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Need to Modify in Current Tax Codes and Wealth Taxes in India

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Abstract: As part of new economic policy, the Government of India introduced far reaching reforms in the tax system. Reforms in the wealth tax system virtually led to its abolition in the year 2015-16. The reason given was the cost of collection was much higher than the revenue collected from it. This argument is not tenable. As part of comprehensive tax reforms, the previous government had planned to introduce Goods and Services Tax which combined all the indirect taxes and the Direct Taxes Code which combined both the Income tax and the Wealth tax. Both the system adopted international best tax practices. But instead of implementing Direct Taxes Code, the Government abolished wealth tax which has created an imbalance in the tax structure. Hence, it is argued here that there is a need to revive Direct Taxes Code and wealth tax in the country.

Index Terms - Wealth tax, Direct Taxes Code, Indirect taxes, Tax Reforms, Inequality.

INTRODUCTION

In mid-1991, the Government of India headed by Mr.P.V. Narasimha Rao embarked on structural adjustment and stabilization 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. The Government of India implemented the recommendations of the Committee in commensurate with New Economic Policy. Later the Government attempted a comprehensive tax reforms in accordance with the International practices. It implemented Value Added Tax in 2005 which replaced the State Sales tax. It is a revolutionary step as it was aimed to bring uniformity in the states indirect tax structure, near uniformity in rate structure, reduction in cascading effects of tax and in tax evasion. Similar type of comprehensive indirect tax reforms which can be called “Big Bang” reform, were implemented by introducing Goods and Services Tax with effect from July 1, 2017. The entire nation came under GST. This reform aimed at unification of Indirect taxes in the country. Similar type of reforms was planned in Direct Taxes structure also by implementing Direct Taxes Code which would unify all the Direct tax legislations into one. The Government of India introduced Direct Taxes Code Bill, 2009 in Parliament. It was considered to be adhering to the international best tax practices. But unfortunately this is yet to be implemented in India and the need to revive it is more today. The Government of India abolished Wealth tax in the Union Budget for 2015 under the pretext that the cost of its collection was much higher than the revenue collected from it. This further reduced the chances of implementation of Direct Taxes Code in India. Further, the Government of India constituted a Task Force in November, 2017 to review and redraft the Income Tax legislation and it shall submit its report to the Government by February, 2018.

OBJECTIVES OF THE STUDY

1. To examine the reasons for introducing wealth tax in India,
2. To study whether the objectives of wealth tax are no longer relevant in India
3. To examine the reason for abolition of Wealth Tax,
4. To consider the need for reviving the DTC instead of only redrafting the Income tax legislation.

METHODOLOGY OF THE STUDY

The study is based on the secondary sources of information. The information is collected from the reports of various Taxation Committees set up by the Government of India from time to time and the research publications.

Scope and Limitations

The study focuses mainly on the need to revive Direct Taxes Code and through it the revival of wealth tax in India. The study has the limitation of non-availability of official statistics about Income and wealth inequality in India. Hence, it is based on the data compiled and published by the international agencies and other researchers.

WEALTH TAX IN INDIA

Wealth tax Act, 1957 came into effect from 1st April, 1957, though it received the assent of the President of India on 12th September, 1957. Consequently, wealth tax was levied in India from the financial year 1957-58 on Individuals, HUFs and Joint Stock Companies. But the levy of wealth tax on companies was suspended from the Assessment Year 1960-61. That means the wealth tax on companies was in existence only for two Assessment Years. However, it was reintroduced on specified assets of closely held companies in 1983 and on all the companies 1992.

The Wealth tax was in existence in India for almost 6 decades and was subjected to reforms as and when the time warranted. 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. It was made applicable to all the companies.

Wealth tax was abolished by the Finance Minister Mr. Arun Jaitly in the union Budget, 2015 with effect from the financial year 2016-17. The reason given for the abolition of wealth tax was that the cost of collection of tax was more than the revenue from the wealth tax. This paper attempts to examine the truth in the reason given by the Finance Minister for abolition of wealth tax. It revisits the historical reason for the levy of wealth tax and the relevance of that reason today. It also examines if there is a need for revival of wealth tax in India and if so, what is the best way to do so.

GENESIS OF WEALTH TAX IN INDIA

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 felt that the tax structure in India is not properly balanced and hence, he 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 was levied in respect of the “net wealth” of the assessee as it existed on the ‘valuation date’. The last day of the ‘previous year’, i.e., 31st March, is the valuation date. Every Individual, Hindu Undivided Family, and company was liable to wealth tax. Partnership Firms and Association of Persons were not liable to wealth tax. But the partners of a firm or members of an association of persons were 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, 1983, wealth tax was chargeable on all types of companies and was 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 assessee 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.

DEFINITION OF ASSETS TILL 1993 [SECTION 2(E)]

‘Assets’ includes property of every description, movable or immovable but does not include-

- (i) agricultural land and growing crops, grass or standing trees on such land;
- (ii) any building owned or occupied by a cultivator or a receiver of rent or revenue out of, agricultural land;
- (iii) animals;
- (iv) a right to any annuity in any case where the terms and conditions relating thereto preclude the commutation of any portion thereof into a lump sum grant;
- (v) any interest in property where the interest is available to an assessee for a period not exceeding six years from the date the interest vests in the assessee.

Agricultural land and building enjoyed total exclusion from the definition of Assets for and up to the assessment year 1969-70 and from the assessment year 1983-84.

CHANGES IN THE DEFINITION OF 'ASSETS' FROM 1993

The definition of 'assets' discussed above was same from 1957 to 1993. Any change in this definition was restricted to agricultural land and building. This definition was completely changed. The new definition came into force from 1st April 1993. While the old definition was all inclusive and gave a list of assets that are excluded from the definition, the new definition is quite reverse. It is all exclusive. It just gives a list of assets which alone are subject to wealth tax. As per the new definition under section 2(ea), asset means-

- 1) any building or land appurtenant there to: commercial building, residential building, any guest house, a farm house situated within 25 Kms from the local limits of a local authority. However, the following buildings will not be included in the asset:
 - a) a house meant for residential purposes allotted by the company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than Rs. Five lakhs,
 - b) any house for residential or commercial purposes which forms part of stock-in-trade,
 - c) any house which the assessee may occupy for the purpose of business or profession carried on by him,
 - d) any residential property that has been let out for minimum period of 300 days in the previous year,
 - e) any property in the nature of commercial establishment or complexes.
- 2) Motor cars (excluding those used by the assessee in the business of running them on hire or as stock-in-trade).
- 3) Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloys containing one or more of such precious metals (excluding those held as stock-in-trade by the assessee).
- 4) Yachts, boats and aircrafts (excluding those used by the assessee for commercial purposes).
- 5) Urban land with certain exceptions.

This is a very significant change from 'all inclusive' definition to 'all exclusive' definition of assets. This has changed the whole structure and purpose of wealth tax in India.

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 specially 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 `92 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 assessee:

- (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.

THE REASONS FOR STRUCTURAL CHANGES:

The reasons given by the then Finance Minister Dr. Manmohan Singh for effecting changes in the structure of wealth tax were as follows:

- a) The exemptions provided under the wealth tax Act, 1957 are far too many making its administration enormously complicated.
- b) The valuation of certain assets such as shares also 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.
- c) There is no distinction at present between productive and non-productive assets. Investment in productive assets such as shares, securities, bonds, bank deposits, and also through mutual funds should be encouraged. And investment in non-productive assets such as residential houses, urban land, jeweler, bullion, motor cars, planes, boats and yachts which are not used in commercial purposes should be discouraged. Hence, wealth tax is levied only on specified unproductive assets.

CLASSIFICATION OF ASSETS AS PRODUCTIVE AND NON-PRODUCTIVE

Let us examine the soundness of the argument for taxing only unproductive assets. Shares, securities, bonds, bank deposits, investment in mutual funds and the like are treated as productive assets. Productive means what? Is it producing some income to the investor? Or using the savings of the persons to produce goods and services, thus productive to the whole society? If it is the first one, investment in the shares of all companies may not yield income. Many gullible investors have lost their savings by investing in fly by night companies, in companies whose projects have not started off, in companies whose shares are neither quoted in the stock market nor dividend is declared for years together. Look at the loss incurred by the investors in capital market during 2008 global financial crisis.

Certain assets are treated as non-productive and have been exempted from wealth tax. For instance, take a residential house. How a residential house is unproductive? Is it that it does not produce any real income to the owner? Or does not contribute directly to the production of goods and services? If it is the first reason, if a person constructs a house and lets it on rent, he earns regular income. Many people do so. Then is it not this type of a house which is used for the purpose of renting out a productive asset? The residential house given to an employee or officer of director who is a whole-time is productive asset. How come the same residential house is used by an individual business man or self-employed person becomes an unproductive asset? What about the indirect contribution of the house to the productive capacity of a man? For that matter, the contribution of the so called unproductive assets like motor car to the productive capacity of a man. Take another example. If motor car is an unproductive asset how come the shares in company manufacturing motor cars are productive then should investment in the shares of companies manufacturing an unproductive asset like motor car be encouraged. Hence, the classification of assets as productive and non-productive is highly arbitrary and ambiguous.

MINIMUM EXEMPTION LIMIT

Since the passing of wealth-tax Act, 1957 there has been constant change in the minimum exemption limit

.To secure equity and administrative efficiency, Kaldor had recommended for a single exemption limit of Rs.1 lakh for all types of assesses. But when the wealth-tax came into existence, an exemption limit of Rs.2 lakh was prescribed for individuals and Rs.4 lakh for HUFs. Later on, with effect from the assessment year 1964-65, these limits reduced were to Rs.1 lakh and Rs. 2 lakh.

The Finance Act, 1971 made the taxation of wealth more rigorous. Although the same exemption limit of Rs.1 lakh and Rs.2 lakh were continued, such exemption was available only where the net wealth was below the exemption limit. When the net wealth exceeded the limit even by a fraction, the tax exempt slab was also included in taxable wealth. However,

there was marginal relief in these cases. The Finance Act brought on the uniform limit of Rs.1 lakh. Later on this limit was gradually increased to Rs.2.5 lakh and this was fully exempt slab.

Now the Finance Act, 1972 has thrown-up this minimum exemption limit to Rs.15 lakh, six times higher than what was existed till then. When the tax was abolished, the minimum exemption limit was Rs.30 lakhs and the tax rate was flat 1 per cent on the net wealth exceeding Rs.30 lakhs.

DIRECT TAXES CODE BILL 2010

The proposals on the levy of wealth tax in the Direct Taxes Code Bill 2010 try to retain the existing structure of wealth tax which came into being from 1992. Wealth tax will be levied on specified assets of individuals, HUFs and Private Trusts. Companies have been removed from the list of taxable entities. Section 113(2) lists out the specified assets as comprising any building or land, farm house, urban land, car, yacht, boat, helicopter, and jewellery, archaeological collection, watch of value in excess of Rs.50,000, cash in excess of Rs. 2 lakh, shares held by a resident in a controlled foreign company, etc.

The minimum exemption limit has been raised from Rs. 30 lakh to Rs. 1 crore and the tax rate is retained at 1 per cent. However, the original proposal in the draft based on Discussion Paper 1 was intended to bring back the structure as it existed before 1992. The original draft proposed the levy on all assets including the financial assets, the so called productive assets. In fact the paper listed several arguments in favour of the levy of wealth tax. Holders of substantial economic resources have the capacity to pay higher taxes than those with similar incomes, but with less wealth. It will add to the overall progressivity of the income tax without increasing marginal rates. It will capture income tax avoided partially. In fact these were the important reasons advanced for the levy of wealth tax in 1957.

IS ABOLITION OF WEALTH TAX JUSTIFIED?

Wealth tax was levied not just for the purpose of raising revenue. Revenue raising was a subsidiary objective of the levy of wealth tax in India. The important objectives were: that wealth tax would help in curbing of evasion of income tax as the information collected regarding assets and liabilities of individuals would also be of material use as a check on the accuracy of income; it would secure a better balance in the incidence of taxation than through the taxation of income alone; it would complement income tax; it would help in reducing wealth inequalities. It does not mean that the wealth tax will achieve these objectives on its own. It would help in its own way to resolve these problems.

Cost of Collection Theory: The Wealth tax was abolished in India giving the reason that the revenue collected from the wealth tax was much less than the cost incurred to collect it. This argument is not tenable as the Wealth tax was collected by the Income tax Department. It means, there was no separate tax authority for wealth tax. Hence, it is not an easy task to allocate the cost of collection of tax by the Income tax Department between Income tax and Wealth tax. Table 1 shows the cost of collection of tax in India. The cost of collection was 1.36 per cent of the total collections in the financial year 2000-01 and it has shown constant downward trend. It was 0.61 per cent in the financial year 2017-18.

Wealth inequality in India is only too apparent. India has one of the most unequal wealth distributions in the world. The annual Global Wealth Report brought out by Credit Suisse indicates that the Gini coefficient of wealth distribution in India estimated in 2018 was as high as 85.4 per cent. This was only slightly below that of Russia (widely recognized to be the most unequal) and even slightly above Brazil and the United States, where wealth inequalities are much discussed. The wealth inequalities have grown in India over the years. The top decile increased its share of estimated wealth from 70 per cent in 2000 to nearly 82 per cent in 2016, and since then its share has fallen only marginally to 77.4 per cent in 2018. Meanwhile the trend in the share of the top 1 percentile is even more shocking. It has gone up from 39 per cent to as much as 58.4 per cent during the same period. So, only 1 per cent of Indians hold more than half of the estimated wealth of the country. But this is only a recorded wealth in the country excluding wealth held by these rich people abroad.

TABLE-1

COST OF COLLECTION

(Rs. in crore)

Financial Year	Total Collections	Total Expenditure	Cost of Collection
2000-01	68305	929	1.36%
2001-02	69198	933	1.35%
2002-03	83088	984	1.18%
2003-04	105088	1050	1.00%
2004-05	132771	1138	0.86%
2005-06	165216	1194	0.72%
2006-07	230181	1349	0.59%
2007-08	314330	1687	0.54%
2008-09	333818	2248	0.67%
2009-10	378063	2726	0.72%
2010-11	445995	2698	0.60%
2011-12	493987	2976	0.60%
2012-13	558989	3283	0.59%
2013-14	638596	3641	0.57%
2014-15	695792	4101	0.59%
2015-16	741945	4593	0.61%
2016-17	849713	5578	0.66%
2017-18*	1002741	6087	0.61%

*Provisional

Source: Income Tax Department, Time Series Data, Financial Year 2000-01 to 2017-18

Lucas Chancel and Thomas Piketty estimated that top 1 per cent of the Indian population account for around 22 per cent of the country's income. As shown in the table 2, total real per adult income growth was 3.3 per cent for the full population and it was 1.9 per cent for the bottom 50 per cent, whereas it was 6.6 per cent in case of top 1 per cent of the population. Growth was 9.4 per cent in case of top 0.001 per cent. This indicates that the real income growth in case of top 1 per cent of the population was much higher than the full population and the bottom 50 per cent of the population.

Table-2

AVERAGE ANNUAL PER ADULT INCOME GROWTH BY INCOME GROUP IN INDIA, 1980-2015

Income group (distribution of per-adult pre-tax national income)	Total real per adult income growth (1980-2015)
Full population	3.3 %
Bottom 50%	1.9 %
Middle 40%	2. %
Top 10%	5.1 %
incl. Top 1%	6.6 %
incl. Top 0.1%	7.7 %
incl. Top 0.01%	8.9 %
incl. Top 0.001%	9.4 %

Source: **Lucas Chancel and Thomas Piketty. Indian income inequality, 1922-2015: From British Raj to Billionaire Raj? July 2017**

Share of Direct taxes in the total taxes: The share of the direct taxes in total tax revenue has been declining since 2010-11. As seen in table 3, it has shown increasing trend from the financial year 2000-01 to 2009-10 and has started declining thereafter. It has declined from 60.78 per cent in 2009-10 to 51.03 per cent in 2015-16. It indicates that the

government is relying more and more on indirect taxation. Indirect taxes are regressive and put the burden of raising fiscal resources on the common people. There are high net worth individuals and highly profitable companies which pay relatively less tax. But no government would venture to tax these groups.

TABLE-3

CONTRIBUTION OF DIRECT TAXES TO TOTAL TAX REVENUE

(Rs. in crore) Financial Year	Direct Taxes	Indirect Taxes	Total Taxes	Direct Tax As % Of Total Taxes
2000-01	68305	119814	188119	36.31%
2001-02	69198	117318	186516	37.10%
2002-03	83088	132608	215696	38.52%
2003-04	105088	148608	253696	41.42%
2004-05	132771	170936	303707	43.72%
2005-06	165216	199348	364564	45.32%
2006-07	230181	241538	471719	48.80%
2007-08	314330	279031	593361	52.97%
2008-09	333818	269433	603251	55.34%
2009-10	378063	243939	622002	60.78%
2010-11	445995	343716	789711	56.48%
2011-12	493987	390953	884940	55.82%
2012-13	558989	472915	1031904	54.17%
2013-14	638596	495347	1133943	56.32%
2014-15	695792	543215	1239007	56.16%
2015-16	741945	711885	1454180	51.03%
2016-17	849713	861515	1711228	49.65%
2017-18*	1002741	915256	1918210	52.29%

*provisional

Source: Income Tax Department, Time Series Data, Financial Year 2000-01 to 2017-18

The above discussion reveals that there is imbalance in the tax structure and there is need to bring back the wealth tax. The best method is to revive the Direct Taxes Code in toto. The Direct Taxes Code has been in public domain for quite long and it adheres to the best international tax practices.

CONCLUSION

Classification of assets as productive and non-productive was highly arbitrary and ambiguous. There was no need for such a whole sale incentive of abolition of tax on so called financial assets and reduction of tax rates. In order to compensate the revenue loss, the government imposed wealth tax on all the companies. It is no secret in India that the corporate lobby is very strong. Removing wealth tax on companies would have created political debates. Best option would have to implement the Direct Taxes Code in which wealth tax on companies has been removed and in its place Private Trusts were brought in. When the wealth tax was introduced way back in 1957, it was mainly viewed as a measure to check evasion of other taxes like income tax, gift tax and inheritance taxes, and for equitable distribution of wealth. Since only a few assets were subject to wealth tax, even this purpose was not served.

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