Tax Policy And Equities

Wednesday, Evening

APPREHENSIONS prevail about the new industrial polity of the Government. But the diminished activity in .stock markets is not solely due to such fears. Them is not much of selling pressure. But equities have' developed a hesitant trend as buyers are reluctant to add to their commitments. Investors remain cautious. Even speculators seem unwilling to extend their operations. In a dull market, equities are, thus, gradually losing ground.

On a closer examination, the present behaviour of stock markets should cause no surprise. Indeed, some are inclined to the view that equities are likely to remain rather stagnant during the duration of the second Plan. There is, of course always the • possibility of an inflationary spurt in equities, That was the main reason for the recent rise in share values. But the spurt has proved temporary, as the belief has grown that the Government is determined to prevent run-away inflation.

Tax Trends

For a proper assessment of the behaviour of stock markets during the duration of the second Plan, it is necessary to appreciate certain developing trends in taxation. It is now common knowledge that the financing of the Plan would involve additional annual Central taxation to the extent of Rs 50 crores. This is not necessarily a "bear" factor for equities. For. even New Delhi concedes that there is not muen scope for further direct taxation of incomes. Up to a certain limit, increases in direct taxation are not likely to affect equities adversely.

Not only is the scope of further direct taxation limited. There are possibilities that the direct taxation of incomes may be so adjusted as to increase incentives to *greater* efforts. Taxation of direct Incomes in this country is too high. Current reports emanating from New Delhi indicate that the problem of a scientific re-adjustment of the system of taxation of incomes is under active consideration of the Government. Under certain circumstances, a downward revision of the level of income-tax is not **unlikely.**

This problem is, in Us practical aspects, directly related to the evasion of income-tax. As recently disclosed by the Finance Minister, annual evasion of income-tax amounts to Rs. 30 crores. It is, therefore, arguable that with improvements in the system of administering the income-tax, there is hardly any case for any increase in taxation as a whole, or in direct taxation, to finance the second Plan, Even if the need for additional taxation is conceded, there is a case for a downward revision of the rate of personal income-tax.

In this context, it is interesting to discuss the trend revealed in the budget proposals for taxation. Tax proposals were significant not for certain upward re-adjustments in super-tax, but *for* increased taxation of industrial profits in various forms, This basic trend in taxation is likely to become more pronounced. Business undertakings and industrial profits are likely to be taxed more. Taxation of personal incomes may even be lowered

Effect On Rentier

There is much to be said in favour of such a system of direct taxation, Any such plan would involve, as the Finance Minister recently hinted, more taxation of all forms of surplus incomes. It will mean steeper death duties. Such a plan should include specific provisions for taxation of capital gains. With these forms of direct taxation developed and fully extended, the tax on personal incomes can be lowered in order to offer reasonable incentives to the entrepreneur.

On the assumption that the system of direct taxation will be changed to lower the tax on personal incomes with simulaneous increases in the level of taxation of industrial profits and various forms of windfalls and surpluses, it is interesting to discuss the future behaviour of stock markets It is clear that, on these assumptions, the next five years should be hard on the coupon-clipper. Here, the problem of the function of the rentier is not under discussion, Nor is that of the changed and changing role of the private investor and the institutional investor, both within and outside the public sector.

Effects On Markets

On the assumption that the stress would be more on taxation of industrial profits as against personal incomes, equities arc likely to remain depressed during the duration of the second Plan. This is a possibility, despite the continued growth in money incomes and gradual reductions in the rate of taxation *of* personal incomes. That is because, under such a system of taxation. equities must yield enough to compen sate the higher burdens on tha-rentier. This is the main reason behind the anticipated decline in equities under the assumed system of taxation.

Assumptions marie above indirar- a fall in equity values so as to raise yields. But these assumptions, and their market consequences, are not necessarily against the investor. Equity yields in India are relatively low. There is much to he said for higher yields on equities. This has some relation with Bank Rate and Interest rates. But the American experience suggests that the relation need not be as close or direct as is generally assumed Behaviour of equities in the last, few weeks would seem to indicate that stock markets are trying to adjust themselves to the hidden implications of the last budget, and subsequent discussions on a proper system of direct taxation for financing the second Plan.