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Dream or scream, sops may go before corporate tax cut

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ADECADE ago, in 1997, finance minister P Chidambaram's dream budget saw the abolition of the surcharge on corporate tax and a cut in the corporate tax rates for domestic companies to 35%. So, when the man who scripted that budget took charge again in North Block in 2004-05, expectations of corporate India were high of an encore.

Such hopes were dashed as the FM retained the basic tax rate for domestic companies at 35%. The statutory tax rate was higher at 36.59%, as he imposed a 2.5% surcharge and an education cess. In the budget that followed next year, Mr Chidambaram cut the basic corporate tax rate to 30% but hiked the surcharge to 10%. The statutory tax rate however dropped to 33.66%. A far cry from what it was close to a decade ago.

The statutory rate for domestic companies is nearly nine percentage points lower than what it was a decade ago. Indian companies are taxable on their worldwide income here. Foreign companies, on the other hand, have to pay tax on the income that accrues from their Indian operations, or is deemed to arise here. The basic tax rate for foreign companies is 35% now.

This time around, domestic companies are pitching for a further cut in the corporate tax rate, saying that it should be brought at par with the rates in leading Asean countries. It is reckoned that a rate cut would attract more inward investment which, in turn, could trigger growth and enlarge the tax base.

Among the Asean countries, Singapore and Malaysia have relatively low rates of 20% and 28%, respectively. Thailand has a corporate tax rate of 30% and Philippines 35%. The tax rate in Philippines will be lowered to 30% by 2009. Both Philippines and Thailand — whose rates are closer to ours — also offer tax holidays for industrial projects. So the effective rates in these countries could actually work out to be lower for some companies.

"Corporate tax rates have come down in Asia, generally, following the European trend in recent years. Recently, Singapore announced its intention to reduce the tax rate by 1% point, effective this year. Hong Kong may follow suit. Asian governments make up for the corporate tax rate reductions by increasing indirect tax rates (value added tax or goods and services tax). Singapore has announced its intention to increase the current 5% GST by 2 percentage points to 7%," according to Pieter de Ridder, tax partner, Loyens & Loeff, Singapore.

Most countries across the globe have consistently chipped away at their corporate tax rates to woo inward investments. A survey by KPMG in 2006, covering 86 countries, showed that the average corporate tax rate over the last 14 years dipped from 38.1% to 27.1%.

United Kingdom was a trail blazer, pruning the corporate tax rate from 52% to 35% in the mid eighties. The rate is 30% now. Others followed suit. The tax rate in the European Union was lowered from 38% in 1993 to around 25.8% in 2006.

Germany, a member of the EU and the G7, went for a hefty reduction in the federal tax rate during this period. Notwithstanding the cuts, its tax rate is still the highest at 38.34%, followed by Italy at 37.25%. Malta and Spain have a corporate tax rate of 35% each and Portugal 27.5%.

The average corporate tax rate of the G7 is 36.5%, significantly higher than quite a few member countries in the EU. Within the G7, Japan

has the highest corporate tax rate of 40.7%, followed by the US at 40%.

Low tax regimes include Cayman Islands and Bermuda: no corporate taxes are imposed on businesses. Many other countries have also dropped rates significantly to attract foreign investments. Poland and Cyprus, for instance, have corporate tax rates of 19% and 10% respectively. Mauritius, which has attracted huge foreign investments, levies a 15% tax on companies that qualify for tax incentives. The tax rate is 12.5% in Ireland, which has also managed to woo foreign in-vestment.

If tax rates were to guide decisions of corporate managements on locating manufacturing or production bases, Hong Kong, Ireland, Cyprus, Hungary, Chile would be the best placed, with tax rates ranging from 10-19%. Or better still, the Cayman Islands which has a nil tax regime. But if America with a 40% tax rate plays host to the world's largest companies, other factors perhaps play a bigger role. For India too, irrespective of the tax rate, the booming market makes it an at-tractive destination to be in.

"Given a choice between a further reduction in the corporate tax rate and other tax reforms, foreign investors would rather opt for clarity, certainty and stability in the tax regime and transparency in tax administration," said Shefali Goradia, head, international tax, Nishith Desai Associates. Back home, policy planners are talking about moderation in tax rates. They are, however, clear that there is a case for a further reduction in corporate tax rates only if all the exemptions are phased out. Companies in India enjoy a range of tax exemptions These include, among others, tax holiday for software technology parks, EoUs, infrastructure service providers and units set up in backward areas. Although the statutory rate is 33.66%, the effective rate is significantly lower due to the slew of tax exemptions. In 2004-05, for instance, effective corporate tax rate was close to 19.4%. A steep cut in the rates, without pruning exemptions, would result in a significant loss in revenues. This time around, expectations are that the government would scrap the surcharge, without tinkering with the basic rate. More corporate tax reform measures may have to wait till exemptions are fully phased out.

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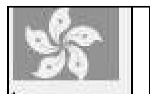
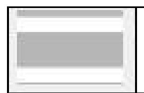


Hong Kong

17.5%
CORPORATE tax rate in Hong Kong is 17.5%. The rate became effective from 2003-04 and applies to Hong Kong sourced profits that are derived from a business carried on in Hong Kong. Offshore profits, capital gains, dividends and most bank deposit interest income are also exempt. Profits accruing from certain types of business — such as qualifying debt instruments or profits derived from the business of reinsurance of offshore risks — are either exempt or taxed at a concessional rate of 8.75%.



Thailand

30%
CORPORATE income tax (CIT) is 30% but it may be reduced to 20% or 25% for certain Thai cos listed on the Thailand Stock Exchange prior to Dec 2005. A tax rate of 10% applies to the remittance of dividends or branch profits abroad. For SMEs with less than Baht 5m paid-up capital, CIT is reduced to 15% on the first Baht 1m of net taxable profits and 25% on the next Baht 2m but not exceeding Baht 3m. CIT exemptions are granted to firms promoted by BoI, AMCs and VC firms investing in SMEs.

Malaysia

28%
CORPORATE tax rate is 28%. A special 5% corporate income tax rate applies to corporations which conduct an inward re-insurance business or an offshore insurance business. Income generated by a life fund of an insurance company is taxed at 8%. Income of resident corporations deriving from the transportation of passengers or cargo on board Malaysian ships is tax exempt. Companies engaged in petroleum operations are subject to petroleum income tax at 38%.

Singapore

20%
SINGAPORE charges a corporate tax of 20%. From the assessment year 2002, a partial tax exemption is granted on the first S$100,000 of income. For new

firms whose first three assessment years fall within 2005 to 2009, full tax exemption of regular income up to S$100,000 can be claimed provided certain conditions are met. Entities engaged in certain activities such as offshore leasing and offshore insurance are subject to a concessionary tax rate of 10% or lower, or are granted tax incentives.