CHAPTER - VII

CONCLUSION

The principal objectives of the present study are (i) to highlight the main events leading to the present form of corporate tax structure in India since 1860; (ii) to stress the needs for rationalisation and simplification of the present tax-structure and (iii) to find out the impact of corporate taxation on corporate behaviour in India. Thus, the main emphasis in the study has been to trace the relationship between the corporate taxation and corporate behaviour, viz., corporate investment, corporate tax savings, corporate liquidity, incidence and profitability. However, importance of corporate taxation in the overall tax-framework in India has also been stressed as a background of this study.

The main difficulty with a study like this, is to keep track with the changes that frequently take place in taxation statutes of India. As for example, there is at least one set of changes in the tax laws every year in the Annual Finance Act. Again, more often than not supplementary budgets, specific amendments to taxation provisions in the interim period and even executive instructions from appropriate authorities bring changes in the taxation statute in India. The main provisions and changes have been outlined in the study. Our main emphasis in the study is to analyse the impact of corporate taxation on certain specific types of behaviour in the corporate sector in general and in the chemical industry in particular. For that we had to depend upon the data, mostly financial, from primary and secondary sources in an aggregative manner, which hardly shows the details of tax benefits availed of by the corporate sector. In the same way, when we attempted to show the impact of taxation on the specific companies in the form of case studies, the audited annual accounts of the companies for a number of years, have been consulted by us as the main source material which also do not reveal the details of tax benefits under different provisions. Of course, we tried to analyse, within the restrictions of data, the details of tax provisions and their impact on certain behaviour of a few other Indian companies like VOLTAS, ABC and TISCO. So, it can be said that another major difficulty with this study we had to face, is the insufficient availability of appropriate data showing the details of tax benefits relating to corporate sector in general and the companies, taken as case study, in particular.

By studying India we have also attempted to understand the various problems of corporate taxation in an underdeveloped country. Recently India has been placed by the United

Nations in the category of semi-industrialised country. The frequent changes of the tax-structure, its quality and quantity, have to a certain extent reflected the growing pains of a developing country. It is well known that being under developed the savings potential of this country is extremely low. In the First Five Year Plan the total savings through fiscal and monetary devices was around 5 per cent of the National Income. Therefore, it is quite understandable that the mobilisation of savings was extremely poor, nearly 33 years back. In the First Five Year Plan the decision was that the Public Sector should be given more importance in the development planning in India. According to the own admission of the Finance Minister of India, the present investment by the Government has exceeded Rs. 56,000 crores which was barely Rs. 200 crores in the beginning of the Five Year Plan. This is an evidence, if evidence is at all necessary, to show that the economy's capital structure has been heavily biased to the Public Sector. This heavy investment in the Public Sector is possible if there is a change in the fiscal structure for the adequate mobilisation of savings and its investment in that Sector. If Friedman is to be believed that since the resources of a country are limited Public Sector can only grow <u>at the expense</u> of the Private Sector. Though this is taken to be an extremely conservative theory the fact remains that there had been frequent changes in the tax-structure in India so that profits of the corporate bodies are adequately mobilised. It has been pointed out by Mr. N. A. Palkhivala, an outstanding tax expert, in his book, 'The Highest Taxed Nation', that India is one of the heavily taxed nation of the world and being underdeveloped it compares very unfavourably with most of the developed countries, like Sweden, France, U.S.A. and West Germany. This is a paradoxical situation because being underdeveloped we need quick industrialisation for the country as such but bulk of the investment is diverted towards Government enterprises. For this the necessary resources are mobilised from private sector, mostly in the form of higher taxes, which generally hinders quick industrialisation. The study of taxation structure in India may help us to understand the problem of development in an underdeveloped country as well.

It will not be out of place to note that recently a theoretical discussion has developed in the literature which has pointed out that the heavy tax rate on the private corporate sector may ultimately inhibit the incentives of growth and potentialities of the Private Sector. To quote Mr. K. C. Khanna, in his article — 'Impact of the Budget', appeared in The Statesman, Calcutta on 16th March, 1982 — " apart from discouraging the generation of internal resources, high corporate taxation hampers corporate growth, distorts the debt-equity ratio, encourage corporate extravagance, erodes integrity and shifts the corporate tax burden;

thereby militating against the consumer and fanning the flames of inflation". Mr. N.A. Palkhivala, in one of his addresses warned the Government that taxation beyond a certain rate would be counter - productive. In short, such school of thought is called 'supply side economics' where emphasis is given on more production and supply rather than on "equitable distribution" of wealth through Public Sector. In the countries which have given emphasis on the Private Sector and have organised the 'taxation' in that fashion have a higher rate of growth than those countries which consider Public Sector as a key to development. Specific third world countries which have higher rate of growth have all emphasised the role of private sector and the impact of corporate tax in such countries have been minimal. In this context Singapore, Hong Kong, Brazil may be mentioned. Evans and Leiffer have calculated to show that where tax burden is low on the corporate sector the rate of economic growth has been very high. It is in this context on the 'supply side economics', Public Sector is criticised on grounds of inefficiency. It is alleged that bureaucrates tend to focus on process rather than output. Further, the incentive structure of the Public Sector always tends to be counter productive to the organisation's mission. In this context it will not be out of place to mention that in West Bengal only one public sector unit earns profit (Brick Kiln) and all other units under direct control of West Bengal Government are running at a loss. It has been estimated that if only 5% profit is available from the public sector units there will not be any need of deficit financing in India. In fact India has been caught in a vicious circle. Public Sector is running at a huge loss and in order to subsidise this loss, tax must be raised from the Private Sector and deficit financing must be resorted to finance the developmental projects. The high rate of tax on private corporate bodies may ultimately prove to be counter productive and may lead to a stagnation of the economy. The deficit financing resorted to may lead to inflationary pressure. It is necessary to stress that the average annual rate of inflation since 1975 has been 10% in terms of wholesale price and 15% in terms of retail price in India. This high inflation has co-existed with huge unemployment in the rural and urban sectors of the economy.

In the dissertation however we have not discussed the issue in terms of supply side economics Vs. Keynesian economics. We have mentioned only some of the related issues in Chapters III and IV. In Chapter-III (Corporate Tax Structure in India) we have attempted to examine how far the present corporate tax structure is rational one from the perspective of growth and development of a country like India. We have tried to emphasise that the present corporate tax structure in India is extremely complicated and there is little scope of achieving balanced economic growth with the help of this present structure. There is a large scope of misinterpretation of the laws connected with widely - held and closely held and industrial and non-industrial units. Further, we have shown that uniform rate, irrespective of the level of income would be a better proposition for the sake of growth of both large and small sectors, small sectors being favoured by other fiscal and non-fiscal means. As the provision of depreciation allowance is one of the major sources of internal generation of fund, we tried to highlight the efficacy of the present form of depreciation allowance. Considering the pros and cons of the present complicated 'depreciation forms' we suggested to continue 'normal depreciation' only and all other types like initial depreciation, additional depreciation, extra-shift allowances and terminal allowances may be dispensed with. After a careful study of depreciation allowance, we tried to emphasise the need for 'allowable limit' of such allowance on each asset within which the companies should have liberty to operate. That will help to generate more fund within the company and will lead to higher growth of national economy.

We have gone into the question, in a country like India, whether capital incentive measure like investment allowance should be given at all and if so in what manner. We have tried to show that the scheme of investment allowance is more investment oriented and less employment oriented. Therefore we stressed the need for employment linkage with such capital allowance and suggested to extend the privilege of investment allowance to all the capital assets and not merely to plant and machinery. We have also tried to show that the present corporate taxation is such that employment, in all probability, gets a reduced weightage in the whole structure.

It will not be out of place to point out that unemploy-ment in a developing country like India is rather increasing than decreasing. In India there are different varieties of unemployment like disguised rural unemployment, seasonal unemployment, open rural unemployment, open urban unemployment and disguised urban unemploy-ment. It has been noted by almost all the authors in India that there has been tremendous growth of "informal sectors" like hawkers, rikshaw pullers, petty retailors, tailors and construction agents in all the cities and urban areas in India. This is paradoxical in the sense that our tax structure is such that it is not inherently conducive to larger employment. In this context we have suggested how the tax structure can be changed so that more employment may be generated.

We have also noted that industrial structure in India is heavily concentrated in few metropolitan areas. All attempts to diversify and decentralise the industrial structure to the back-ward regions have proved to be futile. In the taxation laws no se-rious attempts were made to define 'backwardness' because the degree of 'backwardness' was not delineated. Different tax benefits granted by the Income-tax Act for balanced economic growth in different backward regions are not concerned with the degree of backwardness. Some suggestions have been put forward for balanced economic growth. Whatever may be the reasons the industrial structure in India has not been well dispersed and consequently the dualistic structure of the underdeveloped economy has persisted even after 30 years or more of planning. Therefore, we are constrained to note that modern industrialisation process has neither solved the massive unemployment problem in India nor has acted as a linkage between rural growth and urban affluence. Many reasons may be there but the present tax structure is one of the causes for this dismal picture.

In order to increase the tempo of development it is accepted by all that the ploughing back of profits by business units is absolutely essential. It has been noted that most of the public enterprises in India are running at a heavy loss. It is in this background the ploughing back of profits is most crucial for the Private Sector. The tax structure in India is such that sufficient retention of profits and its re-investment may be a difficult proposition for the private corporate bodies. Higher taxes may lead to lower retention and for any developmental programme the companies may have to depend upon external agencies rather than on internal resources to a great extent. Increasing cost of debt - equity will lead to lower disposable profits for tax purposes resulting lower collection of revenue by the Exchequer. So higher taxes neither improves Government's revenue earnings nor helps the corporate bodies in their growth and extension. We have tried to suggest some means through which further investment by the companies themselves may be facilitated.

From the study we have noted that for the day to day management of the companies and to meet the maturing obligations sound working capital position is required. In this context the place of 'liquidity' is very important. We have analysed the liquidity position of 1720 medium and large public limited companies (non-financial, non-Government) covering 25 industries with the help of data published by the Reserve Bank of India. We have applied different conventional ratios to measure the liquidity of the industries. Liquidity position reflecting as a ratio of current assets to current liabilities of the 1720 companies does not come in close proximity of the "standard norm" of 2:1 for any of the years under study. We have emphasised that the present tax system is such that it is bound to give rise to lower liquidity. This lowering of liquidity has qualitatively changed the nature of management of the corporate sector. In most of the cases there is an increasing tendency of debt - equity ratios. This tendency leads to over dependence on financial and lending institutions of Government of India. This has its inherent hazards. The Financial Institutions expand or restrict credit on the basis of the nature of inflation in India. The inflation in India is the result of many factors like structural bottlenecks, deficit financing, currency expansion, supply in/elasticity, agricultural stagnation and natural calamities. In otherwards, the credit policy of the Government of India is determined independent of the liquidity needs of the corporate sector. The policy of contraction of credit may lead to a crisis situation in the industries under private sector. A literature has grown up in this context to show the one of the reasons of the 'sickness' is the absence of sufficient liquidity or dearth of working capital in the private sector. For example, in the tea sector about 40 out of 96 gardens are sick in the Darjeeling Hill area and nearly 50 out of 150 in Doors area are sick mainly because of dearth of liquidity at the crucial moments. In the Chapter IV - Impact of Corporate Tax on Corporate Behaviour, we have attempted to show the variations of liquidity in different industries in the corporate sector in India. We have tried to relate that very often the tax structure is mainly responsible for this state of affairs.

On the otherhand, curiously enough, the liquidity ratios of units under public management are generally higher than the standard norm of 2:1. For example in our study of Indian Petrochemicals Corporation limited, a large-sized Government chemical company, (Chapter-V) we have found that in all the years under study the ratios reflected more than 2:1 and even more than 6:1 in the years 1979-80 and 1980-81. Though accumulation of inventories had been shown as the main reason for such unwarranted high liquidity position, but "acid test ratio," often reflecting 'true liquidity' seems to be also substantially higher than the norm of 1:1. Whereas our study of 1720 companies covering 25 industries in the non-Government sector reveals that the liquidity ratio has never touched the crucial standard of 2:1. Of course, in our study of Tata chemical company in the Private Sector liquidity position seems to be satisfactory and moving around 2:1 in all the years under study. That means in respect to working capital there is a process of dechotomisation. Whether this dichotomy is healthy for the growth of a country may be a subject of debate. However, we have pointed out that the low liquidity in the Private Sector may lead to 'sickness' in that sector. On the otherhand the high liquidity ratio in the Public Sector may lead to carelessness, mismanagement and maladministration. High liquidity means unutilised cash or near-cash items. If such liquid assets are being properly utilised then that would help the economy by expansion, improvement and higher productivity.

One of the important features of the industrial environment in India is under capacity or low level of capacity utilisation. It has been estimated by the I.D.B.I. of eight year period from 1970 to 1978 that the average capacity utilisation is only 59.5% in basic industries and 64.4% in the capital goods industries and about 75% in the consumer goods industries. In the basic industries the capacity creation is increasing @ 6.6% p.a. and in case of capital goods industries @ 9.4% p.a. and in consumer goods industries at about 6% p.a. Therefore, we have to explain a given fact, namely that the progress of capacity utilisation is not increasing whereas capacity creation has increased at an average rate of 6 to 10% p.a. In this context we have pointed out that there may be a number of factors for the low level of capacity utilisation but the present corporate tax structure is no less important. The system of tax incentives like investment allowance and depreciation allowance is such that capacity creation, irrespective of capacity utilisation is profitable from the view point of corporate investment. We have pointed out in our thesis (Chapter - IV), that the present system of investment allowance is heavily loaded towards capacity creation without either employment creation or increasing productivity. This trend in productivity may ultimately lead to further aggravation in the existing inflationary potential of a developing country. This conclusion however should be modified because sometimes under capacity of the industries are also the result of the shortage of power, coal, railway wagons and aggressive trade unionism. However, in this context of under capacity of the Indian industries tax structure should bear a portion of blame.

It has been alleged that the Indian industries are heavily concentrated in the hands of a few. The nature of concentration of this industrial structure has been widely discussed in Parliament and outside. A voluminous literature has grown in this context and various Government Reports like Mahalanobis Report, Dutt Committee's Report etc., have quantified the nature of concentration in Indian industries. Prof. Jagadish Bhagwati has pointed out that the licensing policy of the Government of India is directly responsible for this concentration. Various other writers like Dr. Namjoshi and Dr. A. K. Chowdhuri have shown that the Government policy regarding input supply, institutional facilities and even caste system are responsible for this type of concentration. But very few others have tried to explain this concentration of wealth in terms of the study of the corporate taxation. We have ascertained that bigger companies, having paid-up capital of Rs. 25 lakhs and above, enjoy higher tax incentives, higher investment in fixed assets, higher profitability and lesser incidence of tax. We have also noted in our study of 220 companies in private corporate sector that the giant companies having investment of Rs. 50 crores and above in total assets have taken the greater opportunities of tax incentive schemes reflecting the lowest rate of tax incidence (Chapter-IV). The present corporate tax system is such that it helps bigger companies to reap the benefit of different incentive schemes under the Income-tax Act. Thus, we can say that the present tax structure also helps in concentration of wealth in the hands of a few. That means the companies operating under small scale are at a disadvantageous position in respect to tax savings by availing of different statutory benefits under the Act.

It has been noted by economists like Kuznet that the development process in almost all the underdeveloped countries has led to higher inequality of income. This famous theory is known as inverted 'U' shaped income inequality curve. This curve shows empirically that the rich gain proportionately more from the progress than the poor. This 'U' shaped curve gets relevance in the background of our study when we come to a conclusion that the taxation structure in our country is such by which there has been an inter-sectoral shift of emphasis from small companies to large companies. Therefore, our study highlights the problem of private corporate sector in the context of a developing country.

In the mixed economy of India Public Sector is given more importance than the Private Sector. But most of the undertakings under Public Sector are running at a loss. In order to compensate this loss private corporate sector is heavily taxed. Most of the industries under private sector have liquidity crisis. Most of them are running at a low capacity utilisation level. This is surely going to affect the total productivity of a country and it is well known to all that a country is poor because its productivity is low

This has, however, not prevented the growth of capacity creation in the Private Sector. Again, this has not resulted in higher employment. Further competition has been thawarted out by a tax structure because the benefits can be enjoyed better way by larger units than the smaller units. It is widely accepted that in a vast country like India, decentralisation of industrial structure and employment creation for the unemployed are major considerations of our developmental strategy. Our study shows that these objectives may not be achieved within the existing corporate-tax structure in India.