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Impact of Financial Sector Reforms on Wealth Tax in India

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Introduction

In mid-1991, the Government of India headed by Mr. P V Narasimha Rao embarked on stabilization and structural adjustment programme. The tax reforms were part of this structural adjustment programme.

As part of fiscal reforms programme, the Government of India appointed a committee under the chairmanship of Dr.Raja j. Chelliah to suggest reforms in the tax system. As per the recommendations of Chelliah committee, far reaching changes were introduced in the wealth tax structure through the Union Budget 1992-93. They changed completely the structure and complexion of wealth-tax in India. They diluted the tax structure. From the Assessment Year 2015-16, wealth tax is not levied in India. This is the gift of BJP Government to the wealthy people of India. The objective of this paper is to examine the reasons for these reforms and the impact of these reforms on direct tax structure in India.

Genesis of Wealth tax in India

Wealth tax was there in India for more than five decades. It was levied since 1957 as per the provisions of Wealth Tax Act, 1957.

The Seventh Schedule to the Constitution of India provides for the levy of a tax on capital value of assets. But the practicality of levy of an annual tax on wealth was examined, for the first time, by the Taxation Enquiry Commission, 1953-54. One of the terms of references to the commission was to make recommendations with regard to fresh avenues of taxation. The Commission made a case, theoretically, for the levy of an annual tax on total wealth at a low rate on the following grounds:

1. That it would complement the income tax;
2. It would secure a better balance in the incidence of taxation among individuals than through the taxation of income alone, particularly in view of the evasion in income tax;
3. The information collected regarding assets and liabilities of individuals would also be of material use as a check on the accuracy of income, inheritance, and gifts reported by the tax payers.

The Commission, however, did not recommend for the imposition of the tax as it felt the valuation of capital assets would pose administrative difficulties.

Subsequently, the government appointed Tax Reforms Commission headed by Prof. Kaldor to investigate into the direct tax system in India. Prof. Kaldor recommended for widening the tax base through the levy of new taxes on wealth, capital gains, gifts, and personal expenditure of individuals. The Government of India accepted the recommendations and the Wealth tax Act, 1957 came into existence for the levy of tax on wealth.

Charge of Wealth tax.

The wealth tax is levied in respect of the "net wealth" of the assesse as it existed on the 'valuation date', the last day of the 'previous year', i.e., 31st March. Every Individual, Hindu Undivided Family, and company is liable to wealth tax. Partnership Firms and Association of Persons are not liable to wealth tax. But the partners of a firm or members of an association of persons are liable for their share in the property of the firm or association of persons, as the case may be.

The levy of wealth tax on companies was suspended with effect from the assessment year 1960-61. In 1983, as a measure to check tax evasion, the levy of wealth tax was reintroduced on certain assets of closely held (Private) companies. With effect from 1st April, 1993, wealth tax is chargeable on all types of companies and is now uniformly charged on all the three taxable entities.

Net Wealth.

The concept of 'net wealth' is an important factor in the wealth tax scheme since net wealth is the tax base. Net wealth means the amount by which the aggregate value of all assets (excluding

exempted assets), belonging to the assesse on the valuation date, including assets required to be included in his net wealth, is in excess of the aggregate value of all debts owed by him on the valuation date which have been incurred in relation to the taxable assets.

Change in the definition of 'Assets"

Wealth tax was levied on the value of 'Assets' as on the valuation date. Section 2 of Wealth tax Act defined the term 'Assets'. Till 1993, the term "Assets" included property of every description, movable or immovable. It included not only tangible property but also Intangible rights. But it excluded: animals, annuity, and short-term interest in property, agricultural land and agricultural building. This was an inclusive definition. But from 1993, the definition of 'assets' was changed. It was made exclusive definition. Only six assets such as buildings, jewelry, motor cars, aircrafts, boats, yachts, Urban Land, cash in hand in excess of Rs. 50,000 in case of Individuals and cash not recorded in the books of account in case of other assesses were charged to tax. Even out of these six assets, assets held as stock in trade and some assets, subject to certain conditions, were also exempt.

Scheme of exemptions from 1993.

In old set up, besides the assets which are excluded from the definition of assets, section 5(1) specified around fifty exemptions in its various clauses and sub-clauses. These exemptions were given keeping in view two objectives: (i) to avoid hardships in certain cases especially because of the inclusive nature of the definition of assets and the low basic exemption limit, (ii) to channelize savings and investments in a particular direction.

In the beginning in 1957, these exemptions were only twenty one. The 1970-71 and 1972 Finance Acts enlarged this list to give incentive to investment in specified financial assets, and investment in the assets of industrial undertakings. This list was further expanded to include investment in foreign exchange assets. With effect from 1.4.1993, the following assets shall not be included in the net wealth of the assesse: (1) Property held under trust, (2) Interest in the coparcenary property, (3) One building in the occupation of a ruler, (4) jeweler in possession of a ruler, (5) assets of Indian repatriate, (6) one house or part of a house or a plot of land belonging to an individual or Hindu Undivided Family.

The scheme of exemption of assets from wealth tax from 1957 to 1992 was laborious and sometime confusing. The exemptions were too many. But what complicated the matter was too many conditions and prescription of limit for exemption. From 1993, the exemption has been given only to six assets and many of the earlier exemptions remain outside the purview of wealth tax because of change in the definition of assets.

Imposition of Wealth Tax on Companies:

Till these reforms, the companies were not liable to pay wealth tax. But from the assessment year 1992-93, the wealth tax was imposed on companies also; but only on these specific assets. The Government could retain this 50 per cent revenue because it brought companies into wealth tax net. However, due to growth in corporate sector, revenue from wealth tax also picked up. In fact, the companies became important wealth tax payers. The wealth tax started yielding revenue of more than Rs. 1,000 crore per annum.

The reasons put forth by the Government for the reforms in wealth tax:

When the reforms were introduced in 1993, the government gave the reason that there should be a distinction between the productive assets and non-productive assets; the valuation of certain assets is complicated, and the exemptions provided under the law are far too many. But these reasons looked not genuine and not based on sound reasoning. But the most important hidden reason was to attract Foreign Institutional Investors into to the country by excluding the financial assets such shares, debentures, deposits, etc. from the wealth tax net. This is evident from one of the arguments put forth by the then Union Finance Minister, Dr. Manmohan Singh for wealth tax reforms. The argument was, that, the valuation of certain assets such as shares which presents problems, and the very high market values due to speculative activity can lead to a heavy burden on shareholders who are long-term investors.

But this was not absolutely true as the valuation of shares and debentures which are quoted on a recognized stock exchange did not involve any procedure at all. Just the price quoted on the valuation date that is, March 31st was taken as the value. The other half of the reason that a very high market values due to speculative activity were leading to heavy burden on long-term

shareholders is true to some extent. But it could have been remedied by a concessional treatment to such long-term investments. As a result of this change the revenue from wealth tax fell by more than 50 per cent.

But the present Finance Minister, Mr. Arun Jaitley, abolished wealth tax last year. The reason given for this abolition was that the revenue from wealth tax was much less than the expenditure incurred to collect it. This is again not the true reason as there was no separate department to collect wealth tax. Wealth tax was collected by the Income tax Department. It is not so easy to allocate the expenditure of tax collection between income tax and wealth tax.

Even if we accept the reason that the expenditure incurred was much more than the revenue collected, for what purpose the Government spent this money? Obviously, it is spent for paying salary to the staff that is in charge of collecting the tax. Then Rs. 1000 crore worth of work was lost in country every year. But the real reason seems to favour the corporate sector by abolishing wealth tax. Nobody openly asked for abolition of wealth tax. But our honorable finance minister did it. Thus, created an imbalance in the tax structure. Income tax is the only Direct Tax in India today. The Finance Minister Mr. Jaitley also buried, along with the wealth tax, the option for Direct Taxes Code.

What everyone forgot was that the wealth tax was never levied for revenue reasons. It was levied mainly to complement the Income tax, to secure a better balance in the incidence of tax and to curb evasion of income tax. Unfortunately the wealth tax was abolished for all together a different reason which is known truly to our Finance Minister Arun Jaitley.

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