STCI
Primary Dealer Ltd

Road Ahead: Reduction in Corporate Tax Rate

As market was highly anticipating some fiscal measures to provide stimulus to the sagging economic growth, Finance Minister on 20th September 2019 cut the Corporate Tax rate to 22% and for new manufacturing corporations incorporated on or after 1st October 2019 to 15% from 30% and 25% respectively. Therefore, the effective tax rate would pan out to be 25.17% and 17.01% respectively. However, these tax reduction benefits are only applicable if the corporations do not claim any exemptions. Additionally, such companies would not be required to pay Minimum Alternate Tax. However, for companies not opting for tax rate cut regime would have to pay Minimum Alternate Tax of 15% down from earlier 18.5%.

Tax Collections So Far:

(Rs. Crores)

Taxes	FY20 BE	FY19 RE	Collections Till July 2019	Collections Till July 2018
Corporation Tax	766,000	671,000	88,381	83,787
Taxes on Income	569,000	529,000	128,752	121,502
GST	663,343	643,900	178,787	150,835

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Central Government's gross tax collections so far show a lag in tax revenue growth. Budgeted figures of FY20 for Corporation Tax, Taxes on Income and GST were pegged higher at 14%, 8% and 3% respectively compared to the revised estimates of FY19. Looking at the collections done till July 2019, it is evident that the tax revenues have merely reached the levels that were completed during same period last year. Although GST revenue has picked up since last year, according to our internal analysis and numbers published, we infer that GST collections for the centre would be short by in the range of Rs 80,000-90,000 Cr for this fiscal year.

Corporation Tax: Lower than FY19 RE

Corporation tax has been cut down to 22% and for new manufacturing companies to 15% from 30% and 25% respectively. Therefore, the effective tax rate would stand at 25.17% and 17.01% respectively. This is applicable to corporations if they do not avail exemptions under any section of Income Tax Act. Budgeted figures of FY20 for corporation tax stood 14% higher than the revised estimate of FY19. After this tax reform, total revenue loss to Central Government would amount to Rs 145,000 Cr. Consequently, the corporation tax collection would reduce to Rs 6,21,000 Cr which would be 7% lower than the revised budgeted figures of FY19.

Fiscal Damage:

Currently, fiscal deficit is projected at Rs 703,760 Cr, i.e 3.3% of GDP. The shortfall in revenue by ~Rs 145,000 Cr is largely compensated by the surplus transferred by RBI of Rs 52,637 Cr under Dr Bimal Jalan Committee recommendations. Therefore, approximately Rs 90,000 Cr would be added to fiscal deficit number. Additionally shortfall in the GST collections would put further pressure on the Centre's fiscal condition. At current juncture, government is not planning to cut down its expenditures in the near future just to follow the fiscal consolidation roadmap.

If Government decides to use a mix of avenues to finance the widening fiscal deficit gap it would not put pressure on the market borrowings, which are already projected at a higher end for the current financial year. In our opinion, following are the ways by which Government could plan to finance the foregone amount:

- ✓ Government could consider not buying back the securities worth Rs 50,000 Cr which was budgeted in the Union budget of FY20. If Government decides this route, this could fill in large chunk of the required funds.

- ✓ National Small Savings borrowing is another likely path through which funds could be borrowed. Looking at the figures till July 2019, borrowing through NSS stood at Rs 79,358 Cr as against the budgeted estimate of Rs 130,000 Cr for full year. With current numbers already approaching the budgeted estimate, NSS route could be a likely option for borrowing ~Rs 40,000 Cr.

- ✓ Another possibility of funding the additional deficit is to issue Sovereign bonds. This would be over and above the estimated market borrowing amount.

However, any shortfall from the above mentioned avenues could be financed by market borrowings and could be in the range of Rs 30,000-50,000 Cr. Though, announcement for the same is expected later during the year according to a statement given by Finance Minister, Nirmala Sitharaman.

Conclusion:

Contradictory to Shri Shaktikanta Das's statement that Government does not have fiscal space and monetary policy measures would be required to give economic stimulus, Finance Minister, Nirmala Sitharaman announced the major boost by slashing corporate tax rates. The measures would certainly impact the fiscal consolidation path. Going forward, it remains watchful that how Government would manage its finances to bridge the widening fiscal deficit. In our view we estimate fiscal deficit target between 3.8%-3.9% of GDP considering nominal GDP growth by the budgeted estimate of 12% at Rs 211 Lac Cr. However, if nominal GDP growth is assumed to be 10.5% at Rs 184 Lac Cr considering slower growth in FY20, fiscal deficit target would further slope down from the estimated target of 3.3% GDP. As far as monetary policy is concerned, we expect a 25 bps rate cut in the October policy. We expect the 7.26% GS 2029 to trade in the range of 6.65%-6.80% in the near term.

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