Opinion

SATURDAY, SEPTEMBER 21, 2019

ECONOMIC BOOST

Union Home Minister, Amit Shah

Rationalisation of corporate tax had been a long pending demand, which is now a reality. This move will make our corporates globally competitive and our markets much more exciting for potential investors

RationalExpectations

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FM takes a punt on growth, finally

Difficult to see capex rising quickly, so the deficit will spiral; but having a tax rate on a par with Asian giants is vital for investment

SEVERAL DECADES AGO, when this columnist still had a hazy recollection of university-level economics, and finance minister Manmohan Singh devalued the rupee sharply, he was sent to interview him. You do realise, a prissy question was put to the FM, you've worsened the current account since imports—of mostly essentials like oil—will rise immediately while exports will take 2-3 years to respond. Given his background—chief economic advisor, economic affairs secretary, RBI Governor, Deputy Chairman Planning Commission—Singh could have dismissed this by saying he'd forgotten more economics than this columnist had learned; instead he said, you're right, and we've taken an IMF loan to bridge this gap, but in the long run, we felt it is more important that the rupee is priced correctly.

Much the same can be said about finance minister Nirmala Sitharaman's mini-budget on Friday; after dismantling part of the budget's proposals like the FPI tax some weeks ago, she has now slashed corporate taxes by around 10ppt, making them on a par with, or even lower than, those in competing nations in south-east Asia. The plan is to stimulate investment, especially that from overseas in the context of firms wanting to quit China, following its trade war with the US.

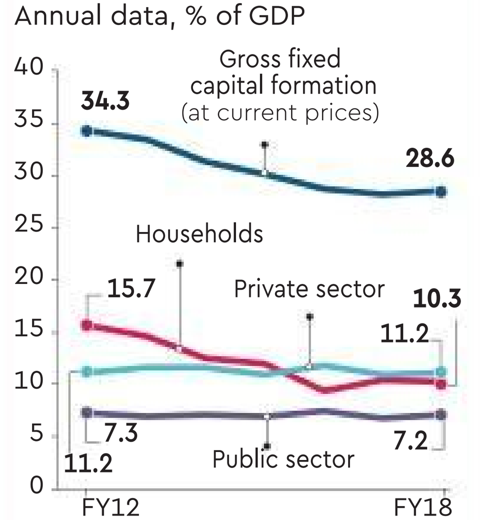
Whether this will happen, like Singh's exports, remains to be seen since several things can go wrong. For one, if deficits rise too much—the tax targets were always aggressive, and Friday's giveaways add up to 0.7% of GDP—interest rates can start trending up again; certainly, the hope of a continued fall in rates looks iffy now. And, in an environment where growth is slowing, especially in consumer demand, not many will rush to invest; in any case, most promoters are financially stretched. And, with nice discounted deals available in the insolvency courts (IBC), several buyers will prefer to channelise investments there; in the initial period, investments in IBC firms will be relatively lower than in setting up greenfield projects. But, as Singh said in 1991, it was important to get the rates right, and that is what the FM has done for corporate taxes.

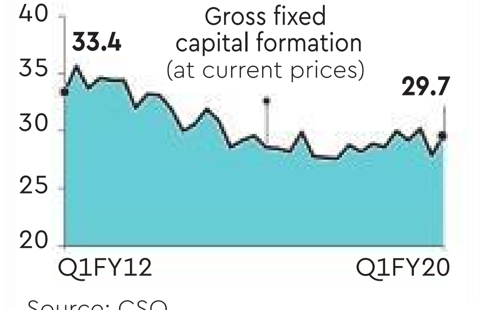
When India's tax rates were 50-100% higher than those in competing nations, any investment in India meant the project had to clear a higher hurdle rate; this was all the more true for production meant for the exports market. Firms, such as Apple or Samsung, that are looking at de-risking their China operations could now find India more attractive, at least from the tax point of view. Indeed, lowering tax rates to 25% was something the late Arun Jaitley had also promised several years ago, but wasn't able to deliver on in its entirety.

It was always odd that Sitharaman didn't lower tax rates since, the day before her maiden budget, the Economic Survey was at pains to explain how India's tax and other policies were creating 'dwarves', or firms that never grew since labour laws, government purchase-preferences, reserving a certain share of bank credit, and even tax rates were all biased towards smaller firms. So, while not cutting rates for larger firms, the FM said the 25% tax rate was applicable to "99.3% of the companies"; clearly, she didn't care as much for the 0.7% that were investing a lot more than their share, creating more jobs, generating more exports, etc. Today, with the top rate coming down to 22%, the FM has clearly changed her mind completely.

Why a 15% rate has been fixed for new firms is unclear. While the plan is to attract global biggies, it creates an odd situation, where older firms pay one rate and new ones another; apart from lowering rates, the idea has to be to reduce arbitrage, not raise it. The fear of existing players trying to avoid taxes by shifting businesses to 'new units' is a real one; even though this will attract anti-avoidance rules, why have a tax system that necessitates such policing?

Capital concerns





Source: CSO

While an increase in investment levels—they have been plummeting for years (*see graphic*)—will require a few years at least, prime minister Modi needs to take a few other steps as well if investment levels are to grow. Top on the list, is resolving the deep problems in major investment sectors (*bit.ly/2mni9g0*) like telecom, oil and gas, mining, real estate, etc. In both oil and other mining, as this newspaper has pointed out before, India's non-tax levies are much higher than global ones, and the overall policy environment is also quite unfriendly. Both offer large investment and employment potential, so the PM just has to fix this. Telecom is another key investment area that was killed by rapacious policy; it didn't help that the policy also favoured RJio, but if the government was to fix even just the problem of high levies, this will go a long way in promoting investments, especially now that the tax piece has been fixed. Too many policy U-turns, like the one on e-commerce, or the hounding of Monsanto or price caps on pharma—including medical devices—have hit investor-faith. And it is difficult to woo either an Apple or a Samsung till the current policy of high import duties on mobile-phone manufacturing is junked; Niti Aayog is working on an alternative plan, and the sooner that is accepted, the better.

That the move isn't a sure-shot fix is, of course, best illustrated by the fact that global rating agencies Moody's and S&P have diametrically opposite views on whether the move is credit-positive (Moody's) or negative (S&P). The good news, on which there is unlikely to be two views, though, is that after seeming to ignore India's economic challenges, the government is now trying to address the major ones. The budget tried to address the NBFC solvency/liquidity issue, and after that, there were moves on real estate and bank recapitalisation. Some, like the real estate package, were not ambitious enough, and the main issue of bank competitiveness is far from being addressed. But, it does appear that, as in 1991, the economic crunch has focused the government's mind.

MoneyMatters

Universities claiming stake in intellectual property developed using their resources can pave the way for further innovation

IT IS A given that a university can provide considerable impetus to new researchers if it were a part-shareholder in a big tech firm, like Facebook or Google. An excellent example is Stanford University. Being the nursery of many start-ups, Stanford has successfully funded innovation, by acquiring stakes in enterprises hatched by alumni—Google, for instance—using the university's resources. Now, Indian universities may be able to do this too. As per the Centre's new draft rules on intellectual property rights, universities will be able to stake a claim in the monetisation of any innovation that came about using their resources. When an invention or finding is monetised, revenue sharing would be in a 60:40 ratio, with the smaller portion accruing to the academic institution; the share of the university won't be allowed to fall below 25%. This applies to video classes, and MOOCs as well; it is only in the case of copyright that the academic institution would enjoy a non-exclusive, royalty-free, irrevocable, worldwide licence.

Although most engineering institutes have incubation centres, their contribution in hatching successful start-ups has been minimal. This, even though start-ups in recent years have seen a phenomenal rise in funding. A financial incentive will prod universities to improve mechanisms for incubating research and entrepreneurship. A change in policy to favour start-up-fostering colleges can alter this. Indian universities and the government need to follow the Stanford model if Institutes of Eminence are to be nurtured. IPR policy can be a good step towards fostering innovation.

MINI-BUDGET

FEW FIRMS WILL INVEST TILL THERE IS A STRONG DEMAND-REVIVAL. THAT NEEDED A CUT IN INCOME TAX RATES; THE FM HAS FRITTERED AWAY MONEY ON CORPORATES & THE ULTRA-RICH

Welcome tax cuts but for the wrong persons!

SHOBHANA SUBRAMANIAN

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THE SHARP CUT in the corporation tax rate can be a big talking point for prime minister Narendra Modi on his visit to the US that begins today. But, back home, the government's giveaway of ₹1.45 lakh crore will benefit only those already doing relatively well—the corporate sector and rich individuals. The anticipated investments from the tax-break could take a long time—at least a couple of years—to materialise. Meanwhile, with consumption demand crimped, the economy will continue to crawl.

Indeed, industry will wait to see a clear uptick in demand before it puts money to work; those business houses that were expanding, have done so by picking up distressed assets via the IBC route. At a time when demand has slumped, job losses are rising, and there is already surplus capacity available, there is little incentive to invest. The other problem is the lack of risk-appetite on the part of lenders, given Indian companies remain highly leveraged. Only those promoters who are able to cough up contribution to the equity of a project are likely to get financial backing for a greenfield project. And, there are not that many.

Looking for money in the stock market is tricky. There could be some brownfield initiatives, with promoters using their cash-flows—money saved from the lower tax rate. However, this is unlikely to create too many new jobs or a meaningful increase in demand. Given the pace at which companies are automating, they are likely to spend more on technology. The immediate issues of weak demand, limited liquidity and a shortage of equity capital, therefore, will not get addressed. Hopefully, industrialists will not return the excess cash to shareholders through buybacks—now that the tax on this has been withdrawn—or pay out hefty dividends.

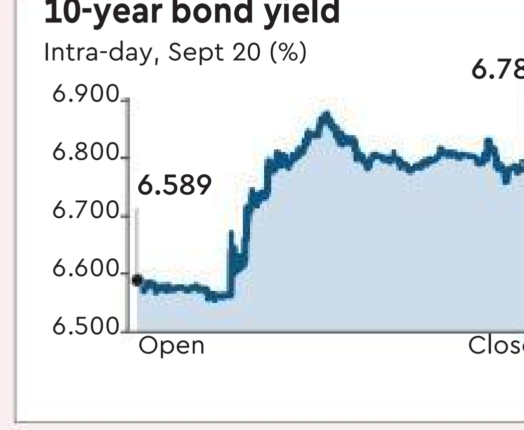
The 15% tax for new investments post October is a red carpet invitation for global players. Will foreign companies come in? They may, because the 15% rate is very attractive; an Apple, for instance, could be tempted to set up shop in India. The question is how much FDI will come in, how soon, and whether the government could have kick-started the economy—which is really what is needed—some other way. A demand-side stimulus would have worked better rather than a supply-side measure. A cut in taxes for individuals—below a certain income level—coupled with some cuts in GST would have spurred consumption. After all, the state governments stand to lose revenue—even by way of corporation tax cuts too. With more purchasing power driving household spending, companies would have seen higher revenues. That, in turn, would have boosted cash-flows and profits.

Right now, a cut in corporation tax does little for the economy. It will not help the near-term momentum, and could have come a year down the line. That's because it is highly unlikely companies will pass on the gains from the lower tax rate by trimming prices of products—the automobile companies are all sitting on cash, but they have not brought down the price of cars or two-wheelers meaningfully; they offer discounts in the form of free insurance or cuts in some fee or other. Moreover, the surpluses need to be accumulated before they are invested. As the government has been saying, many companies have not even passed on the cuts in the GST rates.

Most of the gainers are large profitable multinational consumer giants and profitable private sector banks; an HDFC Bank, a Nestle, a Colgate or an ICICI Bank are already doing well and didn't really need the break. Multinational consumer goods companies are unlikely to make big investments, they have incurred very little capex all these years. It is true, companies today may not be reporting the kind of numbers they were doing a few years ago, but most of them are fairly profitable even if the aggregate profits have fallen in Q1FY20.

Instead, relief for the middle-class—an individual who earns ₹10 lakh per annum and pays a hefty 30% tax rate—would have worked better. Rising consumer spends would have yielded the government higher revenues. But, with incomes not going up and expenses on key areas such as health and education not coming down, consumers are cautious. If revenues don't pick up, and the government needs to curb capex to keep the fiscal deficit within limits, it will keep the economy sluggish. Already, the tax-cuts will mean a loss of revenue, and may force some expenditure cuts—on capex—by both the Centre and the states. The yield on the benchmark rose to 6.8% on Friday on fears that the deficit could slip and the government could borrow more from the bond markets. That, then, would drive up interest rates and crowd out the private sector.

One finds it hard to understand the tax-breaks for the affluent, since less than 3% of India's population invests in shares or mutual funds. It was not necessary to remove the tax on buybacks, nor to withdraw the enhanced surcharge on the capital gains tax—the 'wealth effect' only benefits the wealthy. And, the money will be spent on foreign cars, imported goods and holidays abroad. If the idea was to boost the sentiment with an eye on the disinvestment target, putting more money in the hands of consumers would have been better. It would have been a more inclusive Diwali gift.



*At 2011-12 prices

A more competitive India proposition

A stable and competitive tax regime is a critical determinant for investors to arrive at the jurisdiction of choice for setting up business/investments

NAVEEN AGGARWAL

Partner and Chief Operating Officer, Tax, KPMG in India. *Views are personal*

IF THE STOCK market surge yesterday is to be believed, then September 20, 2019, might go down as a memorable day in the Indian tax landscape. While India Inc waited with bated breath for an impending course correction on the GST landscape, with an all-important council meeting yesterday, the finance minister had a lot more to offer.

In what should be seen as a fulfilment of the government's promise to rationalise corporate tax rates, a baseline tax rate of 22% for domestic companies not claiming any tax holiday and concessions is certainly a leap in that direction.

With an average global corporate tax rate of around 23%, the announcement by FM Nirmala Sitharaman on Friday, led to India joining an elite club of countries offering a highly competitive and compelling tax regime for investors. The stimulus does not stop here, and in a significant boost to the government's 'Make in India' plans, there is also a proposed new lower corporate tax rate, of 15%, for new manufacturing entities, which are set up after October 1, 2019, and which do not claim any tax exemptions. With a changing global trade dynamic, these measures become even more potent in the backdrop of the recent liberalisation of FDI norms in single-brand retail, contract manufacturing, and other areas.

The current administration's focus on responsible governance flows through the announcement on Corporate Social Responsibility (CSR), where, it appears, a balance has been sought for both corporate India as well as the government by widening the options available to businesses to deploy their 2% CSR spend on Public Sector Incubators, and government educational & research institutions. Hopefully, this would also positively impact new innovation and talent development, which is something that both the private and the public sector could surely gain from in the coming years.

With the gradual phasing away of incentives, the difference between taxable profits and book profits has narrowed down. Now, with the announcement that minimum alternate tax (MAT) shall not be applicable for domestic companies not availing any tax exemptions, a more simplified tax structure has come about that will attract investment. Further, for existing companies availing tax concessions, the reduction of rate of MAT from 18.5% to 15% goes quite some distance in pleasing the domestic corporate tax payer.

Amongst the widespread cheer the announcement has generated, there are a few reasons to delve into the fine print. For example, there is a need for clarity on whether companies that opt for the reduced MAT rate will be able to utilise their existing MAT credits, or whether those would lapse. In addition, the 15% concessional rate to manufacturing companies is contingent upon the companies initiating operations by March 31, 2023; however, a key issue that would require careful deliberation is whether there is a claw back mechanism if such conditions are not met.

Whether firms opting for the reduced MAT will be able to utilise their existing MAT credits needs to be clarified. Also, the 15% rate for new manufacturers kicks in only if operations start by March 31, 2023. Deliberation on claw back, if this condition isn't met, is needed

The announcements did not contain any mention of proposed rate cuts for foreign companies, which will continue to be taxed at a higher rate of 40% plus surcharge/cess. For them, having a local subsidiary may now be a much more compelling proposition than ever before. Similarly, no rate changes are proposed for limited liability partnerships and full partnerships, but the fact is that these entities also benefit from not being subject to dividend distribution tax.

In essence, a stable and competitive tax regime is a critical determinant for investors to arrive at the final choice of jurisdiction for setting up business/making investments.

The hallmark of the current Indian administration has been to drive continuous reforms with decisive action, and there is no doubt that the time is ripe to actively look at bringing in the required structural reforms in the overall income-tax ecosystem.

In my view, the writing is very much on the wall. India continues to leap forward on a path towards becoming a premier investment destination, offering a simplified, fair, and competitive tax regime.

LETTERS TO THE EDITOR

PM Modi on Kashmir

Prime minster Narendra Mod's wish, expressed in a pre-election rally in Maharashtra, 'to hug each Kashmiri and create a new paradise' rings hollow in the face of the ground realities now prevailing in the Valley. It simply does not match with his government's strong-arm tactics to deny the people of Kashmir the freedom to react to the abrogation of Article 370, and the resultant revocation of special status guaranteed at the time of accession to India. It is incommensurate and incompatible with the unilateral decision taken by his government to deprive the people of the Kashmir Valley of their identity, culture, and self-respect. It is no surprise that he pins the blame for the Kashmir imbroglio on Pakistan and Congress. The rhetoric of 'hugging every Kashmiri' adds insult to injury. A healing touch, in the form of steps which could include restoration of Article 370 to reduce anger and alienation and banish such words as 'occupation' and 'subjugation', and reintroduce terms such as 'autonomy' and the 'right to self-determination' are needed. As for the talk of turning Kashmir into a 'paradise', we are unable to visualise the world's most militarised zone with 'a large bobbin of concertina wire' as a 'paradise'. Narendra Modi speaks of *naya Kashmir banana hai* (building a New Kashmir), forcing us to ask whether it will be done with 'settlements' of people outside the Valley and ex-army personnel. Modi's promise of 'development' and 'employment' is unlikely to persuade people to give up their genuine political aspirations. Modi has not commented on 'getting brides' from Kashmir (spoken of by some BJP leaders) following its nominal integration with the Indian mainland.

— G David Milton, Maruthancode

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REEL OR REAL?

Accurately identifying disinformation

In this day and age of AI-based tech such as deepfake—one can easily produce or alter video content realistically—seeing should not necessarily be believing

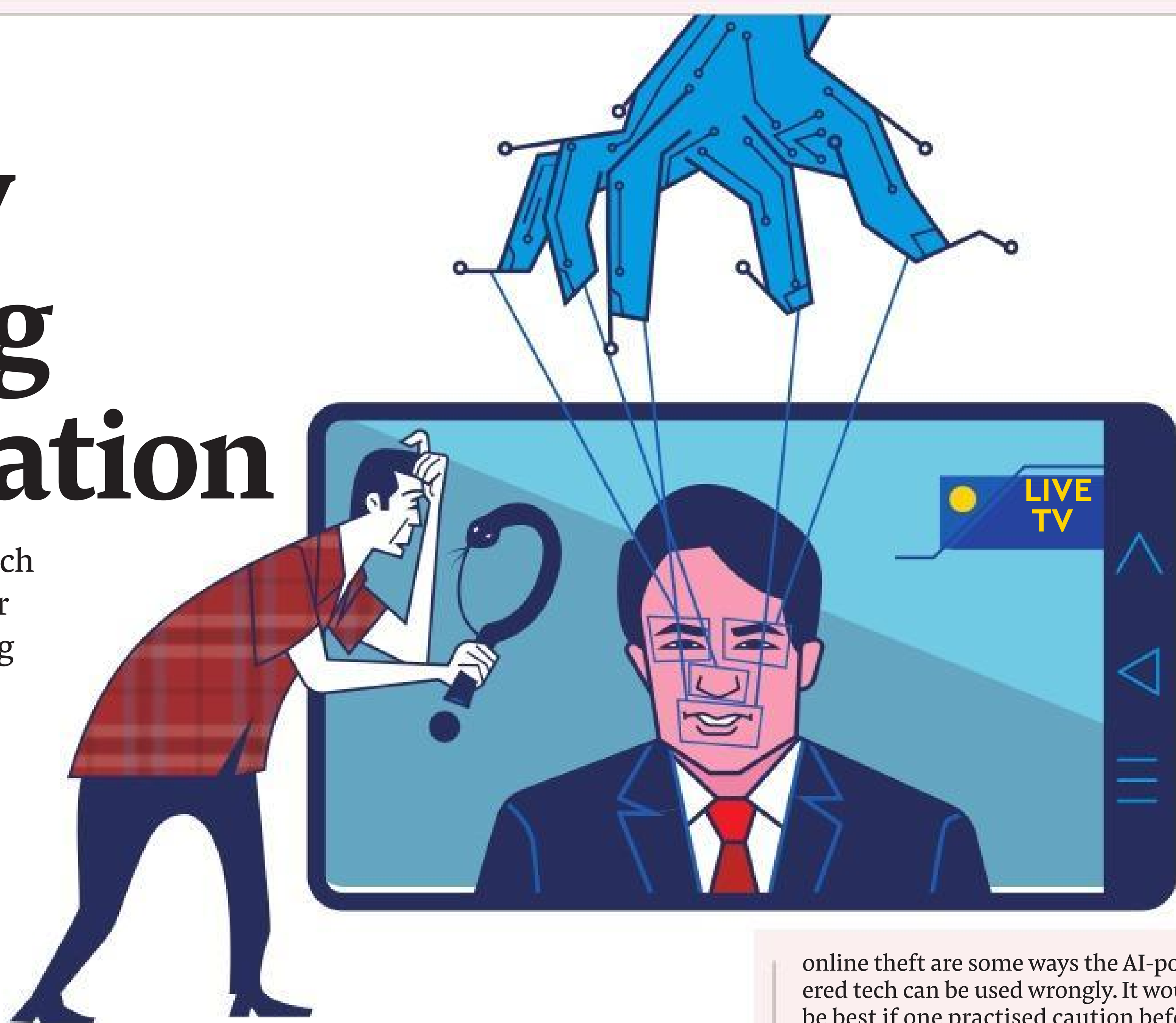


ILLUSTRATION: SHYAM KUMAR PRASAD

CHANDRAJIT BANERJEE
The author is director general, Confederation of Indian Industry. Views are personal

FOR THE LAST couple of years, India has been waging a silent battle against a growing epidemic of fake content that's being used to manipulate and deceive people. The problem is real and has serious repercussions as there is a tendency to amplify or act on the information that we have received, especially from sources that may be trusted by millions from all over the country. The content may look and sound real, and because it is trending on a global platform, authenticity verification is the last thing on anyone's mind.

Many of these fake videos are made with AI applications. Deepfake, for instance, is an AI-based technology through which one can produce or alter video content realistically. Through certain AI tools, one can morph or distort images, or create a scene or a dialogue that never happened. The list is endless.

The exponential growth of deepfakes is a grave concern, given that easily accessible open-source software and apps that can be downloaded free of charge allow pretty much anyone with a computer or a smart mobile device to create deepfakes. The threats posed by deepfakes are developing at an alarming rate.

Often, the target is a celebrity, public figure. But there have been instances where the general public has been targeted. For instance, women have had their faces morphed on pornographic content, which were then uploaded on the Internet. The data was obtained from their social media pages, which lacked the necessary privacy settings.

Another scenario where such tools can cause damage to individuals and businesses alike are deepfake audios. These audio fakes can be created by accessing publicly-available audio content and training the system in the voice modulations of particular individuals. Once an audio training model has been created, a simple text-to-speech software can help generate fake material.

Deepfakes provide means to impersonate a person or a group of people, leading to phishing, scams, frauds or espionage through traditionally secure contexts, like phone calls and video conferences. By perfectly replicating physical features of an individual, deepfakes make live impersonation fraud also easy.

Industry is an easy target for deepfakes due to the significant financial gain and due to the fact they stand to lose so much—reputation, profits, market valuation and customer loyalty. It is essential that companies invest in preparing their employees in advance, by educating them about this emerging threat and giving them the data identification tools to identify and tag the disinformation.

A security firm has already issued a warning of cyberattacks where deepfake audios have been used in the context of financial fraud on companies. At least three such incidents have been reported where the voice of the company CEO was used to call senior financial executives for urgent money transfers, resulting in a loss amounting to millions of pounds. When such techniques are already in use, the probability of the attack landing at one's doorstep increases drastically.

Consider a situation where an audio recording of a company's chairman is released of him purportedly claiming massive losses and the business no longer being sustainable. It can cause investors to lose confidence and the damage to the business could be far reaching. Combine this scenario with a video of the chairman making these statements before the opening of the stock market and the resultant economic loss to the company could be catastrophic. Even more worrisome is the possibility of an organisation using this fake technique to target its business rivals, where the repercussions could be extremely dangerous. Industry needs to come together to find a solution to this emerging AI-based threat.

Deepfakes can also be used in crimes against individuals—identity theft, blackmail through altered video/image, online theft are some ways the AI-powered tech can be used wrongly. It would be best if one practised caution before sharing important information after seeing video evidence because it could be a deepfake. It is also quite feasible that some individuals may claim real videos of themselves as being fakes, trying to give the powers that be the run around.

It's difficult for investigation agencies and the judiciary to grapple with the myriad issues arising out of deepfakes. Globally, research institutes and tech companies are conducting research to create programs that can red flag fake videos, pictures and audio clips. Several fact-checking and content-validation tools have been successful in this regard, but only to an extent. Forensic analysis techniques, rules of evidence and appropriate legislative tools would need to be examined afresh in light of this growing threat.

We need to create a public awareness campaign about such digitally-manipulated content. The general population should also be made aware and educated on the downsides of falling prey to fake content through mass awareness campaigns by the government. Indian tech companies should consider research and development to combat deepfakes.

A collaborative effort between the government, industry and academia to find effective solutions to this menace is imperative, and would go a long way in making India a more cyber-aware and secure country. Till such time India is well prepared to tackle this threat, seeing should not necessarily be believing.

REDUCTION IN RATES

Undoing the mistakes

SHSHANK SAURAV
The author, a CA, is an anti-money-laundering specialist

FINANCE MINISTER Nirmala Sitharaman has announced major relief to the corporate sector and addressed the long-time demand of reducing tax rates. The government expects it will increase the competitiveness of the market from the perspective of foreign investors, and investment will flow in.

The announcement should be viewed at from two angles: Relief to existing undertakings and incentive to new units. Effective tax rate of the entire base of companies reporting profits rose from 26.89% for FY17 to 29.49% for FY18. A 2.6% rise in effective tax rate was due to phase-out of profit-linked deductions and increase in MAT. If we compare the proposed effective tax rate of 25.17% to effective tax rate for FY17 and recommendation of expert panel on DTC, this tax cut doesn't come as a surprise. If we further dig the data, then the effective tax rate for all the large corporations is already 26.3% and, so, the tax cut is not expected to provide a big relief to large companies. But there could be some companies that get benefited due to their structure and the manner in which they operate. Also, concessional tax rate provisions exist for companies with annual turnover of ₹400 crore.

From a macroeconomic view, tax cut for existing undertakings will benefit only when corporates decide to invest the surplus, and this is dependent on the economic outlook. The current slowdown is a result of decline in demand; so efforts should have been made to leave more disposable income with the middle class. Surprisingly, the government is not doing anything to address this.

> The finance minister has acted timely. However, frequent revisions to the policy take away the element of certainty, which is essential

Reducing tax rates for manufacturing companies set up after October 1, 2019, is a welcome step. So far, Make in India has not succeeded in attracting manufacturing giants. This is despite the availability of a huge market and relatively cheap labour. Foreign players often criticise high income tax rates in India, and hopefully their concern will get addressed. But the FM should acknowledge tax rates are not the only factor that determine business decisions, and FPI outflow even after withdrawal of surcharge is an example. Reduction in MAT rates from 18% to 15% is good for those companies that are enjoying a tax holiday, but paying income tax under MAT. Theoretically, MAT credit can be carried forward and utilised in future, but it impacts investment decisions that are usually taken considering the present value of money.

The government's responsiveness should be appreciated from the fact that the FM acted timely (surcharge on FPIs, increasing monetary limit for filing appeal in tax cases, rate cut, etc). However, frequent revisions to the policy take away the element of certainty, which is essential.

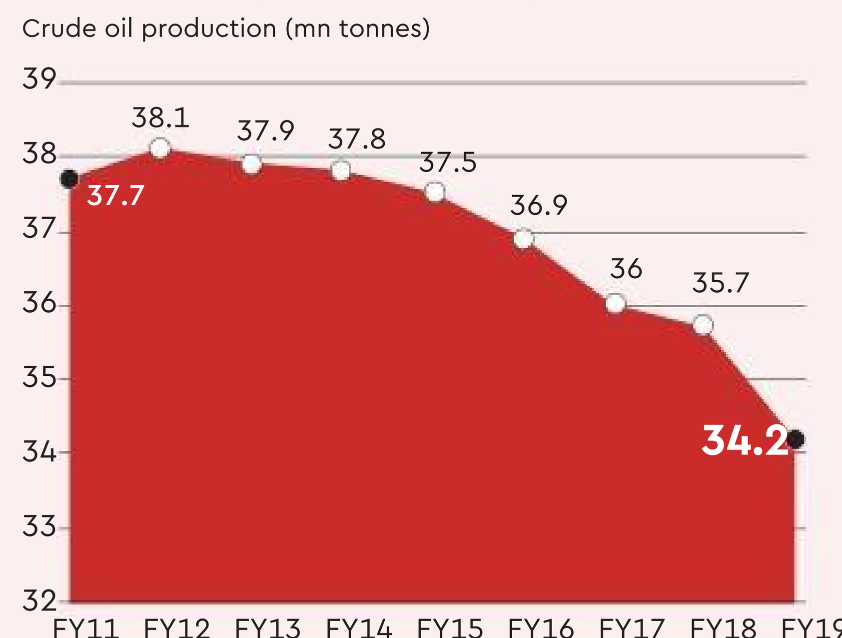
DATA DRIVE

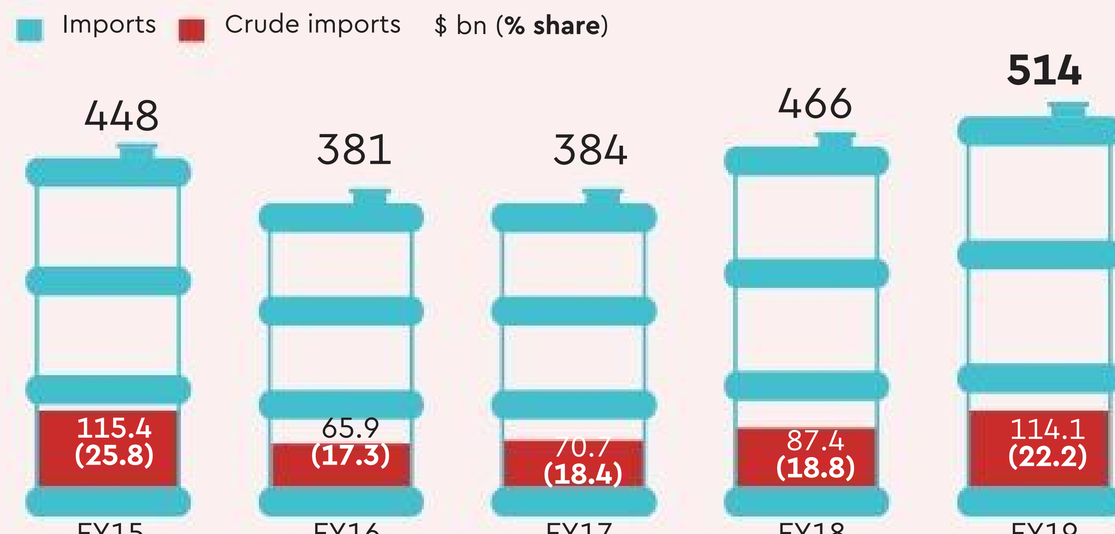
Aramco spillover: Oil will give some heartburn

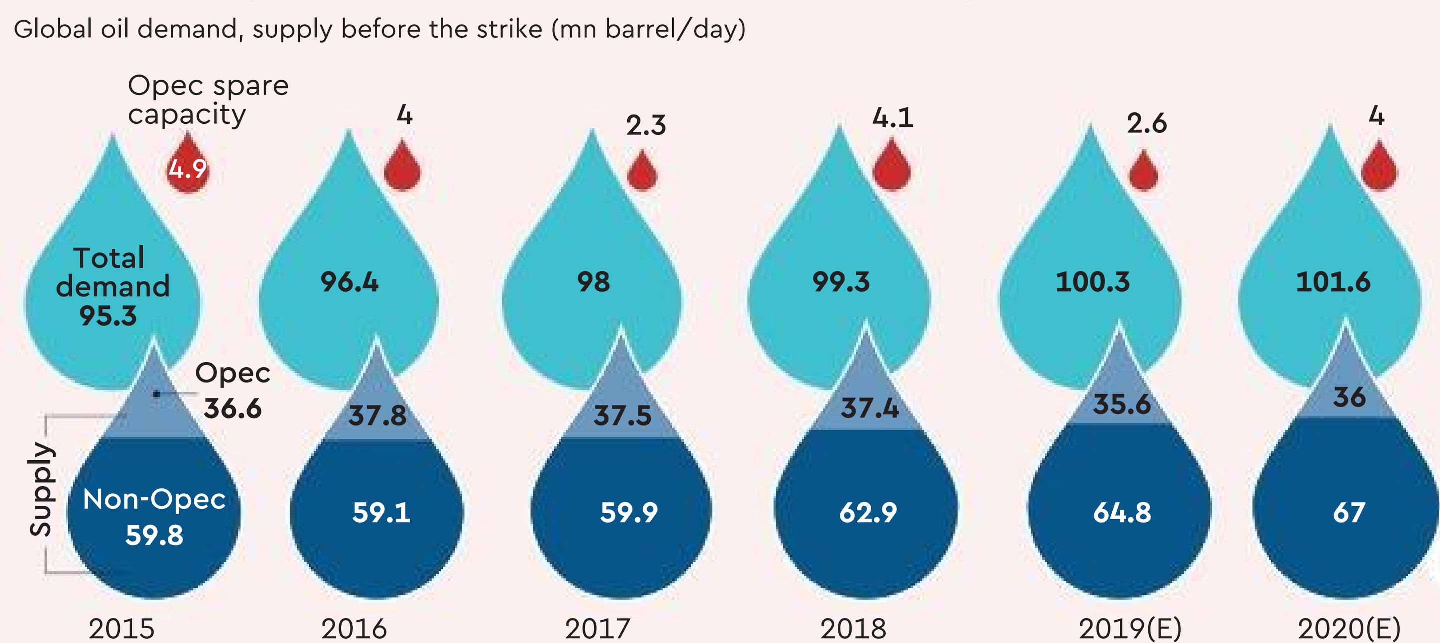
GLOBAL OIL PRICES surged after the drone attacks on Saudi oil facilities. It has impacted around 5.7 mmbd of current crude production, and it may take a few weeks (at the very least) to restore the facilities and bring the production back to pre-strike levels. Suspension of operations at the facilities would affect the global oil supply and further spike up prices.

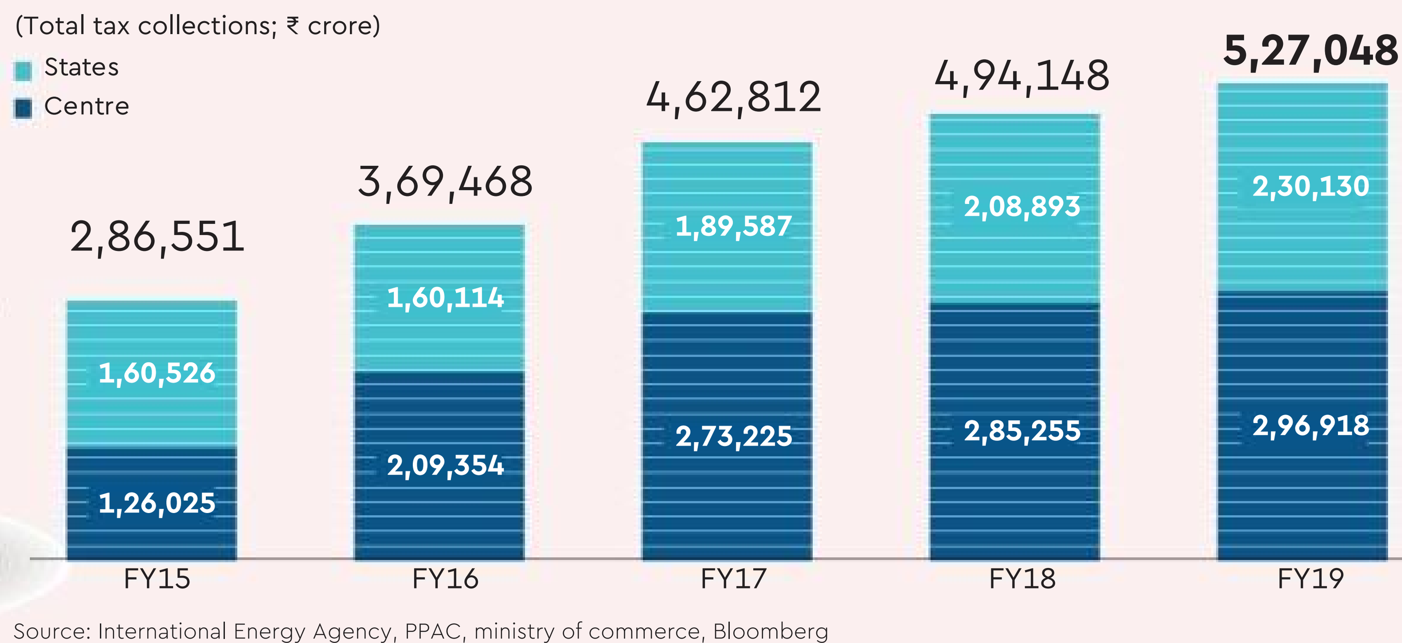
Saudi Arabia is the second-largest supplier of oil to India. India imports around 87% of its total crude oil needs, and higher crude prices will push up trade deficit and current account deficit as the quantity of crude imports is sticky. India has spent $114 billion on oil imports in FY19, up 31% from $87 billion in FY18. Domestic crude production has dropped from 38 million tonnes in FY12 to 34.2 million tonnes in FY19

Any further escalation of geopolitical tensions in West Asia will keep oil prices boiling and impact the fiscal balance of the Indian economy. As India remains vulnerable to global oil price shocks, it must augment its strategic reserves, diversify sources of crude oil imports and invest in alternative sources of energy. The country also needs to encourage foreign players to invest in domestic oil exploration and production for energy security.









Source: International Energy Agency, PPAC, ministry of commerce, Bloomberg