CHAPTER – VII

SUMMARY OF FINDINGS, SUGGESTIONS AND CONCLUSION
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7.1. INTRODUCTION

Taxation of corporate profits in India has been one of the most widely discussed issues in the area of public finance. The share of tax revenue from corporate profits to total Central Government revenue from direct taxes have been increasing steadily over the decades, particularly after the liberalization of the economy. Only due to rapid growth of Indian industries, an increase in corporate tax revenue to government exchequer may be achieved. As the growth of firm mainly depends on the optimal capital, a proper choice between debt and equity is essential. However, choice of fund between debt and equity is mostly based on corporate taxation. Corporate tax payments have risen across all sectors of the Indian economy. During the period from April to December of the fiscal year 2007-08, the direct tax revenue after refund crossed Rs.2,05,000 crores, to post a growth of 42.4 per cent. The mop-up by way of corporate tax increased by 39.8% to Rs.1,27,683 crores. These facts envisage that there has been growth in Indian industries. However, the research areas on the impact of corporate taxation on the growth of industries are scarce. Hence, the study aims to examine whether increase in corporate tax is due to growth of corporate enterprises? What is the relationship between corporate tax and corporate earnings? and how far companies have employed debt to reduce their tax liability?

The specific objectives of the study include: (i) to empirically determine the impact of changes in corporate taxation on companies’ growth in terms of capital structure; (ii) to ascertain how and when companies use debt as a shield against
corporate taxation; (iii) to study the impact of changes in corporate taxation on corporate earnings; (iv) to identify the effect of corporate taxation on the financial healthiness of companies.

The present study is based on the secondary data collected from PROWESS database for a period of ten years from 1996-97 to 2005-06. Fifty eight companies were selected across six industries representing Cement, Steel, Textile, Food, Information Technology and Pharmaceutical. The techniques used for analyzing the data are general descriptive statistics like mean and standard deviation; univariate technique like one-way analysis of variance (ANOVA) and multi-variate techniques such as cluster analysis, multiple regression analysis and logistic regression analysis.

7.2 FINDINGS OF THE STUDY

The various findings emerged out of analysis of the data are summarized and presented.

7.2.1 Shielding ratio for various industries by debt level

- More debt fund is employed by companies in cement, steel, textile, food, information technology and pharmaceutical industries to shield the corporate tax liability.

- Companies of various industries considered collectively have employed more debt fund for financing their assets and thus they have reduced their tax liability.
7.2.2 Effect of Corporate taxation on capital structure

- **Cement industry**

  Effective tax rate, firm size, bankruptcy risk and profitability have significant impact on long-term financing of the companies.

  Decline in tax paid in the preceding years tends to increase the extent of debt financing relative to total assets when there is a decline in profitability.

  Cement companies have used more net debt for financing their assets and used depreciation as tax shield when there is decline in earnings and decrease in corporate tax liability. Therefore, corporate tax has significant impact on the capital structure of Cement companies.

- **Steel industry**

  Increase in effective tax rate tends to reduce the possibility of going for long-term debt even if tax paid in the preceding years and bankruptcy risk are less and use of depreciation as non-debt tax shield is higher.

  There is no relationship between corporate taxation and total debt.

  Corporate taxation has significant negative effect on net debt of larger companies which highly rely on depreciation as non-debt tax shield when there is a decline in their earnings.

- **Textile industry**

  Corporate tax has significant impact on long-term debt.
Decline in tax paid in the preceding year tend to increase the total debt fund in the capital structure when there is a decline in earnings of the companies in turn confirming the effect of corporate tax on debt fund.

There is significant relationship between corporate tax and net debt.

Therefore, corporate tax as significant impact on the capital structure of Textile companies.

- **Food industry**

Corporate tax does not have impact on long-term debt. Thus, null hypothesis has been accepted.

Total debt of the companies tend to increase for large firms when depreciation relative to total assets decreases, at the same time total debt is independent of corporate tax.

Use of debt fund in excess of cash holdings and marketable securities would be higher when tax paid in preceding years is higher. There has been a marginal decline in use of depreciation as tax shield relative to total assets.

- **Information technology industry**

Long-term debt in capital structure has increased when there is a decline in effective tax rate, firm’s size and profitability.

Companies with decline in earnings as well as in growth have opted for more debt (both long-term debt and short-term debt) in the capital structure when there is decline in tax liability of the past year.
Net debt in excess of cash holdings and marketable securities is not related to corporate tax. Net debt increases when use of depreciation as tax shield increases and there is a decline in earnings as well as in firm's growth.

Companies with growth potential which highly rely on depreciation for shielding tax and whose size kept decreasing due to decline in earnings tend to go for more long-term debt in their capital structure even if there is an increase in effective tax rate. Effective tax rate does not have significant coefficient with long-term debt. That is corporate tax does not have effect on long-term debt.

- Pharmaceutical industry

Corporate tax does not have effect on long term debt for pharmaceutical industry. Thus, null hypothesis is accepted.

Companies have relied more on debt fund in their capital when there is an increase in effective tax rate, decline in firm's size, increase in depreciation, decrease in profitability and increase in firm's growth. Increase in corporate taxation increases the debt fund in capital structure.

Net debt increases when there is a decline in firm size and profitability. Increase in depreciation (used as tax shield) increases the firm's growth. Net debt of companies under pharmaceutical industry is not related to corporate tax.

7.2.3 Marginal tax rate and firm's growth

- Growth of firms (through long-term growth in sales) under cement industry is not affected by the marginal tax rate. There is a positive relationship between growth in capital investments and marginal tax rate.
- Marginal tax rate has significant impact on firm’s growth (both long-term and short-term) under steel industry.

- Marginal tax rate has significant impact on long-term growth in sales and short-term growth in capital investments among firms under textile industry.

- Marginal tax rate has no influence on growth in capital expenditure whereas it has significant influence on long-term growth in sales of firms under food industry.

- Corporate growth in information technology industry is independent of the marginal tax rate.

- Short-term growth in terms of capital investment and long-term growth in terms sales are independent of the marginal tax rate for firms under pharmaceutical industry.

- Short-term growth in capital investments and long-term growth in sales are independent of the marginal tax rate for all firms taken collectively.

- Marginal tax rate as significant impact on growth of Steel and Textile companies.

7.2.4 Corporate tax and firms’ short-term growth

- There is significant negative relationship between corporate taxation and growth of firms under cement industry.

- Firms’ growth in capital investments is significantly associated with corporate taxation in the case of steel industry.
Growth in capital investments is not dependent on corporate taxation for firms under textile industry.

Corporate taxation does not have any impact on short-term growth in capital investments among firms under food industry.

The corporate taxation plays only a marginal role in determining the rate of growth in capital investments for firms under information technology industry.

Short-term growth in capital investments among firms under pharmaceutical industry is significantly affected by the corporate taxation.

Corporate taxation does not have any impact on short-term growth in capital investments. However, corporate taxation has a marginal role in increasing the firms’ size and previous years sales on short-term firms’ growth.

Corporate tax has significant relationship with short-growth (capital investment) of Steel and Pharmaceutical companies.

7.2.5 Corporate tax and firms’ long-term growth

Corporate taxation has significant negative impact on long-term growth in sales for firms under cement industry.

Corporate taxation has no impact on long-term firm’s growth in respect of sales under steel industry.

Long-term growth in sales is higher for larger firms and decline in past year sales and debt relative to equity capital have tempted firms under textile industry to increase the sales. Thus, textile firms have increased their sales and reduced the use of debt fund.
• Long-term growth in terms of sales is not affected by the corporate taxation in the case of firms under textile industry.

• The corporate taxation has significant effect on long-term growth in sales among firms under food industry.

• The long-term growth in sales is marginally affected by corporate taxation after partialing out the effect of firm size, past year sales and earning status and use of debt fund in the case of firms under Information technology industry.

• Long-term growth in sales is significantly associated with corporate taxation among firms under pharmaceutical industry.

• Corporate taxation does not have influence on firms’ growth if nature of business is set aside.

• Corporate tax has significant relationship with long term growth (sales) of Food and Pharmaceutical companies.

7.2.6 Comparison of marginal tax rate, effective tax rate and tax paid by level of net worth

• Net worth of the companies under cement, steel and textile industries is significantly influenced by corporate taxation.

• Marginal tax rate has significant negative effect on net worth while effective tax rate and tax payable for previous year have significant positive impact on net worth of companies under food industry.

• Effective tax rate has significant inverse relationship with net worth of the companies under information technology industry.
- Net worth and corporate taxation are associated with each other in the case of pharmaceutical companies.

- Corporate income tax has significant impact on net worth of all the companies of various industries considered collectively.

### 7.2.7 Effect of corporate income tax on net worth

- Corporate tax has significant positive impact net worth of companies belonging cement industry.

- Actual corporate tax paid in the previous year by the companies under steel industry has significant positive impact on the net worth.

- Retained earnings and corporate income tax are positively related with each other even after controlling the effect of some fundamental firm characteristic variables in respect of companies under food industry.

- There is a significant influence of corporate income tax on net worth of companies under information technology industry.

- Corporate income tax has significant impact on net worth of pharmaceutical companies when the effect of net debt to total assets, firm size, bankruptcy risk, profitability and firm’s growth are held constant.

- Corporate income tax paid in the previous year tend to increase the current year net worth while actual corporate income tax payable for current year tend to reduce the net worth of companies belonging to all industries.
Actual corporate income tax of previous year has direct relationship with net
worth while current year corporate tax has inverse relationship with net worth
of all companies of various industries considered collectively.

7.2.8 Corporate income tax and financial healthiness

- Financial healthiness is impaired when there has been an increase in actual
corporate income tax liability of the companies under cement industry.
- There is no relationship between corporate income tax and financial
healthiness of companies under steel, textile, food and information technology
industries.
- There is significant negative relationship between corporate income tax and
financial healthiness of all industries considered collectively. /
- Financial healthiness is influenced by financial leverage (net debt to total
assets), tax deductibility of depreciation and profitability. Financial healthiness
is not affected by actual corporate income tax liability for all the companies of
various industries considered collectively.
- Financial health is not impaired by corporate taxations.

7.3 SUGGESTIONS

Based on the findings of the study the following suggestions are proposed
to the industries and to the government.

7.3.1. To the Industries

Companies need to pay corporate tax and cannot avoid it completely. They
should avoid employing for more and more debt finance with the intention of
minimizing the tax burden, as it may lead to bankruptcy. They can opt for debt
financing only if the firm's growth through additional investments is constrained by quantity of internal finance and the proportion of debt fund to capital is less than the optimal level. The companies should maintain right balance between debt and equity.

The food and pharmaceutical industries relying more on short term debt fund. Thus, the industries should concentrate to maintain optimal capital structure.

7.3.2. To the Government

Government may consider to frame multi-level corporate tax rates. That is, instead of uniform corporate tax rate for all industries, government may formulate different corporate tax rates for different industries. Government can consider the further reduction of corporate tax to enhance the growth of Indian Industries.

7.4. SCOPE FOR FURTHER RESEARCH

The study can be extended to all the industries in order to explore the corporate taxation and its impact on the growth of industries in India. The impact of corporate taxation on the growth of large industrial houses can be considered for further study. The impact of corporate taxation on corporate growth in industry-wise and inter-industries can be analyzed. The impact of corporate taxation including minimum alternative tax and dividend distribution tax can be considered for further study. A Comparative study on the corporate taxation in India and other Asian countries can be carried out.
7.5 CONCLUSION

Firms under cement, steel, textile, food, information technology and pharmaceutical industries have opted for debt financing in order to use the interest on borrowings as tax shield, i.e., to minimize the corporate tax liability. Further, companies of all the selected industries have opted debt financing for further investments when there is a decline in corporate tax liability. There is no significant relationship between corporate taxation and debt financing. There is a negative relationship between corporate taxation and capital structure. There is a significant relationship between the effective tax rate and growth in investments of cement, steel, information technology and pharmaceutical industries. There is an association between corporate tax and firm’s growth when the companies are considered separately, but not collectively. This implies that use of debt fund in capital structure to shield tax has led to increase in retained earnings for the companies.

Corporate income tax paid in the previous year tend to increase the current year's net worth while actual corporate income tax payable for the current year tend to reduce the net worth of companies belonging to all industries. Financial healthiness of all the companies of various industries is influenced by financial leverage, tax deductibility of depreciation and profitability. Financial healthiness of companies is not impaired by corporate taxation.