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To empower the student community...

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OCTOBER 2019
Theme 335

CORPORATE TAX CUT
- Igniting Economic Growth

28th Year of Publication

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SIB STUDENTS' ECONOMIC FORUM

OCTOBER, 2019

Theme No: 335: CORPORATE TAX CUT - Igniting Economic Growth

A well informed customer will make the policy makers as well as organizations which produce goods and render services more responsive to the customer needs. This will also result in healthy competition among organizations and improve the quality of its products. The "SIB Students' Economic forum" is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly meeting of the "Forum". Topic of discussion for this month is "Corporate Tax Cut – Igniting Economic Growth". The changes in Corporate Income Tax (CIT) announced by the Finance Minister constitute an important milestone in India's recent legacy of tax reforms, aimed at boosting sentiments as well as kick-starting growth.

What are the major pronouncements?

Less Tax, More Investment

Indian Companies can opt to pay 22% tax on income, if they do give up tax exemptions/incentives like section 80IA (for captive power undertaking), section 80IE (North-East undertakings), additional depreciation, investments allowance, etc. With surcharge and cess, effective tax on income will come down to 25.17% , from 34.90% at present.

Make In India

Inorder to attract fresh investments in manufacturing sector and there by provide a boost to the "Make in India" initiative, Indian companies formed from October 1, 2019 onwards in manufacturing sector can opt to pay only 15% income Tax (17.01% effective) if they dont avail exemptions and incentives and start production by March 31, 2023.

Off the MAT

The above two categories of companies will also be exempt from Minimum Alternative Tax - a tax of 18.50% imposed on all profit making firms that declare lower tax. MAT now stands lowered from 18.5% to 15% for companies that avail themselves of exemptions and incentives.

Keep more Capital Gains

Surcharge imposed in the Budget on capital gains from sale of shares or units is withdrawn, Foreign portfolio investors will enjoy this benefit also.

Buy-Back of Shares

The applicability of Dividend Distribution Tax, which was extended to the buy-back of shares by listed companies in the 2019 budget, will also not be charged in respect of those companies which had made the buy back announcement before 5 July 2019.

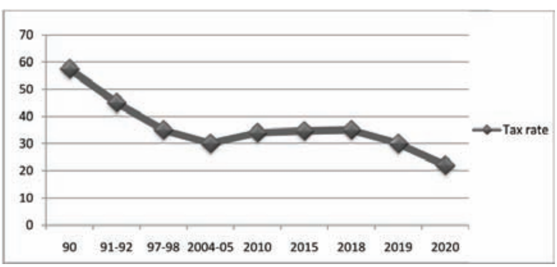
CSR for Startups

Scope of 2% mandatory CSR spending is expanded to include incubators set up by Govts. & PSUs and contributions to IITs, national labs and autonomous bodies doing scientific and medical research.

Why has the government cut tax rates?

A Corporate Tax cut works a lot like an income tax cut for individuals. The reduction in the Corporate Tax rate has been a long-standing demand from the industry. In essence, a lower Corporate Tax rate means businesses have more money left with them; in other words, it increases their profits. A lower tax rate not only improves corporate profitability but also makes India a more competitive market for investments. The approach has further boosted positive spirits in industry to ensure that India becomes as competitive on tax rates as the rest of the world. India’s Corporate Tax rates were quite high in comparison to neighbouring countries. The drastic reduction in Corporate Taxes will be a huge game-changer for the economy. It will catalyse investments, particularly in manufacturing, infuse huge confidence among investors, and set a new springboard for growth. This also indicates that the Government is adopting the tax stimulus route, rather than increasing Government spending, to help the recovery process of the economy.

A history of Corporate Tax cuts over the years



In the early 90s, the Chelliah Committee had recommended bringing down the CIT rate from between 51.75-57.5 % to 45 %. It was gradually brought down to 40 %, and then further to 35 % in 1997-98. Later, based on the Shome Committee (2001) and Kelkar Committee (2002) recommendations, the basic CIT rate was brought down to 30 % in 2004-05. In 2015-16, the then Finance Minister announced that the basic CIT rate would be reduced to 25 %. The latest reforms go beyond this by lowering the basic rate to 22 % for domestic companies and 15 % for new manufacturing companies. The cess and surcharges however will continue.

Who Gains?

- The immediate benefit is increased cash flows to Corporate India that will be either channelised into debt reduction or incremental investments in increasing capacity.
- 2.50 lakh companies out of 8.4 lakh that filed tax returns for 2017-18 had paid tax at an effective rate of 25% or higher. 29.5% was the effective aggregate tax rate on all 8.4 lakh companies. 35.1% was the highest effective tax rate paid by a sensex company. 22.9% was the effective rate paid by 21 non-finance sensex companies. All the above companies will now stand to gain.
- Sectors like banking and FMCG are expected to grow at a CAGR of 48.2% and 18%, respectively vs. earlier CAGR of 42.2% and 12.2%.
- In the Capital Goods space, the companies have effective tax rates from 25 to 34 %. The Corporate Tax cut will have significant positive impact on the mid-cap companies.
- While cement companies, which currently have higher tax rates would benefit significantly from the reduction, only a few players would benefit in the construction sector.
- Consumer durable companies pay effective tax of between 25% and 35% and the cut would benefit most of them.
- Domestic auto equipment makers will tend to benefit from the tax cut.
- Hotels, logistics and liquor as well as metal and mining sectors would also benefit from the reduction.

Impact of Corporate Tax Cut on Companies, Industries & Economy

∇ After this cut, base **Corporate Tax rate in India has become competitive** and should help boost investment. India's base Corporate Tax is now at par with most Asian countries.

∇ Reduction in Corporate Tax was a **long-pending demand of Indian firms**. India is likely to attract investors looking for opportunities out of China.

∇ Taxing new production facilities (that come up by 2023) at 15% will **enable attraction of global capital.**

∇ **The tax cut will boost Nifty earnings growth.**
Profitability of firms will immediately improve. Analysts have accordingly revised earnings estimates upwards (from 16% to 25% for 2019-20)

∇ Lower tax outflow could increase the share of profit making companies in India over time. Tax cuts might also raise their profit margins above 10%.

- ∇ The rise in buoyancy will hit a speed-breaker some time. However, the hope is that lower rates will push up economic activity and increase revenue in the coming years.
- ∇ Catalysing more dynamic growth in the manufacturing sector will be a key pillar to achieving India's objective of becoming an upper-middle-income economy by 2025.

Verdict

In the immediate term, it leaves Corporates with more money, which they can use to either reinvest in existing firms or invest in new ventures if they think doing so would be profitable. But it is also possible that they may simply use this money to pay off old debts or pay higher dividends to their shareholders. Whether or not companies invest will depend on the prevailing economic conditions.

In the medium to long term, that is anywhere between one or two and five years or more, a Corporate Tax cut is expected to boost investments and increase the productive capacity of the economy. That's because regardless of a slump in demand in the short term, investment decisions are taken after considering long term demand projections. If demand is expected to grow, investments will bear fruit and with lowers taxes, profits will be higher. These investments will also create jobs and increased earnings in due course.

However, a Corporate Tax cut also depresses economic activity to the extent that it reduces the money in the hands of the governments in the form of tax revenues. The Corporate Tax cut will cost the government Rs 1.45 lakh crore in revenues foregone. That is 0.7% of GDP. If added to the budgeted fiscal deficit of 3.3% of GDP, the impact will be substantial with the fiscal deficit going to 4.0%. If this money had been with the government, it would have been spent on either paying salaries or creating new productive assets such as roads — either way, this money would have gone straight to the consumers, instead of the investors.

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