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Shift from Wealth Tax to Additional Surcharge on Super-Rich in India: Equity v/s Efficiency

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Abstract:

Wealth tax is an annual tax on the wealthier individuals of a society with an objective of bringing equality in the society and also to raise higher tax revenues. India implemented "The Wealth Tax Act" in 1957 which was an Act of the Parliament of India, enacted with the objective to levy wealth tax on entities with net wealth of thirty lacs and above. However, in the Finance Act of 2015, the Wealth Tax was replaced with an added surcharge of two per cent on super-rich who have a taxable income of one crore and above annually. It was expected that the revenue loss because of this act would be recompensed with revenue from high income group. In this paper we try to highlight upon the shortfalls of the wealth tax in the Indian context keeping the trade-off between equity and efficiency as a backdrop.

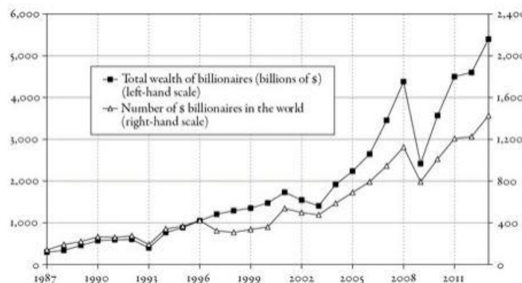
Key words: Wealth Tax, Additional Surcharge, the Super-Rich, India

1. BACKGROUND AND INTRODUCTION

Economists all over the world are trying to solve the problem of allocating the scarce resources in the best possible way. However, Economics as a study does not provide an answer to the question of equity i.e. "What constitutes a just distribution of wealth?" (Isaacs, 1977). According to Isaacs (1977), one can find the answer to the above question only by the use of "value judgments" and "individual preferences". Before the question of

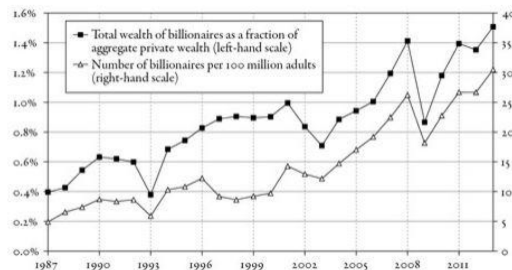
justice, there comes the question of the need of justice in distribution of wealth. Why do we need a wealth distribution? Piketty (2014) reports that between 1987- 2013, the population of billionaires (dollars) increased from hundred and forty to fourteen hundred according to Forbes, whereas the total wealth of these persons increased from $300 to $5,400 billion. This can be seen in figure 1. Further, Piketty (2014) also showed that from the year 1987 to 2013 the world witnessed, an increase in the number of billionaires per hundred million adults from 5 to 30, whereas the share of their wealth in the aggregate private wealth increased from 0.4 per cent to 1.5 per cent (figure 2).

Figure 1: The world's billionaires according to Forbes, 1987–2013



Source: Piketty (2014), p.305

Figure 2: Billionaires as a fraction of global population and wealth, 1987–2013



Source: Piketty (2014), p.306

We know that every individual has been privileged with right to life and right to freedom, but many are being deprived of these

rights in different parts of the world due to acute poverty. In such a scenario, it seems to be fully justified to impose a tax on the wealth of the people of rich countries if it can bring relief to such destitution (Pogge 2007). At a country level a similar transfer can be justified. Thus a wealth tax imposed by many nations can be seen as a step towards bring down the inequity gap within the society.

Wealth tax is an annual tax on the wealthier individuals of a society with an objective of bringing equality in the society and also to raise higher tax revenues. Scandinavia in early 20 century, introduced meek yearly levies on wealth which was then followed by other European nations (Glennerster, 2012). India came up with its "The Wealth Tax Act" in 1957.

The Wealth Tax Act of 1957 is an Act of the Parliament of India which was implemented with the objective to levy wealth tax on "an individual, Hindu Undivided Family (HUF) or a company is in possession of, on the corresponding Valuation Date" (Sec.3(1), Wealth Tax Act, 1957).

Estimated wealth tax collection for the year 2014-15 was INR.1008 crores (Union Budget 15-16), whereas it was approximately INR 788 crores for the fiscal year 2011-12 (Union Budget 2012-13) and INR 844 crores for the fiscal year 2012-13 (Union Budget 2013-14), which are not very impressive numbers if we are concerned about the transfer from the rich to poor for a huge (in population) country like India and which has a large proportion of individuals below poverty line. Even though the collection through the Wealth Tax was minimal it must have created noteworthy compliance burdens on the tax-payers along with burdens in term of administration costs for the tax department.

While announcing the Budget 2015 (also known as the Finance Act, 2015), the India's 37th Hon. Finance Minister Mr. Arun Jaitely replaced the Wealth Tax with an additional surcharge of two per cent on super-rich who have a taxable income of one crore and above annually. It was expected that

the revenue loss because of this act would be recompensed with revenue from high income "assessees", where an "assessee" is defined in section 2(c) as a person by whom wealth-tax or any other sum of money is payable under this Act.

In this paper we try to look at the pros and cons of the wealth tax in India with the help of a comparison with some international cases. In the following sections, Section 2 describes the Wealth Tax Act in brief along with a time-line of the Act. Section 3 talks about some of the major shortfalls of the wealth tax in India. And lastly, section 4 tries to analyse the question of a trade-off between equity and efficiency.

2. INDIA – THE WEALTH TAX ACT, 1957

The Wealth Tax Act of 1957 is an Act of the Parliament of India which was implemented with the objective to levy wealth tax on "an individual, Hindu Undivided Family (HUF) or a company is in possession of, on the corresponding Valuation Date" (Sec.3(1), Wealth Tax Act, 1957).The outset limit for taxable net wealth is INR 30 Lac.

Sec.2(c) defines an "assessee" as a person by whom wealth-tax or any other sum of money is payable under this Act, and includes;

"(i) Every person in respect of whom any proceeding under this Act has been taken for the determination of wealth-tax payable by him or by any other person or the amount of refund due to him or such other person;

(ii) Every person who is deemed to be an assessee under this Act;

(iii) Every person who is deemed to be an assessee in default under this Act;"

However, Sec 324 (45) excludes the following parties;

(i) "Any company registered under Section 25 of the Companies Act, 1956.

(ii) Any political party,

(iii) Any social club,

(iv) Any co-operative society,

(v) A mutual fund specified under section 10(23D) of the Income Tax Act – 1961"

This Act was thoroughly revised in the year 1993 and the list of assets inclusive in the Act Section.2(ea) were as follows;

(i) "Any building or house in use either for "residential" or "commercial" function or for using as a guest house. {excluding; (1) a house allotted by a company to an employee for residential purpose,; (2) any house for residential or commercial purposes which forms part of stock-in-trade; (3) any house which the assessee may occupy for the purposes of any business or profession carried on by him; (4) any residential property that has been let-out for a minimum period of three hundred days in the previous year; (5) any property in the nature of commercial establishments or complexes."

(ii) Motor cars for private use only.

(iii) "Jewellery and any item made wholly or partially with precious metals."

(iv) "Yachts, boats and aircrafts (provided they are not for the commercial uses);

(v) urban land"

(vi) "Cash in hand above INR 50,000, of individuals and Hindu undivided families, for whereas for companies any amount not recorded in the books of account."

Sec. 2(e) excludes the following assets from the wealth tax application (with effect from April 1, 1983; after the amendments)

(i) “agricultural land and growing crops (including fruits on trees), grass or standing trees on such land”;

(ii) “one building or one group of buildings owned or occupied by a cultivator of, or receiver of rent or revenue out of, agricultural land; Provided that such buildings or group of buildings is on or in the immediate vicinity of the land and is a building which the cultivator or the receiver of rent or revenue by reason of his”

(iii) “connection with the land requires as store-house or for keeping livestock”;

(iv) “animals”

“The Direct taxes Code Bill 2010” replaced the “Income Tax Act, 1961” and the “Wealth Tax Act, 1957”. The Direct Tax Code uses the same method of taxing the wealth as the Wealth Tax Act, 1957.

The wealth tax under this Bill was thought to be payable by all tax-payers excluding the NPOs (non-profit organizations). The threshold limit and rate of tax have been suitably calibrated in the context of overall tax rates to provide an exemption limit of Rs.1 crore (which was earlier 15 Lacs) and tax @1% on any amount in excess of this limit (Direct Taxes Code Bill, 2010). Lately the Finance Act 2015, replaced the “Wealth Tax” with an “additional surcharge of two per cent on super-rich” who have a taxable income of one crore and above annually.

3. MAJOR SHORTFALLS OF WEALTH TAX IN INDIAN

In the realm of direct taxes many nations resort to property taxes on the current market price of the real estate as they cannot be shifted under a new State like cash, paper wealth etc. can (Anghel & Ciocodeică, 2011). “In regions where overall

real estate values are high, property tax revenues provide a great deal of revenue to local governments" (Anghel & Ciocodeică, 2011). In India, as discussed in section 2, there is a list of assets, not all same as the real estate, namely jewellery, cash in hand, motor vehicles etc. Henceforth it may become difficult for the administrative department to keep check on off-shore tax evasion activities. A simple real estate tax in lieu of the wealth tax could have ensured tax compliance and an easy tax collection process. Since decades Indian entities have been resorting to tax haven nations to avoid the tax burdens so much so that we have come up with a legislated "Black Money Act" which is an attempt to curtail "black money", or "undisclosed foreign assets and income" by taxing such wealth along with penalising it.

Studies provide contrasting observations from around the world which on one hand say that the majority of nations that have a wealth tax as a part of their tax structure are relatively advanced in terms of the combination of "democracy", "welfare" and "capitalism" and have high government expenditure to GDP ratio. Surprisingly on the other hand we have countries like India and France, have been showing a falling trend in wealth-tax receipts as a share of total taxes and of GDP (Hansson, 2002, as cited in Anghel & Ciocodeică, 2011). The first reason for such a fall could possibly as follows;

"In the late 1980s, when the degree of economic inequality was considerably lower than it is now, the top 1% of consumers in India are estimated to have enjoyed on average about 25 times as much real consumption per person than the bottom 1%; the gap in income was much higher. One of the few studies of trends among the richest Indians found that the income share of the richest 1% declined from above 10% in the late 1950s to about 5% in the early 1990s and then rose again to roughly 10% by 2000. There can be little doubt that it has increased further since then." (Weisskopf, 2011)

Another possible reason to the fall in wealth tax collection over the years in India could be the popularity of tax havens as means to evade high tax liabilities as a consequence of the common tax evading attitude. In America (which has never had a 'wealth' tax), Ramsey Clark (former Attorney General of the United States) in 1976 declared that economic equity must be achieved by levelling of "America's wealthiest families through taxation so that the vast economic power of this group would be prevented from perpetuating itself from generation to generation" (Isaacs, 1977). According to him America's estate and gift tax laws were unsuccessful as they were "unable to reduce or even check extraordinary concentrations of wealth". Clark estimated $11 billion annual wealth tax yield at rate of 3%. , which could shrink huge burdens on the low and middle income earners.

Clark's suggestion of trying to analyse the possibility in the United States of adopting a tax policy like the one in India was critiques by many. Tagi (1968) as cited in (Isaacs, 1977) criticised it by stating that outlooks about tax evasion differ conceivably in the US and India and said that "while in the Western countries evasion is regarded as a social crime by society, in India it is regarded as a feat of intelligence and cleverness evoking admiration."

In France inhabitants are accountable to "a wealth tax on their "worldwide" assets including all properties, subject to the provisions of tax treaties, based on the wealth of the household, including spouse and infant children" and the taxable belongings in France include: "real estate, cars, other vehicles, debts due to you, furniture (except antiques), horses, jewellery, shares, bonds and the redemption value of any life assurance". (Anghel & Ciocodeică, 2011)

In contrast, Indian Wealth Tax Act does not include 'shares' in the assets list. Other assets like mutual funds and fixed deposits are also exempted from wealth tax. Thus a person Mr. X may purchase a company's share worth Rs

2,00,000 and not be taxed upon such an amount. In fact, he may buy shares in the name of his spouse and child for say Rs. 2,00,000 each then also, a total of Rs. 6,00,000 goes untaxed. Although these are the so-called productive assets as they boost an economy's investment but they make a rich person (now a shareholder of a company) more power. "Wealth tax should not decrease the net wealth of an individual, but indirectly tax the income deriving from this wealth" (Anghel & Ciocodeică, 2011). For that matter, unlike in France, 'animals' under Wealth Tax Act, 1957 are in the exclusive list. Suppose, an individual Mr. Z purchase ten horses for say Rs.50,000 each, with his wealth and generate an income stream by setting up a horse riding school. He has then successfully evaded a wealth tax on Rs.5,00,000 along with an additional income from that amount.

A few more critiques in regard to the Wealth Tax Act in India could be as follows;

Example 1: Suppose, a building is under-construction in the city of Jaipur, which would be used as a guest house after the construction. However, it takes 10 years for the building to be built due to a legal conflict between the owner and the builder. Since, under section 2(ea) an unconstructed building not considered to be an urban land or a 'building' hence it will not be accountable to a wealth tax till it is fully build i.e. only after 10 years. Thus an asset remains untaxed for a period of ten years in such a case.

Example 2: Cash in hand as on 31.3.14 of XYZ Pvt Ltd. is Rs. 3 lac. However the balance as per cash book was Rs. 2 lacs. Thus, according to assets under 2(ea) the 'cash in hand' of Rs.1,00,000 which is unrecorded in the books will be taxed under wealth tax. But the problem here is that it is not efficient to monitor such tax compliance.

Further, retirees, pensioners and/or senior citizens have not been given any additional assistance or relaxation in this act. Loopholes and criticisms like above give good argument for

the abolishment of the Wealth Tax in India. Further, a general argument against a wealth tax could be as follows;

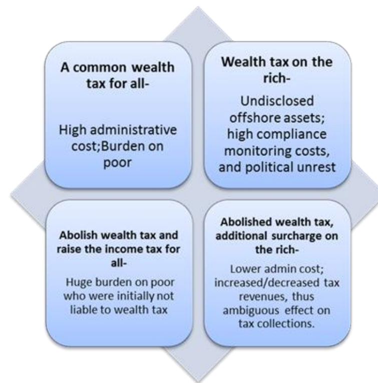
"Materialistic wealth has always been an extremely incomplete index of taxable capacity, since it does not consider the human resources of individuals who depend on earnings from personal services […] Those who seek to justify the wealth tax on equitable grounds fail to consider the significance of the fact that income from different kinds of property of the same value can still differ greatly." (Isaacs, 1977)

If we look at what happened in Spain in 2008, we find that the Spanish government abolished the wealth tax in the year 2008. It was levy of 0.2-2.5% on assets worth €600,000 and above. However, with unions threatening with a protest against this action, the Socialist State was forced to a new tax on the wealthy which was expected to affect only the people "with high-economic capacity and it won't affect general taxes and it won't affect 99.9% of the Spanish population" (Anghel & Ciocodeică, 2011). The replacement of Indian wealth tax with an additional surcharge is also expected to affect individuals with "high economic capacity" without affecting the general taxes.

4. TRADE-OFF BETWEEN EQUITY AND EFFICIENCY

Equity v/s efficiency has always been a debatable topic in Economics. In the scenario of abolishment of wealth tax one can support or oppose the abolishment depending on one's value judgement.

Figure 3: Possible direct tax strategies for a country with a legislated wealth tax



Source: Author

Looking at figure 3, we can imagine a country having four possible direct tax strategies. A 'common wealth tax for all' would imply high administrative costs as it is difficult and costly to track every individual's wealth. Further, it would also put huge burden on the relatively poorer person who has a lower income as compared to the richer group. Thus, it is both inefficient and inequitable. A tax structure whereby there is no wealth tax at all and the income tax is raised for the entire population of taxpayers, the ones who were earlier not liable to a wealth tax would be under an additional burden of higher income tax. Thirdly, if a country puts a wealth tax only on the super-rich say people having annual income of Rs. 1 crore and above, then also there would be high monitoring costs for the income tax departments. For example, to evade the wealth tax burdens the super-rich will not disclose their offshore assets. This may also lead to poor tax revenues for the government and/or unrest in the political domain. Lastly, a scenario of abolishment of wealth tax supplemented by an additional surcharge on the rich people, like happened in India can definitely lead to lowers administration and monitoring costs for the government. However, the equity v/s efficiency can only be tested after looking at the net revenue gains (if any) due to

such a strategy. This is because the increase in revenue from additional surcharge on the rich (in lieu of wealth tax abolishment) is uncertain. We can think of this as a progressive taxation as tax burdens relatively poor persons is reduced and that of the richer group has increase. But the final transfer of income from the rich to poor would in turn depend on the efficiency question, where we would need the 'net' revenue generated in a 'no wealth tax' scenario.

5. CONCLUSION

The Wealth Tax Act of 1957 is an Act of the Parliament of India which was implemented with the objective to levy wealth tax on "an individual, Hindu Undivided Family (HUF) or a company is in possession of, on the corresponding Valuation Date" (Sec.3(1), Wealth Tax Act, 1957). This act provided for the taxation of "wealth" of entities with annual income above Rs. 15 Lac and who have net worth of Rs. 30 Lac and above the rate of 1%. But the Finance Act of 2015 abolished this wealth and supplemented it with an additional surcharge of 2% on the super-rich.

We can expect the following from such an abolishment of the wealth tax - (a) simplification and streamlining of the tax collection process, as it is both difficult and costly to track wealth of an individual than his income; (b) easy tax compliance monitoring; (c) better tax nets, as one can expect more people filing returns who earlier were evading wealth tax by not disclosing offshore wealth.

Thus we can expect reduction in the administration cost but we cannot say anything about the net revenues of the state and the reduction of the inequality gap of income levels. In other words, it is too early to comment on whether wealth tax in India is desirable or not. Estimates of the administrative cost that is being avoided after the abolishment of the wealth tax and along with that one also needs to estimate the

compensated amount of revenue generated from the additional surcharge of 2% in lieu of a wealth tax in India is required. Lastly, whether wealth tax abolishment can be thought of as a move towards more progressive taxation or not again depends on the 'net' effect on tax collection due to wealth tax abolishment and how these sums are allocated within the society.

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