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Two Budget announcements will have far reaching impact

It is indeed laudable that the Finance Minister has finally accepted and now directed that the capital market investors shall have a single ID. This is surely not only in recognition of the several benefits that this will yield, but also that it shall save the common man from harassments in obtaining multiple IDs.

This subject has, in fact, been debated for too long now. Over the years, several solutions were unsuccessfully attempted. It began with Sebi mandating the Unique Client Code, which was very myopic. Then, the Client ID assigned by the depositories was not found good enough as it was not unique to the extent that an individual is allowed to create multiple accounts at a depository and across depositories. A unique ID was then proposed in the form of a more powerful, biometrics-based MAPIN, which was suspended mid way. More recently, Amfi pushed in the MIN scheme.

The IPO scam unearthed by Sebi in 2005, which was substantially about fictitious identities cornering shares in IPOs, had clearly brought into focus the need for a unique ID. After much deliberation, Sebi finally mandated that each depository account holder would need to get his identity verified through his PAN, the final deadline for which was set at 31 December 2006. This decision was in the right direction, making PAN the cornerstone of identity.

However, one major area that Sebi had then left out was the mutual funds. Cornered by the Money Laundering Act, the fund industry then put together a plan to assign new mutual fund identity numbers (MIN) to its investors. It mandated that beginning 2007, MIN would become compulsory for any one making a new investment in any scheme for an amount above Rs 50,000. The problem was again in the approach. The government soon realized the futility of this and accordingly MIN has now been scrapped. (However, the industry is insisting that for KYC, investors will have to go through the registration process and that it would only stop assigning MIN. This is surely unwarranted at least for those investors who have recently verified their PAN with the depositories).

The recent Budget speech states the government proposes to "make PAN the sole identification number for all participants in the securities market, with an alpha-numeric prefix or suffix to distinguish a particular kind of account". However, it is not clear if the government directive means that **all** capital market investors would require a PAN, with no exemptions on size of investment/holding. I hope this is what it means. I am a strong believer that any one who is investing in the risk-driven capital market, directly or through mutual funds, is a person who is either a tax payer or should at least be in a position to obtain a PAN, which now in any case is easy, fast and inexpensive to obtain.

While it has already been mandated that effective January 2007, no investor would be able to sell the shares he is holding in his depository account unless he has provided his proof of identity through PAN, this requirement should also be made mandatory for all mutual fund investors. Presently, PAN is required, as per the MIN plan, by only those who make a fresh investment of above Rs 50,000. Ironically, this will exclude the current unit holder population, which holds assets worth Rs 3,50,000 crore. It will also exclude investors who, by design or necessity, will make applications of below Rs 50,000. Moreover, if an investor, for example, is presently holding Rs 1 crore worth of mutual funds and decides not to invest any more in mutual funds, he would not be required to have a PAN identification! It is well established that exemptions can make the entire system ineffective. It is imperative that all mutual fund investors should also be covered under PAN and a six-month window be given for compliance, as was done for the demat accounts.

The benefits of a unique ID and across all types and sizes of investments are indeed huge. Among others, it would result in better tax collection and minimization of frauds. It will also help in arriving not only at the number of investors, and on a time series basis, but also their distribution summary and their geographical locations and in developing investor profiles in order to frame effective policies and processes. These would also be of help to the industry in designing better products and services. For investors, it would be a boon, saving them from hassles of obtaining multiple IDs as also providing them with the ease of trading through a single ID. More importantly, it will give the honest IPO investors their rightful share in allotments.

Going forwards, the other, and a critical, leg of the market - the banking system - needs to be integrated. Presently, all payments of above Rs 20,000 have to be made by cheques only, giving a false sense of integrity. This, however, cannot be of much help in establishing benami accounts, hidden-from-tax accounts or audit trails/identifying ultimate beneficiaries. Many people are known to operate multiple accounts within a bank and across banks, with many of these accounts not disclosed in the Income Tax returns, though these are used for capital market (and other) transactions. The Finance Minister needs to take one more bold step-that of mandating PAN for bank accounts. This, however, may be limited only to such individuals whose bank account at any time after the specified date has more than Rs 50,000 (in savings and/or in any other account and/or in fixed deposits) or as a starting point, for all such bank accounts that are used by investors for capital market transactions. Any delay on this front would continue to encourage malpractices.

The other Budget move with wider ramifications is the increase in the dividend distribution tax on liquid funds. The near-elimination of tax arbitrage between liquid funds and bank FDs might appear to just be an effort to stem the worrisome decline in bank FDs, but this move can serve another nobler objective: focus on small investors. Today, mutual funds use their tax advantage to service corporate investors. About Rs 1,07,000 crore -- one-third of the industry's assets under management -- is in liquid funds, which is dominated by corporate investors. Mutual funds are obsessed with managing more money, for which, they pay a lot of attention to corporates, which runs contrary to their raison d'tre: small investors. With the tax advantage removed, I hope mutual funds will now focus on effectively and efficiently serving the retail market. As the next measure, corporates should be disincentivised from investing in mutual funds.