CHAPTER 8

EPILOGUE

(SUMMARY OF THE FINDINGS; TEST OF HYPOTHESES AND SUGGESTIONS):
Introduction

The present study entitled "Corporate Tax Structure and Planning: A case study of Eastern India" has been broadly divided into two different parts. The first part deals with the review of theoretical literature relating to the industrial and corporate growth in India, corporate tax planning and financing of capital structure of corporate entities in India. This part also explains elaborately the impact of tax concessions on the financial policies of the corporate enterprise, corporate tax burden and capital structure decisions. The second part is concerned with the empirical analysis of data based on level of equity share capital and the total capital structure of the sample companies selected for the purpose of the study. The present study also highlights the financial decisions of the sample companies in respect of the volume of investment in fixed assets, dividend policy and composition of financing. This part also deals with the empirical analysis of internal financing practices and tax depreciation policy of the government in influencing the fixed assets accumulation and fixed assets financing by the sample companies. Major findings of both the parts have been summarised in the following paragraphs.
Economics of Corporate Taxation and Industrial growth:

The role of fiscal policy in designing any government's economic and social policy is significant. Taxation is a major instrument of social and economic policy. The old-fashioned fiscal theory of taxation, aiming mostly at providing large revenue to the state, has since long been thrown into the limbo of exploded fallacies and governments in most developing nations have now come to realise the significance of 'Functional Finance' as an important part of shaping their fiscal objectives.

It is argued that taxation as an instrument in the hands of the government should never be imposed merely as a means for raising money for the government on the ground that the government needs the money rather it should be judged from the point of view of it's functions in the general interest. This signifies that the primary tasks of fiscal policy of the government is not simply to collect revenue but to raise the ratio of savings to national income, thereby making available a larger flow of resources for economic growth. The most important task of the government is to allocate more resources for investment and restraining consumption.

Corporation tax as one of the direct taxes has been a major source of government revenue. In search for more revenues, the corporate sector has received full attention from the state in view of its growth in size and profitability.
The corporate undertakings have afforded a convenient basis for special tax treatment. The amount of corporate tax, i.e., the income tax paid by the companies, is a significant contribution from the corporate sector to the Indian exchequer. The rates of income tax on companies, both private and public, are very high and constitute a major portion of total spending of a company.

The tax policy of any country is dictated not only by its economic needs but also by the political conditions prevailing within it. Over the past few decades, there has been a fairly elaborate and complicated structure of taxation in India affecting the corporate entities. However, of late the redistribution of taxation became one of the determinants of the economic policy of the government. More recently, the feeling of urgency to find resources for the five-year plans has given a decisive twist to our taxation policy and tax structure. In this way new ideas and new forces are emerging, and these in their turn are influencing our tax policy and structure. The main objectives of the fiscal policy is to ensure an adequate growth of per capita output, capital generation for a higher rate of industrial growth and adoption of modern technology. The tax structure in particular should foster the maximum use of domestic resources, creation of domestic technology, raise productivity and ensure equitable distribution of the fruits of progress.

Industry is the most dynamic sector of the economy, where productivity increases at a rapid rate if the necessary pre-requisites are ensured. As industry
assists the development of other sectors by providing a steady supply of wage goods and by generating skills and organisation, its rapid expansion remains vital for achieving the postulated growth. There are a wide variety of objectives, which tax policy could pursue in achieving the various diverse objectives. Corporation tax, as one of the important 'direct' tax weapons in the hands of the Government armoury, can be made to sub-serve a number of national policy objectives.

The undoubted popularity of the corporate form of organisation is due to the mistique personality. The principle of limited liability is equally responsible for the vogue of the corporations. Numerous attributes namely sovereignty, separation of ownership and control, limited liability, personality, perpetuity etc. are responsible for the increased popularity of the corporate form of organisation in the economy.

A Corporation tax is a tax paid by the corporation from its resources, income or capital. Direct taxes on corporate income were introduced mainly as a complement to the direct tax on personal income and later were chiefly continued on revenue considerations. Moreover, the corporation as a form of business organisation occupies a dominant position in the economy, and hence a tax on the incorporated enterprise will naturally have a wide coverage. After considering the various grounds on which the corporations are supposed to be taxed, it can be concluded that not one of the pleas can exclusively form the basis of taxation. But
now, the taxation of corporations has become a regular, universal and an almost indispensable features of the tax system. The main justification taxing corporations is that it brings in money to the state's coffers.

It is common folklore that we live in a corporate world, and that there is an incessant search for an alternative paradigm of taxing corporate income. After considering the various grounds on which corporations are supposed to be taxed-financial, 'benefit', social costs, social control, and 'ability to pay' - we have come to the conclusion that not one of the above pleas can exclusively form the basis for corporate taxation. In almost all countries of the world tax is levied on corporate profits or income. Therefore, discussions on the system of corporation taxation have often been confined to alternative system of taxing corporate income so as to allow for differentiating between distributed and undistributed profits, avoiding double taxation of distributed profits, taxing of closely-held or widely-held companies or inter-corporate dividends etc. However, recently capital and value added as tax bases for corporation taxation have been given serious consideration. Similarly, taxes could be levied on the gross sales as an alternative basis of taxation.

Normally the objective of any tax is to bring in a certain volume of revenue to the treasury. But the necessary precondition is that the tax authorities should utilise the instrument of taxation to extract the needed revenue without unduly
harming or harassing the taxpayers. Therefore, the tax on corporate sector should conform to the canons of justice. However, the canons of justice to corporation taxation can not be accomplished easily because, this involves considerable subjective interpretations of judgements.

While critically evaluating the merits and demerits of alternative system of taxing corporate entity and also searching the answer to the question that, whether the present system of taxing corporate profits be replaced by any other alternative system. We find that gross sale as a base for taxing corporate entities has its own merits and demerits. The merits of such a tax is that, it would bring certainty in Government revenue and evasion would become relatively difficult. But, the drawbacks of such a tax is that, it would largely be a tax on initiative and risk taking and would favour relatively inefficient and inactive firms. Further, such a tax would place heavier incidence on concern whose turnover of capital is higher and would also add directly to the costs of production. The net result of a tax based on gross sales will be a shifting of the tax to the consumer. As a result such a tax is regressive in character.

Similarly, the value added as a base for taxing corporate entities is favoured under the ground that, such a tax rests primarily on favourable effect that it is likely to have on the efficiency of the organisations. Further, this tax would be neutral between factor costs and profits and therefore, between efficient and
inefficient firms as opposed to income tax which has the effect of shielding inefficient units. But, there are a number of problems in adopting this tax. Firstly, value added is not as satisfactory yardstick of a company's taxable capacity. Secondly, a value added tax is like turnover tax or sales tax and is, therefore, likely to be inflationary and regressive.

It is for the first time, in India, that Boothalingam and Wanchoo committees gave serious consideration to treating capital as a tax base for taxing companies. The committee points out that a capital levy would discourage ineffective and wasteful use of capital. Further, a tax on capital would rationalise the scheme of company taxation and would incidentally check the avoidance of wealth-tax through the medium of closely held companies. A capital levy on both owned and borrowed capital of a company would act as a check on avoidable capital expenditure and on borrowings. However, there are a number of theoretical and practical problems involved in adopting this levy. Such a levy would discourage highly capital intensive business and discriminate between firms of equal profits but unequal capital intensity. The levy would discriminate between old and new units in the same industry as old units with depreciated plant and machinery would feel relatively less burden as compared to the new units. Besides, profit margins of the capital-intensive industries, which are subject to price control
by the Government, would be squeezed further and less profit would be left for ploughing back.

Profit as the base for taxing corporations is the most common form of corporate taxation. As we have seen earlier, the system of corporation profits tax, which are adopted in the world today are the classic system, the split rate system and the tax credit system. Opponents of company profits taxation say that tax on company profits puts a premium on debt financing and discourages equity and risk capital. It penalises efficiency, reduces internal liquidity and net reward of capital. In searching for justice in corporate taxation, various schemes have been suggested for the integration of corporate and personal taxes so as to avoid undue tax avoidance through corporate profit retention. These suggestions have been widely debated in different forums. While the integrationists argue in favour of a single comprehensive income tax that treats all kinds of income in the same manner, on the other hand, the separatists maintain that the separate income tax is an indispensable aspect of the tax regime. However, none of the arguments on either side can be accepted uncritically. In almost all countries tax is levied on total corporate profits. Profits as a base for taxing corporations has become an universal truth. In addition to this sur-tax on corporate profits, which is nothing but a variant of the excess profit tax, has been a permanent feature of the direct taxes on the corporate profit in India. After evaluating the bases for taxing corporation, it may
be concluded that, whatever may be the bases, there must be justice in corporation taxation. Justice for the corporation with reference to taxation means really taxation within its ability to bear, the tax should not be so repressive in its effects that the corporation is made to suffer irreparable damage and justice in corporation taxation must obviously mean also uniformity of treatment to all tax payers. In other words the tax system should not treat essentially similar classes of taxpayers unequally, or treat essentially different classes of taxpayers equally.

It is an accepted canon of taxation to levy tax on the basis of ability to pay. However, exemptions and relief, particularly in the corporate sector, are so extensive that many flourishing companies with disposable commercial profits and declaring attractive dividends could substantially reduce their tax liability by availing of the incentives and concessions, within the framework of Income Tax Act, 1961. To ensure that companies with business profits do not regularly avoid paying tax, Minimum Alternative Tax (MAT) on companies was introduced by the Finance (No.2) Act, 1996. This was necessary due to rise in the number of zero tax companies in view of the tax preferences granted in the form of exemptions, deductions and high rate of depreciation. A minimum alternative tax does not eliminate avoidance or evasion altogether, but caps the advantage from such practices by placing a floor on tax payable. In doing so, it makes the corporate tax more equitable in its incidence.
The most vexatious problem in the field of corporate taxation is the difficulty of determining who exactly bears the tax burden ultimately, and what the consequences of this are. The first half of the problem involves 'shifting and incidence', while the second half involves a study of the effects of tax on the economic system. A consideration of this problem is important for policy makers. As we have seen earlier, taxation is an important financial consideration, which influences the choice of forms of business organisation because of different tax treatment of income of different forms of organisation. A comparison of organisation reveals that a business organised as a proprietorship does not pay an income tax as a business unit; similarly in case of partnership, each partner pays an income tax as an individual on his share of the profits whether it is withdrawn or not. A Corporation on the other hand, is a separate taxable entity. Therefore, financial considerations play an important role in the choice of a form of organisation.

The corporate management is influenced to a considerable extent by tax factors in respect of distribution of corporate profits. Tax factor is more important as corporate income is subject to taxation at both the corporate and the individual level. While the dividend policy is influenced by the tax liability of the shareholders, the companies may not choose to declare high dividends even when the level of profits warrants such declaration, because that will lead to the payment
of taxes at a higher rate by the shareholders. Thus, the accumulation of funds is also affected indirectly. This influence is transmitted via dividend policy.

The effects of taxation are so widespread and complicated that it is hardly possible to take a business decision without regarding the tax implications involved. The taxes may not only affect the volume and pattern of investment, but may also affect the method of financing. Under a corporation tax of the Indian variety, interest payments to landlords are deductible for income tax purposes, whereas no deduction is allowed for dividends. Therefore, financing with debt instrument is cheaper than with equity instruments. Thus, the effect of tax provides an incentive to bond issues as against stock floatation. As the total cost of financing with debt capital is less than the cost of financing with equity capital, there is no argument that taxation does not have an effect upon corporate financial structure.

Leasing equipment affords an advantage from the view point of taxation. There has been an enormous growth in the leasing of business assets. An obvious advantage to the lessee is the use of an asset without having to buy it. The principal tax advantage lies in the fact that through adjusting the annual rentals, the actual cost of the plant or equipment can be realistically charged against current earnings. Though depreciation charges can be claimed as expenses, if the plant and equipment is financed out of equity funds, but it is well known fact that it is not
always possible to complete depreciation charges accurately, with the result that current income is distorted. There are definite tax advantages to the firm, which employs the sale and leaseback technique.

The size of the tax bill is affected by the criterion, which is followed in valuing inventories. The amount of tax payable is influenced by the profits of the company, which in turn is affected by the methods employed in valuing inventories. Business derives the greatest benefit by using last in First out method (LIFO) in valuing inventories when 1) inventories are large in proportion to assets and sales, 2) production periods are of considerable length, and 3) goods included in the inventory are subject to wide price fluctuations. LIFO shows smaller profits during periods of rising prices, thus reducing the size of the tax bill.

Taxation is an important instrument not only for allocation of resources and distribution of incomes, but also in promoting capital formation and in curbing inflation. It is widely believed that corporation tax can influence the pace of industrial growth. To further the pace of industrial growth, a tax system besides aiming at transfer of resources from private hand to public exchequer should incorporate a scheme of incentives aimed at promoting directly an increase in saving and investment in the corporate sector. The factors which generally determine the pace of industrial growth in a country are: i) saving; ii) investment; iii) Technology; iv) Labour; v) resources etc. corporation tax is yet another factor
affecting industrial growth, though it can never be considered in isolation from the general tax system. However, a close correlation exists between corporation tax and industrial growth in that a growth-oriented tax system would reward efficient enterprise by leaving ample internal resources for financing expansion.

Corporation tax may also affect a company's capacity and desire to save. The capacity of corporations to save is reduced when their net profits are reduced by heavy taxation. This is so because the corporate saving usually comes from high and middle-income groups, the stockholders. Taxes, thus, will have a bearing upon the ability and willingness of savers to employ their funds in business venture. In examining the role of corporation tax on saving, we have seen that hike in government expenditure leads to imposition of additional tax on corporate entities and thereby reducing corporate saving. In India the corporate saving has remained within one per cent of the Net National Product (NNP) during 1970-71 to 1989-90. However, it has increased to more than one per cent of the NNP during the period from 1990-91 to 1993-94. Since 1988-89, the corporate saving in India has shown an upward trend. The trend, however, does not suggest that the high rate of corporate has been responsible for the erratic behaviour in corporate saving or whether public expenditure has been unproductive. It is true that taxation affects savings but not to the extent often alleged as impairing the incentives to work and to save. However, any generalisation will be risky if only because all the countries
of the world may not survive severe tax burden equally due to their inherent tax structure and fiscal policy. Empirical studies also have their limitations for obvious reason and therefore, there exists scope for future research.

Investment is one of the major determinants in undertaking any business enterprise. Investment is an act of parting with money for a specified period to acquire capital goods. Investment, when it is taken to mean the production of capital, has a two-fold role to perform in an economy. In the first place, investment helps acquire a variety and number of equipment, and, secondly, it offsets saving, an act of not spending over consumption. Saving is important for investment but it does not automatically enter into investment. An increase in saving will result into an increased investment only when savers themselves, or corporations, or intermediaries decide to invest. This investment is regarded as a highly strategic variable in the business cycle. The major criticism advanced against the corporation tax has been that such a tax will have an adverse effect upon the volume of investment. Because, such a tax can influence the volume of investment by affecting corporation's incentive to invest in new venture, particularly when the corporation needs it for expansion. However, sweeping generalisations by businessmen and other on the adverse effects of taxation are mere assertions, which requires further empirical tests.
It hardly needs to be appreciated that the viability and dynamism of industry is governed by technology. The development of production increasingly depends on how widely and fully the results of scientific discoveries are used in the economy. So far as the effect of a high corporate tax on technology is concerned, it may be argued that the tax may adversely affect the willingness of corporation to effect such changes via rate of return on investment. When profitability of corporations is reduced by tax, it leaves less resource at its command to undertake industrial research. However, even if it is taken for granted that corporation tax can influence the growth of technology adversely, it does not hold good so long as expenditure on scientific research is wholly or partially exempted from 'taxable income' as provided by the Income Tax Act, 1961. So corporation tax may not impair technological advancement provided proper advantages given in tax laws are utilised.

**History of Corporate Tax Legislation in India:**

The history of corporate tax legislation in India is a subject of great interest because it not only explains the existing features of the corporate tax system of the country but also offer considerable guidance for future reforms. The tax policy, which is manifestation of the tax statute, is only a means to an end, therefore, the first step in formulating it is to determine the socio-economic goals being sought.
and then, to train the policy measures to achieve that objective. Otherwise, the means may be confused with the ends.

Corporation tax as an important ingredient of the fiscal system, has a three-fold role to play: to transfer resources from the private to the public sector; to bring about equality in income and wealth distribution; and to promote economic growth, stability and efficiency. From these angles, the corporation tax structure in our country is both a source of satisfaction and an object of criticism - a source of satisfaction, because it does not seem to have produced impending effects on economic growth and an object of criticism, because many still believe that the corporation tax rates in India are highest in the world.

One of the indicators of the rate of growth of private corporate sector is the number of companies at work and their total paid-up capital. While the rate of increase in the number of companies and their paid-up capital indicates the actual growth of private corporate sector, the trend in the growth of both public and private limited companies is itself a pointer to the willingness or otherwise of entrepreneurs to start new enterprises. Over the years there has been a steady increase both in the number of companies at work and their paid-up capital. The total number of public limited and private limited companies has increased from 6819 and 27,147 (in the year 1973) to 56,797 and 3,51,129 (in the year 1996). Similarly during the above period the paid-up capital of public limited company
and private limited company has increased by 2889 per cent and 3251 per cent. The private limited companies have increased at a faster rate compared to public limited companies.

In tracing the history of the evolution of corporation tax in India one will have to analyse the history of levy of the tax, resembling to some extent the characteristics of modern corporation tax. According the Manu, the great Hindu law maker, a king should make the traders pay duty on their profits which should be fixed having regard to the rates of purchases and sales, the expenses for food and condiments and the cost of transport and other charges for receiving the goods. The king should fix the rates of duties and taxes in such a manner that both he himself and the man who does the work receive their due reward. It is evident that a reasonable tax on the profits of the trader was an accepted principle of the Hindu law. Adhya also observes in his studies during 200 B.C. to 300 A.D. that traders were taxed on the profit and not on the capital outlay.

By 1860 the socio-economic structure of India had almost given way and a new India was emerging. The rise of the Indian middle class, the re-generative role of the British rule, the policy of discriminating protection and the two world wars, transformed India into a semi-industrial economy based upon money. Income tax, corporation tax, customs, sales tax, excise duties took roots in the tax system and became responsive to industrial changes.
The first tax on traders and professions was passed into law on July 24, 1860 and became operative from August 1, 1860. This was virtually the first income tax in India. Subsequently the license Act, was passed and continued in that form until they were repealed by the Indian Income Tax Act, 1886. In fact, the Act of 1886 was the first basic Act on which further elaborations were engrafted in course of time.

A Bill was introduced in the year 1917 with a view to amending the Indian Income Tax Act, 1886 so as to improve its administrative machinery and to provide for the allowance of depreciation on a rational basis. Thus, the Indian Income Tax Act, 1918 that replaced the Act of 1886, changed the basis of assessment from previous year to the current year. The Indian Income Tax Act 1922 was passed to replace the earlier Act, which provided that income tax and super tax would be charged in respect of all income, profits and gains of the previous year. However, this Act was further amended in the year 1927. It made provision to segregate the incomes of tea companies for income tax purposes.

During the period from 1922 to 1961, the Income Tax Act was amended several times for different purposes. The Income Tax Act of 1961 which replaces the Indian Income Tax Act 1922, which has remained in operation for forty years is based on the recommendations of the law commission and the Direct Taxes Administration Inquiry Committee.
When the Income Tax Act 1961 was framed, all felt that now there will be an end to the spate of amendments, which used to have in every Finance Act. But to the surprise of all, this Act of 1961 had to be amended several times throughout the period of study.

Impact of Tax Concessions on the Financial Policy of the corporate Enterprise:

In the past, only a relatively few countries in the world have experienced, and come to expect a continued improvement in the material condition of their population. Since the end of World War II, however, the expectation of significant material progress has become a powerful political and social force in many countries whose economic energies have been long dormant and whose material progress relatively retarded. As a result of which Governments and people around the world are embracing the view that their material progress is an immediately achievable objective and that success in achieving it will turn on their own ingenuity, vigour and discipline.

An important by-product of the desire in many countries for a quickened rate of economic and social progress has been a heightened awareness of the key role of tax legislation and tax administration in fashioning the pace and direction of economic development. The necessity of reshaping the tax system so that its
burden distribution is constant with economic development has become acute in many countries where insufficient revenues, a maldistribution of wealth, or a lack of refined fiscal tools for controlling inflation or influencing saving and investment pattern to thwart economic progress. Another trend in the area of fiscal policy has been the use of tax incentives to stimulate industrial development. The impetus that has been given to experimentation in utilising the tax laws as mechanism for diverting the flow of investment or wealth away from activities that have little or no development merit into activities whose encouragement is important for development.

While corporate taxes are important source of revenue and their use is constantly increasing for purposes of social control, they have another controversial aspect. Corporate taxes emerge as a cost of conducting business. It is thus a factor of crucial significance in financial management. The most important effect of taxation upon the corporate financial policy is its direct effect on the sources of financing. The tax liability of a company is directly responsible for influencing the quantum and magnitude of the sources of business finance. Through various Finance Act, several union finances ministers have made several modifications on the existing framework of corporate taxation which are likely to influence the investment decisions and make substantial changes in the financial policies of the corporate enterprise in India.
In India, tax incentives to industries represent the major legislative effort undertaken to hasten development. The tax subsidies may be cast in a variety of forms. The most common are partial or complete exemptions, ordinarily for a limited period of time, from one or several taxes, and special allowances to accelerated depreciation or re-investment. The major significance of tax incentives, however, lies in their utilization as a means of promoting objectives one such objective is to encourage investment in selected manufacturing activities of special economic or social worth. Other objectives of incentives are:

i) to encourage the improvement of product quality;

ii) to utilise domestically manufactured raw or semi finished goods;

iii) to promote increased investment; and

iv) to undertake new ventures or to expand existing units. In recent years, tax incentives have attained prominence in planning. India being a developing country where insufficient capital is one of the most crucial factors resulting in failure to offer the desirable location for investment to both indigenous and foreign investors, tax incentives become valuable in such a situation and act as an indirect stimulus to investment.

In fact, tax incentive policy is a delicate instrument of economic policy whose efficacy depends, besides others on the favourable climate to private
investment. If the concessions are to be effective, they have to be coordinated with other factors having a bearing on private investment. They cannot be used in a general fashion, they have to be pragmatic, selective and experimental so that, given a favourable investment climate, they can play an active role in promoting investment and in achieving other desired objectives. Therefore, tax incentives require utmost care in their usage. There are other factors, which influences the success and failure of an enterprise. If the enterprise does not produce any profits due to the operational factors, then the tax incentives becomes virtually meaningless and ineffective. This brings out the vital fact that a tax incentive can operate effectively only where the other conditions are favourable for profitable operations.

The other limitation is that, with a multiplicity of incentives operating in the same fields, the effect of any particular incentive tends to be weakened. This is nothing but a variation of the "marginal utility" concept which, in this context defined as "the incentive effect of a tax concession diminishes progressively with the addition of a new concession to the existing ones". The most serious of a tax incentive from national point of view is that, it leads to prodigality in the use of scarce resources. As an incentive once introduced is not frequently reviewed not only as to its effectiveness but also to the need for its continuance. An incentive is introduced in the law with an avowed objective, such as i) it should induce tax
payers to save and invest their incomes in certain approved modes; ii) they should incur expenditure in developing markets for Indian goods abroad; iii) they should set up industries in rural and backward areas; and iv) they should contribute to research programmes. However, once the legislation has been brought on the statute book, one should not lose sight of the purpose of a piece of legislation. However, there are instances when the practitioners set about bisecting, dissecting, analysing and interpreting every word of the legislation with a view to serving the clients' interest most.

In India the tax system provides a number of incentives to stimulate the industrial development in the country. Over the past few decades, the government in different Finance Act has withdrawn some of the incentives while some other incentives have been introduced and modified. Of these, tax holiday, development rebate, investment allowance, exemption in long-term capital gains, amortisation of certain preliminary expenses, rural development allowance, exemption for investment in new industrial undertakings, expenditure on acquisition of patent rights or copyright, expenditure on scientific research, concession for rehabilitation of sick industrial units, tax concession to small-scale industrial units set up in rural areas, tax concession to promote export business, and incentives for infrastructure development which represent the major
incentives provided by the government to industrial sector for fostering the economic development.

As Indian exchequer has a significant contribution from the corporate sector in terms of corporate income tax. Therefore, the corporate sector in India has attracted wider attention of the state. Moreover, with the opening up of the economy, to face the stiff competition from the foreign company, it is expected that the state is required to play an important role to uplift the degree of industrialisation by providing certain tax concessions or tax incentives to the industrial sector. At the same time the foreign institutional investors should also receive a fair deal from the Government, so that our country can attract more investment from abroad.

Corporate Tax Planning and Financing of Capital structure:

Planning is a kingpin of development of an economic unit. In the context of the corporate sector, planning, in a very loose sense, is a technique, a means to an end, and end being the realisation of certain pre-determined aims and objectives laid down by the management. In India, the business is run from the tax consultant's office rather than the boardroom. We know that, in India laws are enacted, replaced, revised, modified and amended very frequently. Therefore, managers of Indian industry are more conscious of the tax factor in taking any
decisions relating to the business. Hence, tax planning has become more important for the management. A tax plan involves integration of corporate decision making with its tax consequences.

In recent times, the profound emphasis upon the investment need of our planned economy, the hazards of venturesome new openings, and the clamour of average investors for profitable channels of investment, have all led to greater importance attached to the subject of corporate taxes. Taxation has a significant effect on retaining net income for the business. Therefore, through tax planning, minimisation of tax bill can be most fruitful. The avoidance of any unnecessary taxes, and reduction to the legal minimum of those that are necessary, can perhaps do more to augment the final net income of an ordinary business corporation than can be accomplished by any other similar amount of management effort. The management of any company while conducting the day to day affairs must have sufficient and true knowledge of tax law and regulations prevailing at a particular point of time so as to afford a distinct advantage from the stand point of tax liability.

Both the concepts "Tax Planning" and "Tax Management" have assumed special significance in the corporate world during the recent years. The tax planner suggests the plans and programmes of tax saving, but the actual implementation is possible only through tax management. The job of tax planning is to minimise the
tax burden by suggesting different ways and means. The task of tax management starts thereafter and which consist of proper management of all matters towards the realisation of tax planning. Capital structure decision being one of the vital aspects of tax planning, the management has to take all precaution before going for designing the capital structure of the company.

Capital structure is always determined keeping in view the total needs of capital assets, viz. Capital expenditure on fixed assets such as land, building, plant, machinery, miscellaneous fixed assets, preoperative, preliminary and public issues' expenses including margin money required for working capital. Such a capital expenditure is to be known in definite terms before a company plans its capital structure. For financing a project, or expansion or diversification programme, various sources of finance and how best to determine the capital structure, are discussed so that it matches with external debt through long term borrowings from financial institutions, banks, deferred payments etc. Equity / debt ratio is very important to be considered at this stage to fix the amount of equity and debts to be raised for financing the project. Debt / equity ratio varies from industry to industry as per the norms fixed by the leading financial institutions. Therefore, equity base has to be kept ideal by contributing maximum profits after tax and at the same time serving the equity and debt on regular and consistent basis.
While designing the capital structure of the company we have to consider in depth the impact of both the financial and tax considerations and after making an appropriate correlation of these factors (aspects) we can establish our policy as to what part of the total capital requirements shall be met out of various sources of finance. An optimum line of demarcation for the borrowed funds would be: i) short term or long term; or ii) issue of debentures or bonds or other types of securities; or iii) loans from financial institutions, private sources, deposits etc. and the equity capital (and generation of funds through profits i.e., retained earnings). Tax planning for the optimum capital structure of a company should provide for: i) maximum return on investment per share; ii) scope for self generated cash/funds inflow system for reinvestment and ploughing back of profits for expansion and modernisation etc.; iii) increased (appreciated) value per equity share; and iv) least marginal tax liability on the company. The above noted sources have some notable features from the tax point of view. These are: a) the return (dividend) of the share capital is a charge on the 'profits after tax', and b) the interest to lenders, including debenture holders and other creditors of a company, is a charge on the 'profits before tax'.

This shows that borrowings would contribute to tax saving by reflecting a higher rate of return on the owners' equity. However, excess of borrowings over owners' capital may be disadvantageous in terms of financial risk which may be
defined as the risk of possible insolvency arising out of inadequacy of available cash as well as the variability in the earnings available to the ordinary shareholders. Moreover, serving of debt is a legal obligation and it should be paid with interest irrespective of the fact whether a company earns profit or not. A Company, which can not serve the debt at the proper time, runs the risk of loosing goodwill in the market. This inability of serving the debt will also adversely affect the share market price and hamper further chances of raising debt capital. Therefore, debt service ratio must be kept in view while structuring the capital base. Moreover, greater reliance on debt would affect returns to the shareholders and the risk to the shareholders would also be enhanced.

The capacity of a company to borrow depends on many factors, one being the extent of equity in the capital structure, plus free reserves. The company should make use of the capacity to borrow with sound judgement since the capacity to borrow is an asset with the company.

The points which are to be considered if the project is financed through long term borrowing are viz., i) whether interest liability is deductible from business profits; ii) whether cost incurred on borrowed funds is deductible from business profits; and iii) whether borrowing is considered as a part of capital employed for surtax purposes.
Importance of Capital Structure Decision:

The sources from which funds can be raised by a company from the point of view of charge/return can be categorised in to two parts viz., i) those which carry a fixed (financial) charge/return; and ii) those which do not involve any fixed charge/return.

The fixed returns on some sources of finance affect those who are entitled to a variable return. Since the debt involves the payment of a given rate of interest, the return to the ordinary shareholder is affected by the magnitude of debt in the capital structure of a company. To put it in other way, the existence of fixed rate of return in capital structure has a magnifying effect on earnings per share such that, for a given level of change in earnings before interest and tax, there will be proportionately more change in the same direction in the earnings per share.

The capital structure decision should be examined from the viewpoint of its impact on the value of the company. As the capital structure decision affects the total value of the company, a company should select such a financing mix as will maximise the shareholders' wealth, such capital structure is referred to as optimum capital structure.

The advantages of having an optimum capital structure are two-fold, it maximises the value of the company and hence the wealth of its owners; and it minimises the company's cost of capital, which in turn increases its ability to find
inbuilt additional investment opportunities. Thus it accelerates the rate of investment and growth of the company. While it is true that financing mix can not affect the total earnings of a company, however, it may affect the share of earnings of the ordinary shareholders.

Corporate Income Tax and Capital Structure decisions:

The economic development of any country requires more investment in corporate sector. The financing decision constitutes 1) investment decision, 2) the financing decision and 3) the dividend policy decision. The capital structure financing decision of a company aims at maximisation of the wealth of the shareholders through the mix of debt and equity. The mix of debt and equity in the capital structure is known as 'gearing' or 'financial leverage'. Financial leverage is also called 'trading on equity'.

On the basis of time period, the funds required by a company can be of two types, viz., short-term funds and long-term funds. While the short-term needs are financed by the bank borrowings, the long-term funds are raised through the issue of equity shares, preference shares, debentures or ploughing back of retained earnings. As far as tax factor is concerned, the corporations go for debt financing as the interest paid on debt is a tax-deductible expenditure. But excessive use of
debt over and above a certain limit is considered undesirable in view of the greater amount of bankruptcy risk involved. For the determination of debt-equity mix, the different techniques used are financial ratios, break even analysis etc.

In recent times there is a growing demand in the Indian private sector for higher debt-equity ratio in view of high magnitude of investment needed for the sophisticated industries. It is due to the fact that most of the companies in India are relying heavily on debt capital for meeting their capital requirements due to high corporate tax rates. Therefore, financing with debt instruments is more significant than the equity.

Moreover it is observed that capital structure financing is influenced not only by the corporation tax but also by cost of capital and demand variable. Theoretically, the corporate sector will shift their capital structure bases to take the advantages of tax on debt charges. The usual argument put forth for such discrimination in favour of debt financing is arising primarily from the fact that interest payments on indebtedness are recognised as deductible expenses in computing taxable corporate profits, whereas dividends on equity capital are not. The same advantage is not there in the case of preferred stock, which also possesses the features of debt. Moreover, the dependence on debt capital has been proved more in the case of all the industries including the total sample except tea industry. The growth in the proportion of debt capital has increased by in respect of
electrical (189.28 per cent); jute (47.82 per cent); general engineering (77.58 per cent); metals, alloys and metals product (31.99 per cent); chemicals, pharmaceuticals and refineries (31.26 per cent); silk, fibre, cotton, spinning and weaving (77.23 per cent); sugar and breweries (103.98 per cent); paper and hard board (11.95 per cent); cement industry (72.43 per cent); and for total sample (58.3 per cent) in the year 1996 over the base year 1981. Similarly, the average amount of debt capital to the total capital of all the industries including tea industry during the period of study is found to be more than 50 per cent. The highest amount of debt capital is employed by Jute industry (80.51 per cent). Analysing the equity financing aspect of all the industries, we conclude that the proportion of equity capital in the total capital has been reduced vehemently. The mean of the percentage of the equity capital in the total capital is found in respect of electrical (46.18); tea (48.68); jute (16.98); general engineering (22.35); chemicals, pharmaceuticals, and refineries (39.33); silk, fibre, cotton, spinning and weaving (20.94); sugar and breweries (26.21); paper and hardboard (18.67); cement (15.22); and for total sample (25.66). The fall in the equity proportion is due to the replacement of debt capital to avail the tax deductibility on debt charge.

The empirical analysis of our study shows that corporation tax rates are positively correlated with the proportion of equity in the total capital in the case of industries namely, electrical; jute; general engineering; chemicals,
pharmaceuticals, refineries etc; silk, fibre, cotton, spinning and weaving; sugar and breweries; cement and for the total sample. Thus, our study reveals that higher corporate taxes do not relegate importance of equity capital. However, in industries like, tea; metal, alloys and metals product; and paper and hardboard, the coefficients are negatively correlated. However, except tea industry, the industries showing negative correlation are not statistically significant. It makes to hold our hypothesis good in the case of above industries. We have seen most of the industries under study including the total sample are dependent more on debt capital. Therefore, it may be concluded that the lower interest rates and easy availability of debt capital has forced the companies to go for debt capital for their additional requirements than for equity. The more dependence on debt capital by the companies attributed to the lower amount of equity dividends prevailing in the previous year have made the equity capital in current year as most unwanted. While correlating the proportion of equity capital in the total capital with equity dividends, we find that the correlation is positive in the case of industries namely electrical; tea; general engineering; metal, alloys and metals product; and cement and negative in the case of jute; chemicals, pharmaceuticals and refineries; sugar & breweries; paper and hardboard; and for total sample. The negative correlation explains the benefits of trading in equity. In the industries where the coefficients are positive, it is due to the fact that some industries had suffered loss for which
they were unable to declare dividend and some industries even though made profits were reluctant to declare dividend.

While correlating the accelerator variable i.e., increase in net fixed assets (demand for finance for additional investment in fixed assets) with equity capital, we find that the coefficients are negative in all the industries under study including total sample. These results may be attributed to the increased usage of cheap funds from debt sources.

The correlation between the proportion of shareholders' fund to total finances including retained earnings and the effective corporate tax rates reveals that there is positive correlation in six out of ten industries and for total sample. However, the correlation is negative in industries namely tea; jute; metal, alloys and metals product; and paper and hardboard. Industries showing negative correlation suggest that a rise in corporate tax relegate the importance of shareholders' fund, which is another variant of equity capital. Therefore, the findings enable us to hold our hypothesis good for those industries showing negative correlation. But industries showing positive correlation suggest that higher corporate taxes do not relegate the importance of another variant of equity capital, which is shareholders' fund.

The coefficients of equity dividend with the shareholders' fund reveals that it is positive in respect of electrical industry; tea; general engineering; metal, alloys
and metals product; silk, fibre, cotton, spinning & weaving; paper and hardboard; and cement industry. The above results tells us that the industries had either suffered loss or reluctant to declare higher dividends. The coefficients are negative in rest of the industries because of the higher dividends declared or higher amounts of profit retained by the industries due to huge profits. The negative correlation signifies that a fall in the proportion of shareholders' fund to total finances results in the rise in the dividend or vice-versa. The negative correlation explains the benefits of trading in equity.

The coefficients of correlation between the shareholders' fund to total finances with the accelerator variable (Increase in net fixed assets) are found to be negative in respect of all the industries including total sample expect the paper and hardboard industry. These results tell us that the industries had used funds from debt sources as the accelerator variable has a negative influence on the shareholders' fund.

Observing the results of the correlation between debt capital in the total capital with effective corporate tax rates, we find that there has been negative correlation between the variables in respect of electrical industry; jute; general engineering; chemicals, pharmaceuticals & refineries; silk, fibre, cotton, spinning & weaving; sugar & breweries; paper & hardboard; cement industry and total sample. These findings suggest us that a rise in effective corporate tax rates results
in fall of debt capital or *vice-versa.* However, corporate tax is not the only factor responsible for higher negative results in debt-tax relation. Therefore, debt capital has been correlated with other variables namely dividend and accelerator variable, i.e., demand for finance expressed in terms of investment in net fixed assets.

The correlation between debt capital and equity dividend reveals that there has been positive correlation in case of industries namely, jute, chemicals, pharmaceuticals, & refineries; silk fibre, cotton, spinning & weaving; sugar & breweries; and paper and hardboard industry. These findings lead us to conclude that higher equity earnings are due to greater use of debt capital. These industries by utilising the debt capital were able to declare higher dividend. However, in rest of the industries showing negative correlation suggest that a rise in dividend result in the fall of the debt capital or *vice-versa.*

The correlation between debt capital and accelerator variable (demand for finance for investment in fixed assets) reveals that the coefficients are positive in all industries under study including for total sample. It leads us to conclude that an increase in net fixed assets leads to an increase in debt capital.

From the above analysis it is clear that capital structure financing of the corporate entities under study is not only influenced by the corporation tax but also by other variables like dividend, demand/urgency of funds etc. In our study of capital structure financing, the industries under study had shifted their capital
structure bases to take the advantages of tax on debt charge. After analysing all the aspects we conclude that the capital structure financing decisions are not influenced by the corporation tax rates but also by the equity dividend rates and urgency of funds. From our analysis we conclude that the capital structure of any corporation would never consist of 100 per cent debt capital. Thus the hypothesis "the higher the corporate income tax rates, the greater will be the preference for debt capital over the equity, the preference share capital" is proved otherwise.

Similarly, while testing our second hypothesis "equity capital is influenced by the demand for additional finances to meet the expansion programmes of the company", we observe that, when both the variant of equity capital is correlated with the accelerator variable, measured in terms of increase in fixed assets, the results found to be negative in respect of all the industries under study and as well as for the total sample (except paper and hardboard industry). From our analysis we deduce that during the period of study the industries have availed of other sources of finance namely debt capital and internal source of fund namely depreciation, retained earnings etc. for their fixed assets financing. The result of the analysis says that equity capital is not influenced by the demand for additional finances to meet the expansion programmes of the companies.
Tax structure of the Corporate Entities under Study: Their Financing of Fixed Assets:

The rate structure of Indian corporate income tax depends both on the category of the company and on the source of income. For the purpose of corporate income tax, the companies are classified into two broad categories: domestic and other than domestic (foreign). Domestic companies are further classified into two categories, namely, widely held companies and closely held companies. Domestic companies are subjected to different income tax rate schedules depending on the category of the company. However foreign companies are taxed according to source of income.

The principle and methods of determining the tax base are the essence of tax structure. Though the tax base should have a certain degree of flexibility to adapt itself to the changing context of the economy, the Bhootlingam committee report suggests that any desire for such a change should be contemplated through necessary amendments in the Income Tax Act and not through amendments inserted in the Finance Act as at present.

The corporation tax rate is one of the major determinants of the after tax profitability of the corporate entity and this profitability may be regarded as an index of the corporation's financial performance. Though the reaction of a corporate entity to a change in the tax rate can not be measured precisely. But as a
general rule, higher the tax rate, less will be the profitability after tax of a corporate entity and vice-versa. From Table 6.1 it is observed that the rate of tax on domestic companies have been at a flat rate from the assessment year 1995-96. Table 6.1 reveals that domestic companies are subjected to different income tax rate schedule depending on the category of company. The domestic company has to pay income tax in the range of 55 to 65 per cent of the total income depending upon the category of the company. However, from assessment year 1995-96 onwards the tax rates of the domestic company irrespective of their nature has been at a flat rate of 40 per cent in addition to the surcharge, which during 1984-85 to 1997-98 varies between 5 per cent to 15 per cent. Over the years the recommendations made by different tax enquiry commission and committees have forced the Government to take some measures in rationalising the tax structure of our country. The Government in recent past by rationalising the tax structure is trying to attract more investment in corporate sector from within the country and abroad.

It is generally accepted that saving and investments are distinct functions. If the ability to save of the companies is affected by taxes it does not necessarily involve any obstruction in the rate of capital formation provided anticipated return is not damaged and adequate external finance is forthcoming.
We know that finance is the life-blood of any successful industrial unit. Non-availability of adequate and timely finance is one of the major causes for the failure in industrial growth in Eastern region in India. The capital and money market influence the flow of finance into the industrial sector to a great extent. The companies find it very difficult to procure funds from external sources because of the unavoidable factors. Internal funds, generated internally through the operation of a business unit, are the primary sources of finance to the industrial sector. Generally the internal funds are used for the capital investment by the corporate sector. The main components of internal sources are- a) retained earnings; b) depreciation and amortisation; c) investment allowance; and d) sale of fixed assets.

The analysis of the study of the fixed assets financing is based on the sources of funds available to the sample companies during the period of study. The increment of fixed assets represents investment made in additional fixed assets, namely, land and building, plant and machinery and other tangible assets during the year.

**Trend in Share of Internal and External Funds of total Sample Companies:**

The share of internal and external fund in total sources of total sample companies has been shown in Table 6.3. It is noticed that in fourteen out of fifteen years of study, the volume of internal funds exceeded the volume of external funds.
On an average, internal funds amount to 65.84 per cent of total funds during the period of study. In most of the years of our study the companies were contended with only routine replacement and renewals.

**Trend of Internal Sources:**

The overall trend of the aggregate internal funds of the total sample showed an increasing trend during the period under study. On an average, the annual inflow of funds through internal sources during the period of study (1981-82 to 1995-96) amounted to Rs.412.41 lakhs. The rising trend in internal finance can be ascribed to rising trend manifested by its components such as retained profits, depreciation and amortisation, development rebate reserve/investment allowance during the period. The coefficients of variation of internal sources and external sources are found to be 32.28 per cent and 33.56 per cent respectively. It can be said that internal sources are more stable sources of finance than external sources. Simple regression analysis reveals that net profits, depreciation and amortisation, income tax paid, dividend and retained profits are some of the important factors significantly influencing availability of internal funds.

**Trend of Components of Internal Funds:**

After analysing the overall trend of internal finance, an attempt has been made to analyse the trend of individual components of internal funds and the extent to which those components have influenced the overall trend. In our study, there
are three components of internal funds, namely, depreciation and amortisation, 
development rebate reserve/ investment allowance and retained profits. Table 6.4 
reveals that retained profits has increased from Rs.54.98 lakhs (in the year 1981) to 
Rs.206-16 lakhs in the year 1996. The retained profit has increased by 274.97 per 
cent in the year 1996 over the base year 1981. On an average, the annual inflow of 
retained profit during the period of study is found to be Rs.147.89 lakhs. The 
inflow of founds from depreciation and amortisation is found to be increased from 
Rs.52.96 lakhs (in the year 1981) to Rs.416.29 lakhs in the year 1996. On an 
average, the annual inflow of internal funds through depreciation and amortisation 
amounted to Rs.219.09 lakhs. The co-efficient of variation of the different 
components of the internal sources of finance namely retained profit, investment 
allowance/development rebate reserve, and depreciation and amortisation are 
found to be 39.08 per cent, 88.91 per cent and 53.08 per cent respectively. 
Retained profit is found to be more stable source of internal funds compared to 
other sources.

Table 6.5 reveals that, the major chunk (on an average 53.21 per cent) of 
inflow of internal funds has come from depreciation and amortisation. During the 
period-retained profit on an average has contributed 38.14 per cent of the total 
inflow of internal funds. Besides the retention of profit is grossly affected by 
income tax and dividends pay out. Table 6.6 reveals that the tax liability as a
percentage of net profits varies between 24.73 per cent (1991) to 46.42 per cent in the year 1981, while on an average the tax liability as percentage of net profits is found to be 31.82 per cent for the whole period of study.

**Trend of Incremental Fixed Assets and Availability of Internal and External Funds in Fixed Assets Financing:**

It has been seen that most of the companies depend on the internal funds for fixed assets financing. Table 6.8 depicts the increase and decrease in the fixed assets of the total sample during the year and availability of internal and external sources of funds for financing the fixed assets. It is found that the investment in fixed assets for the total sample has increased from Rs.438.45 lakhs (in the year 1982) to Rs.695.89 lakhs in the year 1996. The investment in net fixed assets has increased by 58.72 per cent in the year 1996 over the base year 1982. On an average, the investment in fixed assets amounted to Rs.521.34 lakhs. Further, it is noticed that the funds available from internal sources varies between Rs.172.25 lakhs (in the year 1982) to Rs.622.45 lakhs in the year 1996. The internal funds as percentage of incremental fixed assets on an average during the period of study is found to be 79.5 per cent. On an average, the quantum of internal funds available for investment in fixed assets of the total sample amounted to Rs.412.41 lakhs.
While planning the study, a set of hypotheses has been formulated based on various theories of financial management. They have been presented in chapter 1 (Introductory). The hypotheses which have been proposed to be tested in this chapter are- i) Internal funds play a significant role in financing the companies; and ii) retained profit plays an important role in the flow of internal funds are tested by the correlation technique(r).

The above hypotheses have been tested after taking into consideration the total sample analysis and industry wise analysis. We have employed Karl Pearson's correlation technique to find out the extent of relationship between the incremental fixed assets and the internal source of funds. Further analysis has been done to find out extent of relationship between retained profit and internal source of funds. Table 6.69 presents the extent of relationship between the above variables. It is observed from the table that the coefficients of correlation are highly positive in respect of the combination of both the variables. The correlation between incremental fixed assets and internal source of funds is found to be 0.805 and the correlation of retained profit and internal fund is 0.847. These results signify the fact that internal fund plays a very significant role in financing the fixed assets of the total sample. Further the retained profit plays an important role in the flow of internal funds. Therefore, it may be concluded that, both the hypotheses hold good in respect of total sample.
While considering industry-wise analysis it is observed from Table 6.69 that, the coefficient of correlation between incremental fixed assets and internal source of funds are found to be positive in respect of all the industries. However, they are statistically significant in case of general engineering; silk, fibre, cotton, spinning & weaving; sugar & breweries; paper & hardboard; and cement industry. While in respect of other industries though the coefficient of correlation is positive but not statistically significant. From the above findings it may be concluded that the internally generated funds have played a significant role in fixed assets financing of all the industries under study.

The result of coefficient of correlation between retained profit and internal source of funds is found to be positive and statistically highly significant in respect of all the industries under study. This positive correlation between the variable suggests that retained profit as a component of internal source of funds has played a major role in respect of all the industries under study. It signifies the fact that increase or decrease in retained profit will bring an increase or decrease in internally generated funds.

The coefficient of correlation between the incremental fixed assets and retained profit is found to be positive in respect of electrical industry; chemicals. Pharmaceuticals and refineries; silk, fibre, cotton, spinning & weaving; sugar and breweries; paper and hardboard; and cement industry. The finding tells us that
these industries have utilised retained profit in financing their fixed assets. In rest of the industry the coefficients are negative which implies that industries namely tea, jute; general engineering; and metal and metals product have either failed to generate sufficient fund to retain for fixed assets financing or dependent on external source or other internal sources for financing their fixed assets.

**Tax Policy and its Implication on Depreciation:**

Depreciation is an expired cost of a depreciable asset, which occurs during the operation of business and is recovered out of earnings. There are a number of concepts of depreciation such as popular concept, accounting concept, engineering concept, economists' concept, appraisal concept and legal concept. Depreciation is caused by several internal and external factors. Internal factors include wear and tear, ageing and depletion. On the contrary, external factors are weathering, obsolescence, efflux of time, fall in market value, accident. The objectives of measurement of depreciation are ascertainment of an element of cost of product, preventing erosion of owner's capital, determination of divisible profits, computation of tax liability, fair disclosure of going concern value of long lived assets and finally to build up fund for replacement and renewal of existing fixed assets as and when necessary.
The measurement of reasonable amount of depreciation requires fair estimation of economic life of the asset, salvage value and selection of suitable method. The Companies Act, 1956 and the Income Tax Act, 1961 create an obligation to provide for depreciation.

There are numerous factors for determining the depreciation to be charged each year. These are the cost of the asset, estimated useful life of the asset, and estimated scrap value of the asset, interest on capital invested.

The bases for calculating depreciation are two types. One is the historical cost, another is the replacement cost of the asset. The hazards of depreciation are the estimation of the useful life of the asset, the estimation of scrap value of the asset and the basis for calculation of depreciation.

Depreciation as a source of fund is a controversial issue. Accountants do not consider depreciation as a source of fund. According to them it is a non-cash book entry and the fund flow from operation remains unaffected irrespective of the magnitude of depreciation. Thus, if depreciation is increased, the net profit falls, but funds generated through operation remain unchanged. However, the financial managers consider depreciation a source of fund. According to them, depreciation amount is set aside out of the stream of revenues received by a firm. Funds so accumulated necessarily constitute a source of fund. Fund flowing in through depreciation used to finance working capital needs and for modernisation and
expansion programme of the firm. But in actual practice the fund generated by way of depreciation is inadequate for replacement. There are two main factors, which are responsible for this inadequacy. These are price level changes and the rapid advancement of science and technology.

Therefore, the calculation of depreciation on capital assets is crucial for the determination of taxable income. It is, of course, not possible to measure exactly the 'true' economic depreciation in the value of an asset every year.

The appropriateness of the annual depreciation charge may be considered from two angles, namely tax equity and the interest of the national economy. From the point of view of tax equity, there should be no under or over-statement of profit or income from business. This result may be achieved, if the annual depreciation allowed enables the investor to recover in real terms the original sum of money expended on the acquisition of the asset by the end of its useful life. From the point of view of national economy, the sum of annual depreciation charges made available during the period should be sufficient to enable the purchase of a new asset to replace the old one so that the economy intact the capital stock.

As in many other countries, depreciation under the Indian Income-Tax Act is allowed as a percentage of the historical capital cost of the asset. The replacement cost method of allowing depreciation has not found favour in many countries including India. It is because of the fact that it is not easy to measure
asset wise replacement cost because of divergent price trends and the cost of replacement is known only at the time of replacement. But the depreciation allowance is availed of during the period of use of the asset. Thus, broad adjustment should be provided for taking care of the rise in price of the assets.

The study concludes that corporate tax is not the sole factor in the capital structure financing decisions. Other factors like, shareholders' expectation regarding dividend, urgency of fund, accelerator variable expressed in terms of incremental fixed asset investment, capital charge, corporate saving behaviour have a significant impact. Internally generated funds on the other hand, constitute an important source in fixed asset financing of the corporate entities under study.

Suggestions

The problem of corporate taxation has been examined by a number of expert committee or commissions beginning with the Report of the Taxation Enquiry Commission of 1953-54, Mr. Nicholas Kaldor's report on Indian Tax Reform, the report of the Direct taxes Enquiry Committee, the report of Mr. S. Bhootlingam, the Wanchoo Committee Report, Report of Tax reforms Committee Chaired by Raja J. Chelliah. Unfortunately, the recommendations of these reports did not attract the Government's attention seriously to pursue them vigorously.
These recommendations if implemented firmly, would go a long way in solving some of the pertinent problems, which Indian tax system suffers, today.

Companies in India, have been classified in many categories without sufficient and valid justification which create ticklish problems for the administration and therefore, it is suggested that the classification of companies be confined to 'domestic' and 'foreign' company only.

Corporate taxation has adversely affected the ploughing back of profit in many industries under study and the state of capital market (primary) is also unsatisfactory. This calls for a substantial reduction in the rate structure of corporate taxes. Moreover, the distinction observed between a company in which public is substantially interested and one, which is not, is superfluous and can easily be ignored.

Surtax or super profit tax or surcharge is positively a tax on efficiency and hence it should be withdrawn. Shri S. Bhoothalingam has also recommended the abolition of the same. However, Larger profits due to monopoly or scarcity, should pay such tax. But in industries where there is cutthroat competition both from inside and abroad, larger retention of profits for ploughing back is necessary. Therefore, the tax rate should be lowered to reward the efficiency of capital.