

Is it the Time to Rethink the Corporate Tax System of India?

Garima Tyagi

Objective

The objective of the paper is to find the answer to the question if some changes are required in the present corporate tax system of India by comparing it with that of other economies and to determine if the current corporate tax rate of India is too high or low. As many developed countries are opening up their economies to become the ideal business destination, it has become necessary for the developing countries to fix a competitive tax rate to expand their economy.

Abstract

Tax rate being the major source of income for most of the governments, the tax system of a country decides the economic position of the country to a great extent. If the tax system is not up to global standards, it might result in making the country financially weak and facing fiscal deficits. The tax system should be neutral and have the ability to deal with the corporate demand and the economic efficiency of the country. The paper discusses the trends in corporate tax system of India, the comparison with developed and developing countries and the indicator Tax to GDP ratio of some developing and developed countries to find out where India stands and if it is following the global trend to be competitive enough. As the countries are opening up their economies and making their country easy to do business in, it has become necessary for the developing countries to fix a competitive tax rate to expand their economy. The paper tries to analyze the current tax rate of India in comparison to other developing and developed countries.

Introduction

A corporate tax system is a tax levied on the profit of the firm, and different tax rates used for different levels of profit. Tax is the major source of income for the government and the taxation system decides to an extent how the country is doing financially. Indian taxation system has gone through many reforms and still stands far from the 'ideal tax system'. Critics argue that the losses incurred because of the current tax system far exceed the revenue raised. A taxation system which does not encourage the ease of doing business might slow down the growth of the economy. The burden of the tax falls not only on a corporation but on a common man too, who tries to maximize his profits by investing in shares, as a corporation is made up of individual investors. An unfit tax system makes the country lag behind in global competitiveness.

Types of Corporate Tax Rate

The corporate tax consists of three different rates,

1. National statutory rate: The amount of taxes imposed by the government that is within its statutory authority to regulate on the income, sales, capital gains etc is known as the National statutory rate.
2. Statutory combined rate: At the starting point for the tax collection, some companies combine the federal and provincial state rates.
3. Effective tax rate: It is the percentage of income actually paid by an individual or a company by taking in account all the loopholes, deductions, credits, preferential rates etc.

Data collection

The study is based on secondary data. The following sites have been used for collecting tax rates and the graphs are derived later from that data.

1. www.tradingeconomics.com
2. <https://www.oecd.org>

Trends in corporate tax system of India

Corporate tax rates of India are expected to come down in the coming 5 to 8 years. Besides strengthening the tax monitoring system, India also initiated indirect tax reform in 2017. The launch of the Goods and Services Tax (GST) in July, last year, replaced multiple indirect taxes. GST establishes a single and uniform market across India. It facilitates transparent business transactions. The tax is collected through value-added goods and services and on each step through the input credit mechanism (Tax credit mechanism).

According to a report by World bank in 2018, India has improved its rank in the metric of paying taxes to 119 from its previous rank 172, out of 190 countries. The tax rates for foreign companies are different from that of the domestic firms. Many facts come into consideration while deciding, like the agreement with the country to which the foreign company belongs.

India presently has a very complex tax structure with a lot of inequities, ambiguities, and distortions. While India has a statutory tax rate of 34.6%, the effective tax rates that Indian companies actually pay is 28%. The huge difference in the statutory and effective tax rate can't go unnoticed. The reason behind such a gulf is seen as the complex system that has a lot of exemptions which at the end is beneficial for the big firms and a loss for small firms. The big firms are able to make use of the loopholes and have a lower effective tax rate as compared to the small firms who can't afford to spend money in huge amounts to save taxes, and they end up paying a larger share of their income.

The burden of the tax is shared by the shareholders altogether, the corporate is like an invisible body paying the taxes. It actually affects the shareholders who aim to maximize their profit by investing money. The tax indirectly affects the life of an individual too. High tax rates increase unemployment too which weakens the economy as it's not able to perform to its efficiency and the lowers the living standard.

Comparison with developing and developed economies

Corporate tax rate of developing countries and India

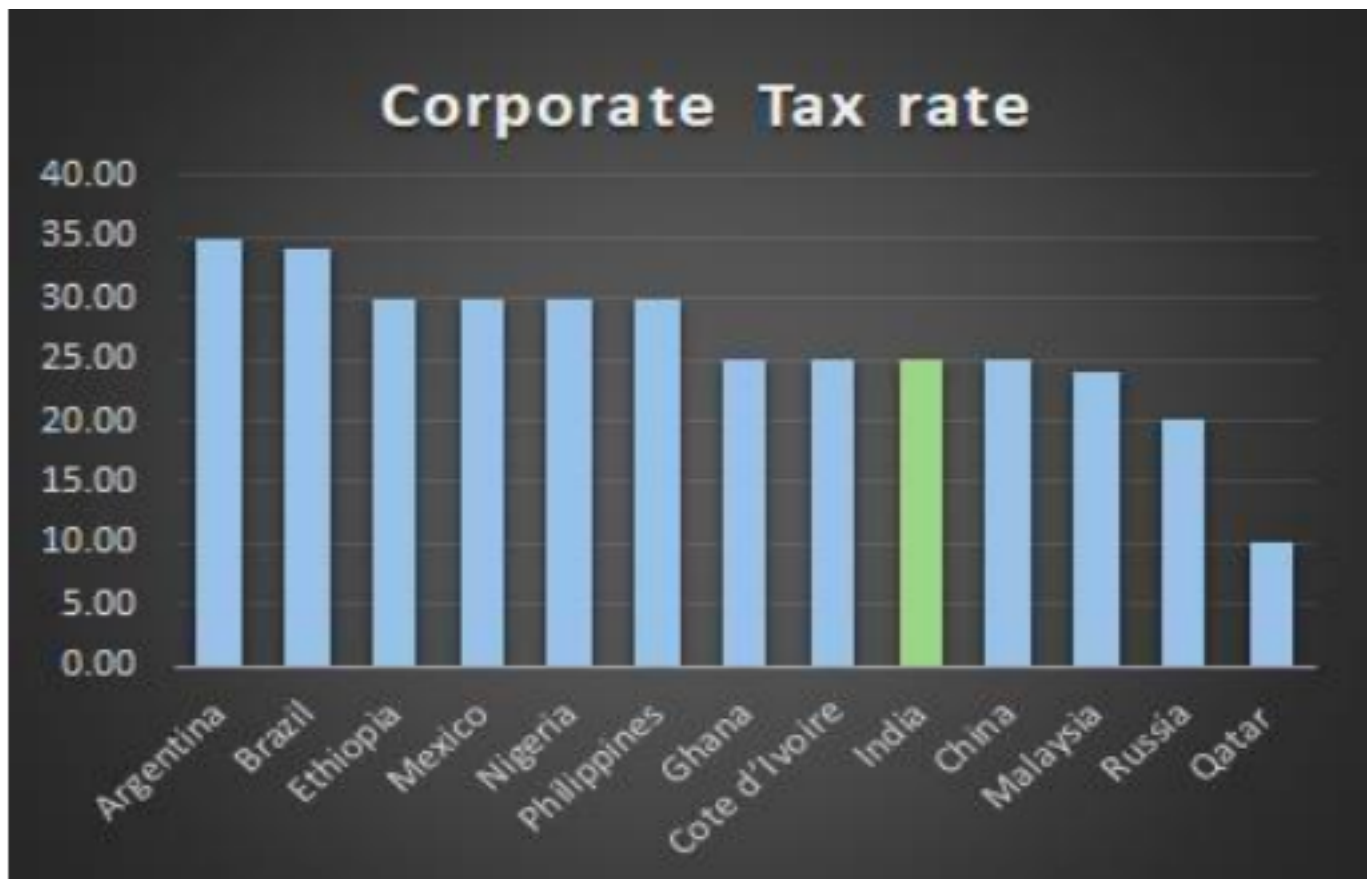


Figure 11: Data source: www.tradingeconomics.com

Argentina has the highest corporate tax rate followed by Brazil among the developing countries which we have taken for analysis. Qatar has the lowest corporate tax rate out of these countries at only 10%. This could be seen as an initiative to encourage business in the country. There is no corporate tax on the domestic companies in Qatar. Russia has the second lowest at 20%. India is among the countries with lower tax rate among these with a tax rate of 25 along with Ghana, Cote d'Ivoire, and China having the same tax rate. The average tax rate is of 26.37 of these countries. India has a lower tax rate than the average of these countries.

Post Soviet Russia changed the system and made it easier to pay tax then to try and

dodge it. Their revenue rose. It was not because of the Laffer Curve argument which says that faster economic growth leads to more tax revenue. Rather, it was that fewer people bothered to cheat. This successful example of tax reduction can be considered for the Indian tax system, as in India there is a huge difference between the statutory and effective tax rate,

Corporate tax rate of developed countries and India

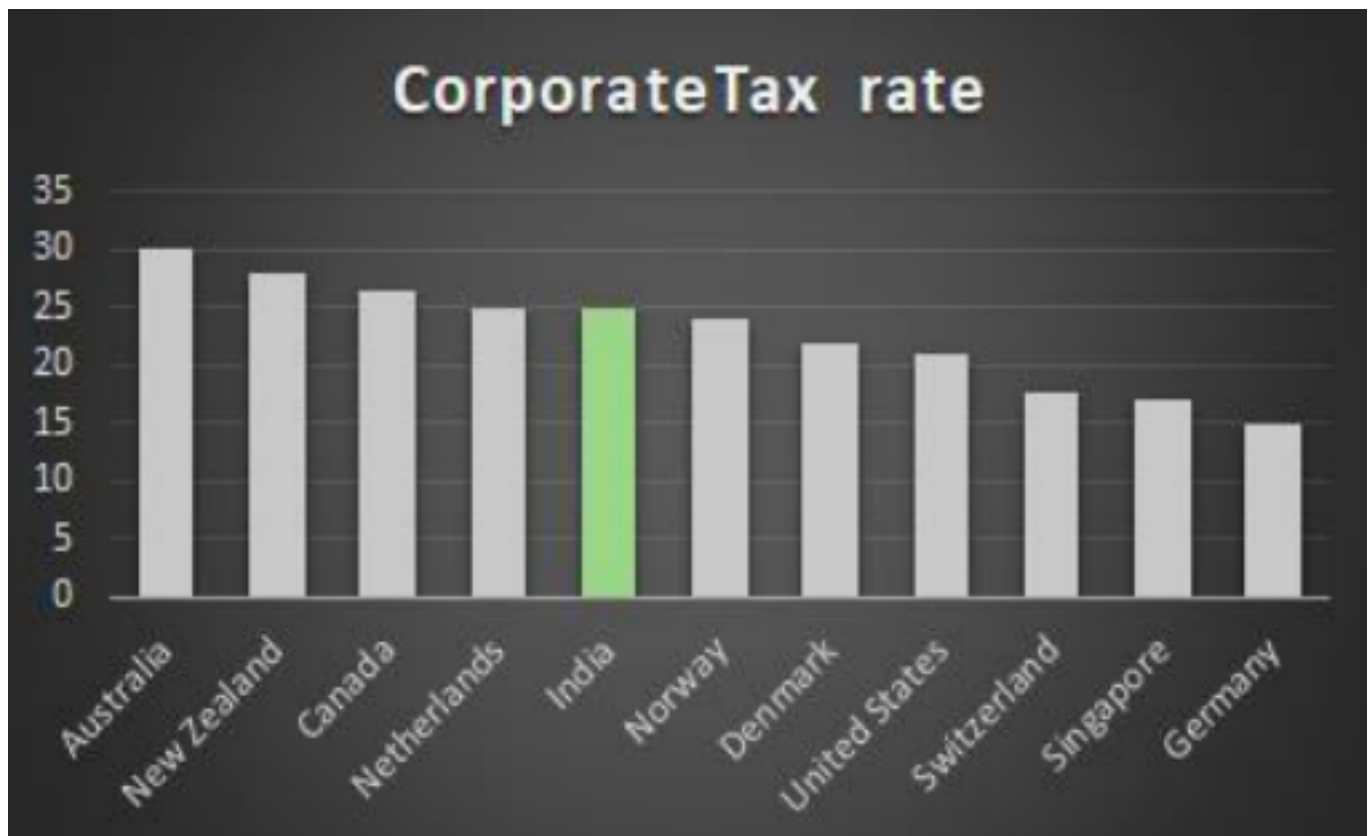


Figure 12: Data source: www.tradingeconomics.com

Among developed countries, Australia has the highest corporate tax at 30 and Germany has the lowest at 15. India lies somewhere in the middle of sharing the same tax rate as Canada. As it can be seen developed countries have comparatively fewer tax rates (Just according to the graph and not a conclusion). India has the 5th largest tax rate among these countries. An average tax rate is around 22.8 of these countries.

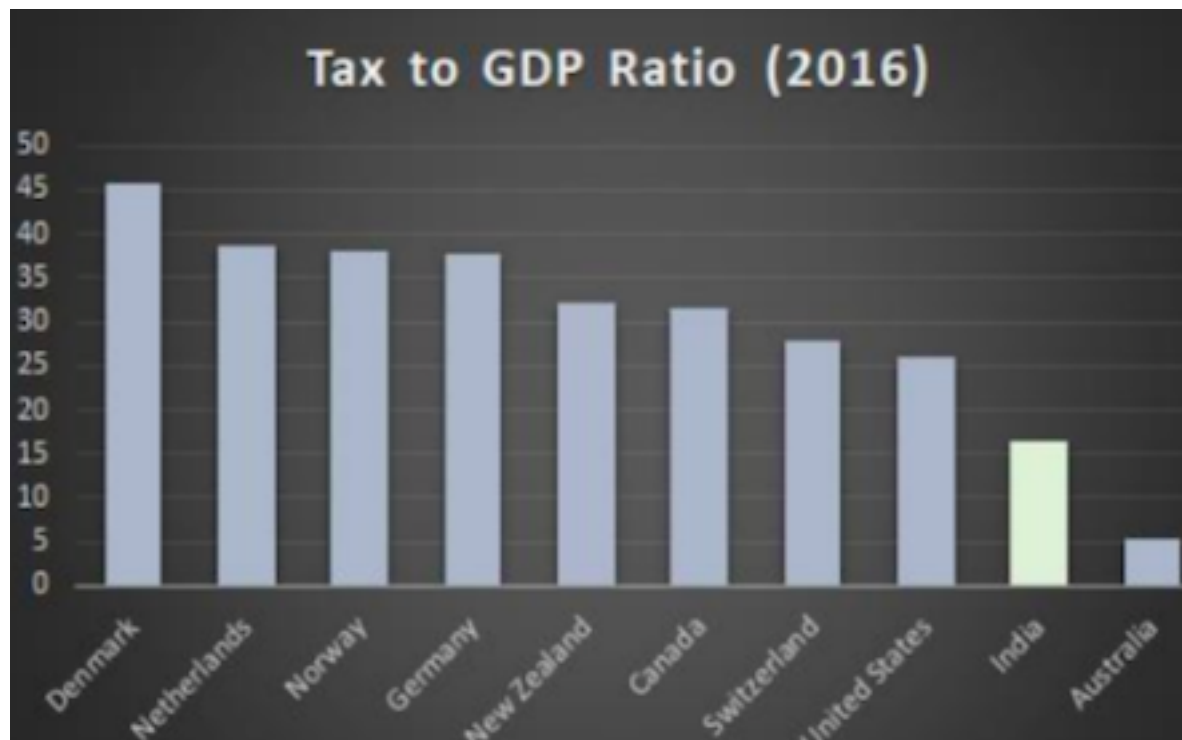
The idea behind the GOP tax plan of the US, which led to the fall in taxes from 35% to 21%, was that to increase employment, investment in the US and the growth of the economy. The step has been praised worldwide and is expected to bring a positive outcome. There has been a decline in Corporate Tax Rates worldwide in most of the developed countries. India is required to keep the pace and build a competitive tax system.

Tax to GDP Ratio

A tax to GDP Ratio can be understood as the contribution of the tax towards the GDP in simple terms. It is the ratio of tax collected to the gross domestic product(GDP). Some of the reasons behind low Tax to GDP ratio can be

- High tax evasions
- Unorganized Sector
- Loopholes in double tax avoidance treaties
- Tax exemption and subsidy policies

A low TGR implies that the proportion of tax is low in the GDP which is an issue of concern.



The tax to GDP Ratio of India is comparatively very less as compared to other developed nations. The average Tax to GDP Ratio of OECD countries has been 34.3%. Denmark has the highest proportion of tax on its GDP and Australia has the lowest proportion. From the above analysis, we know that Australia had a very high tax rate and Denmark had comparatively very low tax rate. India has the second lowest Tax to GDP Ratio among these countries. The tax rate in India was not an outlier, the countries having an almost same tax rate as that of India have much better Tax to GDP Ratio.

Conclusion

India has mixed tax competitiveness records in spite of a developing country trying to expand its economy. A tax reform will not only require a change in the current tax rates but also to fix the current loopholes and make tax laws easy. It will give a message in the corporate world that India is a good investment destination. All this will lead to the boost of the economy and will provide employment to the citizens. The United States has lowered its tax rates from 35% to 20%, introducing the idea to India. However India being a populated country, a very low tax rate might bring hindrances in the working of government as the tax is a major part of the income of the government. Not only this, it will start a race with other countries with them dropping their taxes and ending up to a 'Sad race to zero'. The country might lose jobs to the lower tax

economies in the case of high tax and the investment might decline as companies will choose other overseas destinations with the lower tax rate.

Developed countries are reducing and restructuring their tax rates to expand their economy and increase employment. Over the years there has been a fall in the tax rates of the developed countries to stand in the race of becoming the investment destination in the global economy. India is a developing country and is in urgency to expand its economy with unemployment being a major social issue in India and the number of job seekers constantly rising with time, it's necessary for the Indian government to not take any step which just adds to the problem. However, rolling out a completely new corporate tax system will not be feasible and will take our time and resources which makes it a tough decision to make. In a speech, the finance minister of India himself showed the concern regarding the tax rates of India and the need to make them corporate friendly. India holds a very low Tax to GDP Ratio and this gives rise to a major concern. The tax rate in India is neither too high, nor too low at present, despite this the low Tax to GDP Ratio flames the debate regarding the restructuring of the Corporate Tax System of India.

References

- An Essay on the Effects of Taxation on the Corporate Financial Policy (George Contos, Internal Revenue Service, 2005)
- Why the united states need to restructure the Corporate Income Tax (Jason Fichtner and Nick Tuszynski, 2011)
- Low tax to GDP ratio in India (Vittal Reddy, 2017)
- 4 winners and 4 losers from the Republican tax bill (Tara Golshan, 2017)