# ROLE OF CORPORATE INCOME TAX IN INDIA'S TAX SYSTEM

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*The Corporate income tax has substantial support both on theoretical and practical grounds, Moreover, it is politically feasible and administratively convenient to levy taxes on few thousand corporations than millions of individuals. So, companies are subject to a special tax treatment under Income Tax Act, 1961.*

*Having realized the importance of corporate taxation, many researchers have studied diverse aspects of corporate income tax throughout the world. India is no exception to this and many studies covering divergent aspects of corporate taxation in India have been done from time to time. Moreover, there is a need to do a comprehensive study of all the important aspects of corporate income taxation instead of studying one or two aspects at a time as has been done by previous researchers.*

*The Scheme and working of corporate tax system in India: its elasticity and buoyancy; the question of shifting or no shifting of corporate income tax and the impact of corporate taxation on saving, investment, capital structure, sources of finance and industrial growth.*

## INTRODUCTION

The fiscal policy of a country derives its meaning and direction from the aspirations and goals of the society within which it operates, and the people whom it serves. In other words, because of fundamental differences in the conditions of a developed and a developing country, the objectives of tax and budgetary policy are likely to be different. While the main problem before an advanced country is that of sustaining growth, a developing economy suffers from a number of imperfections like inadequate infrastructure, scarcity of capital, heavy dependence on primary sector, high rate of unemployment, extreme inequalities of income and wealth etc. So the fiscal policy in a developing and underdeveloped economy seeks to correct the above imbalances in a

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planned manner through the formulation of a comprehensive fiscal policy and judicious mix of the various fiscal tools.

Taxation as an instrument of fiscal policy is not only important in making available resources to the government, but it also has a significant effect on the level and direction of economic activity in both developed and developing economics. With the acceptance of a positive role of fiscal policy specially in the context of economic growth, taxation as a major source of revenue for the large development plans and for regulating the behavior of private enterprises in a mixed economy, has acquired a new dimension than merely being a theory of distribution of the tax burden on the economy equitably.

Direct taxes are preferred to indirect taxes on the ground that they are more equitable, administratively effective and progressive.

Of all direct taxes, Income tax is considered the most significant because of its progressive rate schedule and high resource mobilization. Among various assessees subject to income taxation, the corporate sector is of crucial significance.

Corporate taxes are quite convenient to collect and offer the least chances of evasion.

On account of technical innovations and economics of large scale production, the role of corporate form of organization and its contribution to the revenues of the government are quite significant. Therefore, in this article, an attempt has been made to describe in detail the role of corporate tax in India's Tax system. But before that, a few observations are to be made.

## OBJECTIVES OF CORPORATION TAX

Corporation tax, as an important instrument of the fiscal system, has a threefold role to play: to transfer resources from the private to the public sector, to bring about equality in income and wealth distribution, and to promote economic growth, stability and efficiency. It is often said that the reason for such heavy dependence on corporate taxation is not only its high contribution to corporate taxation but also its impersonal character, which has the least effect on the voters. Moreover, it is considered an elastic and progressive source of revenue.

## THEORY OF CORPORATE TAXATION

There are two different philosophies with respect to the tax treatment of companies. Accounting to the first, a corporation does not have any taxable capacity separate from its shareholders. All taxation being invariably personal taxation, a corporation is not a person in the strict sense of the word and, therefore, it is argued that due tax credit must be given to the holders of the stock for the tax paid by the corporation. In India, till the assessment year 1959-60, compound system based on this philosophy was in existence and partial credit was allowed to the stockholders in respect of the taxes paid by their corporations. Under the income tax law provisions then existing, the income tax on companies was refunded to the stockholders.

The other social philosophy rests on the argument that the corporate form gives a separate entity to the company with the distinct capacity of its own to bear taxes. A company enjoys definite legal privileges and it must, therefore, pay for such benefits. The essence of this second point of view on company taxation lies in considering a company as someone or something with its own identity and, therefore, as a natural tax paying unit, side by side, with personal tax payers. On such a consideration the tax levied on the company cannot be regarded as taxation on shareholders. This philosophy is a recognized principle in the tax system of the most countries of the world today.

## SCHEME OF TAXATION OF CORPORATE INCOME TAX IN INDIA

Corporate taxation has been an essential part of scheme of taxation of income in any country. In India, company as the special and separate (from shareholders) assessable entity in the present as well as the previous Income Tax Act, was always required to pay tax separately on their incomes or profits. This separate treatment of corporation income tax is justified not only on economic grounds but also on account of easy administration and enforcement of the tax laws because of it being the most advanced and organized form of business organization.

A simple system of company taxation was followed in 1886 and the 1918 Act. However, the growing complexities of business, increasing requirements of state's revenue and amendments made in the Income Tax Act made the system complicated. The structure of company taxation was made more complicated specially after Independence in view of income tax being used as a fiscal instrument and a number of incentive provisions and control elements were incorporated in the Act of 1961 and thereafter, by amendments to this act through Finance Acts enacted every year.

In India, the expression 'Corporation Tax' means the income tax payable by a company under the provisions of Indian Income tax and Finance Act. However, corporation tax has been defined by article 366 (6) of the Indian Constitution as follows:

**'Corporation Tax'** means any tax on income so far as that tax is payable by companies and is a tax in the case of which the following conditions are fulfilled:

(a) that it is not chargeable in respect of agricultural income;

(b) that no deduction in respect of tax paid by companies (by any other enactments which may apply to the tax) is authorized to be made from dividends, payable by the companies to individuals;

(c) that no provisions exists for taking the tax so paid into account in computing for the purpose of Indian Income Tax, the total income of individuals receiving such dividends, or in computing, the Indian Income Tax payable by or refundable to, such individual.

Corporation Tax is paid by companies as per provisions of the Income Tax Act, 1961 on the total income (excluding the agricultural income) of the previous year which is received or is deemed to be received, accrues or arises or is deemed to accrue or arise in India.

'Corporation Tax' is the tax on 'total corporation income', inclusive of a wide range of exempt receipts and deductible expenditure, which is subject to promotional tax rates, and surcharge. In India, as in most countries of the world, the corporation tax varies according to:

(1) The tax base i.e. 'total income' of 'distributed profits' or 'undistributed profits';

(2) The form of business i.e. priority or non-priority sector;

(3) The residence i.e. domestic or foreign.

Thus, companies are taxed generally at flat rates varying with the nature of income, residential status and class of company.

## ROLE OF CORPORATE TAX IN INDIA'S TAX SYSTEM

The corporate tax has occupied a very important place in India's tax system from the very beginning. However, its importance has increased all the more in recent years because of mounting resource requirements to finance development and defence projects of the government as also because of its administrative efficiency, equitable character and convenience in collection. Therefore, a detailed quantitative analysis of coverage, contribution to revenue as well as significance in tax system of corporate tax has been done. The tools of ratios, percentages, index numbers etc. have been extensively used throughout.

## SIGNIFICANCE OF INCOME TAX INCLUDING CORPORATE TAX IN THE TAX STRUCTURE OF CENTRAL GOVERNMENT

The table 1 shows the importance of income tax in the tax structure of central government, by taking into account corporation tax, which is an exclusively federal source of tax revenue, along with the portion of income tax other than corporation tax retained by the central government.

**Table – 1: Significance of Income Tax (including Corporate Tax) in the Tax Structure of Central Government**

**(Amount Rs. In crore)**

| Year | Net Tax Revenue of Central Govt. | Corporate Tax Revenue | Net Taxes on income retained by centre | Total (3+4) | 5 as % of 2 |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| 1980-81 | 9358 | 1377 | 438 | 1815 | 19.40 |
| 1985-86 | 21140 | 2865 | 665 | 3530 | 16.70 |
| 1990-91 | 42978 | 5335 | 1250 | 6585 | 15.32 |
| 1991-92 | 50069 | 7853 | 1627 | 9480 | 18.93 |
| 1992-93 | 54044 | 8899 | 1831 | 10730 | 19.85 |
| 1993-94 | 53449 | 10060 | 1355 | 11415 | 21.36 |
| 1994-95 | 67459 | 13822 | 3468 | 17290 | 25.63 |
| 1995-96 | 81939 | 16487 | 4318 | 20805 | 25.39 |
| 1996-97 | 93701 | 18567 | 4715 | 23282 | 24.85 |
| 1997-98 | 98672 | 20016 | 3589 | 23605 | 24.67 |
| 1998-99 | 104652 | 24529 | 5755 | 30284 | 28.94 |
| 1999-00 (R.E.) | 126469 | 29915 | 10132 | 40047 | 31.67 |
| 2000-01 (B.E.) | 141323 | 65040 | 11816 | 46856 | 33.16 |

Source:

(1) CMIE (Public Finance), 2000, Economic Intelligence Service, Mumbai (Column 2 to 4).

(2) Column 5 to 6: Self Calculations.

The combined revenue from corporations tax and other taxes on incomes retained by the centre as a proportion of net tax revenue of central government declined steadily till 1990-91. Thereafter, it increased during the period 1991-92 to 1994-95. After that, there was again a marginal decline in this ratio from 1994-95 to 1997-98 which was followed by an increase in the ratio from 1998-99 to 2000-01. On the whole, the proportion of total income tax revenue to total tax revenue of central government has increased from 19 per cent in 1980-81 to 33 per cent in 2000-01. This clearly reveals that the significance of income tax revenue in total tax revenue of the central government has increased in the post-liberalisation period.

## COVERAGE OF CORPORATION TAX

Now coming to the corporate tax revenue, its coverage i.e. the proportion of corporate tax revenue in the Gross Domestic Product of the country, is studied in Table 2 Column 5 depicts the proportion of corporate tax revenue in Gross Domestic Product (GDP at Factor Cost). It shows that corporate tax revenue constituted 1.05 per cent of total GDP in 1980-81, which increased to 1.52 per cent of GDP in 1998-99. Taking into account the fact that a large proportion of GDP is Agricultural Income which is outside the purview of income taxation, the proportion of corporate tax revenue to non-agricultural GDP has been determined. It shows slightly better position. The ratio has increased from 1.56 per cent in 1980-81 to 2.07 per cent in 1998-99. This reveals that importance of corporate tax revenue in total revenue receipts as well as its coverage is improving day-by-day and corporate tax has emerged as an important source of revenue.

**Table – 2: Coverage of Corporation Tax**

**(Amount Rs. In crore)**

| Year | GDP at FC (Current Prices) | Non -Agr. GDP at FC (Current Prices) | Corporate Tax Revenue | 4 as % of 2 | 4 as % of 3 |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| 1980-81 | 130807 | 88341 | 1377 | 1.05 | 1.56 |
| 1990-91 | 511052 | 375890 | 5335 | 1.04 | 1.42 |

| | | | | | |
|---|---|---|---|---|---|
| 1991-92 | 589267 | 429968 | 7853 | 1.33 | 1.83 |
| 1992-93 | 672241 | 494331 | 8899 | 1.32 | 1.80 |
| 1993-94 | 781345 | 559511 | 10060 | 1.29 | 1.80 |
| 1994-95 | 914194 | 659001 | 13822 | 1.51 | 2.10 |
| 1995-96 | 1067220 | 789374 | 16487 | 1.54 | 2.09 |
| 1996-97 | 1237290 | 903261 | 18567 | 1.50 | 2.06 |
| 1997-98 | 1384446 | 1031693 | 20016 | 1.45 | 1.94 |
| 1998-99 | 1612383 | 1183703 | 24529 | 1.52 | 2.07 |

Source:

(1) National Accounts Statistics, 2000, Central Statistical Organization (Column 2).

(2) CMIE (Public Finance), March, 2000, Economic Intelligence Service, Mumbai (Column 4).

(3) Column 3 calculated by deducting GDP of Agricultural sector from overall GDP.

(4) Column 4 and 5: Self calculations.

## GROWTH OF CORPORATE INCOME TAX

The facts revealed by table 2 are further substantiated by table 3. The index numbers reveal the number of times revenue has increased with reference to the base year. As depicted by the table, the corporate tax revenue has increased by more than 25 times from 1980-81 to 2000-01. The percentage increase is 24.25.

**Table – 3: Growth of Corporate Tax**

| Year | Corporate Tax Revenue (Rs. In crore) | Index Numbers or Trend |
|---|---|---|
| 1980-81 | 1377 | 100 |
| 1985-86 | 2865 | 208 |
| 1990-91 | 5335 | 387 |
| 1991-92 | 7853 | 570 |
| 1992-93 | 8899 | 646 |
| 1993-94 | 10060 | 731 |
| 1994-95 | 13822 | 1003 |
| 1995-96 | 16487 | 1197 |
| 1996-97 | 18567 | 1348 |
| 1997-98 | 20016 | 1454 |
| 1998-99 | 24529 | 1781 |
| 1999-00 (R.E.) | 29915 | 2172 |
| 2000-01 (B.E.) | 33663 | 2545 |

Sources:

CMIE (Public Finance), March 2000, Economic Intelligence Service, Mumbai Note:

(1) Base year 1980-81 = 100

(2) $$\text{Index number} = \frac{\text{Current year's Corporate Tax Revenue}}{\text{Base year's Corporate Tax Revenue}} \times 100$$

Here RE. = Revised Estimates, B.E. = Budget Estimates

## CONTRIBUTION OF CORPORATE TAX REVENUE

In order to know the relative importance of corporate tax revenue in the whole revenue structure/system, the proportion or percentage of corporate tax revenue in Total Revenue, total Tax Revenue, Direct Tax Revenue, Net Central Tax Revenue and Central Total Income Tax Revenue, have been computed for the years 1980-81 to 2000-2001. An analysis of the Table 4 shows that contribution of Corporate Tax Revenue to Total Revenue, Tax Revenue, Direct Tax Revenue and Net Central Tax Revenue has increased from 6;7;42 and 15 per cent respectively in 1980-81 to 9;10;48 and 24 per cent respectively in 1999-2000.

**Table – 4: Contribution of Corporate Tax Revenue**

| Year | Corporate Tax Revenue as a Percentage of | | | | |
|---|---|---|---|---|---|
| | Total Revenue (%) | Tax Revenue (%) | Direct Tax Revenue (%) | Net Central Tax Revenue (%) | Central Total Income Tax Revenue (%) |
| 1980-81 | 5.78 | 6.94 | 42.13 | 14.71 | 75.87 |
| 1985-86 | 5.05 | 6.62 | 53.30 | 13.55 | 81.16 |
| 1990-91 | 4.82 | 6.08 | 43.52 | 12.41 | 81.02 |
| 1991-92 | 5.87 | 7.61 | 47.15 | 15.68 | 82.84 |
| 1992-93 | 6.57 | 7.79 | 45.90 | 16.47 | 82.94 |
| 1993-94 | 6.83 | 8.25 | 46.33 | 18.82 | 88.13 |
| 1994-95 | 7.76 | 9.35 | 47.87 | 20.49 | 79.94 |
| 1995-96 | 7.96 | 9.41 | 46.09 | 20.12 | 79.75 |
| 1996-97 | 7.93 | 9.28 | 45.23 | 19.82 | 79.75 |
| 1997-98 | 7.76 | 9.39 | 46.62 | 20.92 | 84.80 |
| 1998-99 | 8.32 | 10.12 | 46.65 | 23.44 | 80.99 |
| 1999-00 | 8.77 | 10.34 | 47.88 | 23.65 | 74.70 |
| 2000-01 | - | - | - | 24.79 | 74.78 |

Note: The figures have been calculated on the basis of information available from Indian Public Finance Statistics (Different Years) and CMIE (Public Finance) March, 2000.

However, its contribution to total income tax revenue has shows no definite trend though it constituted nearly 75 per cent of total income tax revenue in 1980-81 and 2000-2001. On the whole, we can say that in the post-liberalisation era, the relative importance of corporate sector as a revenue mobiliser or contributors is increasing.

## CORPORATE TAXATION: AN IMPORTANT SOURCE OF CENTRAL REVENUE

A number of changes were introduced in the Income Tax Legislation from time to time in order to meet demands of changed socio-economic and political situations and the aspirations of the people. Besides other objectives, one of the objectives of these amendments has been increasing requirement of revenue, which could be easily achieved through the ever-developing corporate sector of the Indian economy. Table-3 has explained well that significance of corporate tax is increasing day-by-day. The present section proposes to analyse corporate tax collections from 1950-51 onward by means of table 5.

**Table – 5: Collections of Total and Corporate Income Tax**

**(Amount Rs. In crore)**

| Year | Total Income Tax Collections | Corporate Tax Collections | 3 As % of 2 |
|---|---|---|---|
| 1 | 2 | 3 | 4 |
| 1950-51 | 173.22 | 40.49 | 23.37 |
| 1955-56 | 168.39 | 37.04 | 22.00 |
| 1960-61 | 278.43 | 111.05 | 39.88 |
| 1965-66 | 576.64 | 304.84 | 52.86 |
| 1970-71 | 843.69 | 370.52 | 43.92 |
| 1975-76 | 2076.06 | 861.70 | 41.51 |
| 1980-81 | 2817.18 | 1310.79 | 46.53 |
| 1985-86 | 5374.00 | 2865.00 | 53.31 |
| 1990-91 | 10606.00 | 5335.27 | 50.30 |
| 1991-92 | 14584.00 | 7867.67 | 53.95 |
| 1992-93 | 16787.00 | 8889.24 | 52.95 |
| 1993-94 | 19183.00 | 10060.06 | 52.44 |
| 1994-95 | 25847.00 | 13820.96 | 53.47 |
| 1995-96 | 32090.00 | 16487.13 | 51.38 |
| 1996-97 | 36798.00 | 18566.69 | 50.46 |
| 1997-98 | 37113.00 | 20016.00 | 53.93 |
| 1998-99 | 48480.00 | 24528.87 | 50.60 |

Sources:

(1) Explanatory Memorandum to the Budget of Central Government and Receipts Budgets, (Various Years) (Column 2).

(2) Reports of Comptroller & Auditor General of India, Union Government (Direct Taxes), No. 5 & 12 (Various years) (Column 3).

(3) Column 4: Self calculations.

This table bears out clearly the important place which corporate tax occupies in the direct tax armoury of the central government and also the growth of corporation tax collections during the period of the last 48 years. Over the entire period, corporate tax collections registered a phenomenal growth to the order of over 600 times and constituted more than 50 per cent of the total income tax collections as against less than 24 per cent in 1950-51. The table clearly revels the importance of corporate tax revenue in total tax collection.

One further step in the direction of analysis of corporate tax revenue structure is to study the variation between budget estimates and actual receipts of corporation tax. The table-6 reveals that actual corporate tax collections exceeded the budget estimate in the period 1988-89 to 1995-96 except in 1993-94, which is a good indication. However, in the subsequent years, it failed to achieve the targets and the variation between actual and estimated figures was around 8 per cent.

**Table -6: Variation between Budget Estimates and Actual Receipt of Corporation Tax**

| Year | Budget estimates | Actuals | Variation | Percentage of Variation |
|---|---|---|---|---|
| 1988-89 | 4050.00 | 4407.21 | 357.21 | 8.82 |
| 1989-90 | 4500.00 | 4728.92 | 228.92 | 5.08 |
| 1990-91 | 5289.00 | 5335.27 | 46.27 | 0.87 |
| 1991-92 | 6704.00 | 7867.67 | 1163.67 | 17.35 |
| 1992-93 | 8125.00 | 8889.24 | 764.24 | 9.41 |
| 1993-94 | 10500.00 | 10060.06 | (-)439.94 | (-)4.19 |
| 1994-95 | 1248.00 | 13820.96 | 1340.96 | 10.74 |
| 1995-96 | 15500.00 | 16487.13 | 987.13 | 6.37 |
| 1996-97 | 18688.00 | 18566.69 | (-)121.31 | 0.64 |
| 1997-98 | 21860.00 | 20016.00 | (-)1844.00 | (-)8.43 |
| 1998-99 | 26550.00 | 24528.00 | (-)2021.13 | (-)7.61 |

Source:

Reports of Comptroller & Auditor General of India, Union Government (Direct Taxes), No. 5 & 12 (Various Years).

So an exhaustive analysis of corporate tax revenue in terms of its growth, coverage and contribution to the whole revenue structure, establishes beyond doubt that significance or role of Corporate Income Tax in the Indian Tax system has been continuously increasing, Especially, in the post-liberalisation period, the resource requirements of government have increased manifold. So, a more responsible and key role has been assigned to the corporate sector for the growth and development of the country. In this background, we are able to conclude that corporation tax has an important place in the Indian Tax System.

## CONCLUSION OR FINDING OF THE STUDY

The suggestions made in the course of this study might give quite a disproportionate or unusual strength to the corporate enterprise in the economy. But it should be remembered that economic development implies heavy capital outlay and large financial resources could be amassed only by the corporate form of organizations. Moreover, an expansion in the corporate enterprise is just in line with the accepted socio economic policies. This is not only because its ownership can be widely dispersed but also it can easily be brought under social control. There are remote changes for the corporate enterprise to assume disproportionate form and adopt anti social policies.

However, it should be kept in mind that sweeping changes have already been introduced like rate reductions; MAT modifications, absorption of double taxation of dividends; base expansion; presumptive tax; capital gains relief; etc. The need is to continue consistent and determined efforts in this direction in order to completely rationalize and streamline the corporate tax structure so that corporate tax is able to serve the role of revenue mobilization and economic growth, efficiently and effectively.

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