**A progressive tax structure for corporate sector**


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# A Progressive Tax Structure for Corporate Sector

## Guest Column


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I would recommend that the finance minister Arun Jaitley, for the first time in India, introduce the concept of "progressive" tax structure for the corporate sector during Budget '16. The term progressive tax refers to the way the tax rate progresses from low to high, with the result that the average tax rate for the entity is less than the marginal tax rate. This reduces the tax incidence for tax payees with a lower ability to pay while effectively taxing those with a higher ability-to-pay.

The concept of progressive income tax is already well established in India in "personal" income taxes, and is generally accepted as the default norm for taxation. The current personal income tax structure is as follows: ₹2.5 lakh - NIL, ₹2.5 lakh to ₹5 lakh - 10%, ₹5 lakh to ₹10 lakh - 20%, and > ₹10 lakh - 30%.

On a similar note, it would not be out of place to have a progressive "corporate" income tax rate on the following lines (illustrative): (< ₹10 lakh - NIL, ₹10 lakh to ₹25 lakh - 5%, ₹25 lakh to ₹50 lakh - 10%, ₹50 lakh to ₹1 crore - 20%, ₹1 crore to ₹3 crore - 25%, ₹3 crore and above - 30%).

Those against this motion will argue that such a structure will reduce the incentive for companies to grow profits beyond the marginal tax rate. In practice, that won't happen if we keep the marginal tax rates reasonable. Furthermore, competitive forces, opportunities in the marketplace, and need for growth will keep them going.

The other argument could be that entrepreneurs could float many entities to enjoy the benefit of lower tax rates. Such incidences could occur, but won't carry an entrepreneur very far, as meeting compliance requirements across many entities will be onerous. For example, they will need to register and maintain separate records for income tax, service tax, excise, BMC licence, professional tax and other such statutory requirements. The entrepreneur will be better off having a stronger balance sheet rather than weak and split balance sheets with low leveraging capability.

It is common knowledge that the MSME sector is often the most vulnerable of sectors in India because the sector is squeezed from all ends. The list of difficulties faced by MSMEs is long, including low financial reserves to weather economic downturns, limited access to capital markets, low scale, cost and quality of power, complexities of labour laws and antiquated laws. While larger reforms are being worked upon for ease of doing business, the finance minister has the power to provide a significant breakthrough to MSMEs through a progressive tax code with a simple stroke of a pen!

This government is desirous of making credit available to MSMEs and the finest way to achieve this is to make them bankable, and getting them to correctly report their income is the first step. For a country with a high-parallel economy, we have no choice but to have a tax rate seen as reasonable and equitable by the MSME, as compliance often depends as much on the MSME's own intention to pay taxes.

**The concept of progressive income tax is already well established in India in "personal" income taxes**

If such a progressive tax structure is adopted, over 30 million MSMEs, which are subjected to a flat tax rate of 30%, will then be required to only pay 5-10% tax on net income. (Larger corporates can continue to pay as per their applicable marginal tax rates.) It is common knowledge that a large number of MSMEs deal in cash, and do not report their entire income. The Laffer curve — this postulates that at a particular tax rate, compliance will be maximum, and beyond a "reasonable" rate, payers will begin to evade taxes if they could — will be most applicable to MSMEs as compared with large corporates, as they often operate in a parallel economy. Millions of MSMEs may start paying their taxes, and we can dramatically expand the tax net.

Armed with such a favourable tax regime for small entrepreneurs, the government can then launch an aggressive educational campaign explaining how paying their taxes makes them eligible for bank credit, for which they otherwise become ineligible. The impact will be profound on tax collections and reduction in parallel economy, one of the key needs to become a developed nation.

*(Views are personal)*