scheme also extended towards the **New Manufacturing Firms** will promote the 'Make in India' campaign a much-needed boost and make the nation a more competitive investment destination. The new entities set up would be a source of massive employment in the country. Additionally, it will further widen the already existing gap of tax payment by manufacturing and non-manufacturing firms.

Despite there being no change or concessional scheme being introduced for the **Foreign companies,** the measures adopted are compelling in putting the economy on the growth trajectory.

On the contrary, it is also debated that the current corporate tax rate cuts are more likely to impact the distribution of income than growth or employment. Companies will now get a larger share of profits from existing investments, while the economy remains on the slow lane. There is a very real danger that this would exacerbate inequality. Furthermore, while rigid fiscal deficit targets can be constraining as it forces the government to cap expenditure and squeeze out more tax from companies, an increase in fiscal deficit does not necessarily entail growth.

Conclusively, the companies that will benefit the most are the ones whose effective tax pay-out was much higher than others like ITC, Tata Steel, Britannia, HDFC Bank, Zee Entertainment, JSW Steel, Kotak Mahindra Bank, ONGC, Eicher Motors. While the other companies with comparatively lower tax rates under the old regime will not gain much.

CONCLUSION

The Corporate Tax Rate Cut can be seen as a genuine attempt to revive the economy. The Corporate tax forgone by the government due to tax cut should not just be judged from a unilateral viewpoint. The increased employment is likely to escalate and balance the revenue of the government from the tax imposed on the income of such employed person. The development of the economy by more investment by the companies while undertaking expansion, is also likely to increase the revenue from the tax imposed on acquisition and registration of property. The incentive scheme is not as futile as the critics claim it to be. It is also a device to promote public welfare. The argument that the Existing private corporate sector simply does not need to invest more because lack of demand has forced it to cut production and capacity utilisation for several years now is highly debatable. It is also said that the saving investment gap has been increasing enormously over the past years. However, it would be

unconfirmed and baseless to assume that the saving investment gap would continue to widen even after the incentive of corporate tax cut. Further, incentives for new manufacturing entities would lead to more flow of funds into the Indian Economy and endorse the Make in India Scheme. Moreover, the increased profits would facilitate companies to undertake expansion which would provide the economy with the much-needed boost and revival of growth. Furthermore, it would promote the Anti-Poverty and Employment Generation Programme in India.