When political battles result in bad tax laws

Updated: 28 Jan 2019, 01:25 AM IST Gautam Nayak

Our tax laws are complicated and unfair enough to taxpayers already. In the past few years, we have been witness to unfair amendments or developments creating commercial difficulty for businesses or investors, which are actuated by political considerations, rather than a genuine need to rationalise the tax laws. The speedy withdrawal of a recent Central Board of Direct Taxes circular is the latest in this line.

This circular had clarified that taxability of receipt of shares of a private company by a firm or private company for less than the fair market value did not apply to issue of shares by a company to a shareholder. This circular was merely an acceptance of a widely held legal view, based on the language of the budget when the amendment was carried out. It provided relief to many genuine taxpayers and had, therefore, been welcomed by many. Unfortunately, it seemed the circular could also come to the rescue of some leading Opposition politicians, who were fighting court battles on this issue. The circular was withdrawn within four days of its issue, on the ostensible ground that a comprehensive circular would be issued later. This, effectively, left hundreds of affected taxpayers in the lurch, leaving them to fend for themselves in respect of the disputed issue.

We, however, have various other provisions of tax laws which owe their origin to political battles, with common taxpayers having to bear the brunt. For instance, after gift tax was discontinued, gifts were not taxable for many years. The provision regarding taxation of amounts received without consideration (mainly gifts) owes its origins to a popular chief minister. This person would ostensibly receive many gifts of large amounts from so-called admirers and, hence, in 2004, the government brought in a provision to tax amounts received in excess of Rs.25,000 each. After the introduction of this provision, this former chief minister continued to receive gifts, but in amounts of less than Rs.25,000 each. The law was then promptly amended in 2006 to tax aggregate amounts received in excess of Rs.50,000.

The amended law now requires all taxpayers to pay tax not only on amounts received in excess of Rs.50,000, but also on deemed gifts, i.e. receipt of certain assets for less than their fair market value. This has led to an enormous amount of litigation for a large number of taxpayers, on what is the fair market value of certain assets, and on the applicability of the provisions to various situations, such as partition of an HUF (Hindu Undivided Family), distribution by a trust, receipt of rights shares from a company, etc. For all of this, taxpayers have to thank the battle between the political party then in power and this chief minister!

Similar was the situation regarding the provision for taxation of a private company on share premium received by it in excess of fair market value of the shares. This provision was introduced in 2012, ostensibly to restrain the son of a former chief minister. Some companies floated by him were alleged to have received more than Rs.3,000 crore from several companies for issue of shares at a very high premium, in exchange for benefits that his father's government gave in the form of land allotments, irrigation contracts and infrastructure projects.

Similarly, a former Union minister from another state was alleged to have received bribes of Rs.550 crore from a foreign company for grant of licences by receipt of huge premium for allotment of shares in his brother's media company. The law was then amended in 2012 to tax the premium received by a company in excess of the fair market value of the shares.

Today, this provision is causing immense grief to innumerable genuine businesses, in particular, start-ups. As if raising capital to fund a fledgling idea is not difficult enough, start-ups now also have to deal with a tax officer, who has no commercial understanding of a business, let alone fund-raising. In most cases, huge tax demands are raised on start-ups on the ground that the large premium charged by start-ups is not justified, effectively destroying the business. It is not just start-ups that are affected, even large wholly-owned subsidiaries of foreign companies face the same problem.

Building an attractive business environment for businesses to flourish in is a difficult and long-drawn task—tax provisions that are administered in this manner can easily wreck the efforts of many years, by scaring off businesses in a short period of time.
It is time that serious thought is given by the government to the long-term effect of such tax changes on businesses and common taxpayers, rather than enacting them as a knee-jerk reaction to catch opposition politicians on the wrong foot. Fighting political battles through tax laws certainly makes for bad tax laws!

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