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CORPORATE TAX DISPARITIES IN INDIA: CAUSES AND IMPLICATIONS FOR TAX POLICY

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Abstract

The objective of this article is to investigate corporate tax disparities in India and the likely causes. The objectives were met by investigating the country's current tax structure, problems with corporate taxation, and the causes of these problems. The author also consider how we may handle some of these issues in relation to other growing economies. Emerging economies are vital to the global economy. India is clearly growing in importance, not just among emerging economies but also in the global economy. The tax environment in India is frequently viewed as a complex system, with a plethora of indirect taxes, burdensome litigation, and a lack of predictability. Tax policy can be an efficient instrument for promoting both international and domestic investments, which India desperately needs. The country's current huge fiscal deficit necessitates making revenue growth a main issue of Indian tax policy. Although indirect taxes have been an important source of development funding in developing nations due to their broad coverage, we believe that corporation taxation has the potential to become a future source of revenue.

Keywords: Corporate Tax, Economy, Income, Taxation. Policy.

I. Introduction

Emerging economies are vital to the global economy. India is clearly becoming a significant and vital country, not only among emerging countries but also the global economy. Tax regimes around the world are facing major problems in the face of global economic instability. Countries are being compelled to decrease tax rates in order to attract and increase investment. Many countries around the world will rely on tax policy to keep up with the various stages of liberalisation and globalisation. With the publication of the Direct Tax Code (DTC), India is on the verge of massive corporate reforms.

Unprecedented fiscal and economic imbalances plague the current global economic climate. The flow of finance from wealthy countries that allows poor countries to access international resources has been significantly hampered. As a result, countries that grown accustomed to such resources require immediate answers to mobilise domestic resources in order to compensate for the interruption in their funding paradigm. There are many medications available for them. Some are advised to cover tax cuts by spending cuts. Others advocate maintaining government spending while raising tax rates or imposing new taxes to balance the budgets.

Prime Minister Narendra Modi stated in October 2020 that he believes India will be a USD 5 trillion economy by 2024. India's GDP in 2020 is expected to be USD 2.66 trillion. Despite a 7.3% drop in GDP from 2019 due mostly to the pandemic, the economy has showed amazing resiliency and GDP growth has picked up pace during the previous year and a half. However, the goal of a USD 5 trillion economy remains a long way off. Clearly, continued and sustained high growth would be required, not only to reach the USD 5 trillion-dollar goal within a few years, but also to recover from the COVID-19-induced disruption and achieve the United Nations (UN) agenda's Sustainable Development Goals (SDGs) for emerging and developing economies. Because such expansion would necessitate significant government spending, consistent growth in tax revenues would also be required.

As we have seen during the previous two years, the implementation of fiscal consolidation measures in various nations has been hampered by seemingly overwhelming political and social obstacles. Whether it is a tax rise or a decrease in spending, any attempt to implement a solution that fails to adequately account for particular local factors is likely to cause delays and aggravate societal polarisation. In rare situations, the cure may be worse than the disease. For example, successful execution of domestic cuts could be made a prerequisite for receiving critical external financial aid. However, such policies are likely to cause a deeper economic recession, jeopardising social stability and economic revitalization in the short run.

II. Hypothesis.

Corporate tax disparities in India are because of a complex tax structure, troubles with company taxation, and a lack of predictability in the tax environment. These problems can be addressed through simplifying the tax structure, improving the efficiency of tax administration, and making the tax environment more predictable.

III. India's Corporate Tax Structure.

India is the seventh largest country in South Asia and the world's tenth largest in terms of nominal GDP. Market-based reforms began in 1991, when the country was obliged to liberalise its economy due to a severe balance of payment difficulty. Tax reforms began in the mid-1980s and became more aggressive in the 1990s. India is a multi-religious country, maybe the only place in the universe where different religions, cultures, and customs coexist to make the economy operate.

Annual growth reached 6.2 percent in 2011-2012 before falling to 5% in 2012-2013. Poverty and corruption are common in the country, and they remain on the agendas and manifestos of political parties even now. Tax evasion by Indian taxpayers has climbed from Rs 1,717.17 crores in 2001-2002 to Rs 5,041.71 crores in 2003-2004.¹

Public finance is critical to India's economy as well as its residents' well-being. The Indian tax system is broad and well-structured, with a three-tier federal structure consisting of the union government, state governments, and urban/rural municipal corporations. According to the provisions of the Indian Constitution, the ability to impose taxes and duties is divided between the central and state governments. Direct taxes like as income tax (personal and corporate), wealth tax, and customs duty, excise duty, stamp duty, central sales tax, and service tax are levied by the central government.

State governments levy state value-added tax, profession tax, stamp duty, and other taxes. Local governments levy taxes such as octroi, property tax, road tax, and so on. In India, tax policy was directed by a wide number of demands placed on the government to boost growth and achieve equitable income distribution, as well as the role that history and institutions had in developing India's tax system.

The country's tax structure is divided into two categories:

- Direct Tax;
- Indirect Tax.

¹ India Stat, <http://www.indiastat.com> (last visited May 23, 2023)

Direct taxes have accounted for more than half of total gross tax revenue since 2007-2008, and direct tax revenue has climbed tenfold in the last 14 years, from \$8.62 billion in 1996-1997 to \$87 billion in 2010-2011.² The composition of the tax revenue in India has shifted dramatically in favour of direct taxes, which currently account for approximately 60% of total tax receipts. Corporation tax (sometimes known as super tax) is a direct tax applied on a company's total taxable income. The constitution of India empowers the union government to levy corporation tax. Under the provisions of the Income Tax Act of 1961, firms and commercial organisations in India are taxed on the income from their worldwide dealings. A company is considered to be a resident of India if it was incorporated in India or if its control and management are fully located in India.

Corporate income tax, according to public finance experts, is an important and necessary tax that complements personal income tax and contributes to the complete realisation of local and international tax policy objectives. Corporation tax is charged at a single rate for each kind of corporate entity but is subject to a number of rebates and exemptions that vary according on the activities, criteria/type of corporate incomes, profits, and investments.

Corporate tax rates are 30% for domestic companies and 40% for international companies.

- **Tax reforms over the years**

The Central Government has implemented a number of far-reaching tax adjustments in recent years. On the direct tax front, some significant initiatives were taken, including:

1. Corporation tax structure rationalisation, including dividend taxation.
2. The expanding and depth of the tax base through the elimination of different profit-related income tax deductions and the imposition of new levies to tackle the difficulties of e-commerce and highly digitalized business models.
3. The execution of the G20/OECD Base Erosion and Profit Shifting project guidelines, as well as the amendment of India's tax treaties by ratification of the multilateral instrument.

Measures to modernise tax administration have also been implemented, including:

- 1) Utilising information and modern technology to facilitate filing
- 2) Faster return processing

² The Navhind Times (2011), "DTC to come into force from April 2012", The Navhind Times, 9 December.

- 3) Data analytics and impersonal evaluations.

IV. Rationale for the 'Tax Gap'.

1. **Informal Sector:** One of the primary causes of this 'tax gap' is the comparatively lower level of compliance among persons working in the informal sector of the economy. According to research undertaken by the International Monetary Fund (IMF),³ the informal sector, while diminishing, nonetheless accounts for up to one-third of economic activity in low- and middle-income nations. According to the report, this sector accounts for approximately 30% of the economy (in terms of GDP) in South Asia and approximately 28% in emerging market economies from 2010 to 2017.

Because of non-registration under any law, the informal sector stays primarily outside the tax system. It is extremely difficult to monitor compliance in this sector because it primarily consists of self-employed individuals and small firms. While withholding tax rules are important in sustaining and preventing loss of the tax base, bringing the informal sector into the formal/organized sector is critical to broadening this base. While presumptive taxation of small enterprises has resulted in a high number of returns being filed, a large proportion of such forms state income that is not taxed.

2. **Revenue Loss:** Another source of concern is revenue leakage, particularly in the micro, small, and medium-sized enterprise (MSME) sector, as a result of the blurring of the distinction between personal and business expenses, which leads to claims of excess deductions, as well as the tendency to exploit the continued prevalence of cash transactions by falsely claiming tax-deductible payments where the money is returned in cash. These leakages are usually uncontrolled due to inefficient administrative verification processes.

The issue of revenue leakage is not limited to direct taxes, but also affects indirect taxes. According to official data, the government uncovered fraud totalling INR 408,530 million

³ International Monetary Fund, <https://www.imf.org/Publications/fandd/issues/2020/12/what-is-the-informal-economy-basics> (Last Visited May 23, 2023).

in FY 2019-20 alone, of which only INR 184,640 million could be recovered.⁴

Similarly, under-pricing of goods is a prevalent practise at customs, which reduces revenues and causes economic distortion and governance difficulties. Misdeclaration through incorrect classification of products, as well as improper use of exemptions, deprive the government of its rightful share of customs charges.

To detect such fraudulent acts, the risk-management system must be reinforced and fine-tuned.

GST fraud is typically associated with fraudulent invoicing, in which taxpayers claim input tax credit to lower outward liabilities or claim refunds. Furthermore, fraudulent invoices are frequently used not only to cheat GST, but also to overstate turnover for bank loans, book fake invoices to avoid income tax, and even reroute cash. In recent years, the GST authorities have taken concerted action to combat the plague of tax evasion by utilising data analytics and risk profiling. However, tax administrations in different states have varying degrees of ability. Many states will struggle to successfully repair income deficits without increased capacity building and streamlining of activities such as scrutiny, audit, and inquiry.

- 3. Benefits and Concessions:** While a number of old tax benefits have been phased down over time, an abundance of new breaks and exemptions have been added in an unorganised manner. The total estimated tax revenue foregone for FY 2020-21 due to various deductions, rebates, and special exemptions is INR 1,032,850 million for corporate taxpayers, INR 88,270 million for non-corporate taxpayers (firm/association of persons/body of individuals), and INR 1,705,830 million for individual/ Hindu undivided family, according to the Statement of Revenue Impact of Tax Incentives published as part of the Budget Receipts 2022-23.⁵

⁴ GST officers detect Rs 7,421 crore tax evasion in April-June; recover Rs 1,920 crore, The Economic Times, (May 23, 2023, 05:56 PM), <https://economictimes.indiatimes.com/news/economy/finance/gst-officers-detect-rs-7421-crore-tax-evasion-in-april-june-recover-rs-1920-crore/articleshow/85004716.cms?from=mdr>.

⁵ Revenue foregone to corporates estimated at Rs 99,842.06 cr in 2019-20, The Economic Times, (May 22, 2023, 02:55 PM), <https://m.economictimes.com/markets/stocks/news/revenue-foregone-to-corporates-estimated-at-rs-99842-06-cr-in-2019-20/articleshow/80634746.cms>.

Similarly, the overall revenue impact of tax concessions (exemptions as well as export promotion schemes) on account of basic customs duty for the fiscal year 2020-21 is INR 2,348,130 million. On the other hand, such tax expenditure could be viewed as targeted spending for the growth of specific sectors or as an incentive for certain social and economic activities. It must also be accepted that, given the scarcity of suitable infrastructure and other resources in developing nations, the application of tax incentives is a fundamental component of the right to development in these countries. However, the long-term viability of these incentives, particularly those that have been in place for some time, must be considered.

V. Hindrances in Indian Corporate Tax Law.

Because corporate tax is a high-yielding tax, the government can utilise it to raise funds for development and other purposes. Corporate India is increasingly concerned about the lack of stability and the revenue authorities' stance on a variety of topics. The fact that it takes a long time to obtain a settlement in litigation is cause for concern. The country's present tax structure is riddled with complications as a result of annual modifications. Corporate taxes in India are also determined by the tax regime. Tax competitiveness under various tax regimes results in business tax policies that are efficient from the standpoint of the economy as a whole.

Gaps and overlaps in taxation can occur to the extent that the tax system incorporates taxable income definitions and administrative practises, particularly permissible deductions that are mutually compatible. In India, the tax gap (the difference between possible revenue and actual collection) remains considerable. This is a major source of concern. In 2005-2006, there were 9,534 income tax cases outstanding in the country, totalling Rs 17,001.08 crores.⁶

Refunds against advance tax collection must also be settled as soon as possible. We require simpler regulations that can be simply implemented. When it comes to taxes, India is regarded as the most tough country. The tax authorities have failed to erase a number of tax misrepresentations.

⁶ Comptroller & Auditor General of India's Performance Report, Government of India (2005/2006).

VI. Corporate Tax framework in Emerging countries.

Because different research has used the phrase in different circumstances, we need to define the term emerging economy. What we need to realise is that the meaning and definition of words vary as countries advance and enter different stages of development. A developing economy primarily meets two conditions: rapid economic expansion and government policies that encourage economic liberalisation and the adoption of a free market. Emerging economies are low-income, fast-growing countries that rely on economic liberalisation as their principal source of growth.

The majority of emerging market countries are in Asia, Latin America, Africa, and the Middle East. These countries have unique characteristics such as shifting GDP, distinct business cycle stages, less developed markets, and less sophisticated enforcement organisations and legal infrastructure, to name a few.

Emerging economies prioritise attracting foreign money, creating job opportunities, export promotion, and balanced regional growth. Because private initiative and money are restricted in developing or emerging economies, the government must play an active role in encouraging economic progress. Fiscal policy, or the budget, has become increasingly crucial in encouraging growth and development in these economies.

In South Asia, the average tax-to-GDP ratio was 9.74 percent in 2010, while in 18 Latin American nations, the average tax revenue-to-GDP ratio increased from 18.9 percent in 2009 to 20.7 percent in 2012. In 2010, the average tax-to-GDP ratio in OECD countries was 33.8%.

VII. Analysis and Discussions.

- 1. Corporate Tax rates:** Among wealthy countries, the United States and France have high corporate tax rates of 35 and 33.33 percent, respectively, followed by New Zealand at 28 percent and the United Kingdom at 23 percent, while Canada and Germany are each at 15%.

Argentina has the highest corporate tax rate in Latin America, at 35%, while Paraguay has the lowest, at 10%, followed by Brazil at 15%. The corporate tax rate in the remaining 13 countries remains in the 25-30% range.

In most African countries, the rates range between 20% and 30%. Japan came in second with 25.5%. Tax uncertainty exists because the rates are not stable. A comparison of corporate tax rates with those of other nations reveals that our corporate tax rates are moderate, and the direct tax code is likely to result in a drop in corporate tax rates, coinciding with the international trend of lowering tax rates.

- 2. Tax-GDP:** Tax-GDP is defined as the total tax collected by the government divided by the GDP of the country. The level of taxation in a country is traditionally measured by the ratio of taxes to some measure of national revenue, known as the tax-GDP ratio.

The tax-GDP ratio is significant to study since taxation developments in a country are evaluated primarily in terms of this ratio and the composition of tax income. India has one of the lowest tax-to-GDP ratios, at 15.5%, compared to 17.7% for middle-income countries. The percentage of direct taxes to total taxes in India is 37.7%, while it is 57.5 percent in South Africa, 55.85 percent in Indonesia, 41.3 percent in Russia, and 75.8 percent in the United States, while the average for Organisation for Economic Cooperation and Development (OECD) countries is 34.6 percent.⁷ As a result, India must improve its tax-to-GDP ratio. It is preferable to attain a greater tax-to-GDP ratio by widening the tax base rather than dramatically increasing marginal tax rates. Higher tax rates create more incentives to engage in taxable activity, which promotes tax evasion.

- 3. Tax-incentives:** Taxation is utilised as a tool to collect revenue for the government's development operations. Many emerging economies give tax breaks to attract foreign investment by granting a short time of tax exemption and reduction for tax investors; tax breaks have been shown to effect non-compliance.

To boost the tax-to-GDP ratio, almost all growing countries offer tax breaks and lower tax rates which is known as Tax-incentives.

⁷ Business Standard (2013), "India's tax-GDP ratio one of the lowest", Business Standard, 26 March.

VIII. Conclusion

India is rising as an important and necessary country in the world economy; let alone emerging countries, the country's tax policy should be consistent with the global tax code. The tax environment in India is frequently viewed as a complex system, with a plethora of indirect taxes, burdensome litigation, and a lack of predictability. Tax policy can be an efficient instrument for promoting both international and domestic investments, which India desperately needs. The country's current huge fiscal deficit necessitates making revenue growth a main issue of Indian tax policy.

Although indirect taxes have been an important source of development funding in developing nations due to their broad coverage, we believe that corporation taxation has the potential to become a future source of revenue. There is no shortage of tax reform legislation in the country. What is lacking is the political resolve to impose tough measures to accelerate administrative changes and revenue collection in the country. The need of the hour, therefore, is not to change the tax system, but to improve tax administration and compliance.

