Corporate tax cut in India

What is the issue?

- The government issued an ordinance to reduce the corporate tax rate for domestic firms and new manufacturing units.
- This 10 to 12 percentage points' cut effectively brought India's tax rates on par with its competing Asian peers.

What is the story so far?

- Finance Minister Nirmala Sitharaman announced a cut in corporate tax rates (including various cesses and surcharges) from **35% to 25%**.
- Under the new corporate tax policy, new companies that set up manufacturing facilities in India after October 1, 2019 and commence production before the end of March, 2023 will be taxed at an effective rate of **17%**.
- Following the government's decision, both the Nifty and the Sensex rose over 5% (biggest one-day rise in a decade).

Why is the government cutting taxes?

- The corporate tax cut is part of a series of steps taken by the government to **tackle the slowdown in economic growth**, which has dropped for five consecutive quarters to 5% in the June quarter.
- The immediate reason behind the tax cut may be the displeasure that various corporate houses have shown against the government's policies.
- Many investors were spooked by the additional taxes on them that were announced by the government during the budget 2019.
- So, they began pulling money out of the country.
- The government hopes that the new, lower tax rates will **attract more investments** into the country.
- This will help revive the domestic manufacturing sector which has seen lacklustre growth.

What impact will it have on the economy?

- Tax cuts, putting more money in the hands of the private sector, can offer people more incentive to produce and contribute to the economy.
- Thus the present tax cut can help the wider economy grow.

- The corporate tax rate is also a major **determinant of how investors allocate capital** across various economies.
- So there is constant pressure on governments across the world to offer the lowest tax rates in order to attract investors.
- The present cut in taxes can **make India more competitive** on the global stage by making Indian corporate tax rates comparable to that of rates in East Asia.
- The tax cut is expected to cause a yearly revenue loss of ₹1.45 lakh crore to the government which is struggling to meet its fiscal deficit target.
- If it manages to sufficiently revive the economy, the present tax cut can help boost tax collections and compensate for the loss of revenue.

What lies ahead?

- Some see the present tax cut simply as a concession to corporate houses rather than as a structural reform that could boost the wider economy.
- The current economic slowdown is due to the problem of **insufficient demand** which is addressed by the tax cut.
- This could be addressed by advocating greater government spending to boost the economy.
- The lacklustre demand faced by sectors like automobiles can be a symptom of **supply-side shocks** (like GST) that have affected various businesses and caused job losses.
- If so, tax cuts and other supply-side reforms can help the economy recover from its slump.
- However, the government will also need to simultaneously enact along with these tax cuts, other structural reforms that **reduce entry barriers** in the economy and make the marketplace more competitive.
- The government could extend the tax cuts to smaller businesses.
- The benefits of the present tax cut will also depend on whether the government sticks to its promises in the long run.

Source: The Hindu