8. THE EXTENT OF OVERTAXATION: FINAL RESULTS

1. Extent of Overtaxation by Groups

In this chapter, we present the estimated overtaxation of profits as revealed by the actual effective rate of tax and the adjusted effective rate of tax (actual tax provision/adjusted profits before tax). After presenting these for all the twenty groups, we blow up the figures for the three age-groups of the non-government companies and for the government companies with the appropriate blow-up factors. Then summing up the blown-up figures we estimate the overtaxation of corporate manufacturing sector as a whole.

Tables 8-1.1 to 8-1.4 list the actual and the adjusted effective rates of tax for the twenty groups, derived by using the four price indices. In many cases, profits before tax (adjusted) are negative and hence the adjusted rate of tax cannot be computed as to be comparable to others. These are indicated in the tables. The difference between these two rates is taken to be the extent of overtaxation.

Table 8-1.1 gives results for only ten industry groups for reasons mentioned earlier. The least overtaxed group is group 15 (Ceramic Tiles, Glass and Glass Products, Cement and Asbestos Brake Lining), where, however, the effective tax rate (adjusted) is higher than the nominal effective tax rate by more than 73 per cent. The other figures require no explanation.

Looking at Table 8-1.2 now, we see that the nominal effective tax rate of 71 per cent for the whole corporate manufacturing sector soars up to 306 per cent after adjustment for inflation. This is a fairly explicit indication of the extent of overtaxation of corporate profits due to inflation. As for the government companies as a whole, the adjusted tax rate cannot be calculated as profits are negative; hence, overtaxation can also not be calculated. For non-government companies, the effective tax rate goes up from 48 per cent to 82 per cent implying an increase of about 71 per cent. Among the sub-groups, the real burden on the smallest size-group is the heaviest after adjustment, since they have to pay taxes even when their profits after adjustment are negative. Among the age-groups, the one most affected due to inflation seems to be the middle age-group and the new companies seem to be overtaxed to a very small extent. Among the industry groups, group 16 (Basic Metals and Alloys) is obviously the most overtaxed. The least over-taxed is group 11 (Fuel, Power, Light and Lubricants).

In line with the other results obtained using the general wholesale price index, Table 8-1.3 presents the worst picture. Corporate manufacturing sector as a whole (as well as both government companies and non-government companies as diffe-rent groups) pays taxes despite incurring losses, if adjustment for inflation is undertaken. The smallest and the oldest compa-nies within the sample, as sub-groups, also exhibit the same pattern. Other sub-groups make some profits in real terms, but are shown to be bearing an adjusted tax burden far greater than they can reasonably be expected to.

As far as the industry groups are concerned, in two cases (groups 10 and 12) the unadjusted profits before tax are nega-tive, and so the actual effective tax rate cannot be calculated. In three more cases (groups 13, 16 and 18) adjusted profits before tax are negative. However, all these groups show positive tax provision. Excluding these groups, the maximum adjusted tax rate among those for the industry groups is that for group 17. The least affected industry group is group 11, as in the case of Table 8-1.2 also.

We now examine Table 8-1.4. The corpo ate manufactur-ing sector as a whole had a fairly high effective rate (71 per cent) to begin with; after adjustment for inflation, the rate becomes an astronomically high 1176 per cent. Of course, this high an adjusted effective tax rate is due primarily to the fact that the government companies as a whole are bearing a heavy tax burden. For the non-government companies, the effective tax rate increases from 48 per cent to 81 per cent after adjust-ment, i.e., a rise of almost 69 per cent. So far as the other groups are concerned, the pattern is similar to that in Table 8-1.2. In the case of group 16, its adjusted tax rate cannot be

Table 8-1.1

Overtaxation of Capital Income in the Corporate Sector using Specific Price Indices

(*Rs '000*)

Group	*Tax provision*	*Profits before tax*	*Adjusted profits*	*Actual effective tax rate (percentage)*	*Adjusted effective tax rate (percentage)*
	(1)	(2)	(3)	(4)	(5)
1.	—	—	—	—	—
2.	—	—	—	—	—
3.	—	—	—	—	—
4.	—	—	—	—	—
5.	—	—	—	—	—
6.	—	—	—	—	—
7.	—	—	—	—	—
8.	—	—	—	—	—
9.	—	—	—	—	—
10. (1)	0.00	−30.60	−1176.53	—	—
11. (2)	2540.00	4652.50	570.36	55	445
12. (3)	16.80	−5696.80	−32511.56	—	—
13. (4)	58360.00	115356.70	60156.49	51	97
14. (5)	75601.00	202445.00	34229.18	37	221
15. (6)	21754.00	47895.00	27717.40	45	78
16. (7)	4904.00	4868.20	−18266.46	101	—
17. (8)	38895.60	55727.00	7285.24	70	534
18. (9)	11022.00	26180.00	−5783.91	42	—
19. (10)	25960.00	40321.00	7054.22	64	368
20. (11)	—	—	—	—	—

Table 8-1.2

Overtaxation of Capital Income in the Corporate Sector using the Consumer Price Index

(*Rs '000*)

Group	*Tax provision*	*Profits before tax*	*Adjusted profits before tax*	*Actual effective tax rate (percentage)*	*Adjusted effective tax rate (percentage)*
	(1)	(2)	(3)	(4)	(5)
1.	695782.69	975206.81	227613.94	71	306
2.	428000.00	419740.00	—142532.61	102	—
3.	267782.69	555466.81	324725.69	48	82
4.	35616.90	20873.80	—20156.22	171	—
5.	166465.80	371087.91	298156.62	45	56
6.	65700.00	163505.11	107367.99	40	61
7.	137882.30	347870.59	226268.23	50	61
8.	53196.40	153207.70	109877.39	35	48
9.	40704.00	54388.50	51748.21	75	79
10. (1)	0.00	—30.60	—542.93	—	—
11. (2)	2540.00	4652.50	4393.13	55	58
12. (3)	16.80	—5696.80	—12130.00	—	—
13. (4)	58360.00	115356.70	80931.05	51	72
14. (5)	75601.00	202445.00	140038.25	37	54
15. (6)	21754.00	47895.00	33824.63	45	64
16. (7)	4904.00	4868.20	831.86	101	590
17. (8)	38895.60	55727.00	43715.10	70	89
18. (9)	11022.50	26180.00	12757.46	42	86
19. (10)	25960.00	40321.00	32928.21	64	79
20. (11)	28728.80	63748.80	52651.21	45	55

Table 8-1.3

Overtaxation of Capital Income in the Corporate Sector using the General Wholesale Price Index

(*Rs '000*)

Group	*Tax provision*	*Profits before tax*	*Adjusted profits before tax*	*Actual effective tax rate (percentage)*	*Adjusted effective tax rate (percentage)*
	(1)	(2)	(3)	(4)	(5)
1.	695782.69	975206.81	—1568071.75	71	—
2.	428000.00	419740.00	—1523037.12	102	—
3.	267782.69	555466.81	—28575.64	48	—
4.	35616.90	20873.80	—120079.00	171	—
5.	166465.80	371087.91	57553.31	45	289
6.	65700.00	163505.11	24013.63	40	274
7.	137882.30	347870.59	—70701.73	50	—
8.	53196.40	153207.70	33057.90	35	161
9.	40704.00	54388.50	13939.92	75	292
10. (1)	0.00	—30.60	—1100.97	—	—
11. (2)	2540.00	4652.50	3144.98	55	81
12. (3)	16.80	—5696.80	—30654.15	—	—
13. (4)	58360.00	115356.70	—22044.57	51	—
14. (5)	75601.00	202445.00	18513.37	37	408
15. (6)	21754.00	47895.00	22392.63	45	97
16. (7)	4904.00	4868.20	—20833.08	101	—
17. (8)	38895.60	55727.00	873.18	70	4454
18. (9)	11022.50	26180.00	—10457.53	42	—
19. (10)	25960.00	40321.00	5503.54	64	472
20. (11)	28728.80	63748.80	19559.21	45	147

Table 8-1.4

Overtaxation of Capital Income in the Corporate Sector using the Implicit GNP Deflator

(*Rs '000*)

Group	*Tax provision*	*Profits before tax*	*Adjusted profits before tax*	*Actual effective tax rate (percentage)*	*Adjusted effective tax rate (percentage)*
	(1)	(2)	(3)	(4)	(5)
1.	697582.69	975206.81	59143.28	71	1176
2.	428000.00	419740.00	—256954.17	102	—
3.	267782.69	555466.81	329321.72	48	81
4.	35616.90	20873.00	—34882.89	171	—
5.	166465.00	371087.91	264743.06	45	63
6.	65700.00	163505.11	94565.46	40	69
7.	137882.30	347870.59	182463.66	50	76
8.	53196.40	153207.70	101795.30	35	52
9.	40704.00	54388.50	43729.72	75	93
10. (1)	0.00	—30.60	—502.36	—	—
11. (2)	2540.00	4652.50	4289.05	55	59
12. (3)	16.80	—5696.80	—13985.10	—	—
13. (4)	58360.00	115356.70	63627.02	51	92
14. (5)	75601.00	202445.00	128932.60	37	59
15. (6)	21754.00	47895.00	32773.16	45	66
16. (7)	4904.00	4868.20	—1251.99	101	—
17. (8)	38895.60	55727.00	35874.15	70	108
18. (9)	11022.50	26180.00	8965.69	42	123
19. (10)	25960.00	40321.00	26441.43	64	98
20. (11)	28728.80	63748.80	47136.12	45	61

The implication of this set of tables is obvious. Inflation has caused the corporate manufacturing sector to bear a substantially higher real tax burden than is revealed by historical cost accounting. Even when we realise that the adjusted effective tax rates would fall once the adjustment for net financial liabilities is undertaken, it is unlikely that the above conclusion will be controverted. This is because the net financial liabilities are likely to be much smaller than total fixed assets in general. Also, given the fact that depreciation adjustment is cumulative and that many of the fixed assets have lives which are longer than the period for which a loan is generally kept outstanding, the adjustment for net financial liabilities is likely to be outstripped by depreciation adjustment alone, at least in the case of manufacturing companies. The scenario for other types of companies (financial or service) is less clear.

The corporate manufacturing sector, it is also clear, cannot really afford the dividends it has been paying, if it wants to grow in real terms with internally generated funds. It has been growing by using the alternative of external funds, which implies that through taxing the corporate sector too heavily in real terms, the government is transferring a part of the investible surplus of the economy to itself.

Of course, taxation is not entirely to blame for the capital erosion in real terms. As the results in Table 8-1.5 show, profits before tax are negative for many groups. In such cases, even if taxes were nil, capital erosion would occur in real terms; but what should be the remedy is not clear. If inefficiency is the cause, inflation accounting would help the investors to recognise it as such and decide about the future of such companies. In other cases, alternative policy measures can be weighed and decided upon.

2. Estimates for the Population

We now present the blown-up estimates of the two major inflation adjustments and estimate the impact in quantitative terms for the population of the whole corporate manufacturing sector for the year 1979. These are arrived at after the amounts to be adjusted as well as the other figures were blown up separately for the government companies and the three age-groups of non-government companies, and then summed.

Table 8.2

Estimates for the Population of Manufacturing Companies

(*Rs '000*)

Items	*Using consumer price index*	*Using general wholesale price index*	*Using implicit GNP defiator*
	(1)	(2)	(3)
Profits Before Tax	11687639	11687639	11687639
COSA	469314	12910100	2282217
Depreciation Adjustment	4730245	5276069	4499670
Adjusted Profits before Tax	6488689	—6498530	4905752
Tax Provision	5923327	5923327	5923327
Nominal Effective Tax Rate (%)	51	51	51
Adjusted Effective Tax Rate (%)	91	—	121

Adjustment for inflation is the least when we use the consumer price index and the most when we use the general wholesale price index. The major difference, however, is due to COSA, and since it depends on the movement of the particular price index during the course of only one year, the same calculations for another year may reveal a different pattern regarding adjustment for inflation and the price index used. Taking even the lowest adjustment among the three, it is seen that historical cost profits are almost 80 per cent higher than the adjusted profits. The adjusted effective tax rate is 91 per cent. Use of the other two indices reveals that the tax burden is far in excess of the capacity. That inflation is causing overtaxation of corporate capital income is evident; the minimum overtaxation, by our calculations, is 78 per cent (using consmer price index).

This kind of heavy taxation (in real terms), coupled with our finding that the real profitability is far lower than that shown in the accounts, implies that the corporate sector is being asked to pay taxes beyond its capacity. The inimical aspects of such a situation hardly need to be stressed.