

**CORPORATE TAXATION IN INDIA :
IMPACT ON CORPORATE PROFITS,
SAVINGS AND INVESTMENT**

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INTRODUCTION

India is supposed to be a highly taxed nation, so far as direct personal taxation and taxation of corporate income are concerned. Naturally, it is argued that the high rate of corporation income tax in our country must have adverse effects on the corporate income after tax, saving, investment, ploughing back of profits, capital structure and their policies of dividend distribution.

Corporations in India are subject to company tax at a flat rate under the Indian Income Tax legislation. However, the rates of company taxes are discriminatory in character, viz., private companies and closely-held companies are charged a higher rate as compared to public limited companies or widely-held companies. Domestic companies receive favourable treatment vis-a-vis foreign companies and foreign collaborations. There is a general consensus in the private sector and among economists that the rates of company tax for different types of corporations are relatively higher. In a developing country of the third world like ours, where rapid industrialization and shifting of surplus manpower from agriculture to industries and tertiary sector is the need of the hour, it is not desirable to have heavy taxation of corporate income. It is argued that such taxation would lead to a decline in corporate

saving and investment. It may also have an important impact on the capital structure of the corporations.

Every Finance Bill brings about some changes in the allowable deductions or in the incentives for investment. The method of allowable deduction for depreciation, investment allowance, development rebate, allowable business expenses and entertainment expenses, etc., is changed from time to time. These changes do have certain impact on tax base and tax revenue of the Government. A shift from risk capital to borrowed capital or vice-versa is possible due to a number of factors. Even the flat company tax rate is sometimes changed. Any change either in the tax base or tax rates leads to a greater change in the effective tax rate (explained in Chapter 2 of this work) which may affect companies working under different sets of conditions differently. For instance, if the business prospects of a company are bright, it can raise more borrowed capital, pay out fixed interest liabilities and make a handsome income for distribution of attractive dividends. But if the venture is a new one and its future is uncertain, companies do not prefer to have borrowed capital. Where the expected rate of profit before tax is low, companies prefer maximum ownership capital because they find it difficult to raise borrowed capital through issue of debentures, public deposits or bank borrowings.

Interest liability on borrowed capital is an allowable

deduction from income for computing taxable income whereas the dividend payment is not. Therefore, interest income of the creditors is subject to single taxation in their own hands whereas dividend income of the shareholders is subject to double taxation. Firstly, at source of company's profit before dividend distribution and secondly, on the dividend income as a source of personal income of the individual shareholder. Some economists argue that double taxation of corporate income has a discouraging effect on public responses to issue of shares by companies. The business corporations in the private sector, particularly with new and risky ventures, generally find it difficult to list their securities at the stock exchanges. Thus, any change in the rate of corporation tax, allowances and deductions affect the market prices of securities at the stock exchanges.

Thus, the corporate tax structure may have widespread effects on profitability of business corporations, their saving, investment, capital structure and policies of dividend distribution, capacity utilization, etc. This topic has been chosen for M.Phil. dissertation with the following objectives.

Objectives

- 1) To examine the rates of Corporation Income Tax for the period from 1970-71 to 1989-90 introduced by the Finance Acts from time to time;
- 2) To assess the utility of various tax concessions, allowable deductions, and incentives for savings and investment by the business corporations;

- 3) To examine the impact of corporation tax on the savings, investment, capital structure of the corporations and on overall growth of business corporations; and
- 4) To assess the revenue elasticity and effective tax rate of the corporation income tax.

Statement of Hypotheses

The study of corporation income tax in India and its impact on the Indian economy was undertaken with following hypotheses.

- 1) India's rate of corporation income tax is high and as such there is scope for downward revision of the tax rate;
- 2) Corporation income tax in India adversely affects profits after tax, saving, investment and capital structure of business corporations; and
- 3) Discriminatory tax treatment for closely-held domestic companies and foreign companies has a positive effect on the growth of domestic and widely-held companies.

Methodology and Scheme of Chapterization

The study covers the period from 1970-71 to 1989-90 and is based on available literature on the topic and secondary data from RBI Bulletins, Currency and Finance Reports of the RBI and a number of scholarly articles

appearing in different journals and newspapers. Each and every borrowed material is duly acknowledged. Since Corporation Tax is the revenue item of the Union Government, the data about tax collection, share of corporation tax in the total tax revenue, in the direct taxes and Corporation Tax as per cent of National income pertain to the whole country. Statewise break-up was not attempted in this work. In a way, it is a humble attempt to present existing literature on the topic in a systematic manner with a view to bring about some useful conclusions.

This dissertation is planned into five chapters as detailed below:

- (1) Corporate Personality.
- (2) Structure of Corporation Income Tax in India.
- (3) Deductions and Allowances.
- (4) Impact of Corporation Income Tax on Indian Corporate Savings, Investment, Capital Structure and Employment.
- (5) Summary, Findings and Suggestions.

Limitations of Study

The work is based on secondary data that is available from published literature some of which was discontinued due to changes in classification of certain items. A greater degree of accuracy would have been obtained had appropriate and continuous series of information been available.