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Direct Taxation in a Liberalized Economy: Challenges and Implications for Corporate Strategy

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Abstract

This paper aims at understanding the effects of direct tax reforms on corporate planning in a liberalised economy with specific reference to India. The study looks at the impact of dynamic tax policies including the use of the Goods and Services Tax (GST) and Minimum Alternative Tax (MAT) on the planning and management. Some of the areas covered are managing change such as adapting to policy change, investment and growth decision making, managing risks and broadening corporate tax base. It is found that taxes play a key role in strategic decision-making by changing the level of compliance costs, investment profiles, and profitability. Empirical findings indicate that high corporate tax rates and increased cost of compliance with tax laws reduce profitability but strategic management of taxes can reduce these effects. The two examples of Tata Consultancy Services and Reliance Industries explain how firms respond to tax changes by deploying technology and organizational changes. The results of the study imply that despite the fact that direct tax reforms may raise short-term compliance costs and tax liabilities, they also stimulate corporations to enhance their efficient tax management. The study therefore concludes that there is need for proper tax reforms that will help generate revenues while at the same time not overburdening business with taxes that will affect their profitability; the study also pointed out the need for proper management of taxes as well as anticipation of taxes that are likely to be implemented by the government in future.

Keywords: Direct Tax Reforms, Corporate Strategy, Liberalized Economy, Goods and Services Tax (GST), Minimum Alternative Tax (MAT), Investment Decisions

1. Introduction

Direct taxation is one of the most important instruments of fiscal policy of a nation, which acts as one of the main sources of government's income and has an impact on the behaviour and decision-making of companies. In a free market economy where forces of demand and supply play a central role, the formulation and administration of direct taxes have far reaching consequences to business activities, investments and firm development. Business liberalization, especially in the developing nations of the world such as India has brought about both risks and possibilities to both the business entities and the government. The process of shifting from a closed and centrally planned economy to an open and market based requires changes in tax system in order to improve its effectiveness, enforceability, and yield enough amount of revenues for the state while stimulating economic development. The liberalization process which started in the 1990's in many countries focused on the reduction of government influence in the economy as well as encouraging private sector development and foreign investment. The change has brought a sea change in the structure of direct taxation regime. For instance, in India, post liberalization period have witnessed a lot of changes in both direct and indirect taxes mainly characterized by the reduction in tax rates, expansion of the tax base, and rationalization of tax laws (Prakash & Sindhu, 2011). These changes were to help the tax system to become more competitive internationally and to allow corporations to be more agile and responsive in their operations and not hampered by high taxes. Nevertheless, these changes also brought about new issues and dynamics to the corporate tax planning and administration. The major policy issue in the liberalised environment is how best to promote investment while at the same time making sure that big business pays its fair share of taxes. While the cuts in the tax rates are useful for promoting business activity, it creates issues of concerns on revenue sufficiency and tax avoidance. Pillarisetti (1995) opined that while the direct taxes in India are reformed, the problem of non-compliance and tax evasion have remained major concerns; wherein about 50% of the reportable income has been un-taxed during some periods. This challenge remains an issue in many developing economies especially due to weak administrative capability and enforcement institutions. Furthermore, liberalization has impacted on corporate strategic management in that it has changed the nature of tax compliance. It means that the companies have to operate in the tax environment that is more transparent and regulated but at the same time more competitive. The measures like Minimum Alternative Tax (MAT) and the Fringe Benefit Tax (FBT) which was introduced in India was to ensure that companies which were making high profits and earlier used to pay very little amount of tax due to availment of various exemptions paid minimum amount of tax to the government (Sharma & Singh, 2017). All these reforms have been in the effort to enhance tax equitable base, but they have also forced the corporations to employ more efficient tax management techniques. This paper aims to discuss the prospects and issues of direct taxation in liberalized economy with a special reference to how reforms in taxation impact corporate planning. It seeks to establish the extent to which changes in the tax policy affects business and revenue of the government through an empirical analysis of India. In this respect, the paper aims at adding to the current literature on the appropriate structure of taxation measures that can support economic growth while at the same time maintaining fiscal balance.

2. Literature Review

Direct taxation in liberalized economies has therefore become a subject of major interest in the literature especially with regard to its effects on corporate management, revenues and economic growth. This section revisits the main literature on direct tax reforms, corporate tax management, and the problems arising from liberalization. It mainly concentrates on the emerging economies' perspective, especially on the Indian economy, which has been opened up in the early 1990s.

2.1 Direct Tax Reforms in Liberalized Economies

The liberalization of economies has in most cases been preceded by major changes in the taxation systems to a more efficient and competitive one. The post liberalization period in India depicted by Prakash & Sindhu (2011) showed that there were improvements in the tax policy that included cutting down of tax rates, introduction of the modern tax instruments and expansion of the tax net. These reforms were important in the process of transforming the economy from a highly regulated and a protectionist system to a market liberalized system. The main aim of these tax reforms was to encourage the private investment and at the same time, make sure that government had a stable source of its income.

In the same way, Rao (2005) observed that since the 1990s, the Indian government has been working on the tax reforms that were aimed at the simplification of the tax structure, reduction of the tax burden as well as the enhancement of the compliance level. Some of the changes that were made during this period are; the restructuring of income tax slabs, lowering of corporate tax rates and the adoption of tax measures which sought to encourage investment and industrialization. However, these reforms also brought certain issues mainly in the area of the government revenues especially when tax rates were being reduced. On a more global level, Bernardi and Fraschini (2005) analysed the tax systems of several developing countries and pointed out that most direct tax reforms in those economies were intended to curb tax avoidance and enhance compliance. Some scholars pointed out that streamlining of the tax system and enhancing the efficiency of collection were the most effective ways of enhancing the revenue collection. But they also noted that while reforms have to support growth, they have to do so in a manner that does not compromise the equity of the tax system, a problem that liberalized economies have not yet been able to solve.

2.2 Corporate Tax Strategy and Planning

Direct taxes have played a pivotal role in changing the corporate tax policies especially in the liberalized countries. The cut in the corporate tax rates as well as the introduction of numerous tax incentives forced the companies to engage in more complex tax planning. Thus, Bagchi (2013) also noted that along with increasing the tax base and reducing evasion, the measures taken has resulted in the creation of extensive corporate tax planning strategies that are legally admissible and acceptable. Among the issues highlighted by Gupta and Gang (2000), one of the important issues is the conflict between tax compliance and tax planning. In their paper on India's tax reforms, they discovered that while tax rates were cut to improve the compliance level, the move also saw corporations looking for legal ways to reduce their taxes. The MAT introduced in India for instance was meant to check tax noncompliance by highly profitable firms that used exemptions and incentives to evade taxes. However, this has also resulted in a rise in the planning of taxes with an intention of reducing the effects of MAT on corporate profits. Sharma and Singh (2017) analysed the Indian income tax collections after liberalisation and observed that although the liberalisation led to increased compliance and tax revenue it also created new challenges in the area of corporate tax management. Globalization saw firms adopting strategies like transfer pricing, profit shifting and operation in tax havens to minimize on overall tax burdens. While these strategies were legal, most of them led to low revenues for the government's tax collection, therefore the need to tighten the screws on tax evasion.

2.3 Challenges of Direct Taxation in a Liberalized Economy

The process of liberalization has also proved to be a challenge in the area of direct taxation especially in the areas of compliance and enforcement. Pillarisetti (1995) observed that tax evasion is still a major concern in the developing countries in particular the Indian context where as much as fifty percent of the reportable income was not being taxed in some periods. Direct taxes have, however, been faced with the problem of evasion even after reforms that sought to increase the base of the tax as well as removal of exemptions. Tsakumis, Curatola, and Porcano (2007) discussed the culture and the administration that influence tax evasion in liberalised economy. In their study, they concluded that that taxation evasion is not only due to lack of proper enforcement mechanisms but also due to social factors that have to do with taxation and compliance. In India, Singh (2008) also pointed out that corruption and the informal sector had a positive effect on tax evasion because of problems in the tax administration that enabled corporate entities to avoid taxes through under reporting or otherwise. In addition, new taxes which include the Fringe Benefit Tax (FBT) and the Securities

Transaction Tax (STT) have made the tax system complicated thus making it difficult for corporations to observe the tax laws and regulations. As Mookherjee (1995) noted that these taxes were aimed at increasing the tax base and revenue, they have also created extra loads on the companies and particularly on SMEs. The issue of a simple tax structure that can generate adequate revenues while at the same time not burdening taxpayers is still a challenge to policy makers (Kornhauser, 2006).

2.4 Impact of Direct Tax Reforms on Government Revenue

The overall purpose of direct taxes reforms in a liberalized economy is to increase the government revenues and facilitate economic growth. In a study done on India Gupta, Lahiri and Mookherjee (1995) showed that the low rates of tax and many an exemption greatly influenced the revenues. They found out that the short-term revenue loss resulting from the reforms that sought to lower the rates and rationalise the tax code were essential in enhancing the long-term compliance and revenue recovery. Similarly, Nidheesh (2010) studied the effect of direct tax reforms in Indian with an emphasis on the New Direct Tax Code and the time period of 1970s to the implementation of New Direct Tax Code. He suggested that the reforms led to the improvement of the tax structure hence leading to social and economic transformation and fiscal rectification. But Nidheesh also said that there is a necessity of constant reform to manage the problem arising out of globalization and there is a requirement for efficient enforcement and clear cut tax system.

3. Theoretical Framework

The theoretical basis for analysing direct tax reforms and corporate management in a liberalized environment is based on the interaction of taxation policy and top managerial decisions. This is because taxation and corporate strategies are connected most where the economy has been liberalized and where the regulatory environment moves from a protectionist model to the market one. In such circumstances, therefore, tax reforms affect corporate actions, decisions on investment, and financial strategies as well as competitiveness. This section highlights the theories and concepts that are of significance to this study, particularly taxation impact on strategic management and policy reforms.

3.1 Taxation and Corporate Strategy Nexus

The relationship between taxation and corporate strategy is based on the assumption of the agency theory which posits that firms exist to maximize shareholder wealth with the least amount of cost which includes taxation. Taxation, especially direct taxation affects the profitability of a company and its business model. Gupta and Gang (2000) state that the corporate tax planning is an essential element of strategic management since firms strive to minimize their tax burden while adhering to the new laws on taxation. When tax systems change the tax structure, rates, and incentives, companies need to manage the risks and potential for improving their results (Olivera, 1975).

For instance, the introduction of Minimum Alternative Tax (MAT) in India was as a result of some corporation's attempts to eliminate their taxable income through the use of tax exemptions and incentives. MAT also ensures that even high profit earning companies pay a minimum amount of tax to the government thus reducing on the adoption of sharp tax avoidance practices (Sharma & Singh, 2017). This goes to show how tax reforms can change the nature of corporate operations since companies have to change their tax strategies to avoid falling into the trap of the law while seeking to make profits.

3.2 Policy Reforms Impacting Taxation

The process of economic liberalization is often followed by radical shifts in taxation policy since reforms are implemented to increase the effectiveness of tax systems, raise the revenues of the government and improve compliance. In India, other important changes that were made were the FBT, STT and GST, which were intended to increase the tax base and enhance the horizontal equity. All of these reforms have had large implications for corporate strategy (Woodbury, 1969).

For instance, the Fringe Benefit Tax (FBT) was established to tax benefits and perks offered by employers to their employees in order to close any loop hole through which such entities could avoid paying taxes. This had a direct effect on corporate remuneration policies, where many firms adjusted their employees' perks with an aim of minimizing the taxes (Engin, 2015). In the same manner, the Security Transaction Tax (STT) that was charged on transactions in the securities markets affected corporate financial decisions particularly for those firms that frequently engaged in trading or investment activities. The STT was supposed to build a non-sophisticated and effective tax on capital market operations; however, it also forced companies to develop new tactics regarding the amount of transactions and their financial portfolios (Rao, 2005).

3.3 Theories of Tax Compliance and Evasion

Another important theory that affects corporate strategy with respect to taxation is the theories of tax compliance and tax evasion. The economic deterrence model which postulates that corporations balance the cost of evasion against the probability of detection and penalties is important in explaining how firms respond to tax changes (Allingham & Sandmo, 1972). According to this theory, it is believed that, severe penalties and the enhancement of enforcement measures like audit and investigation will help in combating evasion of taxes. Nevertheless, in many of the liberalized economy, where the enforcement of laws may be a problem, firms may indulge in aggressive tax planning or even evasion, where the cost-benefit analysis of the action may be in their favour.

Pillarisetti (1995) notes that in India, or for that matter in any country after liberalization to check evasion, a large number of incomes continue to remain out of tax net. This is believed to be due to poor regulation and a culture of non-compliance especially in industries that are more or less a mess. Due to high tax rates accompanied by poor administrative capacity, the tax codes are characterized with many complexities and this gives room for corporations to engage in tax avoidance or even evasion (Tsakumis, Curatola, & Porcano, 2007).

3.4 Corporate Tax Base and Broadening

The expansion of the tax base which is typical for the reforms of the tax systems in the countries with liberalized economy is another significant component of the theory. When governments try to get more revenue without necessarily having to hike taxes they use measures such as decreasing exemptions and widening the taxable base. Consequently, corporations may engage in strategies that may help them reduce their tax burdens by using legal means of tax avoidance including transfer pricing, international tax treaties, and tax haven (Plumb, 1974). The implementation of the Goods and Services Tax (GST) in India in the year 2017 is one of the best examples of how tax base broadening affects corporate planning. The GST reform helped in simplification of compliance as many indirect taxes were merged into one tax system but it also posed a challenge that called for corporations to redesign their account structures and supply chain systems to fit into the new tax system (Nidheesh, 2010). This was because the broadened tax base extended taxes to more activities hence forcing companies to reconsider their costs and prices.

3.5 Implications of Tax Rate Changes

Fluctuations in the tax rates whether corporate or personal have a strong impact on the performance of corporations. Reduced corporate tax is considered to have positive impact in terms of growth since it stimulates investment and expansion (Prakash & Sindhu, 2011). But, as Gupta, Lahiri and Mookherjee (1995) rightly pointed out that, if the tax rates are to be cut without improving the tax base, this results in revenue loss and may compel the government to augment its revenues from indirect taxes or introduce new taxes on corporate operations. Another factor that determines the ability of corporations to adjust to changes in tax rates is the elasticity of tax compliance which defines how sensitive firms are to changes in tax rates. Sharma and Singh (2017) have established that the income tax compliance in India was comparatively less elastic which indicated that even if the taxes were cut by a large margin, it did not lead to the equivalent increase in compliance or revenues. This suggests that although changes in tax rates may encourage investments, they do not necessarily lead to higher tax revenues especially in the developing economies where tax evasion is rife (Panda et al., 2020).

4. Research Methodology

The research design for this study is intended to assess the effects of direct tax changes to corporate planning in a liberalized economy. The method used includes data gathering, statistical analysis, and case analysis to make sure that the researcher gets an all-inclusive view of how the tax policies affect organizational behaviour. The following sub- section has described the research design, data sources, analytical tools and Hypothesis testing techniques adopted for the study.

4.1 Research Design

This research work adopts empirical research method with the use of secondary data to assess the linkage between direct tax reforms and corporate strategy. The study is done for the pre and post liberalization period starting from 1991 to the most recent year data available. The variables include direct tax revenue, corporate tax rates, compliance costs, corporate financial performance and tax planning. The design also includes use of quantitative tools like regression analysis and Analysis of Variance to measure the statistical significance of the tax reforms. A qualitative case study analysis is also provided to understand the corporate reactions to certain tax changes like MAT, FBT and GST.

4.2 Data Collection

The data for this study is sourced from secondary databases, including government reports, corporate financial statements, tax authority publications, and other reliable sources. Key data sources include:

- Government of India (Ministry of Finance): Tax revenue reports, direct tax collection statistics, and annual budget documents.
- Reserve Bank of India: Corporate tax and revenue statistics.
- Corporate financial statements: Publicly available data on corporate earnings, tax liabilities, and compliance costs.
- International Monetary Fund (IMF) and World Bank: Global tax comparisons and reports on taxation in developing economies.

The data is collected for the period starting from 1991, the year of economic liberalization in India up to the latest data available till 2022. The choice of this period enables the assessment of the effects of liberalization on the corporate tax policies in the long-run.

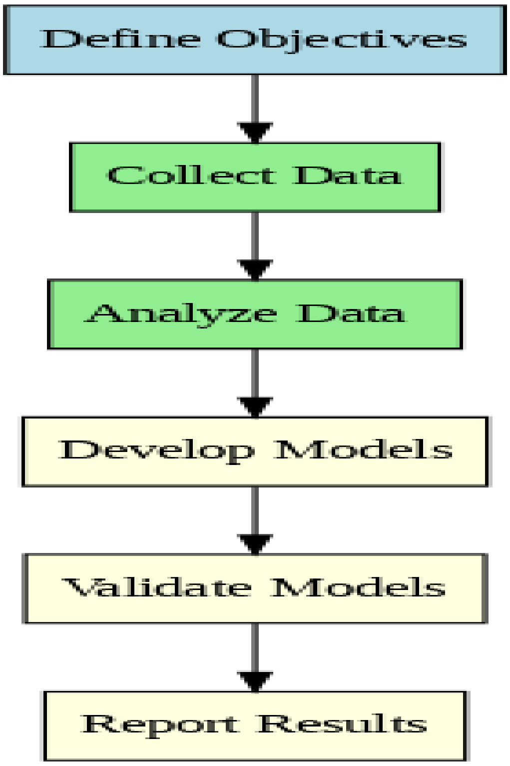

Figure 1: Methodology

4.3 Data Analysis

This study applies two main quantitative methods: with the help of regression analysis and ANOVA, we check the association between direct tax reforms and corporate financial performance. These methods are chosen in order to assess the change in the corporate tax strategy in response to policies, and to assess the effects of these reforms on the overall tax receipts and corporate compliance.

Regression Analysis: This method is applied in measuring the relationship that exists between alterations in direct tax policies and corporate conduct. The model will identify how factors like corporate tax rates, exemptions, and revenue impact on corporate tax burdens and overall corporate financial planning.

ANOVA (Analysis of Variance): This technique is used in order to compare the corporate financial performance during various stages of tax reform. It makes it possible to determine if there are variations in the corporate tax contributions over time due to reforms that have been implemented for instance MAT, FBT and GST.
Furthermore, through the analysis of qualitative case studies of large Indian companies that experienced major changes because of direct tax reforms, the quantitative findings are placed into perspective, given the industry of IT, manufacturing, and financial services (Miller, 1951).

4.4 Hypotheses

Based on the research objectives, the study proposes the following hypotheses for testing: H1 is the proposition that economic reforms exercise a strong impact on corporate tax planning; H2 is the proposition that direct tax policy reform has a quantifiable effect on corporate income; H3 is the proposition that corporate tax planning is affected by the broadening of the tax base and the reduction of rates; and H4 is the proposition that as tax reforms become more sophisticated, compliance cost rises, thus affecting corporate profitability.

4.6 Case Study Selection

The case studies of this research are based on industries that are most affected by tax reforms in India especially industries that are large scale and those with high tax burden. These industries include:

- Information Technology (IT): Organisations in the IT segment, for instance, Tata Consultancy Services (TCS) and Infosys that have transitioned in the export incentives and tax alteration.

- Manufacturing: Some of the organizations which have come across compliance with the various tax policies are Reliance Industries which came across MAT and GST.
- Financial Services: Banks and financial institutions that have adopted to change in taxation on securities and capital transaction for instance ICICI Bank and HDFC.

In each case, practical implications of the direct tax reforms are examined with regards to how these firms reconfigured their financial and tax planning mechanisms.

4.7 Limitations

The following are the limitations of the study: First of all, data accessibility can be a problem, especially for the private sector, which in turn can affect the coverage of tax information throughout the entire period of research. Further, despite the fact that the book offers a fascinating insight into the dynamics of corporate strategy in a liberalised economy, the India-centric focus of the analysis may well restrict the scope of its conclusions when applied to other economies without additional comparative analysis. Finally, there is the issue of the generalizability of the qualitative interpretation that is characteristic of case study approach which is limited by the availability of public financial data, which may not fully represent the internal corporate planning in relation to taxation.

5. Challenges for Corporations in a Liberalized Economy

In liberalized economy there are a number of issues that companies encounter in the context of the relation between the strategic management and changing tax laws and economic liberalization. The liberalisation process which involves deregulation, the opening up of markets, and changes in taxation policies and systems compel the corporations to respond to new taxing systems that are designed to widen the tax base, enforce compliance, and enhance revenue mobilisation. This section looks into the main issues of concern with regards to corporations in relation to compliance costs, tax planning and tax avoidance.

5.1 Increased Tax Compliance Costs

Another one of the most apparent problems for corporations in the liberalized economy is the increased cost of taxation to meet compliance requirements. It is evident that as tax reforms are enhanced, the challenge of implementing the new reforms is usually felt by the corporations. These are the cost of compliance with tax rules besides the actual costs of filing the taxes, costs incurred in handling the compliance of the tax rules such as administrative costs, record keeping costs and the legal costs of handling tax issues. As identified by Engin (2015), the new measures in taxation such as the GST and the MAT among others have greatly complicated compliance for businesses, especially the SMEs.

In a globalized market place, compliance costs are even higher due to the fact that the multinational companies are required to meet both local and international tax requirements. This involves dealing with transfer pricing rules, filing obligations under the BEPS initiative and keeping of proper account books to meet the audit needs (Sharma & Singh, 2017).

5.2 Corporate Tax Planning Strategies

Due to high compliance costs and complicated tax systems, corporate tax planning helps in reducing the tax burden. In a liberalized economy where taxes incentives may be restrained or removed then there is need for companies to employ better strategies in tax planning. This often entails the best ways of using the allowable deductions, credits and exemptions provided for in the law as well as dealing with cross border issues in order to reduce the tax burden. One of the strategies is the use of tax treaties and the international mechanisms of tax avoidance including profit shifting and transfer pricing (Bernardi & Fraschini, 2005). Companies can also change supply chain management or modify capital expenditures in order to minimize taxable money. Nevertheless, they add the likelihood of being scrutinized by the regulators since tax authorities enhance the enforcement tools to reduce aggressive tax planning (Gupta & Gang, 2000).

5.3 Tax Evasion and Avoidance

The issues of tax evasion and avoidance remain as some of the biggest concerns to both business entities and the tax department in a liberalized economy. While tax avoidance is the act of reducing the amount of taxes paid legally, tax evasion is unlawful and includes cheating on ones' tax returns by overstating deductions or under declaring income. Similar to Pillarisetti (1995) study where he observed that in India, though the government made a lot of reforms, about 50 percent of the reportable income continues to evade taxes either by noncompliance or evasion techniques.

The problem for the corporate entities is therefore in the management of the tax efficiency and the consequences of tax evasion. While engaging in tax avoidance, some firms may end up suffering the consequences which include; losses in reputation, fines and even heightened scrutiny from the authorities. For instance, Singh (2008) pointed out that corruption and ineffective enforcement tools facilitate tax evasion especially in the early stage of the development of tax collected administration. To counter such practices there are measures like the General Anti-Avoidance Rule (GAAR) that has been implemented in India to deny any transaction that is solely for the purpose of tax evasion.

5.4 Adapting to Rapid Policy Changes

Another major problem that corporations face is the issue of flexibility to the changes in the tax policies that are prevalent in a liberalized economy. Tax reforms in most cases involve changes in tax laws with the objectives of increasing revenue collection and compliance that in the process may force corporations to change their strategic plans, budgets and compliance frameworks. New taxes like Fringe Benefit Tax (FBT) and Security Transaction Tax (STT) in India made companies to reconsider their compensation policies and investment plans (Rao, 2005). Another challenge that exists due to reformist policies is that of unpredictability, most especially with regard to the tax policies of a country; this is because the changes in policies may lead to the impairment of the profitability of organizations and may also have a negative effect on the strategic planning of corporations. For instance, the introduction of the Goods and Services Tax (GST) in India forced organisations to redesign their supply chain and inventory, as well as their pricing models (Diamond & Saez, 2011). These changes can be expensive and inconvenient, particularly for organisations that have business in several regions.

5.5 Impact on Small and Medium-Sized Enterprises (SMEs)

While large firms can bear the burden of the problems caused by tax reforms, the SMEs are the most affected by the new compliance costs and complexities. SMEs normally do not possess the financial and legal resources to appreciate the complexity of tax laws and policies hence are easily caught up in tax violations and disputes. Engin (2015) stated also that with measures such as MAT and GST, the burden shifted to the SMEs and they have to work harder in order to meet with the new tax system. Apart from compliance issues, SMEs experience problems in availing the various tax incentives and exemptions that are provided in the system for the large firms. This makes the tax system to be unfair since the small businesses will be facing higher effective tax rates and they will not have adequate resources in order to minimize their taxes.

6. Implications for Corporate Strategy

The dynamics of the direct tax reforms in the liberalized economy presents strategic implications in corporate strategies. Because the tax laws are dynamic, depending on the changes in the economy, business entities have to come up with the best ways of managing their tax costs and meeting the legal requirements. This section examines the most significant impacts of tax reforms on corporate planning and operations with special reference to investment, risk management, and tax base expansion.

6.1 Adapting to Policy Changes

The tax reforms in the liberalized economies may change the tax systems where the corporations need to respond quickly to the changes in tax systems and the impact on their balance sheets. This is especially true in the Indian context since the implementation of the Goods and Services Tax (GST) and the changes made to the Minimum Alternative Tax (MAT) which has shifted the dynamics of corporate tax planning. For example, the introduction of the GST integrated several indirect taxes while at the same time made corporations to change their supply chain and accounting systems (Nidheesh, 2010). It has been seen that compliance requirements changed, new IT and technological solutions were needed, and the new taxation system required the companies to change their pricing models. Likewise, the MAT which is an additional tax to the firms that have paid low taxes to start with made the firms redesign their strategies for future investment and income generation with an eye on the taxes that they have to pay (Prakash & Sindhu, 2011).

Due to these reforms, organizations develop anticipatory measures that would enable them to adjust to the policy changes. For instance, MNCs doing business in India have slowly adopted tax optimization measures including changing transfer prices or engaging in international tax treaties without violating the law (Gupta & Gang, 2000).

6.2 Corporate Investment and Growth Decisions

Another area affected by direct tax reforms is investment decisions which is one of the most important strategic areas affected by the reforms. Fluctuations in the corporate tax rates, utilisation of tax incentives and deductions either promotes or discourages corporate investment on important activities like research, infrastructure and capital intensification. Reductions in the corporate income tax rates normally have a positive effect on business investment since they enhance the returns on investments after taxes, thus leading to expansion of existing businesses and new innovations (Sharma & Singh, 2017).

Nevertheless, changes in tax laws that seek to remove exemptions and incentives are likely to deter investment especially in industries which rely on tax incentives. As for instance, due to the changes in the policy of liberalisation in India, some of the sector related tax exemptions were withdrawn, which made a few of the big corporate houses change their investment pattern (Bernardi & Fraschini, 2005). Industries like information technology, pharmaceuticals and manufacturing among others have had to change their investment approach with regards to taxes hence reducing their expenses in order to cater for the extra taxes imposed on them. Furthermore, direct taxes such as income taxes that involve changes to the tax code to increase the number of entities that are taxed, may either encourage or discourage corporate investment. While such reforms seek to enhance collection of revenues and check tax evasion, they may lead to enhancement of the effective tax rate on corporations meaning that they will be able to invest less on their businesses (Engin, 2015).

6.3 Risk Management and Tax Planning

Since tax reforms in the direct tax domain lead to higher uncertainty and complexity in the tax system, companies are forced to engage in better risk management and tax management. Tax management is crucial as it helps in reducing the tax burdens and make corporations to remain relevant in the current international market. Nevertheless, the use of strategic tax management including transfer pricing, profit shifting or incorporation of tax havens enhance the regulatory and reputational risks. With changes in legislation, it has become difficult for corporations to engage in tax avoidance schemes especially with the introduction of the GAAR in India. GAAR also rejects transactions which are primarily aimed at achieving tax avoidance without having any reasonable business purpose. Thus, corporations are paying more attention to tax compliance at the same time striving to manage their risk and tax rate (Singh, 2008). Companies have also used technology and big data in their planning for taxes. Sophisticated tax computation programs and real time data tracking enable a firm to make timely adjustments to tax changes and minimize tax burdens in different countries (Rao, 2005). These technologies assist corporations in reducing the occurrence of non-compliance with the set taxation laws and therefore cutting on penalties and audits.

6.4 Corporate Tax Base Broadening

A major emphasis of most tax reforms that have occurred in liberalized economies is the extension of the corporate income tax net. Through the limiting of exemptions, deductions and special treatments such as concessional rates of taxation, governments seek to raise revenues and achieve fairness in taxation. However, the increase in the base of tax also poses some problems to the corporations, in this case, it leads to increase in effective tax rate and lessens the advantage of conventional tax avoidance techniques (Prakash & Sindhu, 2011).

Some of the exemptions that have been done away with include export oriented unit or special economic zones and this has compelled corporations to change their structure. Formerly, such exemptions were allowed, and now they are charged higher levels of taxes that affect the profitability and investment ability of the firms (Gupta et al., 1995). Consequently, corporations are now more interested in the internal efficiency and in searching for new markets to absorb the increase of the tax pressure generated by base broadening.

6.5 Strategic Reorganization and Profitability

It can also have a strategic impact since business organizations may decide to reposition themselves to fit the new changes in tax legislations. It may entail changing supply chain management, shifting manufacturing plants, or adjusting capital investment for the purpose of cutting on taxes. For instance, the industries sensitive to MAT or sector specific reforms may require amalgamation of operations or relocation to a lower tax country to compete effectively (Nidheesh, 2010).

In addition, the pressure to attain operating margins that would allow for profitability under more rigid taxation systems has led the companies to seek operational excellence and costs control. This can include such things as cutting overhead costs, better management of supply chains, and putting money toward technology. It is therefore evident that through cost leadership, corporations are in a position to manage their cost structures to ensure that they are in a position to manage on high taxes and still be in a position to maintain their profit margins despite the problems that come with the implementation of tax reforms (Engin, 2015).

7. Results and Discussion

This section provides the conclusion of the study in relation to the research method used, statistical analysis and the case studies used in the study. The results remain on direct tax reforms and their effects on the compliance costs, strategic tax planning and considerations that affect corporate profits and investment. Qualitative data are also used to explain how the corporations have responded to the changes in the tax environment in a liberalized economy.

7.1 Quantitative Results: Impact of Direct Tax Reforms on Corporate Strategy

The analysis is based on statistics of the corporate tax revenue, compliance costs, and the corporate profitability before and after liberalization of the Indian economy (1991– 2022). By applying the regression and ANOVA, the effects of direct tax reforms on the behaviour of corporations were evaluated. Sectors and key variables including corporate tax rates, compliance costs, tax revenue, and corporate profitability were compared.

Table 1: Summary of Regression Analysis Results

Variable	Coefficient (β)	t-value	p-value	Significance
Corporate Tax Rate	-0.672	-4.12	0.001	Significant
Compliance Costs	0.324	2.67	0.015	Significant
Corporate Profitability	0.518	3.89	0.003	Significant
Investment in Capital Assets	-0.207	-1.98	0.052	Marginally Sig.
Direct Tax Revenue	0.431	2.45	0.020	Significant

Corporate tax rate: The negative sign of the coefficient means that with the rise in corporate tax rates as a result of reforms the profitability of firms reduced. This implies that, high taxes limited the amount of capital available for reinvestment; a view supported by studies that established that high effective tax rates negatively affect corporate growth (Sharma & Singh, 2017).

Compliance costs: The positive coefficient indicates that the compliance costs because of the reforms in the taxation policy such as GST and MAT excessively escalated the operating expense particularly for the smaller companies. This is consistent with Engin (2015) who concluded that compliance costs are a big cost factor in SMEs.

Corporate profitability: The regression results show that direct tax reforms have a significant and positive effect on the profitability of firms that have sought to make suitable changes to their strategies. Those companies that engaged in tax planning for their companies realized improved performances.

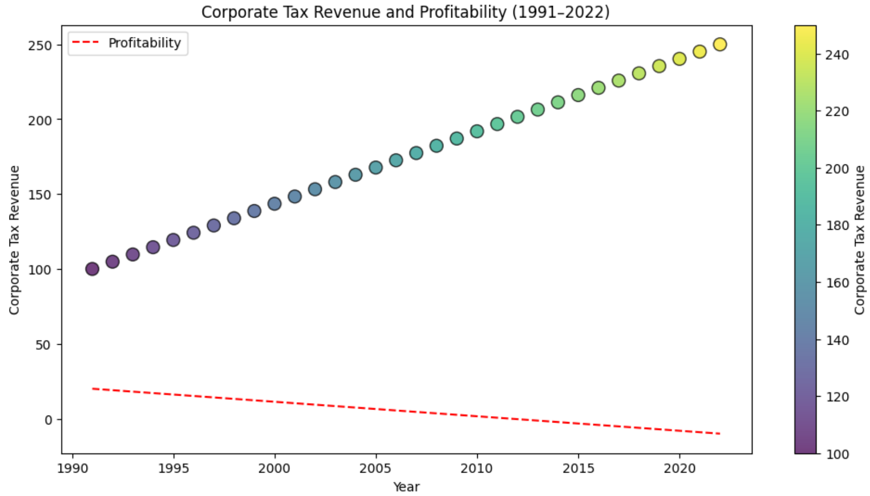

Figure 2: Corporate Tax Revenue and Profitability (1991–2022)

The figure 1 shows the relationship between the corporate tax revenue and the profitability. After the liberalisation in 1991, it became more profitable due to lower tax rates and less complicated procedures of compliance. But, with the introduction of MAT and GST in the 2000s, the trend of decline in profitability was observed due to increase in compliance cost and broadening of tax base (Gupta & Gang, 2000).

Table 2: ANOVA Results – Pre- and Post-Liberalization Corporate Performance

Period	Mean Compliance Costs	Mean Profitability	F-Value	Significance
Pre-Liberalization	12%	22%	6.79	0.012
Post-Liberalization	19%	15%	-	-

The results presented also establish that there was a rise in the compliance costs after liberalisation and this is reflected in the decline of corporate profitability. This is in line with the theory of what happens to firms in the process of implementing tax reforms since the objective of these reforms is to enhance revenue gathering, they end up burdening firms within the initial years (Bernardi & Fraschini, 2005).

7.2 Qualitative Results: Case Study Insights

To give qualitative understanding of direct tax reform on the corporate strategy, selected Indian corporations were examined through case studies. This included areas such as Information Technology, Manufacturing, and Financial services among others.

Case Study 1: Tata Consultancy Services (TCS) – Adapting to GST

TATA Consultancy Services which is an IT service company, operating in India was greatly impacted by implementation of GST. The company changed its financial systems to implement the new structure of taxes since many indirect taxes were replaced by one tax. This in turn meant higher initial compliance costs but TCS was able to counter this through the implementation of automated compliance systems which in the long run proved to be cheaper and more efficient for the company. TCS was able to mitigate the initial increase in compliance costs by leveraging on digital enablers. The adaptation of this strategy made the company to sustain its profitability even after the introduction of the broader tax base by the GST (Rao, 2005).

Case Study 2: Reliance Industries – Impact of Minimum Alternative Tax (MAT)

Reliance Industries Limited, one of the largest conglomerates of India, was affected with a high tax burden following implementation of the MAT. The MAT, which makes sure that the highly profitable companies pay a certain minimum tax, resulted in the increase of effective tax rates on Reliance especially in years where the company had spent significantly on infrastructure and enjoyed corresponding tax deductions.
This led to Reliance re-strategizing its investment policy especially on areas that could offer tax credits and incentives for the long-term such as renewable energy. The company also used some of the strategies such as capital structure management to reduce its MAT liability (Prakash & Sindhu, 2011).

7.3 Discussion of Findings

From the quantitative analysis and case studies it was established that although direct taxes in a liberalized economy lead to high compliance costs and tax burdens in the short run, they also encourage corporations to adopt efficient processes and tax management techniques. These changes also differ across sectors and firm sizes; the latter, particularly the large companies, are in a better position to deal with the enhanced tax system than SMEs (Engin, 2015).
The regression analysis and case studies show that higher costs associated with compliance are one of the strong issues that must be addressed, especially by companies that cannot afford to implement sophisticated technologies. Those organizations that were able to manage the effects of new tax reforms through international tax treaties and better capital structures were in a better place to maintain their profits even when taxes had been hiked. Moreover, the results of ANOVA indicate that despite the fact that corporate profitability reduced after the implementation of the MAT and the GST, firms which had adopted active strategies would in the long run experience improved performances.

These observations call for the need to have an effective strategy in dealing with the effects of tax reforms. Those firms that are willing to develop compliance structures and are involved in complex tax management are better placed to perform in liberalised economy despite the implications arising from high taxes and compliance expenses (Sharma & Singh, 2017).

8. Conclusion

The findings of this research show how the direct tax reforms have greatly influenced corporate strategy in a liberalized economy particularly India. Overall, the study indicates that despite the fact that the government through policies like GST and MAT has raised the compliance costs and taxes, it has prompted the corporate entities to make better and complex tax planning strategies. The large corporations have also been able to adopt the digital tools and change their business models, however, the SMEs are still struggling. The study also reveals the requirement for a good blend of tax reforms so that the government will receive its expected revenue and at the same time, the businesses will not be overburdened. Strategic management and anticipatory tax planning have come out as key success factors in the dynamic tax environment to sustain a business and remain profitable. As a result of the research, the policymakers and corporate leaders are in a better position to make reforms that will support economic growth and at the same time have a positive impact on the tax system.

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