Corporate Tax Rate Cut

Why in news?

Finance Minister announced the slashing of corporate tax rate to 22% from 30%; an ordinance in this regard has already been issued by the government.

Why is this notable?

- This big cut (more than a fourth) in corporate tax rate comes after a gap of almost 15 years.
- In 2004-05, the tax rate was reduced to 30% from 35% (one-seventh).
- This was 7 years after it was brought down to 35% from 40% (one-eighth).
- Now, it has been slashed from 30% to 22%.
- Also, for companies that are incorporated after October 1 and whose projects will be commissioned before March 31, 2023, the tax rate will be as low as 15% (compared to 25% currently).
- The effective tax rate for this category of companies will be 17.01%, about 12 percentage points lower than what prevails now.
- [The effective tax rate for a corporation is the average rate at which its pre-tax profits are taxed.]

What is the effect?

- The tax rate cut does the following:
    1. it increases the profitability of companies in India, leaving them with extra cash to invest; restrains them from demanding more sops, putting pressure on them to invest
    2. it creates a feel-good sentiment, and sends a strong message about the government's faith in India Inc (the formal sector - government & corporate)
    3. it puts pressure on the fiscal position of the Centre

What are the implications for the states?

- The annual cost of this corporate tax rate cut, which no government will be able to restore, is Rs 1,45,000 crore, almost 1% of the GDP.
- States do not have a choice, but to face the impact of this.
- 42% of Union taxes is devolved to the states; so, they will receive almost Rs 61,000 crore less from the Central government now.

- Consequently, they will have little fiscal space to expand spending programmes.

What are the concerns?

- **Drawbacks** - The move will certainly help companies address the imbalance in their balance sheets.
- However, these measures do not address the structural issues that need much attention.
- [The government, so far, has been overusing cyclical tools of fiscal and monetary policy to reverse the economic slowdown.]
- Nor do they seriously address the immediate problems of demand revival and weak private investment.
- Because, the move may not significantly boost the private investment in the short run, which has remained dull for almost 7 years now.
- **Fiscal** - The move is certainly good for the economy in the medium term.
- However, in the short term, until revenues bounce back, the government has a fiscal problem on its hands.
- The move is significant in the context of the over-estimation of revenues in the Budget and the under-performance in terms of tax collections so far in 2019-20.
- The 2019-20 Budget assumes net tax revenues of Rs. 16.49 lakh crore.
- This is a rather ambitious 25% growth estimate over the actual revenues of Rs. 13.16 lakh crore in 2018-19.
- If the revenue foregone now is weighed against this unrealistic Budget target, the outlook for the projected deficit this year is worrying.
- Given these, the deficit target of 3.3% for this fiscal is less likely to be attained.
- The bounty of Rs. 1.75 lakh crore received from the RBI as dividend is obviously an advantage, and it is this money that the government has now given away.
- But, if the fiscal deficit target is to be met, then the gap from the original over-estimation of revenues has to be bridged.

What are the other possible options?

- Higher infrastructure spending could have been done as this has a better multiplier effect.
- The indirect taxes could have been cut sharply, which would give many, the benefit of lower prices.
- Besides these, the structural issues that need to be addressed are land and labour reforms.
- Sorting out the issues related to availability of land and price of land is

crucial to achieve the real benefits of giving more money to corporates.

- Also, products and services affordable to middle and lower income people should be given due attention.
- India has been predominantly a consumption-driven economy; but, for sustainable growth, private sector must start investing.
- In all, the two pillars of sustainable growth now are consumption and private investment.

Source: Indian Express

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