

SECURITIES MARKETS CODE HAS ADDRESSED A DOCTRINAL DISPUTE, BUT DEEPER INSTITUTIONAL ISSUE PERSISTS

A fee must not become a tax

FOR CONNOISSEURS OF India's regulatory state, three legislative moments stand out. The Securities and Exchange Board of India (Sebi) Act, 1992, marked the agencification of securities regulation; its 1995 Amendment empowered the regulator; and the proposed Securities Markets Code (SMC) turns to regulatory governance.

Yet across these transitions, one foundational issue has defied resolution: How should the regulator be financed? A regulator dependent on executive largesse may hesitate before confronting powerful interests; one insulated from all financial discipline may drift from its statutory purpose. The design of financial flows shapes its institutional character.

Sebi's financial history reflects evolution by accretion rather than conscious design. When constituted by executive resolution in 1988, it depended on contributions from public financial institutions. From 1991, it received a share of listing fees from stock exchanges. Though the 1992 statute authorised it to levy fees, the early years were financially uncertain—the fee regulations were challenged; recoveries were delayed; and the government did not extend grants. Instead, it advanced an interest-free loan of ₹115 crore, which Sebi repaid in full by 2009.

Judicial affirmation of Sebi's power to levy fees in 2001 decisively altered the landscape. Registration fees and market-linked charges, coupled with expanding market volumes, generated a stable revenue stream and, over time, a substantial surplus, enabling Sebi to emerge as a self-financing institution.

With financial comfort came constitutional unease. Through the Finance Act, 2019, Parliament amended the parent statute to mandate that 25% of its annual surplus be credited to a reserve fund, capped at two years' expenditure, with the remainder transferred to the Consolidated Fund of India (CFI), and to obtain government approval for capital expenditure. In August 2021, Sebi remitted ₹1,000 crore as a one-time measure while requesting reconsideration of the framework. Although notified, the government

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kept the operationalisation of the amendment in abeyance. The SMC largely carries this architecture forward, omitting only the requirement of approval for capital expenditure. It thus recognises a two-year financial buffer, signalling a measure of autonomy while asserting a sovereign claim over excess surplus.

Behind these legislative recalibrations lay a sustained dialogue rooted in the Constitution of India. Article 266 provides that all revenues received by the government form part of the CFI, and that other public money received "by or on behalf of" the government are credited to the Public Account of India. The executive contended that what the government could have done departmentally, it chose to do through a regulator. Money collected by Sebi and similarly placed Insurance and Regulatory Development Authority are therefore, in substance, governmental receipts and must ultimately enter sovereign funds.

Sebi's counter-position drew on corporate personality and statutory purpose. Despite being "state" within Article 12, they are not "government". They possess a distinct legal personality; are subject to taxation; may receive grants; and collect money not "for or on behalf of" the government but pursuant to the statutory authority for defined objectives. Funds so vested for specific purposes, they argued, cannot be submerged into sovereign funds.

The SMC has largely addressed the doctrinal dispute. But the deeper institutional issue persists. Financial control is intimately connected with regulatory

independence. Even absent overt interference and fiscal dependence can induce subtle caution. Experience across sectors demonstrates this dynamic. Several regulators operate with thin revenue streams and rely on government grants. The application of executive financial rules to grants-dependent regulators illustrates how fiscal leverage can translate into administrative influence.

The government already derives substantial revenue from the securities ecosystem through securities transaction tax, goods and services tax, and income tax. Regulatory fees are distinct—they are levied to defray the cost of supervision and enforcement. If these fees are appropriated as general revenue, the boundary between regulatory charges and fiscal instruments blurs and regulators risk gradual departmentalisation.

The government's concerns, however, are not frivolous. Persistent accumulation of large reserves outside the fiscal framework invites legitimate scrutiny. Can excess statutory levies be indefinitely warehoused without parliamentary oversight? Should the regulated community fund an ever-expanding corpus unrelated to foreseeable regulatory need?

These questions lead to a core constitutional distinction between fee and tax. A tax is a compulsory exaction for public purposes without quid pro quo. A fee, by contrast, must bear a reasonable and demonstrable relation, not a mathematical equivalence, to the cost of services rendered. In *BSE Brokers' Forum v. Union of India*, the Supreme Court upheld Sebi's

levy, rejecting the contention that it was a tax in disguise. Implicit in that affirmation was a discipline—regulatory fees must be commensurate with regulatory load. Surplus per se is not constitutionally fatal, but material and persistent over-recovery risks altering the character of the levy.

It is here that the SMC architecture warrants caution. If the levy is designed to generate revenue beyond the requirement and the sovereign structures are mechanisms for automatic appropriation of the excess into the CFI, the design effectively validates regulatory exaction for fiscal ends. Constitutional character is shaped at the point of imposition not by the subsequent routing or accounting treatment of funds. The regulator becomes the tax imposer; the government the appropriator.

Fiscal discipline must be attached to the architecture of the levy itself, not merely to the disposal of accumulated surplus. It must operate at the front end. Fee-setting must be anchored in transparent, periodically reviewed medium-term expenditure projections. Collections must align with regulatory load; reserves must be limited to clearly defined and publicly justified buffers; and rates must be recalibrated where sustained surplus indicates over-recovery.

Sufficiency of resources is integral to meaningful regulatory independence. The statute should secure adequate and predictable funding for the regulator but not generate a surplus for the sovereign. A regulatory levy must be normatively and constitutionally principled. It must remain what it is in law—a charge calibrated to the cost of regulation—and not imperceptibly harden into taxation through design or drift.

The tension exposed here is not peculiar to securities regulation. It reflects a broader design challenge in India's model of statutory regulation. The SMC, however, offers an opportunity to craft a balanced resolution. If carefully designed, this framework can serve as a template for other regulators navigating similar tensions in India's evolving administrative state, preserving autonomy without permitting a fee to quietly become a tax.

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