Book Review

Indian Corporate Taxation

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The author set out "to study the evolution, working, effects and future prospects of the taxation of corporations in India". In the process he examines whether the Indian corporate tax policy has been rational. The study is divided into five chapters. The titles of the chapters are rather misleading and the text is at times over-loaded with superfluous quotations.

Basis of Taxation

The first chapter, "Economics of Corporate Taxation", analyses the meaning of the term corporation and examines the reasons for, and the method of, taxation of corporations and the consequences of such taxation. Half a century ago, corporate taxation was unheard of. But, today, it has become a universal and almost indispensable feature of tax systems. Ambirajan examines the three possible bases of corporate taxes: gross sales, capital stock and income or profits. The advantage of a tax on gross sales (total earnings without deducting costs), at low rates, is the difficulty of evasion; but it fails to take into account differences in the quality of management. A tax on capital stock can be an 'annual capital tax' or an occasional 'capital levy', both of which have long before been dealt with at length by Hicks and Rostas. Income is of course, the most common base of corporate taxation. But, its computation leads to problems and Ambirajan enumerates the various definitions of 'income' by Haig, Hicks, Fisher, Kaldor and others. Towards the end of the chapter, running into fifty-seven pages, Ambirajan takes up the twin problems of shifting incidence, but is content with the now ancient Colwyn Committee Report on National Debt and Taxation and the Pigou Robertson controversy which followed it.

The second chapter, "Corporate Sector in India", running into 60 pages, contains an uncritical analysis of the structure and growth of corporate management and finance in India. While the explanation of such concepts as fixed and working capital, share capital, authorised and paid-up capital, etc, is lucid, it adds nothing to our understanding of the effect of corporate taxation on capital structure and cost trends, Ambirajan makes a rapid historical survey of the growth of the corporate sector in India and his study reveals that only after 1945 did the growth gather momentum, mainly due to the War, which increased the demand for goods at home and abroad, and the 'Swadeshi' movement which gave a fillip to Indian industries. He analyses two important indicators of the growth of the corporate sector—paid-up capital and net profit—but fails to examine other indicators like output produced and productive capital employed due to alleged lack of relevant data.

Plough-back of Profits

The study of profits is enlightening. The fundamental determinants of corporate profits are the demand for goods produced, the competitive conditions in the industry and the system of controls. However, it is retained profits which are of real significance for expansion and Ambirajan makes an interesting study of it. Retention of profits is largely determined by the company's dividend policy, which is influenced by the tax liability of the shareholders, the size of the company, the company's programme of expansion, the situation in the capital market, the nature of the business and government intervention. Generally, the plough-back is 50 per cent and in certain American manufacturing companies it is as high as 90 per cent. In India, Central Board of Revenue figures for 1958-59 and 1959-60 reveal it to be 46 per cent and 41 per cent, respectively; the Taxation Enquiry Commission's sample of 492 joint-stock public companies showed 40 per cent, which was about the same as the figure revealed by the Reserve Bank of India's sample of 750 public limited companies. This is followed by the familiar reasoning that excessive corporate saving reduces the economic function of the capital market, leads to concentration of economic power and creation of large monopolies, and results in sub-optimum use of capital.

The first two chapters having provided the "appropriate background" or, rather something in the nature of textbook appeal, the author comes to the heart of the matter in the third chapter on "evolution and structure of the taxation of corporate income". He makes a rapid survey of the evolution of corporate taxation in India and examines its constituents, especially during the last two decades. The study reveals that major changes in our tax structure have taken place only since independence, to meet the increasing needs of a developing economy as also to check tax evasion.

The definition and classification of companies under the Indian income-tax laws is derived largely from the principle of 'division of dichotomy', by which the corporate form of organisation could be utilised to avoid certain types of tax liability. To prevent this, tax authorities differentiate between types of companies.

Complex Structure

The structure of tax rates in India has evolved from a comparatively simple to an increasingly complex one. After a period-wise analysis, Ambirajan finds that tax rates have, on the whole, been moving up. But rightly points out that, "while the formal rates look truly formidable, the actual rates are much less so" because various concessions and rebates—which are briefly examined—effectively reduce tax liability. The 1955 Finance Act reforms are considered and light is shed on the ticklish problem of whether 'bonus shares' are dividends. Towards the end of the chapter, Ambirajan examines the computation of income and allied problems. Total assessable income is calculated by deducting 'certain' expenses from the assessee's receipts during the 12-month period. The chapter is rounded up with a survey of the various taxes on business.

The fourth chapter on "effects of corporate taxation" is the most interesting. Ambirajan makes an interesting point on the principle of "grossing", according to which income tax paid by companies is refundable to shareholders to a certain extent and
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under certain conditions and so, it is generally held, the net burden on the company is reduced to that extent. Ambirajan shows that this may not be the case, for the advantage of grossing is applicable "only to the amount actually distributed"; the undistributed profits still have to bear the whole burden of the income tax.

Unequal Distribution of Burden

Another interesting point is that while the number of companies operating in India has increased by over 16,000 between 1940 and 1959, the number of assesses paying corporate tax increased by only 6,308 so that in 1959 only 10,777 out of 27,479 (i.e., about 30% of operating companies) paid taxes. This has very interesting implications: it could mean that the majority of companies sustain losses, or their profits are eaten up by depreciation allowances, development rebates, etc. or they enjoy a tax holiday, or simply that they accomplish plain evasion. Also, companies paying taxes have increased by about 2½ times, profits by about 6 times and taxes by about 14 times, which indicates that a few companies really bear the major part of the tax burden.

Ambirajan's analysis of the effects—which he divides into psychological and physical—also make good reading. The psychological effects are significant for they can affect corporate activity—they may induce people to shy away from risky enterprises or distort the direction of investment or productive activities. Analysis of this effect is difficult; Ambirajan's resort to the trends of security prices for this purpose is open to the objection that market valuation of companies often lags a good deal behind the change in their earning power.

As regards the physical or economic effects, much depends upon who ultimately bears the burden. The final word on this has not yet been said. In the short run, it is generally believed, the corporation tax cannot be shifted, but actually much depends on the prevailing conditions, the tax rates and the sacrifices involved. A corporation can shift its tax burden to labour, consumers, or shareholders. Ambirajan, therefore, in his study empirically examines the effects of corporate taxation on wages and labour, prices and consumers, dividends and shareholders, corporate savings, supply of capital and the growth of the corporate sector. The statistics on the earnings of factory workers, collected by the Labour Bureau reveal an increasing trend, in spite of increase in corporate taxes and profits. Also government regulations and trade union pressures prevent shifting of corporate taxes to labour. Shifting of corporate taxes to the consumers is, however, an open issue. The price level of manufactured goods in India has been continuously rising and so have corporate taxes. But, this cannot lead to the conclusion that a high correlation exists between the two. Increases in demand, production costs, administrative inefficiency, black marketing, and not corporate taxes alone, may be responsible for the rising price level. Ambirajan, therefore, contends that taxes must fall either on companies direct or on their shareholders, so that a fall in retained profits or dividends, or both, results. He shows that in the period 1939-51, a 'significant part' of the burden was borne by shareholders, but as dividends cannot be reduced below a certain minimum (say, 5 per cent), without grave consequences, any rise in costs (whether by tax or any other factor) has to be borne, in the short run, by companies in the form of reduced retained profits.

Taxation and Incentives

Now since, as Ambirajan opines, companies bear the brunt of the corporate taxes, what reaction has this on the progress of the corporate sector? He lucidly examines and demonstrates that the reaction is not as deleterious as many laymen claim it to be. The present situation in our developing economy is such that "there is no question of lack of incentives" or lack of willingness on the part of individuals to undertake investment and entrepreneurial activities. If the rate of industrial activity is not higher than what it is, it is not due solely to corporate taxes. Increased labour costs and prices of raw materials and machinery, heavy competitive borrowings by the government, various governmental controls and regulations all interact with each other, so that it is not possible to isolate the effects of any particular factor. In fact, if we take the tax structure as a whole, the disincentive part is more or less neutralised by the positive incentive; to industries. Ambirajan's analysis of the data on capital issues therefore shows, not surprisingly, that there is "no lack of enterprising producers and promoters to float new companies".

The title of the fifth chapter "corporate taxation and economic development" is misleading. A better title would have been 'Prospects of corporate taxation in India' or 'Rationalisation of Indian corporate tax structure'. The early part of the chapter is pedestrian; later, however, it becomes interesting, though not always convincing. Ambirajan examines corporate taxation as a means of reducing inequalities in income, encouraging savings, investment and economic progress, but feels that in a developing economy corporate taxes are not the correct weapon and so he pleads for "lightening of the present burden of corporate taxation". He is not, however, clear as to how this should be done. In fact, after having earlier shown that tax rates are not really very high or adverse in their effects, he yet contends that as all taxes (direct or indirect) are paid by corporations, and since government is now placing more emphasis on excise duties and other indirect taxes, which cannot be always easily shifted, the government "can afford to reduce the rates of corporate taxation."

Case for New Incentives

A critical examination of the various incentive measures then follows and suggestions for improvements are made. The trouble with the existing concessional measures, the author observes, is that "the more advantage is taken of them, the nearer is the period of full-fledged taxation". This can hit the corporate sector hard. He, therefore, suggests, for instance, the conversion of the five years tax holiday into a 'partial working day', involving payment of say 30 per cent of the tax liability and the tax gradually rising to the full complement in 10 or more years. But, such a 'partial working day' would not serve the purpose, as many of the new enterprises do not make profits in the early years to become liable for taxation and thereby enjoy the 'holiday'. The purpose would be better served if the 'holiday' is extended beyond 5 to 10 years. Also, by continuous reinvesting, a company can enjoy the advantages of tax concessions for a longer period.

Ambirajan suggests other tax reform measures, such as, administrative improvement, prevention of evasion, simplification of the tax structure, elimination of 'nuisance' taxes and continuity in the tax structure for reasonable lengths of time. But, these are already common knowledge, though not fully implemented.

In an appendix, the author has an international comparison of the
percentage share of corporate taxes in national income and the percentage of income paid by corporations as direct taxes. This is informative, but its utility would have increased had a comparison been made with countries in a similar position, or had a balance been made for various concessions.

The total impression that a reader forms of this book, after ploughing through it, is that it could well have been much smaller in size. The subject of corporate taxation has yet to be fitted into the main body of economic literature in our country; and nothing concrete has emerged so far on the shifting and incidence of corporate taxes. The major virtue of this book is that it sets out to fill this gap. While the book cannot be said to fully succeed in this objective, it is nevertheless, informative and can serve as a good introduction to corporate problems.

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