

# INDIA'S "TRUMP" CARD: TAX CUTS!

**Gaurav Sinha — Associate Director, Asset Allocation and Modern Alpha**  
**09/24/2019**

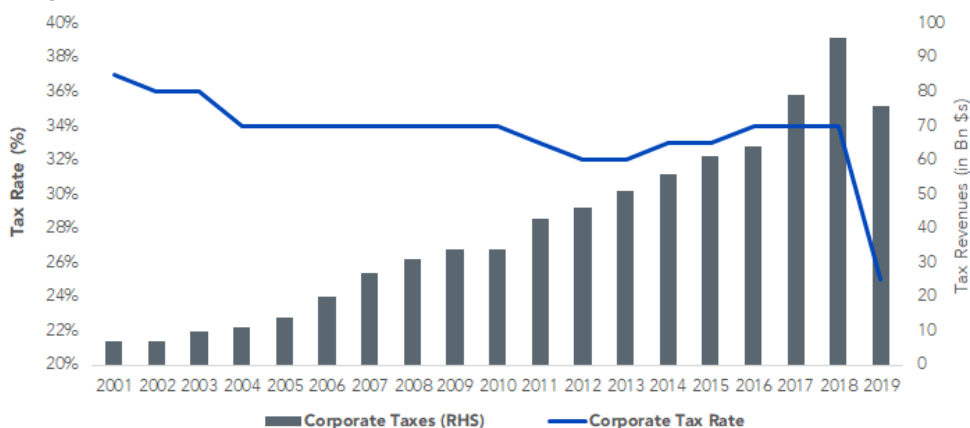
The [International Monetary Fund \(IMF\)](#) has been predicting India to grow solidly above 7% for the foreseeable future. Despite some recent transient weakness, we think India is very well positioned to continue its impressive growth.

Several recent measures to boost the economy point to a political willingness to support India's growth. [After an unprecedented rate cut](#), India's government, in a big boost to "India Inc.," just announced corporate tax cuts of 8% to 15%.<sup>1</sup> My analysis below breaks down what this tax cut means for different sectors and how investors might benefit.

## Scale of Tax Cuts and the Reasoning Behind Them

On September 20, the finance minister of India announced an unprecedented cut in corporate taxes, bringing them down from 35% to 25% in most cases and from 30% to 22% in some cases.<sup>1</sup> With an approximate total tax revenue of around \$100 billion, that's a drop in government revenue of about \$20.5 billion.

### Corporate Taxes



Sources: Credit Suisse, Government of India. Period covered: 12/31/01–9/20/19. Past performance is not indicative of future results. Tax Revenues are the taxes collected by the government in the corresponding fiscal year

### Reason 1: Domestic Growth

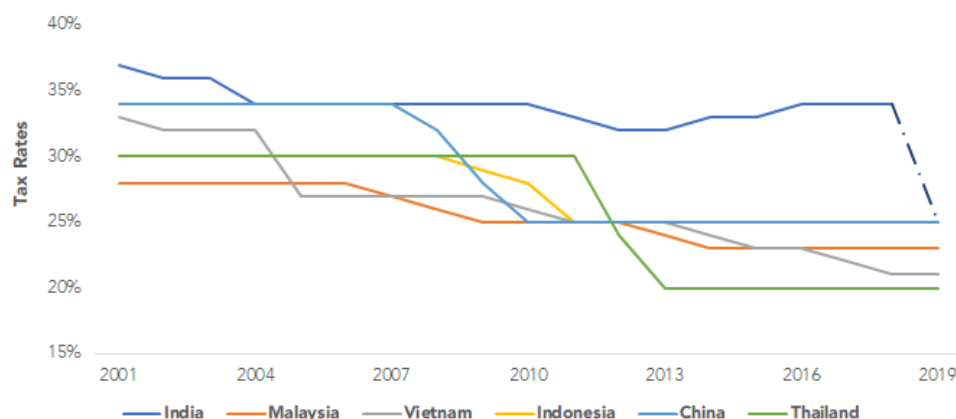
This step reflects policy making in India that responds fast to changing domestic and international environments. Back-to-back reforms that were focused on streamlining taxes caused stress for manufacturers and distributors, and weakening credit growth has affected consumer spending. This has been reflected in weakening sales of automobiles and consumer goods. Thus, it was necessary for government to provide a fiscal boost in addition to the monetary boost provided by the Reserve Bank of India (RBI) in August.

### Reason 2: Trade Competitiveness

Beyond domestic reasons, the tax cut? was made to help incentivize global manufacturing companies to hedge against the effects of the [volatile](#) U.S.-China trade dispute. Early this year, Apple<sup>2</sup> announced that it was shifting some of its manufacturing from China to India, and other companies are also shopping around.

The figure below shows that over the last two decades India has had higher tax rates when compared with China, Malaysia, Vietnam, Thailand and other potential manufacturing hubs in Asia. This put India at a relative disadvantage for companies that were considering moving out of China because of the recent U.S.-China trade war. Thus, current cuts by India are much welcome and, in my opinion, aimed at giving companies an incentive to move to India.

### Corporate Tax Rates (Asian Manufacturing Countries)



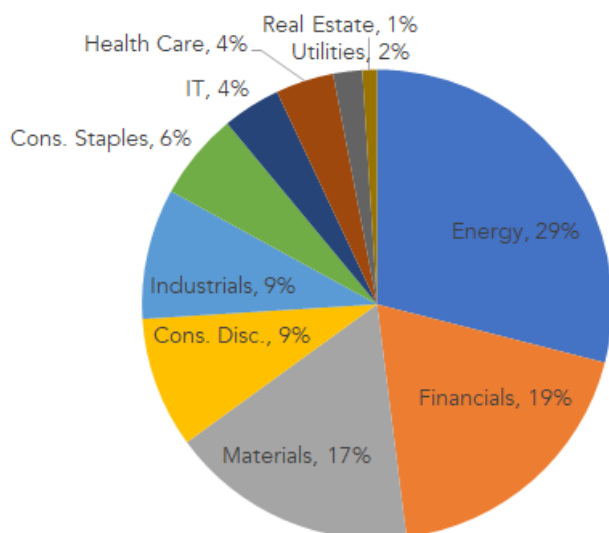
Sources: Credit Suisse, Government of India, World Bank. Period covered: 12/31/01–9/20/19. Past performance is not indicative of future results.

### What Sectors Might Benefit Most?

Breaking down India's tax collection by sector, the Energy and Financials sectors are among the larger tax-paying sectors, and therefore companies in those sectors stand to benefit the most.

This is a shot in the arm for public sector banks that have been reeling from nonperforming assets. This may also help the Energy sector, leading to potentially higher industrial utilization and increased investment activity. ***Extra cash can help corporate companies deleverage and improve their profitability, margins and [return on assets \(ROA\)](#).***

### Tax Collection Per Sector (% of Total Taxes)



Sources: Credit Suisse, Government of India. As of 12/31/18.  
Subject to change.

### Tapping into India's Growth

The [WisdomTree India Earnings Fund \(EPI\)](#) screens for profitable companies and then weights by net earnings. This [mark et cap](#)-agnostic weighting methodology leads to a diversified exposure across [large](#)-, [mid](#)- and [small-cap](#) companies with relatively inexpensive [valuations](#). Relative to the [MSCI India Index](#), this leads to the following:

- Roughly 25% over-weight in mid- and small-cap (but profitable) companies. These firms tend to have a stronger connection to local economy and reflect India's growth more closely than large caps.
- An approximate [price-to-earnings \(P/E\) ratio](#) of 13.6, compared with about 19.6 for the MSCI India Index; thus, a discount of >30% for the same market.
- About 4% over-weight in the Energy sector, which is the biggest beneficiary of the current fiscal boost.

For standardized performance of EPI, please click [here](#).

Recently, we also launched the [WisdomTree India ex-State-Owned Enterprises Fund \(IXSE\)](#), a continuation of our very successful [ex-state-owned](#) product family. This methodology screens and selects only companies with less than 20% ownership by the government. Relative to MSCI India Index, this leads to the following:

- Lean and efficiently run companies led by managers whose objectives are streamlined with those of shareholders.
- No exposure to state-owned banks, financials, etc., which are often unprofitable.
- Basket with overall improved profitability (>30% improvement in ROA).
- Better corporate governance, thus focusing on the G in [ESG](#).

We believe that in this challenging investment landscape filled with geopolitical tensions, India could be an oasis of growth. It went through its [election cycle, with the government led by Prime Minister Narendra Modi coming back to power for another five years in May 2019](#). This removed much of the political instability, which combined with the resolve that the Modi government showed in listening to industry in its first term indicates a period of decisive policy making ahead. The current fiscal boost is another shot in a series of measures fired by policy makers in India to help ensure its

solid growth.

We believe reforms and growth are going to be the story ahead. Trumping most other markets, India is well positioned to outshine.

<sup>1</sup>Companies in different sectors fall in different tax brackets in India. The tax structure of a firm in the Financials sector is very different from a firm in the Technology sector. With the new cuts depending on which sector a firm falls in and what existing cess (levy) /rebates were already applied to the firm, tax rates can fall from 35% to 25% or from 30% to 22%.

<sup>2</sup>Neither IXSE or EPI hold Apple.

#### Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty; these may be enhanced in emerging, offshore or frontier markets such as India. These Funds focus their investments in India, thereby increasing the impact of events and developments associated with the region, which can adversely affect performance. Investments in emerging, offshore or frontier markets such as India are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. As these Funds have a high concentration in some sectors, the Funds can be adversely affected by changes in those sectors. Due to the investment strategy of these Funds, they may make higher capital gain distributions than other ETFs. Funds focusing their investments on certain sectors and/or regions increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. These Funds invest in the securities included in, or representative of, their Index regardless of their investment merit and the Funds do not attempt to outperform their Index or take defensive positions in declining markets. Please read each Fund's prospectus for specific details regarding the Funds' risk profile.

Neither WisdomTree Investments, Inc., nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax advice. All references to tax matters or information provided on this site are for illustrative purposes only and should not be considered tax advice and cannot be used for the purpose of avoiding tax penalties. Investors seeking tax advice should consult an independent tax advisor.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

## **IMPORTANT INFORMATION**

**U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## DEFINITIONS

**International Monetary Fund** : international organization for global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth around the world.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;.

**Return on assets (ROA)** : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

**Market Capitalization** : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

**Large-Capitalization (Large-Cap)** : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

**Mid-Cap** : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

**Small caps** : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**Valuation** : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**MSCI India Index** : A market capitalization-weighted index designed to measure the performance of the Indian equity market.

**Price-to-earnings (P/E) ratio** : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

**Ex-SOEs** : ex-state owned enterprises or companies that are neither wholly or partially owned and operated by a government.

**ESG** : An acronym for environmental, social and governance, ESG standards quantify the degree to which a company is socially responsible. &nbsp;.