Lower the corporate tax rate

Small changes in taxation can kick off disproportionate responses by way of shifts in capital

India is unusual, when compared with emerging markets or the G20 countries, on the high taxation of corporate profit. The Indian corporate tax rate was higher than the G20 median, by about 9 or 10 percentage points, in 2001, 2005, and 2006. After that, India's gap has risen to 21 percentage points, as corporate taxation has declined the world over. India gains by reducing corporate taxation as this improves the appeal for investing in India for local and foreign persons, it reduces double taxation of the corporate form, and it generates increased property and tax revenues through indirect channels. This process had begun in 2015, and needs to be featured in the July 5 speech.

The Organisation for Economic Co-operation and Development (OECD) runs a measurement system which shows the total taxation of the income of corporations. On June 27, Krishna Kant and Sachin P Mampatta *<a href="https://www.business-standard.com/article/economy-policy/at-48-3-in-2018-corporate-taxes-in-india-among-highest-in-the-world-119062700062_1.html">* wrote about this in *Business Standard*. India stands out in two respects.

In 2018, India stood at a high rate of 48.3 per cent. This was out of line when compared with the median emerging market (EM), which was at 25 per cent, or the median G20 country (27.7 per cent).

SNAKES & LADDERS

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India is also out of line in the lack of change, over the years. In 2000, the Indian rate was at 48.1 per cent, which is essentially the same as where we are today. But over this period, the median EM dropped rates by 5 percentage points and the median G20 country dropped rates by 7.3 percentage points. This has made India stick out, to a greater extent, as a high-tax jurisdiction.

It is striking to see that the Indian gap, over the G20 countries, was at its lowest values in 2001, 2005, and 2006. This was the period when a great business cycle expansion ignited. We do not for a moment wish to suggest that there is a monocausal explanation that improved tax competitiveness sets off an investment boom. Many elements of policy-making went into India's remarkable period from 2002 to 2008. It is likely that tax competitiveness was one of them.

Why is this an important issue? There are three arguments in favour of low taxation of corporations. The first principles idea is that we should focus on taxation of individuals. Let's measure the total income of each individual, and apply a personal income tax on it. Once this is done, there is no need to additionally tax the organisational structure adopted through which the income is generated, whether it is a partnership or a proprietorship or a limited liability company. By penalising the corporate form, we give incentives for businesses to be organised in other ways, which is inefficient for the economy. Rules demanding substantial dividend payouts by corporations can ensure that corporate profits show up as personal income, where personal income tax is applied.

The second key insight is about the mobility of capital. Taxation of capital or of financial transactions works poorly because these markets are quite mobile. In the modern world, Indian and global holders of capital choose from a global menu of options for investment. Small changes in taxation can kick off disproportionate responses by way of shifts in capital. Shifts away from India, in the patterns of investment, are particularly harmful for India as we require a vast amount of investment to achieve prosperity.

This is why the right focus of tax policy in India should be upon three elements of the economy where flight of activity is difficult, ie
(a) the property tax,
(b) the consumption-based GST, and
(c) the residence-based personal income tax. All other attempts at taxation are termed 'bad taxes' as they lead to large changes in behaviour, which are not good for the country.

The third key insight is that the country and the government gain amply when an Indian or global corporation chooses to place operations here in India. The prosperity of the people of India goes up when firms decide to operate here. In addition, the government gets more tax revenue. Corporations that rent or buy property generate improved property tax revenues. Corporations that buy labour generate personal income tax, both at the first round effect (corporation hires one person) and through downstream impacts (this person buys a biscuit, and that generates personal income in the seller of biscuits). The Indian residents that obtain income from the corporation will turn around and consume, which generates GST revenues as the GST is a consumption tax based on a destination principle.

These three ideas have generated a historic movement, all over the world, away from high taxation of corporations. The average global corporate tax rate has steadily declined since 1980. Even in rich countries with an expensive welfare system, where large tax/GDP ratios are required, the focus is on getting the money through the three good taxes only (the GST, the personal income tax, and the property tax).

A COMPARISON

Year	India	Median EM	Median G20	Gap for India against median	
				EM	G20
2000	48.1	30.0	35.0	18.1	13.09
2001	43.9	30.8	35.0	13.1	8.9
2002	45.1	30.0	34.5	15.1	10.55
2003	44.1	30.0	34.0	14.1	10.09
2004	44.9	30.0	33.5	14.9	11.38
2005	43.0	29.0	33.5	14.0	9.46
2006	43.3	28.0	33.5	15.3	9.87
2007	45.2	27.0	33.5	18.2	11.73
2008	45.2	25.0	30.0	20.2	15.21
2009	45.2	25.0	29.7	20.2	15.52
2010	44.3	24.2	29.7	20.1	14.57
2011	43.4	24.2	29.8	19.2	13.63
2012	43.4	24.2	29.8	19.2	13.61
2013	45.2	25.0	29.8	20.2	15.38
2014	45.2	25.0	29.9	20.2	15.35
2015	47.9	24.2	29.9	23.7	18.03
2016	47.9	24.0	29.9	23.9	18.02
2017	47.9	24.2	28.8	23.7	19.1
2018	48.3	25.0	27.7	23.3	20.66
Overall change	**0.2**	**-5**	**-7.3**	**5.2**	**7.57**

Source: OECD and author's calculations

We should not be content with matching the median values of emerging markets. We should be competitive with world standards. The 25th percentile value among emerging markets is 20 per cent. Thus, if India goes to a 20 per cent corporate tax rate, we will be better than three-quarters of emerging markets. In particular, we will be more attractive than China, where the rate is 25 per cent.

In 2015, such an announcement was made, with many future dates on which the announcement would take effect. This led to a tepid response on the part of domestic and foreign investors, and their scepticism was proved right by the lack of follow through. It would be efficient for the July 2019 speech to introduce this action effective right now. This might generate some fiscal stress in 2019 and 2020. With a lag, the gains would kick in.

This is comparable to the thought process of cutting customs duties, from 1991 till 2003, where tax officials steadily protested the loss of tax revenue, but this was amply compensated by the economic dynamism that came from removing protectionism.

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