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Corporate Tax Patterns in India

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Corporate taxes are a significant item for revenue generation and year after year the Corporate tax and Profit Before Tax (PBT) is increasing. But after the year 2001 the Tax/PBT ratio has been undergoing an unhealthy pattern comparing to previous years without giving any major tax sops by Government. This study is to enlighten what is happening to Tax/PBT ratios in various industry sectors, ownerships and size of companies after the year 2001 and its impact on Exchequer.

Introduction

Corporate Taxes are a significant item for revenue generation by the government. While deciding the tax structure, the government has to ensure that the tax structure does not adversely impact the corporate sector performance, and that the tax sops do not create inequities across different industry sectors, favoring some sectors unduly. It has also to keep in mind the shock sustaining capacity of smaller companies and the opportunity for fair returns to the share holders.

What has been the pattern of corporate response to the government's corporate tax policies over the years? How effective have they been to there any need for a re-look? These are some of the questions that are addressed in this paper.

An AEP study (1) claims that contribution of India Inc. (read private sector) has more than doubled in the period 2002-2005. The study also mentions that the share of top business houses has shot up considerably (189%). The total corporate tax by all the business houses too has gone up by 159%. "It is in sharp contrast" the study claims, "to the contribution of state owned companies, which rose only by 67% during the same period".

The study, however, does not reveal the exact state of affairs. For instance it does not indicate the tax base of the India Inc. and the public sector in the year 2002. It also does not indicate what should have been the payment and how much more or less is the actual payment. This issue becomes significant in light of the finance minister's anguish that "the methods of corporate tax evasion were becoming more and more sophisticated and tax officials must also equip themselves to tackle the malaise" (2).

The above also does not indicate what has been impact of tax on industry sales etc. Industry has been asking for reduction in rate for growth etc and a study is necessary to respond to such requests.

Methodology

The data source for the study is PROWESS database developed and managed by Centre for Monitoring Indian Economy. The database covers large size public limited companies. The database is updated on weekly basis, year after year, which gives an opportunity to undertake longitudinal study for identifying corporate sectors response patterns over the years. Since the information is based upon audited annual accounts of the companies, it is most authentic and accurate data available in public domain.

The period of study is 1990 - 2005. It thus covers the entire period of economic reforms, during which the Indian corporate sector grew, faced crisis and bounced back. Since the database considers all public limited company of a minimum size, the number of companies has increased steadily. This also covered the public sector companies when they opened up sale of their shares from mid nineties onwards. Some of the companies could not face the heat of the competition and failed. Hence the member of the companies reporting came down. Some of them restructured and changed the accounting periods for a while. Therefore, the annual financial accounts were not reported for certain years. However, a longitudinal study over 16 years period for the entire population (Industry set) absorbs such aberrations and broad patterns are undistorted ones.

Table 1 (A)

Reduction in No. of Companies Reporting from the First Year of Reporting

Year of Reporting	Total Cos. Cumulative	Net Reporting	First Year of Reporing															
			1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
Mar-90	1471	1471	1471															
Mar-91	2124	2074	1419	653														
Mar-92	2493	2379	1382	628	369													
Mar-93	3470	2930	1378	575	355	977												
Mar-94	4463	3873	1381	592	324	908	993											
Mar-95	5629	4972	1395	584	337	880	949	1166										
Mar-96	6238	5429	1389	568	332	872	865	1129	609									
Mar-97	6654	5567	1367	567	314	836	835	966	585	416								
Mar-98	7158	5767	1374	526	308	808	799	900	460	402	504							
Mar-99	7751	6253	1471	454	311	814	787	863	454	325	498	593						
Mar-00	8243	6628	1411	504	308	804	783	862	441	325	427	586	492					
Mar-01	8725	6890	1365	501	302	772	751	840	437	310	435	524	481	482				
Mar-02	9214	7527	1337	508	307	789	777	914	483	331	447	539	445	478	489			
Mar-03	9791	7720	1301	439	297	750	767	846	446	315	428	514	413	401	484	577		
Mar-04	9998	6806	1240	433	265	675	684	735	377	261	350	401	312	271	300	572	207	
Mar-05	10029	5057	1113	362	223	563	545	552	274	168	199	236	214	182	208	223	199	31

Table 1(B)

Co.s Making Profit Over the Years

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Mar-90	83%														
Mar-91	82%	79%													
Mar-92	81%	79%	89%												
Mar-93	78%	69%	82%	87%											
Mar-94	80%	73%	76%	81%	91%										
Mar-95	83%	76%	79%	79%	86%	90%									
Mar-96	81%	70%	74%	73%	72%	81%	82%								
Mar-97	74%	61%	67%	62%	61%	58%	66%	71%							
Mar-98	70%	51%	58%	55%	51%	48%	49%	66%	76%						
Mar-99	66%	42%	51%	48%	47%	45%	49%	50%	75%	77%					
Mar-00	62%	46%	49%	48%	49%	48%	50%	54%	66%	76%	79%				
Mar-01	57%	42%	47%	45%	42%	42%	47%	47%	64%	66%	75%	78%			
Mar-02	56%	43%	47%	44%	44%	43%	49%	50%	64%	64%	63%	72%	70%		
Mar-03	57%	42%	49%	45%	48%	42%	49%	46%	62%	64%	59%	63%	72%	74%	
Mar-04	60%	44%	50%	46%	46%	42%	44%	44%	54%	53%	47%	44%	47%	78%	100%
Mar-05	59%	39%	46%	42%	40%	35%	36%	30%	34%	30%	35%	28%	36%	33%	96%

Growth of Corporate Sector of India

The study analyses the pattern of corporate taxes in relation to the performance of companies. The data was collected for total income (TI), profit before tax (PBT), corporate tax (CT) and dividend (D) provisions made by each company. Table No 1 shows the growth of corporate sector in India in terms of companies that entered Prowess database. The total number of companies qualified for inclusion in the database steadily increased from 1470 in 1990 to 10017 in 2005. The year wise entry of new companies qualified to enter database varied over the year, some times there was steady increase. The number of reporting dropped, also as some companies stopped reporting due to their merger into other companies. Some companies underwent major restructuring. The net effect of the two factors can be seen in column 3 of the table.

A glance at the data in table 2 will indicate that the growth of corporate sector as been averaged at 14%. In the first half of the decade after commencement of economic reforms (1990-96) it averaged above 28%, but slow down to less than 10% after that.

It may be argued that the data may not be accurately reflecting the actual scenario as the data flow to Prowess comes with a time delay. For example, the number of companies actually reporting total income on March 5, 2006 (5057) and December 7, 2006 (5182) for the year ending March 31, 2005 differed in absolute numbers. However, the difference in the total income of the companies reporting was Rs. 15015 crores that was only 0.8% of the total reported on December 7, 2006, which was not very significant. Further, there is unlikely to be major difference finally, as the TI of all the companies that reported sales in 2002, (despite entry and dropouts in the number of companies reporting in 2003, 2004 and 2005), still reflected 96%, 94% & 94% of the TI in 2003, 2004 and 2005 respectively (see table 3). This means that the companies, which did not report their performance, were not significant enough to distort the patterns of corporate tax. Furthermore, tnormally he companies which have better performance, declare their annual accounts faster than those who do not. Hence, the companies which have not declared annual accounts, by August 25, 2006 i.e., after one year of closure of the expected date (March 2005) for closure of accounts are unlikely to be superlative performance and pay higher corporate tax. Thus, the figures given in the table 1 can be taken as representing state of affairs for analysing and interpreting the patterns of corporate tax over the years without getting worried about data inadequacy.

Table 3
Comparative Performance of All the Companies in database in 2002 Over the Period 2003-05 Vs. Performance of All the Companies

Data of 2003-05 for Companies That Reported Performance in 2002 (A)				Performance of All Cos. Reporting Performance during 2003-05	Percentage
In the Year	# Cos Reporting	Drop	Total Income		
2002	7526		1477116	1477116	100%
2003	6826	700	1574050	1638635	96%
2004	5531	1295	1682336	1780649	94%
2005	4164	1367	1860034	1973190	94%

Fall in Corporate Tax

Table 4 below gives patterns of total income (TI), profit before tax (PBT) and corporate tax (CT). It will be observed that all the three parameters have steadily increased over the years. The TI has gone up 9- fold during 1990-2005 period, PBT gone up 20-fold, CT has gone up 22-fold and Dividend gone up 20-fold. These indicate a robust performance of corporate sector as a whole, over and period of 15 years, although the mix of growth and share of different sectors has undergone a major shift over the period (3).

A closer look at the table, however, will show certain intriguing patterns. One, there is a kind of cyclic nature. Two, occasionally there is substantial difference in the rates of growth in TI & CT. Finally and more importantly, in the last four years, there is a steady fall in CT/ PBT ratio. The CT/PBT ratio always has been above 30% from 1997 and went up to 40% even there was economists slowed down from the year 1997-2002. ***But there is a steep fall is CT/PBT ratio from 40% to 27%during 2002 to 2005 even when PBT was rising.***

Table 4

Performance of Corporate Sector During 1990-2005 (Rs. in Crores)

Year	Company Reporting	Total income	Tax Provisions	PBT	Dividend	Total income	Tax Provisions	PBT	Tax/ PBT
						% Rise	% Rise	% Rise	
1990	1471	221798	2751	11048	1755				25%
1991	2074	282667	3168	12385	2078	127%	115%	112%	26%
1992	2379	341561	4546	15620	2578	121%	143%	126%	29%
1993	2930	400031	4752	14822	3025	117%	105%	95%	32%
1994	3873	456958	5606	22798	4255	114%	118%	154%	25%
1995	4972	594400	7236	43386	6052	130%	129%	190%	17%
1996	5429	731804	10683	52319	7688	123%	148%	121%	20%
1997	5567	824782	15013	52656	8841	113%	141%	101%	29%
1998	5767	906976	16870	57123	9923	110%	112%	108%	30%
1999	6253	1006054	16631	50941	11329	111%	99%	89%	33%
2000	6628	1185984	19825	60648	13122	118%	119%	119%	33%
2001	6890	1419459	23008	65401	16072	120%	116%	108%	35%
2002	7527	1477116	33121	82419	18280	104%	144%	126%	40%
2003	7720	1638635	45335	122506	24455	111%	137%	149%	37%
2004	6806	1780649	54268	177693	29222	109%	120%	145%	31%
2005	5057	1973190	60180	220031	35859	111%	111%	124%	27%
		Average Rise				116%	124%	124%	
Growth in No. of Times Over 1990 - 2005		9	22	20	20				

Table 5
Estimated Tax Loss

Year	TAX/PBT Ratio	Estimated Tax at Tax / PBT Ratio 40%	Estimated Tax Loss
2002	40%		
2003	37%	49003	3668
2004	31%	71077	16809
2005	27%	88012	27832
Estimated Tax Fall			48309
Increase in Tax 2002-05			27059
Net Tax Fall			21251

Why this fall in the CT/PBT ratio? Has government given major tax sops during this period? What has been the efficacy of this policy? The growth in income during 2002-2005 has remained more or less at previous levels, i.e., around 10% despite decline in CT/ PBT ratio. If the CT/PBT ratio was retained at 40% during 2003-05, there would have an estimated additional collection of Rs. 48309 crores corporate tax (see table 5), which is more than total CT of 2003 (and 133% of tax collected in 2002), that has been foregone. The net increase in CT is only Rs. 27059 crors (80 %), while increase in PBT has been more than 150% (139612 Crores). ***The net estimated loss of the CT over 2003-05 period is about Rs. 21,251 crores,which is more than total tax collected in the year 2000. Should not government have a relook at the CT paid by the corporate sector?***

Corporate Tax by Size of Companies

Table 6 gives CT pattern by size of the companies. For this purpose the companies were divided in three categories, TI of Rs. 1000 crores and above, Rs. 100-1000 crores, and Rs.10-100 crores in the year. In an earlier study, it has been observed that profit performance of the companies is correlated to size. The performance of larger size was better than the smaller size companies (4).

Table 6
Patterns of Corporate Tax by Size of Companies

Tax/PBT	Size (Rs. in Crores)			
	1000-10000	100-1000	10-100	=< 10
>40%	8%	12%	14%	9%
>30%	42%	45%	37%	8%
>20%	63%	58%	46%	4%
>10%	74%	60%	53%	7%
>5%	83%	76%	61%	7%
>0%	87%	81%	65%	5%
0	97%	98%	96%	49%
<0%	0%	2%	99%	3%
ND	1%	0%	0%	8%
Total	100%	100%	100%	100%

It will be noticed from the table 7 that the CT/PBT ratio is some what inversely related to size of the companies. While for 14 % of smaller size (10-100 crores) companies, the CT/PBT ratio was 40% or more, for only 8% of larger size (Rs. 1000 crores and above) CT/PBT ratio was 40% or more. On the other hand, number of companies having CT/PBT ratio of 30% or more was higher (45%) in the medium size companies (TI between Rs. 100-1000 crores). If one considers CT/PBT ratio of 20% or 10% and above, the percentage of companies was highest in large size (Rs. 1000 crores & above) category.

The pattern gets even more interesting if one considers only companies with CT/PBT ratio of 10% or above, as the small size companies are more fragile and a large number do not make profit to pay taxes. ***Thus, among the high performing companies (CT/PBT ratio of 10% % above), the percentage of small size companies having higher CT/PBT is than the % in the larger size companies. This pattern gives credence to finance minister's anguish that top 100 corporates need to be watched closely as they may be evading taxes. (5). Should not Government review as to why smaller size companies have highs CT/PBT ratio than larger ones.***

Table 7
Tax/PBT Pattern by Size of Better Performing Companies

Overall (By Total)				Overall (By Total 10%+)			
Tax/PBT	1000-10000	100-1000	10-100	Tax/PBT	1000-10000	100-1000	10-100
>40%	8%	12%	14%	>40%	11%	18%	26%
>30%	42%	45%	37%	>30%	55%	66%	69%
>20%	62%	58%	46%	>20%	82%	85%	86%
>10%	76%	68%	54%	>10%	100%	100%	100%

Corporate Tax by Industry Type

The study also analysed the pattern of corporate tax paid by different industry sectors. For this purpose, the 4 Industry types, namely financial services, banking services, other services (like Telecom) and the manufacturing sectors were considered. From table 8 it will be seen that out of the four, the financial service sector, whose size has increased substantially, has paid the least taxes, with CT/PBT ratio in all ranges being lower than the other three sectors. In contrast, the ***manufacturing sector has paid the highest taxes in all the ranges.*** The banking sector too, though profitable, did not pay higher. Neither the other services like telecom had high CT/PBT ratios.

Table 8
Patterns of Corporate Tax by Industry Sector

Tax/PBT	Banking Services	Financial Services	Manufacturing	Services
>40%	12%	9%	12%	13%
>30%	28%	22%	35%	31%
>20%	41%	29%	45%	40%
>10%	49%	39%	53%	47%
>5%	55%	48%	61%	54%
>0%	59%	56%	63%	59%
0	97%	89%	96%	93%
<0%	100%	91%	99%	96%
Total	100%	100%	100%	100%

Given the concern for enhancing manufacturing competitiveness, is government giving the sector adequate support through corporate tax incentives? Should not the government seriously review the situation, if it wants manufacturing sector to come to the fore(6).

Corporate Tax Patterns by Ownership

The study also examined the ownership patterns of CT. The results of the analysis are shone in table 9.

Table 9
Patterns of Corporate Tax by Ownership

Tax/PBT	Central Govt		Foreign	Pvt. Indian	
	Independent	Incl.Group		Pvt Ind	Bus. Grps
>40%	11%	10%	20%	12%	10%
>30%	39%	39%	50%	32%	30%
>20%	49%	50%	58%	40%	39%
>10%	53%	55%	63%	48%	49%
>5%	62%	64%	68%	56%	57%
>0%	74%	75%	74%	60%	62%
0	97%	97%	96%	93%	95%
<0%	99%	99%	100%	96%	98%
Total	100%	100%	100%	100%	100%

It will be observed that unlike the common perceptions, ***the percentage of public sector companies (Central Government) paying higher taxes was higher than the domestic private sector companies.*** The study thus, negates the perception that all the public sector companies contribute less (7) to the exchequer. There is a need to be more specific in defining public sector. Indeed, if one considers CT/PBT ratio of 5% & above, public sector companies are very close to foreign companies. The domestic private sector is clearly paying less than the foreign and the public sector companies. This is irrespective of whether private sector companies are independent ones or part of a business house. Given the fact that the prescribed tax rates for foreign companies were higher by 10%, the foreign companies are also paying less, if not evading the tax.

Table 10
Corporate Tax Provided 2002-05

Ownership	Corporate Tax Provideed				Increase In CT	CT/PBT			
	2002	2003	2004	2005	2002-05	2002	2003	2004	2005
Private (Indian) Total	3854	5181	5942	5909	1.5	57%	48%	34%	27%
Top 50 Groups	7789	9751	12866	14201	1.8	30%	27%	25%	23%
Top 51-588 Groups	2055	2892	3976	4857	2.4	-79%	139%	46%	31%
All Pvt Groups	9844	12643	16842	19057	1.9	42%	33%	28%	25%
Central Govt	15769	22569	25400	28072	1.8	35%	36%	31%	28%
State & Joint Sector	385	547	940	1204	3.1	-11644%	70%	19%	23%
Private (Foreign) Total	2006	2913	3376	4146	2.1	49%	44%	35%	34%
Foreign Group	1243	1453	1680	1700	1.4	38%	40%	35%	33%

Incidentally, foreign companies' performance somewhat deteriorates if the companies include those, which are part of the business, while public sector companies performance improves if the companies which are part of a group, are clubbed with independent companies.

Implications of the Study

The study shows certain important patterns of corporate taxes in India. Firstly, while the corporate tax is growing over the years steady, there is a significant development, i.e., the CT/PBT ratio is steady declining over the past four years. It peaked at 40% in the year 2002, but thereafter it has started dropping alarmingly and moving to a level of early nineties .The study also exposes the reported claims that Indian Inc.pays more than elsewhere (8).The tax rate may be higher but reality is different. As the India Inc. shines, it contributes lesser and lesser of its profit to the exchequer through taxes.

Secondly, a larger percentage of smaller companies are paying higher tax than the larger companies. This is against the general expectations that the larger companies will be paying larger taxes. The study therefore supports finance minister's apprehension that more and more sophistic methods are being used by corporates (9).It also highlights a relook at exemptions and withdrawing it, while reducing the rates,as proposed by Kelkar committee (10).

It is also unfortunate that service sector, especially financial services sector, is paying the least on their profit before tax than others, while the manufacturing sector pays the highest tax on their profits. When there are serious concerns that manufacturing sector needs to be strengthened (11), it requires a ***re-look at tax structure, which may be treating manufacturing sector harshly.***

Finally, it is observed that ownership-wise, central government public sector companies pay a larger percentage of tax on profit than the private sector, which negates the findings of the other studies (12), due to differences in the base. The study also brings to notice that foreign companies do not pay as much as they ought to. Though they are paying marginally higher than public sector, but they are not paying what they should.

The findings need careful consideration as to why corporate taxes on profit falling, given the fact that overall tax structure has not changed effectively, (see table 10), it is intriguing to find a steep fall that may have serious implications. ***The corporate taxes are a significant part of income for the government and the government shall be losing out when the industry is claiming to have better economic performance and when the former is facing resource crunch.***

Table 10

Financial Year Ended	Rate of Tax	Surcharge	Total
31.3.2002	35%	2%	35.7%
31.3.2003	35%	5%	36.75%
31.3.2004	35%	2.5%	35.88%
31.3.2005	35%	2.5%+2% Cess	36.59%

It also necessary to examine as to the ***why private sector pays less*** to the exchequer than the public sector and why a larger number of smaller sized companies are paying more tax than larger size companies.

Issues for Future Research

The findings of the study are quite strong as it is based on a sound duly audited financial data, the entire industry set of the PROWESS database, which is one of the strongest databases available in India. The chances of it not reflecting the reality are less. However, since the flow of companies financial data to the database is with a time lag, there could be possibility of the entire data not having been captured can't be ruled out. It may, therefore be advisable to conclude after six months or so that permits two years time from the closing of account to database. Although the possibility of the pattern changing favourably is remote, as the better performing companies, who will pay tax, announce annual performance promptly not with delay.

The study in present form is on aggregate basis. It may be worthwhile to examine the patterns by successive levels of industry classifications.

There is a possibility that the reduction in tax is due to, mergers and acquisition associated adjustment. This issue may also be examined, although it would still not be considered as a desirable outcome in view of financial statues of the government.

The study does not explain the causes of the patterns identified. For drawing policy implications it is necessary to have clearer explanations. Further studies need to be undertaken to this effect. The study must take up examinate the exemptions and other possible methods of evasion. That might be in use.

Limitation of study

The study examines the pattern of taxes by large size companies which find place in PROWESS database. It does not cover the private limited companies and other form of organisations. Studies are also needed in other form to get a better idea of the tax paid by corporate sector. The study has a serious limitation, i.e., it uses data pertaining to public limited companies. Given that there are a large number of private limited companies, the pattern may not reflect the total corporate sector contribution. There is a need to do studies including private limited companies, to get full and fair picture.

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AEP : Assocham Eco Pulse
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