

## FISCAL REFORMS

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### As bold as it gets

India's FM announced one of the boldest reform to kick start the investment cycle by reducing effective corporate tax rate by 4.3% to 25.2%. The measure will benefit smaller firms and services sector the most. Fresh investments will be taxed at 17% thus leading to a much improved RoE. The aggregate impact on Budget is Rs 1.45tn (0.7% of GDP). With expenditure management and buoyant asset sale in light of the above measures, we believe government will be able to restrict fiscal deficit to 3.5% of GDP in FY20 (3.3% earlier).

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**Reforms to boost growth:** In one of the boldest reform measure to address current economic slowdown, the government reduced the effective corporate tax rate to 25.2% from 29.5% currently (26.9% in AY 2017-18). MAT has also been reduced from 18.5% to 15%. The aggregate impact of these measures will result in Rs 1.45tn reduction in tax revenue (0.7% of GDP).

**Who benefits?:** Services sector and smaller firms benefit most from the above measures (Fig-1, 4). Notably, manufacturing firms currently pay an effective tax of 27.8% and services firm an effective tax of 30.6%. Firms with turnover greater than Rs 5bn pay an effective tax of 26.3% compared with an effective tax rate of 29.1% for firms with turnover between Rs 100-500mn.

**Current fiscal state:** Provisional estimates for direct taxes show collections are 4.9% higher than last year at Rs 5.5tn (Apr-Sep'19). The Budget estimated an increase of 18.6%. With today's announcement, direct tax collections will be lower by Rs 1.45tn compared with BE. GST collections have increased by 5.4% during Apr-Jul'19 compared with BE of an increase of 19.1% in indirect taxes. However, Centre's net tax revenues have increased by 14% in FYTD20 (Apr-Jul) vs 15.4% last year.

**Fiscal deficit at 3.5% of GDP:** Given current revenue collections and the impact of new measures, we believe the fiscal deficit for the year is likely to be revised upwards to 3.5% of GDP thus implying additional borrowing of ~Rs 550bn. The market reaction also suggests the same. In Dec'17 when government had increased borrowings by Rs 500bn, 10Y yield increased by 18bps compared with 16bps increase today. A mix of expenditure management and additional revenue mobilisation through asset sales will help the government in restricting fiscal deficit to 3.5% of GDP.



**FIG 1 – PROFILE OF COMPANIES ACROSS RANGE OF PROFITS BEFORE TAXES (FY18)**

Profit before taxes	No. of companies	Share in Profits before taxes (in %)	Share in total Income (in %)	Share in total Corporate Income-tax liability (in %)	Ratio of total Income to Profits before taxes (in %)	Effective tax rate (in %) [Profit to tax ratio]
Less than Zero	362,829	0.00	1.34	1.34	0.00	0.00
Zero	88,214	0.00	14.38	6.61	0.00	0.00
Rs. 0-1 Crore	3,45,458	2.72	2.84	2.43	91.71	26.39
Rs. 1-10 Crore	35,745	7.17	7.13	6.66	87.40	27.38
Rs. 10-50 Crore	6,670	9.44	8.62	9.31	80.29	29.09
Rs. 50-100 Crore	1,162	5.41	4.71	5.22	76.44	28.44
Rs. 100-500 Crore	1,236	16.85	14.54	16.35	75.82	28.62
Greater than Rs. 500 Crore	373	58.41	46.44	52.08	69.87	26.30
<b>All Companies</b>	<b>8,41,687</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>87.87</b>	<b>29.49*</b>

Source: Union Budget, Bank of Baroda Research; Note: \*Higher effective rate is due to factoring in the taxes paid by companies having zero profit before taxes

**FIG 2 – PROFILE OF COMPANIES ACROSS RANGE OF EFFECTIVE TAX RATES\* (FY18)**

Effective tax rate (in %)	No. of companies	Share in Profits total profits (in %)	Share in total Income (in %)	Share in total tax liability (in %)
Less Than Zero and Zero	3,80,006	3.18	1.57	1.43
0-20	86,936	14.41	6.50	7.77
20-25	41,118	27.16	16.84	21.76
25-30	1,58,190	16.26	18.49	16.38
30-33	52,822	33.39	44.62	41.75
>33	34,401	5.61	11.98	10.91
Indeterminate (PBT = 0)	88,214	0.00	0.00	0.00
<b>Total</b>	<b>8,41,687</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: Union Budget, Bank of Baroda Research; Note: \*Effective tax rate is inclusive of surcharge and education cess.

**FIG 3 – EFFECTIVE TAX RATE\* OF COMPANIES IN THE PUBLIC AND PRIVATE SECTORS (FY18)**

Sector	Number of Companies	Share in total profits (%)	Share in total tax liability (%)	Effective tax rate (%)
Public#	214	16.64	15.11	28.29
Private	8,41,473	83.36	84.89	29.73
<b>Total</b>	<b>8,41,687</b>	<b>100.00</b>	<b>100.00</b>	<b>29.49</b>

Source: Union Budget, Bank of Baroda Research; Note: \*Effective tax rate is inclusive of surcharge and education cess, # Based on the information given by the assessee companies (as PSU) in their respective returns

**FIG 4 – EFFECTIVE TAX RATE\* IN MANUFACTURING AND NON-MANUFACTURING SECTORS (FY18)**

Sector	Number of Companies	Share in total profits (%)	Share in total tax liability (%)	Effective tax rate (%)
Manufacturing	1,30,676	38.92	36.74	27.83
Non-manufacturing	7,11,011	61.08	63.26	30.55
<b>Total</b>	<b>8,41,687</b>	<b>100.00</b>	<b>100.00</b>	<b>29.49</b>

Source: Union Budget, Bank of Baroda Research; Note: \*Effective tax rate is inclusive of surcharge and education cess

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