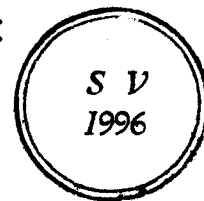
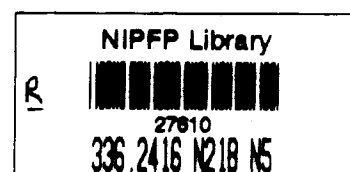


# BLACK MONEY IN THE REAL ESTATE SECTOR:

## A STUDY



January, 1995



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## PREFACE

The National Institute of Public Finance and Policy is an autonomous non-profit organisation, whose major functions are to carry out research, undertake consultancy work and impart training in the area of public finance and policy.

The study on **Black Money in Real Estate Sector** presented below was entrusted to the Institute by the Ministry of Urban Development in the context of the widely held perception that real estate has been a prime generator of black money while investment in housing has fallen far short of the country's requirements.

The role of "black" money in the Indian economy has exercised the attention of the public, policymakers and many experts. The NIPFP itself conducted a major study, **Aspects of Black Economy in India** in 1985, and attempted an estimation of black money emanating from or flowing into different economic activities including real estate. The Institute has also been involved in studies on fiscal policy and reform of the tax system to curb the generation and use of black money and find a long term solution to the problem. Liberalisation of the Indian economy and the need to lessen the pressures on the government budget have lent urgency to the task of addressing the problem of black money generation in the economy with appropriate market devices.

The present study seeks to provide an idea of the broad dimensions of the flow of black money in real estates. It also makes an attempt to identify the factors behind the spiralling real estate prices in major urban areas, rampant speculation, widespread undervaluation of transactions even by the otherwise law abiding citizens and the implied evasion of taxes. It draws attention to the need for procedural changes, rationalisation of taxes bearing on the ownership and transfer of real estates, realistic land policies and reform of major laws. It is hoped that the study will be of value to the Central and State governments and be of interest to the academic community.

The Governing Body of the Institute does not bear any responsibility for the contents of views expressed in the report. That responsibility lies primarily with the authors and the Director.

January 1995

A. Bagchi  
Director

## TABLE OF CONTENTS

	Page
Executive Summary	i-xi
Chapter 1: Introduction	1
Chapter 2: Structure of Real Estate Markets	9
Appendix: Working of Tacit Collussion	28
Chapter 3: Tax Burden on Real Estate Transactions	30
Appendix: Pre-emptive Purchase of Immovable Property: Section 269 UC, 269 UD & 269 UE	78
Chapter 4: Economic Reform, Legal Bottlenecks and Black Money	81
Chapter 5: Link Between Real Estate Market and Black Money	107
Chapter 6: Estimation of Black Money in Real Estate	117
Appendix: Expected Mean and Variance from a Truncated Sample Distribution	140
Chapter 7: Policy Options	143
References	150

List of Tables in the Text

Table No.	Title	Page No.
1.	1.1 Population Rate of Growth	7
2.	1.2 Housing Gap	7
3.	1.3 Housing shortage in Urban India	7
4.	1.4 Backlog in Housing Supply by DDA (As on 1986)	8
5.	1.5 Growth Rate of Land Price in Selected Cities	8
6.	2.1 Position of Registration/Allotment of Houses (1980s)	16
7.	2.2 Number of Agents with which Collusion can work in Real Estate	25
8.	3.1 Details of Properties Purchased by the Central Government under the Provisions of Chapter XXC of Income Tax Act, 1961 (ending March 1993)	34
9.	3.2 The Rates of Registration Duty for Immovable Property in different States	45
10.	3.3 Cost of Inflation Index	46
11.	3.4 Rebate Allowed on Property Tax for Timely Payment in Major Corporations in India	53
12.	3.5 Share of Capital Gains Tax in Sale Value of a Property	63
13.	3.6 Stamp Duty Payment on Immovable Properties in Five Metropolitan Cities in 1992	64
14.	3.7 Understatement of Sale Price of Properties in Delhi	65
15.	3.8 Rates of Property Taxes in Delhi and other Major Municipal Corporations in India	66
16.	3.9 Rate Schedule of Income Tax	72
17.	3.10 Payment of Property, Wealth and Income Taxes out of Rental in Delhi 1992	73
18.	3.11 Acquisition of Properties by Appropriate Authority	76
19.	4.1 Acquisition of Vacant Land	92
20.	4.2 Land Taken into Possession in Major Cities	93

21.	4.3	Land Exempted Under Section 20	93
22.	4.4	Land Acquired and Land Exempted Under the Act	94
23.	4.5	Enactment of Rent Control Legislation in various States in India	103
24.	4.6	Selected Features of Rent Control Acts of Different States/Union Territories	104
25.	6.1	Intervals of Black Income Generation in Real Estate Transaction	121
26.	6.2	Proportion of Black to White Money	122
27.	6.3	Analysis of Variance	129
28.	6.4	Intervals of Black Income Generation in Real Estate Transaction	134
29.	6.5	Estimated Black Income in Real Estate	136
30.	6.6	Registered Value of Immovable Properties	139

## **Executive Summary**

The use of unaccounted money in the real estate market in urban India has emerged as a major problem in recent years. While its dimension is not known accurately, the growing influence of black money in many transactions of real estate is commonly accepted. The process of economic reform and liberalisation has not only opened opportunities for investment in various manufacturing and service activities by domestic and foreign investors, but it has also significantly increased the demand for land and property for the operation of these activities, residential and office premises, and thus increased the pressure on available scarce supplies of land and built up property. The fungibility of undetected money between the capital market and real estate has further fuelled the scope for the greater use of black money and the push to land and property prices in the course of liberalisation.

### Effect on Land Prices

A major concern of the use of black money in the real estate market is its distortionary effects on prices, although this also causes significant welfare losses due to widespread evasion of taxes on transfer of immovable properties on the one hand, and the denial of the vast majority of the population from access to affordable housing because of the concentration of the black-money-based real estate industry on the high income group. The residential land and buildings in urban India in general, and metropolitan cities in particular, have registered a steep increase in prices in recent years. While the shortage of housing owing to inadequate investment in house construction and urban infrastructure could be the reason for this, there is room for the belief that black money in the real estate market has also influenced the trend owing to its use for speculation in urban land and property. This has of course been facilitated by the stifling legal and regulatory framework for housing and various constraints to housing activity that have been well recognised in official documents.

### Incentive and Policy Induced Factors

The nexus between real estate and black money is based on incentive- as well as policy-induced factors. The incentive to evade tax is partly an offshoot of the heavy tax burden and attendant procedures

imposed on the conveyance and registration of property for real estate by a multiplicity of Central, State and local authorities. Notwithstanding the efforts initiated under the regime of economic reform, the burden of real estate taxes on declared or notional income from recently acquired property continues to be high. While the one-time imposts, such as the gift tax, stamp duty registration fees, unearned increment levy, and capital gains taxes require a payment of 27% to 19% of the purchase price of a property, the three prominent recurring levies, income tax, wealth tax and property taxes, take away 55 to 63 per cent of the income accruing from renting a house fully for residential use. The problem is aggravated by the cumbersome procedures for the registration of conveyance and the payment of stamp duty, (and the payment of capital gains tax till recently), and the disparate systems of valuation under different taxing legislations. These issues were highlighted by the Chelliah Committee on Tax reform and are being pursued by the Government of India as a part of its agenda for long term fiscal policy.

On the other hand, disruption of the functioning of land and housing market due to the Urban Land (Ceiling and Regulation) Act and the Rent Control Acts along with the inadequate information on real estate to the public seems to have strengthened the influence of black money. The monopoly status of public authorities like DDA and their penchant for using land as a resource through maximum profit has aggravated the trend.



An assessment of the transfer of immovable properties in the five metropolitan cities indicates that the generation of black money could be in the range of 66 per cent to 73 per cent of the declared value of immovable property transferred. It is, however, difficult to draw any precise conclusion on the quantum of black money used for generating more black money in real estate.

#### Real estate industrial structure and regulation

The nature of accumulation of black money can be understood by considering the category of economic agents who often invest their capital in real estate and simultaneously keep themselves away from the system of formal financial market. The study helps in identifying the various types of participants in real estate market and the nature of their transactions that results in self-perpetuating growth of black money. It suggests that the role of small real estate developers and builders who concentrate in 'near city-centre' pockets needs to be monitored closely. In this connection, the proposals like giving real estate the status of an industry rating of builders and developers in public and private sector and setting up a self-regulating council

deserves encouragement. The speculative use of black money is in part a consequence of conditions of induced scarcity of urban land, and, in part, due to the product differentiation practised by oligopolists or monopolistic competitors in a situation of poor information base for consumers.

The operation of informal financial market serves as an entry point of black money as the developers do not have access to formal finance due to the uncertain collateral status of their land. The real estate operators who depend on informal credit to finance their activities become instrumental in providing a major entry point for black money into the real estate market. Thus, there is a case for enlarging of credit supply from the organised finance market in the line with statements in the National Housing Policy - directly or through innovative systems of community level financing. The real estate sector could be helped to raise capital by conforming to rating criteria of some of the agencies involved in credit finance.

It is emphasised that, apart from the reform agenda identified recently in urban land supply and management as a result of discussions between Central and state governments and experts, reduction of tax burden and simplification of administration of different Central, State and local taxes, attention must be paid also to problems associated with the structure and operation of real estate market. The real estate

market in the larger cities of India has an oligopolistic market structure. Hence, the presence of a small number of agents in real estate who could support the persistence of a tacitly collusive price and speculative trends has to be recognised. It is necessary to proceed expeditiously to enact appropriate legislation on the lines of the model law drafted by the Central Ministry for Urban Development and also by the removal of barriers to competition in the sector. This will provide the non-exploitative social frame for the involvement of private sector in various forms of housing activity and encourage larger investment from the cooperative sector. Foreign investment in various forms of real estate will be facilitated by the recent concessions announced by the Government.

#### Legal Bottlenecks and Land Policy

Due to freeze in the land market on account of proceedings under the Land Acquisition Act as well as due to Urban Land (Ceiling and Regulation) Act, speculative pressure on land and rising prices, access to land at an affordable rate has been denied to many who arrive in a city to earn a living and also to the majority of the urban population and they may be obliged to seek shelter in unauthorised colonies and slums. On the other hand, people who could make payment partly in black money in extra legal transactions seem to have taken control of a substantial chunk of marketable urban land. Many people of this category

have taken recourse to development of unauthorised colonies or unregulated development of agricultural land such as farm houses, even as the poor are driven to squatting or subletting in slums. Essentially these features have led to a foreclosure of competition in the market as only a few people are controlling the marketable land. These developers in turn oblige the buyers to pay in black money, thus setting in motion a chain of extra legal transactions, tax avoidance and black money.

The functioning of the real estate industry and land market disrupted by the legislative intervention and unimaginative master plans should be brought on competitive lines, resting on a free flow of information. While unconstrained legitimate transfer of land and building should be revived, the credit facility from the formal market for various forms of housing activity should be arranged as a prerequisite directly or through community based groups. The competent enforcement policy authorities such as Consumer Courts and MRTP Commission should monitor the anti-competitive practices of real estate operators, builders and developers and real estate agents, while the enactment of a legislation on the lines of the Model Bill is pursued.

#### Rationalised Tax Burden

That the laws and taxation provisions governing real estate property transactions provide incentive to both buyer and seller to

under-report the value of property and to avoid payment of taxes is well documented by now. To reduce the incentive to avoid taxes, lower rates have to be fixed keeping in mind the total effective burden of taxes and duties on real estate transactions and transfers. The present rates of Central, State and local taxes on real estate could be brought down in aggregate in order to reduce the incentive of evasion and this has of course to be placed in the context of federal-state fiscal transfers and compensation to states for loss of revenue. The direction of policy change for reducing the tax burden has so far been more concerned with the problems of individual taxes which may not be sufficient for reducing the incentive for underreporting the value of land and buildings in the document of transfer presented for registration. A programme of reducing the combined burden of taxation of real estate by governments in Central, State and local bodies level seems pertinent to deal with the problem of undervaluation. Moreover, there is a need to revamp the administrative structure dealing with real estate transactions and their registration with a view to minimise the loss of time and harassment of tax payers. It is envisaged that the incentive to greater reporting of transactions and the lesser use of black money will by itself compensate for the loss of revenue due to reduced rates and simplified procedures.

The existing provisions of 'power of attorney' transfers in case of immovable properties should be modified and such transfers be made

compulsorily registrable as proposed in the case of Delhi. The Registration Department could incorporate in a single window process the collection of stamp duties, registration charges and unearned increments etc. (and also over State taxes) payable for the property at the time of registration of the deed through a single window process.

#### Pre-emptive Purchase Provisions

The operation of pre-emptive acquisition seems to have led to suitable modifications in the method of evasion. The prominent **modus operandi** of tax evasion under the regime of pre-emptive acquisition is reported to be splitting the transacted property to non-reporting levels and also to declare lower sale value. The division of transactions shows the value to be less than the limit, i.e., Rs. 10 lakh, set by appropriate authorities in the Income Tax Department. There are problems of lack of coordination with the Sub-Registrars and certain lacunae in present provisions. The solution to these problems could be found in steps such as raising the ceiling value for declaration and increased probability of detection on under-reporting of value by adopting a uniform base of valuation for all Central and state taxes and improved coordination with Registration Department. Thus, there is a need to review operation of the present functioning of the provision of acquisition of property in the CBDT as suggested in the study.

Need for uniform valuation of property and other reforms

Over and above these considerations, there are two crucial requirements for the successful operation of provisions such as pre-emptive acquisition and levy of stamp duty. Correct assessment of the value of land based urban immovable properties through uniform valuation procedures by different government agencies and annual notification of the rules would promote self assessment and deter under-reporting. Adequate information on price of urban land and properties and on the land supply situation are essential for reducing the incentive for black money transaction and for monopolistic competition based on product differentiation. The real estate agents take advantage of the asymmetric information in the urban property markets to fragment the market and generate speculative conditions. A regular publication of area-wise property values, availability of rental housing along with rent-price and ownership housing would serve a useful purpose for reducing the price setting role of real estate agents. This could flow from the proposed legislation to register developers and property agents and to set up an agency for rating developers.

In sum, the need for government intervention in the real estate market in the overall context of curbing acquisition and use of black

money and for consumer protection cannot be avoided. The Central and State governments under the regime of economic reform will have to formulate and implement, in consultation with the real estate industry and consumer groups, an agenda for the liberalisation of the land and housing market in consonance with economic reform. Some of the tasks before them appear to be addressing to issues like simplification of the property conveyance rules, reduction of combined tax burden on housing and transfer of property, introducing appropriate amendments to urban housing and land policies and professionalising the real estate sector with improved flow of information to consumers, and enforcement of anti-monopolistic laws.



## Chapter 1

### INTRODUCTION

In recent years, the use of unaccounted money in the real estate market of urban India has emerged as a major problem. The purchase of land is paid for 'under the counter', bungalows and flats are transferred through ingenious devices such as 'power of attorney'. To escape the tax payment frequent under-valuation of immovable properties is resorted to. Although it is difficult to assess its dimension accurately, the growing influence of black money in the real estate sector is well-known.

The use of black money in real estate market, besides significant loss of revenue to the government due to widespread tax evasion, has its distortionary effects on prices. As a consequence, the residential land and buildings in urban India in general, and metropolitan cities in particular, have registered steep increases in prices in the recent years. While the long-standing shortage of housing in the country could be a reason for the recent spurt in prices, there is a strong suspicion that black money in the real estate market is influencing the present trend.

There are two apparent reasons for the real estate to have become the nerve centre of black money. First, the real estate properties such as land and buildings have become increasingly attractive for transaction through unlawful modes of concealment like the understatement of actual value. Second, once black money enters into the real estate market it is finding a safe haven from being caught by the tax enforcement authorities.

The 'attractiveness' factor of the real estate sector as a channel of preferred investment could be explained, at least partly, by the persistence of inflationary pressures and scarcity of urban land and housing in the country. Under conditions of inflation the value of savings in the form of bank deposits or bonds depreciates in real terms. In contrast to these assets, the rate of increase in land prices remains higher than the rate of inflation resulting in the appreciation of the value of investment. So many investors have looked to real estate as an avenue of investment in an appreciating asset. Urban land is thus acquiring the status of an investment good as well as store of value, apart from being a consumption good for a large number of households.

The reason for the real estate becoming a safe area for the operation of black money, on the other hand, rests largely on difficulties of deciding the value of real estate properties, and the scope for undetectable under-valuation in the existing provisions of Central and State tax laws. A unified method of valuation among the tax administering authorities at Centre, State and local levels is absent. The price that gets determined in the free market by the forces of demand and supply is, mostly, absent in the real estate market due to a highly regulated land market and master planning system, problems of land use conversion, delays in the provision of city infrastructure, and the cumbersome approval system. The provision for auctioning of land and buildings by the government does indicate a market price, but the valuation problem remains far from being resolved in such an approach, as the prices quoted by the bidders reflect the scarcity premium due to inadequate supply. Taking advantage of weaknesses inherent in the valuation problems in real estate, buyers and sellers resort to undervaluation in order to avoid the payment of

capital gains tax, higher wealth tax, and the fixation of higher rateable value, besides other levies resting on the declared property value.

The need for an appropriate policy to tackle the problem of black money in the real estate cannot be overlooked. The policy has particularly to take care of the important urban centres which are increasingly bearing the consequences of the operation black money. While there are no easily available solutions to the black money problem, a good opportunity to start containing it has been opened up by the policy of economic liberalisation. Some of the avenues of black money generation, that sprang up as the unintended effect of the preceding policy regime would decline under a more transparent regime and reduced controls. The policy could, therefore, concentrate on avenues that still remain open to black money due to artificial scarcity and control.

A major task before the National Housing Policy (NHP) spell out clearly the areas under the Enabling Strategy that need government intervention in order to reduce the scope for speculation and the use of black money. This was in fact referred to in an earlier draft of the NHP. The major areas where suitable modification of the existing policies may have to be effected appear to be the legal obstacles posed by Urban Land Ceiling Act, Rent Control Acts , Stamp Act and Registration Act, the prevalent valuation procedures, the rigid Master Plan and approval systems, property titling systems, and fiscal policy in respect of real estate. Since a number of steps have been initiated under the liberalisation programme, it may be necessary to point out the additional tasks before the government.

### **Scope of the Study**

The major thrust of the study will be the estimation of the generation of black income in the real estate transactions and analysis of the functioning of the real estate market with a view to find out the probable influence of black money on rising prices of real estate properties. While the primary focus of the study would be on the pattern and magnitude of generation of black money through real estate property transactions, and the nature of speculation in urban real estate, it will comment upon the avenues of black money generation in the context of economic liberalisation also, and the changes required in the fiscal and regulatory systems at the Central and State levels.

A major interest of the present study remains that of black income generation in real estate market. It, therefore, would focus on the income generation, over a time span, say, of one year. But difficulties in getting appropriate data have sometimes come in the way of maintaining a strict distinction between black money as a stock (wealth) and a flow (income). Though inferences drawn from the data will be based on income, the flow concept, the term used will be black money pertaining to both income and wealth (Gupta, 1992, has pointed out the implication of confusing these concepts). In this sense the study comes closer to those which refer to tax evaded income as black income. For example, according to the definition adopted in the NIPFP (1985) study, the entire unaccounted income detected in a particular year in any transaction relating to real estate is called as black income (see, p. 190). As stated in the study, "if property is sold and part of the proceeds are unrecorded on the sale deed, then all of his unrecorded portion is treated as black income for the seller".

## **The Approach**

The secretive nature of transactions that form the basis of black money generation makes it difficult to have a definite idea on its character. The present study, therefore, draws heavily from the insight thrown by past studies on real estate, and a number of official reports, starting from the Wanchoo Committee on direct taxation. As in earlier studies, extensive interviews with real estate agents, builders and developers, private individuals and the Government officials dealing with the real estate policy are the major sources of information.

In attempting to estimate the black money generation in real estate, we have relied more on the data collected from the Appropriate Authorities of the Income tax Department set up under Chapter XXC of IT Act. The pre-emptive purchase of properties in case of under-statement of the sale consideration in the instrument of transfer and subsequent auction of these properties in open market are considered by us to estimate the black money generation. Detailed description of these data are given in Chapter 5.

An evaluation of the policy on urbanisation in general and land and housing policy in particular, is considered necessary for gaining a perspective on the problem of black money. The present study has not gone into these issues specifically. On the other hand, it has attempted to use several findings available in the studies already completed.

For an assessment of the black money generation in real estate the present study focuses on five metropolitan cities of India. As these cities of the country have emerged as major income and employment generating centres, the demand for real estate properties in them is growing rapidly. The black money

transactions are presumably greater there as well. It, is expected that an understanding of the functioning of market in these places will be helpful to comprehend better the black money in real estate of India.

#### **Plan of the study**

The structure of the urban real estate market is examined in Chapter 2 which also looks at the prevalence of collusive prices. The succeeding Chapter 3 discusses the tax burden on real estate properties which is perceived by many as a major factor responsible for the generation of black money. Chapter 4 documents the salient features of economic reform process, on the one hand, in order to see the macroeconomic setting, and, on the other hand, the state Rent Control Acts and the Central Urban Land (Ceiling and Regulation) Act which, together with other factors listed in the NHP, are believed to be responsible for land scarcity and the entry of black money into real estate. The link between black money and real estate properties is elaborated in Chapter 5. Chapter 6 gives an estimate of the quantum of black money, drawing upon various methodologies. Finally, Chapter 7 discusses the policy options to tackle the problem of black money, in the context of macroeconomic reform and in the setting of the NHP and the real estate sector.

**Table 1.1**  
**Population Rate of Growth**

(in number)

Metropolis	Population				Compound Rate of Growth		
	1961	1971	1981	1991	1961-71	1971-81	1981-91
BOMBAY (MC)	4152056	5970575	8243405	9909547	3.70	3.28	1.86
DELHI (UA)	2359408	3647023	5768200	8427083	4.45	4.69	3.86
MADRAS (UA)	1944502	3169930	4289347	5361468	5.01	3.07	2.26
BANGALORE (UA)	1206961	1664208	2921751	4086548	3.26	5.79	3.41
CALCUTTA (UA)	5983669	7439869	9194018	10916272	2.20	2.14	1.73
	15646596	21891605	30416721	38700918	3.42	3.34	2.44

Source : Government of India, Registrar General Census Reports

**Table 1.2**  
**Housing Gap**

(in number)

Metro	Housing Gap 1981
Bangalore (UA)	6770
Bombay (MC)	33960
Calcutta (UA)	25696
Delhi (UA)	116621
Madras (MC)	12072

Source: SCAG Report of 1993 on Central Govt.  
Revenue Accounts

**Table 1.3**  
**Housing Shortage in Urban India**

(Number in Million)

Year	Household	Usable housing stock	Housing gap
1961	14.8	11.2	3.6
1971	19.0	16.1	2.9
1981	30.7	23.7	7.0
1991	47.1	36.7	10.4

Source: Government of India, N.B.O.

**Table 1.4**

**Backlog in Housing Supply by DDA  
(As on 1986)**

Income Category	No. of Registrants	No. of Flats Allotted	Backlog
MIG	47521	9500	38021
LIG	67502	15320	52182
EWS	56247	21887	34360
SFS (no income bar)	69115	39261	29854
<b>TOTAL</b>	<b>240385</b>	<b>85968</b>	<b>154417</b>

**Source:** DDA, Performance Report 1986-87, New Delhi.

**Table 1.5**

**Growth Rate of Land Price in Selected Cities**

(in percentage)

	City	Year	Rate of growth per year
1	Bangalore	1980-91	26.18
2	Bombay	1984-91	21.60
3	Calcutta	1983-91	12.26
4	Delhi	1980-90	25.98
5	Madras	1982-92	22.06

**Note** : Prices of other commodities during 1982-91 have grown at following rates: primary articles 8.12 %, fuel, power, light & lubricants 7.12 manufactured products 6.22% and all Commodities 7.57%.

**Sources:** TCPO, (1984), Tandon (1987) and N.B.O.(1991)



## Chapter 2

### STRUCTURE OF REAL ESTATE MARKET

#### Introduction

The generation and use of black money in real estate is primarily through the medium of the various persons and organisations connected with the operations of land assembly, authorised or unauthorised plotting out and development of the land, (upto whatever standards the market will accept), construction of houses and other facilities, financing through related informal or formal mechanisms or developer financing of the buyers, and brokering of the sale, resale and renting of properties. The operations could range from the sophistication of well-known builders in major cities, and corporate developers to small time builders, and the wide network of licensed or unlicensed brokers. There have been serious efforts in the last few years for the bigger and small time builders to introduce codes and practices for self-regulation and for professionalisation of the industry. There are also moves to introduce rating of the developers and builders, under the auspices of the National Housing Bank, and some efforts in this regard have already been made by CRISIL. However, with continuing examples of exploitation of the consumer by some builders in terms of quality, escalated price, extortions of additional price for various disclosed or undisclosed items, delayed delivery, failure to transfer title to the association of buyers, and other malpractices, the consumer courts and the civil courts have expressed their concern about the unregulated character of the real estate industry. The Government of India and the State governments are reported to have agreed on a model law to regulate the real estate industry, and a number of

states are in the process of enacting such laws. In this context, we project a theoretical model of the exercise of market control by the agents controlling the land and housing market, and then we go on to analyse the actual practice in the market.

The basic objective of the following exercise is to assess conditions that may have led to exercise of the market power by agents controlling activities of real estate. It attributes the recent years' high level prices of land and building to the non-competitive behaviour of the controllers of real estate.

The higher prices of land and building in urban India has been attributed to the effect of inappropriate public intervention on the functioning of real estate market (see, Government of India, 1979 & 1988). However, it is not easy to discern the relationship between effects of public intervention and higher prices. One possible reason for such a conclusion by the studies is to establish that the real estate policy led to the emergence of a market structure whereby, only a few operators took control of the ownership as well as activities of real estate. It can then be argued that these operators recognise their interdependence and collude tacitly to sustain the presently observed price level.

The association between the exercise of market power and market structure is pointed out by traditional as well as recent theories of oligopoly. The traditional wisdom, as reflected through the market-conduct-performance paradigm, predicts that the presence of a few producers in the market would lead to collusive price formulation (see, Bains, 1956). The other strand of thought, which tries to overcome the criticism labelled against the traditional wisdom, points out the importance of strategic interaction among firms rather than the small number alone being the determining factor giving rise to collusive pricing behaviour.

The recent theories subscribing to this view of non-competitive price, however, admit that the structural characteristic like small number of producers in an industry is a useful indicator of competition. It provides first hand information on the non-competitiveness of an industry (see, Tirole, 1988).

The present analysis highlights the oligopolistic market structure of the real estate market in the important metropolitan cities of India and points out the number of operators, referred to as owners of land, that supports the persistence of a collusive price. The evaluation proceeds through three sections. The theoretical insights that bring out conditions of the persistence of non-competitive pricing behaviour in a market is contemplated in Section I. Section II documents some of the important features of real estate market structure. Section III on the other hand, discusses the conditions under which the non-competitive price in the real estate market is sustained.

#### **I. The Theory of Tacit Collusion and Market Structure**

Once out of the structure-conduct-performance paradigm, it may be necessary to look at the dynamic oligopoly theories for a satisfactory answer to the problem of non-competitive behaviour of economic agents. One of the ideas of dynamic oligopoly pricing rests with repeated interaction among firms in the same business, which makes them realise the advantage of cooperation (collude tacitly) rather than competition. It works because of strategic choices and pay-off functions available to firms and the threat of punishment in future for deviating from the collusive arrangement (see, Shapiro, 1989). When firms' perception of the future stream of collusive pay-off is high and the threatened punishment for deviation is severe enough to inflict a heavy loss, the inducement to collusive behaviour appears a distinct possibility. For example, when prices are raised to monopoly levels, each seller

stands to gain by making undetected price cut. Deviations of this kind are made less attractive through quick detection by other members of the arrangement and punish the cheat. The supergame framework points out the conditions for the effectiveness of such a process (see, for example, Abreu, 1986). Conditions under which the tacit collusion work can be seen from appendix at the end of the chapter.

The basic insight gained from the above theory is that of collusive outcome's dependence on the discount factor. The larger the  $\delta$ , the more weight is given to the future. When  $\delta$  is very high, equal weight is placed on the pay-off of each period and collusion becomes more profitable. On the other hand, with  $\delta$  close to 0, future pay-offs are heavily discounted and firms are more concerned with the payoff of the current period. Setting aside the problem of too many equilibria, which is addressed by many recent studies, the repeated game theory indicates that competition policy must take into account factors determining the discounting rates.

The relationship between the structural characteristics of the number of firms and tacit collusion can be analysed by taking into account the strategic variables adopted by competing firms. There are two variables around which most of the oligopoly competition is analysed. The first takes the view that output is the strategic variable of firms, whereas the second assumes it to be the price. The number of firms that can support an equilibrium collusive outcome, however, differs according to whether output or price is the strategic choice (see, Shapiro, 1989).

The differential outcome due to price or output as the strategic variable in competition is also highlighted by the static oligopoly equilibrium analysis. The positive association between the structural characteristic of concentration and

exercise of market power that dominated the era of structure-conduct-performance is supported by static Cournot competition. It, for example, predicts a negative relationship between Herfindhal Index of concentration and industry performance. This relationship, however, does not hold good in Bertrand's static framework and the theory points out a perfectly competitive outcome with two or more firms.

The importance of the number of firms alone as a condition for collusion to be successful has declined in the recent analyses of strategic behaviour. The dynamic oligopoly theories emphasise that as long as future profits are not discounted too much, firms can tacitly collude by designing appropriate strategies that would leave no incentive for defection.

To see the usefulness of structural variables like the number of firms in recent theories, it is necessary to consider these in combination with the rate of discount, decision of firms on the length of time to stay in the business, detection lag and punishment for deviating from collusive price.

Results of the supergame theory can be usefully applied to real estate market of India for an assessment of anticompetitive behaviour of operators in activities of land and building. The knowledge of the rate of interest in the formal as well as informal credit market for real estates and flow of information on transactions and transfer of immovable properties can be utilised to form some broad idea on the discount rate of the payoff from collusion as well as deviation from it. Given the rate of discount, the number of firms with which the market can successfully sustain the arrangement of tacit collusion can be estimated.

## II. Structure of Real Estate Market

The market structure of real estate in the metropolitan cities of India is examined in the following. Keeping in view the objective of the present analysis, an attempt is made to focus on the emergence of a small number of operators in real estate that makes collusion easier to sustain.

i. **Government policy as applied to urban areas:** The Government policy on real estate market is responsible in a major way for the emergence of the present market structure. Due to Land Acquisition Act, Rent Control Act, introduction of a land policy in 1963 and Urban Land (Ceiling and Regulation) Act, activities of real estate have come under the control of a few participants.

The Government acquired a substantial control on urban land market due to some of the above policies. As it could be seen, the Urban Land (Ceiling and Regulation) Act, 1976, empowered the Government for acquisition of the excess vacant land above a certain limit with a single property holder. Also it imposed certain restrictions on the transfer of land in urban agglomerations. It was, for example, aimed at "regulating the transfer of urban or urbanizable land with any building (whether constructed before or after the commencement of the proposed legislation) for a period of ten years from the commencement of the legislation or construction of the building, whichever is later;" (Government of India, 1976, comment (vi) on statement of objects and reasons). This provision of the Act became instrumental in imposing entry barrier on the land market.

The consequence of the strategy of large scale acquisition of urban land was the exodus of the urban land market to underground where only a few people could participate. The acquisition of land for public use by invoking Land Acquisition

Act, 1894, was undertaken in a major way since the Third Five Year Plan. There was some confusion as regards the extent of acquisition, which generated an impression of the Government getting involved in the real estate business (see, Government of India, 1988). So, the announcements like freeze of land-use, acquisition of land and getting it distributed through development authorities did not result in regulated urban land market which the policy aimed at achieving.

Since access to land was denied legally, people who could pay substantially in underhand dealings took control of land in the underground market. So, it was not surprising that the NCU found a class of land dealers in the real estate who were themselves criminals.

Besides land, a substantial proportion of houses demanded in the important metropolitan cities of India was also supplied through the construction undertaken by the Government agencies. However, the supply was not adequate to meet the demand arising from different income groups. Consequently, housing units went to a selected few who could pay the price in an illegal transfer.

One of the consequences of land and housing policies is the emergence of people with big money in the construction business of big cities. Describing the situation in Bombay, for example, Dange(1983) points out that 2/5th of the new construction is controlled by 20 builders. Out of this, a single builder claims 2/3rd of the share. The study also describes a similar pattern influence of the real estate brokers on the construction activities of Madras and Calcutta.

The housing market could be evaluated better by examining the case of Delhi. It is because of the fact that Delhi has the distinction of relying on a single development agency (i.e., DDA)

while cities such as Bangalore, Bombay and Madras have entrusted the construction and distribution of houses to more than one agency. The DDA, despite being entrusted with the responsibility, could not supply houses demanded in the 1980s and there was a huge backlog of allotment to the registered applicants as seen in (Table 2.1). The sale and purchase of DDA flats through 'power of attorney' that emerged in the 1980s in Delhi, is a manifestation of the supply scarcity situation.

Table 2.1

Position of Registration/Allotment of Houses (1980s)

Category	No. of registrants	No. of allotments	No. of registrants awaiting allotment
MIG	47521	20620	22280
LIG	67502	39574	25857
Janta	56249	50923	5118
Total	171272	*111117	*53255

Note\* The difference in figures is due to cancellation/surrender of allotments.

Source: Report of Comptroller and Auditor General of India for year ending March 31, 1993, No.3 of 1994.

Similarly, the Rent Control Act introduced to protect the tenant from the exploitation of landlords retarded the building activities in most of the large cities and towns. The Act in practice became a major hurdle in the development of new rental housing (Government of India, 1988). The construction activities got diverted to catering to the demand of a small number of high income group only. Due to rent control, the return on investment in rental housing schemes for lower and middle income groups of



tenants became unattractive. The shortage of housing brought in the Act gave rise to black market activities like payment of 'pugree' in the metropolitan cities.

**ii. Private operators and market structure:** As pointed out above, the public sector policy on the urban real estate failed to develop a regulated market to meet the demand of urban consumers. Consequently, the attention of these consumers got diverted towards the private sector. The following presents the market structure of the real estate keeping in view the activities of the private sector.

Three groups of people, viz., (i) big real estate developers and constructors, (ii) real estate agents and (iii) individual consumers and investors entered it. A large chunk of potential residential land and building seemed to be controlled by the first two groups due to their access to organised and unorganised financial markets. The individual investors from the third group also acquired some properties in the first half of the 1980s. But they are not as active in their participation as the real estate agents and builders are determining the prices of properties transacted. In terms of behaviour, they could safely be put in the category of price takers where the price is set by the real estate agents.

#### **Functioning of the Market**

**a. Operation of the property dealers:** The entry barriers created by Government regulations described above has helped the property dealers in limiting the number of operators. In the absence of large scale entry into the sector, the incumbents seem to be functioning without threat of competition.

The real estate agents concentrate mostly on the acquisition of small plot of vacant land as well as residential buildings, authorised and unauthorised, in the city and sell these off after waiting for a while to allow the land value to appreciate. Their success in enticing customers to the unauthorised colonies is well documented by some studies(see, for example, NBO, 1969). The finance for this activity comes from the unorganised financial market as organised credit market does not provide credit for the purchase of land. Besides, they act as the middle men in selling, purchasing and renting of private houses as well as other categories of flats in metropolitan cities.

The entry into the business of property dealership is also fairly restricted due to restricted supply of credit. While there is the necessity of borrowing large sums of money at a short notice when the opportunity of acquiring some land or a building comes up, the unorganised credit market which supplies such finances requires known customers rather than a stranger to minimise the risk of detection of black income.

#### **Features of Property Dealers' Market**

Despite a number of property dealers one comes across in the different parts of a city, the rate of commission charged for arranging a rented house or selling a property is surprisingly uniform. Similarly there is no intra-zonal variation in the price of land sold by agents. For example, one month's rent is the prevailing rate of commission charged by property dealers in Delhi. Similarly arrangement for the sale-purchase of properties, 2 per cent of its value is charged as a commission. These rates move up uniformly through out the city whenever there is a change. The cost involved in executing the deals seems to be uniform within the region of operation. The uniform price of these real estate services per se does not indicate the operation of a

non-competitive price. But the possibility of one agent accepting the prevailing rate of commission as long as the rivals do not charge differently cannot be ruled out. It helps him to stay in the business because by not deviating from collusive arrangement, the dealer continues to have the equal probability of getting the customer as of his rivals. By lowering the rate of the prevailing rate of commission, he can attract more customers but his rivals would come to know of it very soon due to the proximity of their operation in the same colony/zone and information gap is not significant. As a consequence, competition among agents will drive down the commission rate.

**b. Operation of big developers and builders:** The big real estate developers and builders operate on a much larger scale in acquisition of land compared to the real estate agents. Many of them have enlisted themselves as corporate bodies and raise their finances from the organised capital market. Their acquisition of land is based on the programme for short and long term house construction. The availability of land with unique locational advantage in terms of accessibility, transport cost and developed market has been the prime target of big developers. As undivided long patches of land are no longer available in the developed centres of the cities after the introduction of the Land Ceiling Act, they concentrate in acquiring the undeveloped land in the suburban rural areas, often stretching their activities to ring towns of the metropolitan areas. In order to understand their character, it will be useful to look into the areas like Gurgaon, Faridabad and Ghaziabad (these places come under the National Capital Region), Ulhash Nagar (near Bombay) and K K Nagar (Madras).

### **Features of Developers' Market**

A commonly observed feature of this group is their aggressive advertising policy to attract the buyers. The information on cost of land and houses, instalments to be paid over a span of time and probable credit supplying agencies are prominently displayed in the widely circulated newspapers. There are also features like arrangement of free trips for customers to the proposed site.

One of the important strategies of this group appears to be bringing the high income groups into its fold who would like to have their own accommodation in the outskirts of the city or would like to invest in real estate for future gains. The price of land as well as houses is usually kept at a higher level compared to the corresponding rates of the Government agencies by introducing "quality" difference in the products. In any case, the middle income group of consumers cannot purchase the land supplied by them due to lack of credit availability in the organised financial market. They also remain outside the affordable limit in respect of houses supplied by the private builders as the total cost is much higher even when the finances available in the organised credit markets are considered (see, for details, Dange, 1983).

There are two major factors which help the big developers and builders maintain a higher price line. First, their major operation being confined to important metropolitan cities, the demand coming from Indians working abroad but planning to settle down in the country forms a substantial proportion of the total output. The affordable capacity of these consumers for acquiring the real estate properties is higher than the income earners inside the country and they are willing to pay the price charged by the real estate developers (see, Dange, 1983).

Second, the entry of black money into this segment of the real estate market seems to be substantial to foreclose the possibility of lack of demand. The property dealers buy some of these properties. Advertisements inserted in the newspapers informing the availability of land and houses point out to their control over the properties of the newly developed places. It is in the context of speculative purchases made by property dealers that the relationship between price rise in the real estate and black income could be evaluated.

In the presence of the above mentioned factors and the common knowledge that availability of land with the 'near-city centre' locational advantages is limited, the developers have very little incentive to undercut the prices. The limited availability of land near the cities also works in favour of incumbents by acting as a deterrent to new entrants. On the other hand, benefits of implicit cooperation for maintaining the price line could be more palpable.

The discussion on market structure of the real estate in the metropolitan areas, exhibits the characteristics of an oligopolistic market. It is necessary, therefore, to examine the conditions which enforce the uncompetitive price.

### **III. Number of Real Estate Agents and Tacit Collusion**

The number of operators that the real estate market can accommodate for enforcement of tacit collusion is examined in the following. As noted above, the present analysis will focus on the rate of discount, decision of firms on the length of time to stay in the business, detection lag and punishment for deviating from collusive price to determine the number of firms that can sustain the non-competitive price. These variables will help work out the critical number when strategic variable for competition is known.

The choice of price or quantity has different implications for the nature of competition between firms. As documented in Dixon (1988), there are two types of views. In one strand of thought, the choice seems to depend on structural or institutional characteristics of the market, such as the flexibility of production, type of market (whether it is an auction market). The other notion is that of the choice of quantity or price itself as a strategic decision (Klemperer and Meyer, 1986; Singh and Vives, 1984).

There are some features in the real estate market that would support the view of quantity as the strategic variable. The supply of urban land being limited, firms could be trying to increase the profit from real estate activities by increasing the market share. So, there is a possibility of taking into account the rival's reaction through quantity adjustment. Moreover, a commonly observed feature of the metropolitan real markets is the involvement of brokers who operate as the link between seller of property and a prospective buyer. This character, as observed in auction markets, indicates a Cournot type competition in real estate market.

#### **Data Sources**

The present study has to make heroic assumptions on some of the variables employed for analysing the non-competitive price of urban immovable properties. For example, it is assumed that operators of real estate in the important metropolitan centres will stay in the business for a long period. This assumption is made in view of the finding of the present study that not many real estate brokers for developers have left the business since 1970. Another assumption is with respect to the detection lag for deviating from the prevailing arrangement. The evidence of competition among real estate agents is not commonly observed.

Therefore, the detection lag for deviation of and punishment for the cheat is not easily available. In the absence of such a process, the study has tried to find out the approximate time taken by one agent to get the information on transactions undertaken by his rivals operating in the same area of the city. Interviews with property dealers of the five metropolitan cities indicate that the information takes about 10 to 30 days to circulate in the area. The timing of information flow noted above cannot be verified easily as there is no record of evidence. The present study assumes the upper limit of 30 days and a relatively lower period of a fortnight as the detection lags.

The rate of interest in the unorganised credit market of real estate is assumed in the range of 15 to 36 per cent per annum due to findings of an earlier study (NIPFP, 1984). While by no means unique, the lower limit of the above range is usually not found further below in the borrowing rates of informal real estate credit market. However, the upper limit can be stretched a little further (see, NIPFP, 1989).

#### **Number of Colluding Agents**

That the strategic variable of competition in the real estate market could be the 'quantity' is pointed out above. So, the problem before the present analysis is to find out the number of real estate agents who will sustain tacit collusion when the option arises for a 'Cournot' type competition. The following procedure of estimation is taken from Shapiro(1989) and the number of collusive agents are taken from variables of real estate activities in the five metropolitan cities.

It is noted above that a tacit collusion will be sustainable when at least  $\pi^C = (1 - \delta)\pi^d + \delta\pi^P$ . To see the equilibrium profit in Cournot competition, let operators of real estate activities face a demand function with constant and equal marginal cost. The inverse demand function takes the form,

$$p = \alpha - X$$

where  $p$  = price,  $X$  = output. With  $n$  operators in an activity the profit of 'i' th operator will be,

$$\pi_i = (\alpha - X)x_i - cx_i$$

where  $c$  is marginal cost.

In Cournot equilibrium per firm profit is  $\{(\alpha - c)/(n+1)\}^2$ . According to 'Cournot reversion' of the supergame theory, it will be the punishment profit ( $\pi^P$ ) in case of detection of deviation.

The collusive profit per firm ( $\pi^C$ ) is  $\{(\alpha - c) / 2\}^2$ . This result shows that the collusion among the players of real estate gives them monopoly profit, which is equally divided. If a particular operator deviates, he will supply a different quantity of output in the period of deviation while the remaining  $(n-1)$  will produce their share of Cournot output. Maximising the Cournot profit by taking the output of rivals as given, the deviant operator will get a profit ( $\pi^d$ ) of  $\{(\alpha - c)(n+1) / 4n\}^2$ .

By putting the above values of collusive, deviation and punishment profits into the inequality,

$$\delta > \text{or} = (\pi^d - \pi^C) / (\pi^d - \pi^P),$$



One gets,

$$\delta \geq \text{or} = (n+1)^2 / \{(n+1)^2 + 4n\}.$$

The value of n can be worked out when  $\delta$  is known.

Consideration of two key parameters of collusion, the rate of interest and detection lag in the real estate market of five metropolitan cities of India would indicate a discount rate for the controllers that remains above 90 per cent. With quantity as the strategic variable of competition, tacit collusion can work very well even with more than 100 operators.

The limit below which the number of operators in a real estate activity, be it land transaction, land development or supply of dwelling units can successfully collude is given below in Table 2.2. The discount rates used to calculate the given number are as follows:

**Table 2.2**

**Number of Agents With Which Collusion  
Can Work in Real Estate**

Detection lag	Number with Rate of interest	
	15%	36%
1/2 month	635	262
1 month	316	129

**Discount rate:** With 15 per cent and 36 per cent rates of interest per annum, a detection lag of half a month gives the discount rates ( $\delta$ ) of 0.9938 and 0.9851, respectively. On the other hand, a detection lag of one month with the same rate of interest as above,  $\delta$  is 0.9876 and 0.9704.

**Number of colluding operators:** Table 2.2 shows that with the rate of interest of 15 per cent per annum and a detection lag of half month, 636 operators can successfully sustain the collusive pricing. A detection lag of one month reduces that number to 316 only. When the rate of interest is 36 per cent per annum, a collusive arrangement can successfully work as long as the number of operators does not exceed 263 and 129 for detection lags of half and one month, respectively.

The persistence of non-competitive price in the real estate activities of metropolitan cities becomes clear from the above results. The group of operators termed as property dealers earlier remains far below the above number in a geographical area of their operation. The same inference also can be drawn for big developers. Moreover, as the incentive to collude increases due to multimarket contact (see, Bernheim and Whinston, 1990), the probability of collusion of big developers increases as they operate in more than one area.

### **Conclusion**

The foregoing discussion examines the possibility of a persistence of collusive price in the real estate market. The prevailing market structure of real estate and underlying incentives for tacit collusion are assessed for this purpose.

An examination of real estate market indicates that there are only a small number of owners as well as developers in recent years. Due to Land Acquisition Act and Urban Land (Ceiling and Regulation) Act, access to land has been denied legally. People who can pay substantially in underhand dealings have taken control of land and activities in the underground real estate market have increased.

An offshoot of the disruption in normal development of real estate market is the recent emergence of property dealers and big developers in the metropolitan cities. The entry barriers created by the real estate policy has helped in foreclosing the competition in the market as the number of entrants remains restricted.

The incentive for collusion appears to be strong enough to accommodate greater number of property dealers and developers than that can be found in activities of real estate at present. The discount factor on payoff of this market seems to be relatively higher. It indicates that operators of real estate are giving more weight to future rate of return that would accrue to them for staying in the collusive arrangement.

## APPENDIX TO CHAPTER 2

### Working of Tacit Collusion

To see how the arrangement of tacit works, let  $(\pi^C)$  be per firm per period collusive profit. If a firm decides to deviate from the collusive arrangement, it will earn higher profit  $(\pi^d)$  in the period of deviation. But other firms will come to know of the deviation and punish the deviant firm by forcing it to earn only punishment profit  $(\pi^P)$  for the remaining period of its stay in the business. The firm would be in the collusive arrangement as long as the total payoff in the entire period works out to be greater than or equal to the total profit from deviation. In other words, the decision of the firm to stay in the collusion depends on the following inequality:

$$\pi^C / (1 - \delta) > \text{or} = \pi^d + [\delta / (1 - \delta)] \pi^P$$

or,

$$\pi^C = (1 - \delta) \pi^d + \delta \pi^P$$

where  $\delta$  is the discount factor of the payoff and can be assumed as  $e^{-iT}$ , the term  $i$  being rate of interest and  $T$  is the time required for detecting deviation; total collusive profit of the firm is:

$$\pi^C + \delta \pi^C + \delta^2 \pi^C + \delta^3 \pi^C + \dots$$

or,

$$\pi^C / (1 - \delta) \text{ and total punishment profit of the firm is}$$

$$\delta \pi^P + \delta^2 \pi^P + \delta^3 \pi^P + \dots$$

or,

$$[\delta / (1 - \delta)] \pi^P.$$

## Chapter 3

### TAX BURDEN ON REAL ESTATE TRANSACTIONS

#### Introduction

The generation of black money in real estate in India is attributed, largely, to an unintended consequence of the fiscal policy implemented under the regulatory regime encompassing also control on ownership and use of land (see, Government of India, 1979 and 1985). One of the important findings of the studies that have gone into the policy evaluation points to high incidence of tax on the real estate properties as a factor responsible for compelling the tax payers to adopt extra legal or illegal methods of avoiding or evading taxes. It can be seen, for example, from the report of the Tax Reforms Committee (Government of India, 1991) that the liability of three taxes - property, income and wealth - on some urban real estate properties works out to as high as 63.43 per cent of the total rental income. The Committee therefore observed, "Most would agree that such a high burden at 63 per cent of income provides strong incentive to avoid or evade taxes". The observation of the Committee on high incidence of tax burden on real estate properties is only indicative in nature as it does not include many other minor levies, especially, those collected with the property tax. Inclusion of these taxes would increase the ultimate burden further.

#### Macroeconomic Context

Coming as it did from the findings of an expert committee, the high tax burden factor was bound to receive greater attention in the process of policy formulation of the Government.

The introduction of economic liberalisation programme in 1991 and action taken on the recommendations of the Tax Reform Committee (1991) have led to a general reduction of tax burden in the Indian economy and the real estate sector has benefited in the process. On the macroeconomic front, the liberalised industrial policy and foreign investment regime, and the encouragement to the investment by the domestic and foreign investors to enter all but a few regulated sectors, has seen a flurry of investment proposals. The capital market is undergoing a tremendous expansion in terms of new issues and trading, and diversification in terms of the type of instruments and trading institutions. Many urban areas are expected to witness increase in construction activity and demand for office and residential premises, and the ripples are already seen in the dramatic increase in real estate prices and rents in Bombay and other large cities. Yet the concern for the problem of tax evasion in real estate property persists simply because reforms initiated in the financial and capital market sector would be inadequate for eliminating the monetary and other incentives to evade taxes. Such apprehensions come up due to persistence of factors like excessive regulations governing land use and ownership, multiple authorities involved in taxing the real estate, the high rates of stamp duty in a number of states and other factors. For, without coordinated steps by the governments and agencies at different levels in order to carry forward the liberalisation process at the state and city government levels, it may not be possible to reduce the tax burden significantly. Moreover, the rigid institutional setting which strengthens the process of evasion, unless revamped, would make the expected gains from reform ineffective. It would therefore be necessary to evaluate the nature of tax structure of real estate, and the steps initiated to bring down the share of burden contributed by different imposts under the regime of economic liberalisation.

It is important to note here that the levy of taxes on the ownership and transfer of property and land in India has been motivated as much by the desire to mobilise maximum revenues from this steadily appreciating asset, as from the ideological aim of curbing profiteering in real estate, and speculative holding of real estate for consumer exploitation and the realisation of unwarranted prices and rents. That is why, states like Tamil Nadu imposed a tax on urban vacant land along with the imposition of a ceiling on possession. The attempt to tackle the malaise of black money through provisions like Chapter XXC of the I.T. Act was made thus from the ideological angle first, and consequently the revenue angle of realising tax on undeclared income at the point of origin and on a recurring basis.

The following exercise seeks to examine the problem by considering four inter-related aspects viz., (i) forms of tax evasion, (ii) institutional setting, (iii) rate structure of some of the important taxes, and (iv) tax burden.

## **Section I**

### **Forms of Tax Evasion in Real Estate**

There are numerous ways of tax evasion taking place in real estate. Taxes - Central, State and local - are evaded by the processing of unauthorised land development and sale in big cities, unauthorised construction or use, conversion of properties, their renting or sale arising from inflexible master plans and building regulations, or ineffective control over urban development by public authorities. The amount of black money generated in these types of illegal activities get multiplied in every successive stage of transaction. The black money handed out to facilitate or to ignore such illegal transactions are not taken into account while speaking of tax evasion in real estate

activities. The problem can be judged better by looking at frequently adopted methods of many tax payers. Very often taxes are evaded through understatement of the value of properties at the time of purchase or subsequent transfers. Some of the other practices commonly observed while transferring properties are (i) a will, (ii) a simple agreement between seller and buyer, (iii) a General Power of Attorney and (iv) a cash receipt.

It is difficult to quantify the magnitude of evasion through channels (i) to (iv) in conveyances enumerated above as data are not available easily. The evasion through understatement of value of properties is the only *modus operandi* that provides some evidence on the seriousness of the problem. The following discussion attempts to highlight this.

**A. Tax evasion through understatement of the value of properties**

In the instrument of transfer, buyers and sellers do not report the correct value of the property. Both the parties benefit from such a strategy by way of saving from the payment of capital gains tax, stamp duty and registration fees. To deal with such cases, the government has been taking the help of provisions of the Chapter XXC of the Income tax Act, 1961 and the Appropriate Authority is purchasing all such suspected under-reported properties valued more than Rs 10 lakh entering the market for transfer. As the validity of the resorting to this provision is upheld by the Supreme Court of India (see, the judgement in Appendix to Chapter 2), the strategy of acquiring suspected properties is likely continue. Since it started operation in 1986, the Appropriate Authority has passed order to acquire as many as 685 properties valued at Rs. 275 crore by the year 1991 (Table



3.1). From among these the Appropriate Authority has auctioned 275 properties and succeeded in detecting an understatement to the tune of Rs 34 crore.

Table 3.1

**Details of properties purchased by the Central Government  
under the provisions of Chapter XXC of Income Tax Act, 1961  
(ending March 1993)**

	Calcutta	Madras	Ahmedabad	Delhi	Bombay	Total
i) No. of state- ments received in Form 37 I	78	522	171	349	2348	3468
ii) No. of properties purchased	13	7	4	8	46	78
iii) Value of properties purchased (Rs.lakhs)	235.52	505.48	105.56	262.04	3102.35	4229.95
iv) No. of proper- ties where con- sideration exceeds Rs.50 lakhs	1	4	-	1	21	27

Source: CAG Report of 1993 on Central Government Revenue Accounts.

Some individual cases of attempted under-reporting in the transfer of properties in five important cities of India will be examined in Chapter 6 while estimating the magnitude of black money generation. In order to appreciate the problem of undervaluation, Table 3.2 gives a few examples of property transacted in Delhi. Data given in the table are taken from Sharma (1993) and relate to a sample survey undertaken in the months of

January, February and March 1989. It is stated in the study that the survey covered 94 transactions registered with the Sub-registrars in Delhi of which 18 cases are given in the table.

Information recorded in the table indicates considerable amount of under-reporting of the market value of properties. It can be seen that the fair market value of the properties is as much as Rs 40 - 50 lakh while the sellers show an apparent consideration of less than Rs 10 lakh. Some indication of undervaluation can also be obtained by looking at the average value per document of the documents for conveyance of property brought for registration, and the value at which they ought to have been registered, going by the prevalent market value of properties. It was reported by the Registration Department of West Bengal, for example, that the average value of the registered sale deeds in Calcutta over the last year came to Rs.60,000, whereas, in view of the fact that a considerable proportion of real estate transactions was of the value exceeding Rs.5 lakhs, the understatement was of the order of ten times.

#### **B. Other forms of evasion**

i. **Agreement to sell:** Taxes, in the transfer of real estate properties, are evaded as well as avoided by devising methods which ensure the possibility of a court of law enforcing the contract in case of any conflict between the parties. Under the Indian system, an Agreement to Sell with possession has become convenient for carrying out the transfers. Mention may be made of the following provisions of Indian Registration Act, 1908, Transfer of Property Act, 1882 and Specific Relief Act, 1963 that are used to execute the transactions without paying transfer Duty and stamp Duty:

- a) An Agreement to sell with transfer of possession is not required to be compulsorily registered under section 17 of the Indian Registration Act.
- b) Section 53-A of the Transfer of Property Act ensures the legal validity of a contract in case of an agreement to sell with possession given.
- c) The Specific Relief Act states that if the buyer is willing to make payment of the balance amount of an agreement, he cannot be asked to hand over possession back to the seller.

These provisions combined ensure that the Agreement to Sell with possession is a clever way of executing a transfer without paying stamp duty and registration fees. Its attractiveness increases under the regime of regulatory policy because the restrictions on sale and purchase of land and buildings could be circumvented.

**ii. General power of attorney:** In recent years, the practice of transferring properties through General Power of Attorney has been increasingly resorted to. It is used to designate someone as the duly authorised agent of the executor to do all acts as specified therein on his behalf in respect of the property. Parties involved in a transfer of immovable property avoid registration through this method. The Power of Attorney, moreover, is registered often outside the state where the property is located. States like Maharashtra have tried to plug this loophole by requiring the parties to pay stamp duty at the rates prescribed for the conveyance, where the GPA seeks to confer authorisation to deal in property.

iii. Will: A Will safeguards the buyers' interest after the death of the seller when the property is transferred through Power of Attorney. In case of immovable property it is covered by optional registration under section 18(e) of the Indian Registration Act and provides a safe way of shifting ownership without payment of taxes due.

iv. Cash receipts: A cash receipt is furnished by a seller of the property to be retained by the buyer. Usually it gets registered with the registrar stating merely amount paid by one party to other. The possibility of detection of the transaction and subsequent payment of taxes are avoided by omitting to mention the fact that the payment has been made in connection with a purchase of immovable property.

#### C. Institutional Setting and Registration

Under the Indian administrative system, the control of real estate conveyance is in the hands of multilevel authorities. A major consequence of the operation of multiple authorities is the hardship, in terms of money and time, caused for the people while dealing with the different levels of officials. Consequently, many buyers and sellers of land and buildings have tended to resort to extra-legal means which gives rise to problem like entrance of black money into real estate.

An upshot of the regulatory economic policy followed in India until recently is the practice of issuing 'no-objection' certificate before any land transaction can be registered. There are offices of the Competent Authority for Urban Land Ceiling Act, the Revenue Department regarding the land not being under acquisition, the no objection under the Land Reforms Act to guard against the alienation of agricultural land, and general approval to prevent registration of documents against public policy as in

Karnataka and Maharashtra, NOC of Appropriate Authority of Income Tax Department for all transactions above Rs. 10 lakh, and Income tax Clearance Certificate in case of transaction of more than Rs. 2 lakh, whose clearance is necessary for transferring real estate properties. As documented in a recent study (NIPFP 1994), the requirement of clearances and approvals prior to registration of the document causes considerable delay and expense, apart from the scope for alleged corruption, and deters the parties from going through the registration process.

*Sub-Registrars* in the taluka and district levels deal with registration of land and property transactions and related instruments. Since all land transactions above Rs 100 are required to be compulsorily registered under Section 17 of the Indian Registration Act, 1908, almost every property entering the market has to be presented to these officials. In practice, the process of registration has become complex, and prone to delay. In a number of states, barring Delhi (where the provision for enquiry for undervaluation does not exist), it is common for the Registering Officer to refer the document to the Collector for the fixation of the market value for the purpose of deciding on the stamp duty, and this results in delays upto one year. It is pointed out in studies (Government of India, 1993 and NIPFP 1994) that a large number of different types of documents/instruments are to be presented before the Sub-Registrar approves registration of a transaction.

The registration of land transaction in India does not automatically change the ownership title of land record. The city record office and the municipal body has to be approached to deal with change of title on land when transfer takes place between two parties.

In important urban centres, the public agencies have undertaken the task of acquisition of private land as well as development, allotment and administration of leasehold lands. There are many agencies such as L & D.O, Housing Board Development Authorities like D.D.A., Slum Clearance Boards, and Municipal Corporations, who are engaged in control of the use of urban land, regulation of construction activities and collection of the unearned increase on transfer of lands allotted by them. No objection certificates have to be taken from various Central and State agencies before construction is commenced.

In case of leasehold land, where the Government or a designated agency is the lessor, sale permission is required from the lessor before the sale can be registered. This practice makes it imperative to visit the Government officials more than once and the lessee has to wait for months before permission can be obtained for sale transactions or for a change of use.

All these permission-obtaining requirements result in loss of time, harassment and payment of money. It is not surprising that many buyers/sellers try to avoid these by choosing some easy way out like the Power of Attorney transactions, and this leads to the entire money exchanged in the transaction getting into the black money stream. They run the risk, of course, of not being able to get the names of the rightful buyer being entered in the official title records. In case of undervaluation, prompted both by the proportion of black money involved in the transaction and the heavy stamp duty, even previously law-abiding citizens end up by helping in the conversion of part of their white money into black. They are then obliged to resort to extralegal means to invest the black money realised by them, and not declared in the tax return in a sense, undervaluation results from the very

practice of requiring part of the payment in black money, and the prospect of lower quotations for purchase of existing property if payment is demanded entirely in white.

## **Section II**

### **Real Estate Taxes/Levies and Burden**

There is a multiplicity of taxation authorities at Centre, State and local levels. The State governments levy stamp duty, registration fees and transfer duty (sometimes accompanied by a surcharge to be passed on to the local bodies as in Tamil Nadu), urban land tax in some States, and some development authorities levy a charge on the unearned increment realised by the seller on leasehold property. The Income Tax Department of Central Government, collects the wealth tax on the assessed market value of the land and property beyond prescribed values every year, capital gains tax on the realisation of profit on sale of the property according to prescribed formulae, and gift tax on gifts beyond a prescribed value; finally, the local governments impose property taxes or development charges and special levies on land and buildings. Apart from these taxes, income earned from real estate properties through rents and deposits is taxed under the personal and corporate income tax. With the prospect of exemption of built up properties having a rental value beyond Rs.3500 per month, in cities other than Delhi, and the liberalisation of the rent control laws, rental income will increasingly form an important component of the income of assesseees in the middle and top brackets. Thus, property is subject to one-time levies like stamp duty and registration fees, gift tax, unearned increment fee, development charges etc., and recurring levies like the wealth tax, income tax, property tax and other local taxes resting on individual valuation bases. It is the cumulative incidence of these direct or indirect levies, imposed without apparent

coordination, but only with an eye on revenue, by a multiplicity of authorities that the Chelliah Committee and others refer to as an adverse factor to be immediately addressed in the context of tax reform.

#### **Tax Rates on Real Estate**

As mentioned above, real estate taxes, on the basis of their occurrence, can be divided into two groups as one-time levies and recurring levies. A recent study on **Problems in Urban Land Transactions** (Sharma, 1993) has documented these in detail. Three important one-time levies payable by the buyer/seller are (i) Stamp Duty and registration fees (ii) Capital Gains Tax, and (iii) Gift Tax. Besides these, there are other forms of imposts. As may be seen in Delhi, either the Land and Development Officer, the Government of India or the D.D.A., as lessor, collects a certain percentage of the profit realised by the lessee on the transfer of the leasehold right to another party. The share of such unearned income in Delhi is 50%. In a recent move, the rates were substantially reduced in respect of residential plots upto 500 Sq.m. and houses constructed thereon. The lessees including the power of attorney purchasers can convert leasehold plots to freehold tenure on liberalised terms on payment of prescribed conversion fees for flats and cooperative or individual plots. However, this provision is yet to become popular as there is a feeling among many a leaseholder that the conversion rates are still too high and the procedures involved are too cumbersome.

#### **Development Charges and Unauthorised Development**

In metropolitan centres such as Delhi, the unauthorised colonies come up frequently and these do not have the provision of civic amenities like drainage, sewerage and roads. When the local bodies are authorised by the Government to provide such services,



payments are required from the beneficiaries towards the cost of providing these facilities. In Delhi, these development charges are Rs. 72.50 per square metre for water supply and sewerage apart from charges for electricity supply levied by Delhi Electricity Supply Undertaking. The money exchanged in the course of sale and purchase of plots in these colonies is never taxed because the development is illegal, and the money so generated joins the stream of black money. The same applies to the transactions in the plots and houses in the resettlement colonies of Delhi, since, on paper, the plots are held on licence fee, and are not allowed to be transferred. The development charges proposed for the unauthorised colonies at present are also less than 10% of the prevailing cost of development applicable to normally developed colonies. Hence, the Government and the local bodies lose heavily on account of legalisation of these colonies.

#### **One-time Levies**

##### **1. Stamp duty and registration fees**

Stamp duty and registration fees are paid at the time of transfer or sale of land and buildings. In practice, the buyer bears the burden of this levy although under the Indian Stamp Act, 1899, the seller was required to pay it.

The collection of stamp duty and registration fees may be linked to legal benefits conferred on the registrant and administered by State governments. However, the burden arising out of these imposts seems to be responsible for undervaluation of land and buildings in the documents presented for registration. The parties display a lot of ingenuity in effecting the process of sale or transfer of possession otherwise than through the registered sale deed. The State governments look at these imposts as sources of revenue and keep on bringing additional instruments

of transactions within the definition of conveyance, well aware of the impact of these charges on the cost of acquisition or transfer of property. As a result, a higher incidence of stamp duty on the real estate properties is seen in India when compared with those of some developed countries. For example, it is reported that the stamp duty in U.S.A. is in the range of 1 to 5per cent in different states, while in U.K., stamp duty is 1 per cent of the consideration exceeding £60,000 for transfer of land and building. A transfer of immovable property in Germany does not attract stamp duty. The Canadian system aims at a lower incidence of the duty in respect of transfer. For transmission mortgage of land, the tariff is 2 per cent of the first \$ 1000 and 0.2 per cent for the amount between \$ 1000 upto \$ 1 million and .01 per cent for the amount above \$ 1 million (see Chapter IV, NIPFP 1994). In contrast to these, the rates in India in most states are not only higher but also exhibit wide variation across the States.

a. **Stamp duty:** The rate of stamp duty varies from State to State. The duty charged is 14.5 per cent of the value of immovable property in the State of Uttar Pradesh, whereas in Maharashtra the rate is 10 per cent only for most properties. Similarly, in the State of Orissa, the duty for transfer of immovable property is 10.7 per cent of the consideration amount. An inter-state comparison of the impost on selected values of immovable property given in Table 4.3 is to establish its important features. Apart from variation, it is apparent from the table that stamp duty follows a graded rate structure in Bangalore and Bombay. While the duty of any instrument of conveyance in Bangalore is around 10per cent. In Delhi, there is a transfer duty collected at the rate of 5per cent on the amount of consideration shown in the instrument of transfer. It is a surcharge on stamp duty. With the rate of basic stamp duty fixed at 3per cent, the total payment of stamp duty in Delhi is 8per cent of the consideration shown in a

transfer document. Further, the basis of determining stamp duty in Delhi varies in case of leasehold and freehold land (see, Sharma, 1993). In case of Bombay, an immovable property conveyance attracts a duty rate of 10 per cent of the value unless it belongs to cooperative society or residential premises to which provisions of the Maharashtra Ownership Flat Act, 1963 apply. In these categories of residential properties a progressive rate structure is applied. In the city of Madras, the stamp duty has a constant marginal rate of Rs 8 though only nominal charge is levied in slums and house sites developed by the public authorities. In the course of discussions with the real estate developers in a number of states, and representative bodies like the Chambers of Commerce, it was stated by them that the combined incidence of stamp duties and registration charges was very high especially as this was levied on officially determined guideline levies, and this was a major contributory factor to undervaluation, reluctance to register transactions, and the use of black money in real estate.

b. **Registration fees:-** In comparison with stamp duty, the registration fees are of less significance as a source of revenue, though the picture varies across the states. The rate of fees charged varies among the cities. For example, while the registration fee charged on property valued between Rs 200 to Rs 300 is Rs 6 in Bangalore, it is Rs 3 in Madras (Table 3.2). In Bombay, registration fee is 1 per cent of the value subject to a maximum of Rs 5,000 whereas in Calcutta, it is Rs 11 per 1,000 rupees of the cost of property. Delhi shows yet another pattern by charging a maximum amount of Rs 101 irrespective of conveyance value as registration fees. The impact of the registration fee is looked at more from the point of view of the dilatory procedures accompanying the process of registration, and the delay in the return of the registered document, as described in NIPFP 1994.

**Table 3.2**  
**The Rates of Registration Duty for Immovable**  
**Property in different States**

1.	Maharashtra	1 per cent of value, but not exceeding Rs.5000.00
2.	U.P.	1 per cent of value, but limited to Rs.251.00
3.	Delhi	1 per cent of value limited to Rs.500.00
4.	Karnataka	2 per cent of value ad valorem (no limit)
5.	A.P.	1 per cent of value ad valorem (no limit)
6.	Tamil Nadu	1 per cent of value ad valorem (no limit)

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Source: Replies to questionnaire furnished by State Governments for NIPFP study on Stamp Duty.

## 2. Capital Gains Tax

Under the provision of the Income Tax Act, 1961, land and buildings are treated as capital assets and subject to capital gains tax under section 45(1). For the purposes of the Income tax Act, capital gain is the amount by which a capital asset is sold, net of any expense incurred in connection with the sale of the asset, if it exceeds the price at which the capital asset was purchased. Since the tax is levied according to the duration of ownership of assets such as land and buildings, usually a distinction is made between short- and long-term holding.

Similar to that of stamp duty and registration fees, capital gains tax has in India has given rise to the problem of under-valuation of land and buildings in the document of transfer presented for registration. Moreover, Indian experience of the tax indicates very little capital gains tax being paid after taking the advantage of many provisions of exemptions.

Taking such a feature into account and following the simplification objective to be pursued under the regime of economic reform, the year 1992-93 witnessed a few important modifications in the long-term capital gains tax in India. The tax rates proposed from the assessment year 1993-94 are put under three groups. Depending on the type of ownership as individual, company or others, the tax will be 20per cent, 40per cent and 30per cent respectively. Further from the year 1992-93, the cost of acquisition in case of assets acquired prior to 1.4.1981 is to be considered as the value subject to adjustment Cost Inflation Index (CII) as shown in Table 3.3. For example, in the assessment year 1993-94 the mode of computation of long-term capital gains is to be worked out as under:

*[(Cost of acquisition) X (CII of the year in which the asset is transferred)/(CII of the year of acquisition or the year beginning on 1.4. 1981)].*

**Table 3.3**

**Cost of Inflation Index**

Year	Index
1981-82	100
1982-83	109
1983-84	116
1984-85	125
1985-86	133
1986-87	140
1987-88	150
1988-89	161
1989-90	172
1990-91	182
1991-92	199
1992-93	223

**Source: Government of India, Income Tax Act, (1993).**

In case of suspicion on the understatement of sale value of property, an Assessing officer may be asked to ascertain its fair market value. The fair market value is defined as the price that the land or building would ordinarily fetch on sale in open market (section 2(22B), the Income tax Act, 1961).

It may be useful to point out that the above arrangements of taxing capital gains in respect of real estate are a result of latest measures introduced to simplify the tax administration. The important provisions withdrawn from the preceding schedule are:

- i. Total exemption enjoyed by transfer of residential houses valued less than Rs 2,00,000 and held for more than three years. The partial exemption given to residential houses of more than Rs 2,00,000 value is also withdrawn.
- ii. The statutory deductions in respect of long-term capital gains for the real estate properties is Rs 15,000 plus 50per cent of the balance.
- iii. In case of investment of the capital gains into another house property or investment in certain specified securities etc. with the Unit Trust of India (UTI), Industrial Development Bank of India (IDBI), Housing and Urban Development Corporation Limited (HUDCO) and National Housing Bank (NHB), capital gains are not subject to tax.

However, there are other exemptions in capital gains taxation which continue under the present regime. For example, while capital gains arising due to development and sale of land and buildings are subject to tax, exemptions are accorded if persons concerned are engaged in the business of purchase,

development and sale of land. Parallel provisions have been made in the definition of wealth in the Wealth Tax Act for this purpose.

Usually the transfer of agricultural lands is exempted from capital gains taxation. Exceptions to this provision can be found in case of the transfer of agricultural land situated within the territorial jurisdiction of a municipality with a population of 10,000 or more according to the latest Census. Similarly, the agricultural lands coming within 8 Km. radius of a municipal area with population of 10,000 or more, according to the latest Census, are taxable. The amount of capital gains is not taxable if a residential house is constructed within three years of the transfer or a residential house is purchased within one year before or two years after the transfer and the cost thereof is more than the capital gains (*section 54*). In case of a land or building used for a industrial undertaking is compulsorily acquired by the Government and the owner constructs or purchases another building for shifting or re-establishing the undertaking within three years after transfer, the amount of the gains utilised for construction or purchase is exempted from being taxed (*section 54D*). The amount of net sale of land remains beyond the levy if the owner constructs a residential house within three years of sale or purchases a residential house one year before or within two years after sale (*section 54F*).

At present, long term capital gains are adjusted in accordance with cost inflation index, and then only the real profits are subjected to tax. However, short term gains, which are also real profit, are subjected to a harsh treatment by clubbing them with all other income. There is no need to distinguish between long and short term capital gains and both should attract the same rate of tax.

With the introduction of new rates, the tax burden due to capital gains taxation in India appears to be comparing well with many developed countries. An elaborate documentation of the rates of capital gains taxation of real estate is given in Tandon (1987), but this has to be read with the Chelliah Committee Report.

The exemption of the long term capital gains in the U.S. is upto 50 per cent and the tax rate around 17.5 per cent. In U.K., the first 500,000 pounds of capital gains have been fully exempted from the tax. In case of any excess value over that limit, price indexation of the capital assets has been introduced. Such a provision allows the acquisition cost of an asset to be determined by the increase in the retail price index after one year of the asset being held. Japan makes a distinction between short and long term gains from real estate. A property has to be held for a minimum period of 10 years to be classified as long term capital asset. Long term capital assets are taxed at the rate of 20per cent for gains upto Yen 40,00,000. In case of a larger gain, the tax element is determined in a way such as to keep the burden less than 30per cent of the gains.

#### **Recurring taxes**

The other group consists of the recurring taxes such as (i) property taxes (ii) wealth tax, (iii) income tax from the income on house property, (iv) betterment tax and (v) vacant land tax. From these, the wealth tax is levied on all non-productive assets including land and buildings by the Central Government on their market values. Also, the income tax is levied by the Central Government on the income from house property. The remaining taxes are local bodies' imposts. Property taxes are levied on land and buildings on their rateable annual values. Betterment taxes are imposed by some local bodies. The owner of properties pays such a



tax in areas where some capital intensive schemes are executed and consequently market value of land and buildings increases. The vacant land tax, on the other hand, is levied by some local bodies at the rate of one per cent of market value of the vacant land and there is a state-wide urban land tax on 1981 values in Tamil Nadu. In some of the cities such as Delhi, the tax is built into the property tax assessment. The main purpose of the tax appears to be to discourage speculation in land and to act as a disincentive for the land owner to keep the land vacant for long. The rate structures of three important taxes - property, wealth and income - are discussed in the following.

#### 1. Property taxes

Issues for property taxes in India until now were as much the problem of high tax burden in some cities for new properties, as the stagnant tax base, inelastic local revenue, and the rising gap between tax burden of new and old properties. The paucity of funds to finance the services provided by the local Governments and the role of property tax in revenue augmentation of local bodies have received great attention. Attempts to introduce reforms in property taxes therefore highlight the revenue impact of regulated rents under the Rent Control Acts in the light of various Supreme Court judgments in this regard, and methods of property valuation to delink the base of the property valuation from the standard rent and to devise alternate bases. The protection enjoyed by the protected tenant and the efforts of the landlords to persuade them to relinquish the tenancy in return for substantial cash compensation have resulted in the generation of black money. This is followed by the installation of a new tenant at the same low rent, but with a substantial puggree, or by steps to redevelop the property. The latter alternative would of course invite higher assessment of rateable value for the flat purchasers, while the former option is often balanced by the loss

of substantial capital receipts from additional dwelling units on the same property. Rent control, the burden of property taxes and their influence on the black money generation, therefore, are substantive issues to be considered not only for the development of housing market in urban India, but for the effect on private investment in the redevelopment of low rent inner city areas and the use and generation of black money in the process.

Property taxes are levied on the annual letting value of land and buildings and the rates of taxes generally vary between 10per cent to 40per cent on the annual value in the local bodies of India. The details of rates prevailing in major corporations of India are given in Table 2.7. (It is learnt that the states of Tamil Nadu and Andhra Pradesh have recently revised the rates of property taxes, while A.P. has also enacted legal amendments to rationalise the system for fixing the rateable value, thereby considerably augmenting the revenue from this source). The only exception to above range of property tax rate is Rajasthan where the property tax rate is 6.25% of the property value (see, Government of India, 1993). The tax burden due to local bodies increases as other taxes such as scavenging tax, water tax, and fire tax are collected along with the property tax.

In most of the municipalities of India, the property tax liability is determined on the basis of the notional rental income, or agreed rent. For example, Section 116(1) of the Delhi Municipal Corporation Act, 1957, stipulates the following:

"The rateable value of any land and building assessable to property taxes shall be the annual rent at which such land might reasonably be expected to be let from year to year less

(a) a sum equal to ten per cent, of the said annual rent which shall be in lieu of all allowances for costs of repairs and insurance, and other expenses, if any, necessary to maintain the land or building in a state to command that rent, ... "

Another feature to be noticed from the property tax rate schedule is the provision of a rebate for timely payment which ranges from 10 per cent to 25 of the tax. Table 3.4 documents the rebate allowed in the major corporations of India.

For the purpose of this study, what is of importance is the combined incidence of different recurring taxes at the Central and State level, and the property tax at the local level on the same property, and the incentive for undervaluation of the property in order to reduce the tax liability of one or all of these taxes.

## 2. Wealth tax

One of the major objectives of wealth tax in India, as observed in the Tax Reforms Committee (Government of India, 1991) was 'to make a dent on inequalities in the non-agricultural sector'. Reviewing its experience the committee pointed out that the tax has failed to achieve the main objective. It is not surprising therefore that a review of the operation of the net wealth taxation has been undertaken in 1992-93.

It is too early to assess the influence of changes introduced in the wealth tax provisions on revenue yield and inequality reduction objective. The new rates have lower tax rates. Following on the recommendations of the Chelliah Committee, there is also an attempt to redefine the tax base by including the so-called unproductive assets like land and houses. Some of these changes are documented in the following for a better appreciation.

Table 3.4

**Rebate Allowed on Property Tax for Timely Payment  
in Major Corporations in India**

Corporation	Rebate												
1. Ahmedabad	10 % if paid in April and 5 % if paid in May.												
2. Bhopal	Statutorily maximum rebate allowable, 65%. Now 5% rebate is allowed if tax is deposited within the first two months of the financial year.												
3. Delhi (MCD)	No statutory provision. But currently (1989-90) rebate for prompt payment of tax is allowed as follows: <table border="1" style="margin-left: 40px;"> <thead> <tr> <th>Property</th> <th>Rebate on the demand for 1989-90</th> </tr> </thead> <tbody> <tr> <td>a. SOP residential</td> <td>25 per cent</td> </tr> <tr> <td>b. Partly SOP residential (owner occupied portion is not less than 40 per cent of the covered area)</td> <td>15 per cent</td> </tr> <tr> <td>c. SOP completed and occupied after 31.3.85 and is not covered in (a), the rebate will be available for 5 financial year only.</td> <td>25 per cent</td> </tr> <tr> <td>d. Registered Societies, used as educational institution but not exempt from general tax.</td> <td>25 per cent</td> </tr> <tr> <td>e. Other land and buildings.</td> <td>10 per cent</td> </tr> </tbody> </table> <p style="margin-left: 40px;">A property can avail of only one type of rebate.</p>	Property	Rebate on the demand for 1989-90	a. SOP residential	25 per cent	b. Partly SOP residential (owner occupied portion is not less than 40 per cent of the covered area)	15 per cent	c. SOP completed and occupied after 31.3.85 and is not covered in (a), the rebate will be available for 5 financial year only.	25 per cent	d. Registered Societies, used as educational institution but not exempt from general tax.	25 per cent	e. Other land and buildings.	10 per cent
Property	Rebate on the demand for 1989-90												
a. SOP residential	25 per cent												
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c. SOP completed and occupied after 31.3.85 and is not covered in (a), the rebate will be available for 5 financial year only.	25 per cent												
d. Registered Societies, used as educational institution but not exempt from general tax.	25 per cent												
e. Other land and buildings.	10 per cent												
4. Khandwa	5 per cent on advance payment.												
5. New Delhi	No such provision.												
6. Vijayawada	Rebate of 10 per cent if paid within 15 days.												
7. Amritsar	Rebate of 10 per cent if paid within 15 days.												
8. Belgaum	No such provision. But old buildings may be considered for rebate.												
9. Bombay	Residential 20 per cent Regd. Coop. Hsg. Society. 30 per cent (For 10 years from first letting)												
10. Calcutta	5 per cent												
11. Indore	6 per cent												
12. Madras	No such provision.												

Source: Delhi Administration Report on Property Tax prepared for Malhotra Committee Report on Property Taxes, 1992.

Starting with the financial year 1992-93, the wealth tax rates on taxable net wealth are 1% uniformly with a provision of exemption upto Rs. 15 lakh. In contrast to this structure, the rate of wealth tax on the taxable value of the asset upto 1991-92 was in the range of 0.5% to 2%. The initial exemption from wealth tax was available upto Rs 2.5 lakh while additional exemption was available for land and building upto Rs. 5 lakh. A taxpayer owning land and building valued less than Rs. 7.5 lakh was not required to pay wealth tax.

In order to appreciate the changes effected through the Financial Acts of 1992 and 1993, it is necessary to look into the present definition of wealth taxation. The new concept evolved is that of levying wealth tax on "non-productive assets". As a result of the change in definition of assets, the farmhouses and agricultural land in metropolitan cities that were outside the purview of wealth tax earlier have been made taxable. The recent amendments clarifies assets to be treated as "non-productive" are:

- i. Any guest house and any residential house including the farm house situated within 25 km from the limit of any municipality. This category does not include:
  - a) A house meant exclusively for residential purposes allotted by a company to an employee, an officer or a director who is in whole time employment, having a gross annual salary under Rs 2 lakh.
  - b) Any residential house which is part of stock in trade.
- ii. Urban land. For the purposes of the tax 'Urban land' means any area coming under the jurisdiction of a municipality or a cantonment board and has, at the

time of valuation, a population of more than 10,000 as evident from the published report of the preceding census survey. Urban land may also lie in any area within 8 km from the local limit of any municipality which the Central government may have set aside for urbanisation by notification in the official Gazette.

The definition of wealth tax does not include urban land on which construction is not permissible except where it is held as stock-in-trade. Also, a house property belonging to an individual or Hindu Undivided Family is exempted from wealth tax payment. On the other hand, farm houses, agricultural land and vacant urban land are brought under the tax net. Considering the base prescribed for assessing the value of the residential and other property for the purpose of the tax, the liability for taxation would appear to hinge on the efficiency of the valuation machinery, and would seem to provide scope for concealment of the real value at the time of initial acquisition of the property. As pointed out by the Chelliah Committee, it is also possible to invest considerable sums of money in the ornamentation and decoration of the house, and still not be liable for additional wealth tax under the present dispensation. The tendency of the companies to invest large sums of money in the purchase of houses for their employees or for guest houses, and treat it as deductible expenditure for tax purposes, would seem to deprive the government of revenue. At the same time, the allowance of five years for the holding of developable land for real estate operations would encourage the growth of genuine private developers.

## Provisions in the Wealth Tax Act, 1957

Wealth tax is levied under section 3 of the Wealth Tax Act, 1957, on the net wealth of individuals, Hindu undivided families and companies every year on the value as on 31st March. The net wealth would have to be worked out as the excess of the value of assets over the value of debts owed on the valuation date. For the purpose of taxing the real estate properties, assets would mean land and buildings and would include the following exemptions:

- i) Any interest on property for a period not exceeding six years.
- ii) Agricultural lands.
- iii) A building owned and/or occupied by a cultivator of agricultural land in the immediate vicinity of the land. Section 5 provides for exemptions to the following land and buildings:
  - a) Dwelling units with a plinth area of less than 80 sq. metres only. This exemption is available for 5 years.
  - b) Dwelling units with plinth area of less than 80 sq. metres used for residence of workers employed in plantation or industrial undertaking of the owner.

The assessable value of the property is either 12.5 or 10 times of the net maintainable rent depending on whether the building is on freehold or leasehold land. When the building is on a leasehold land of less than 50 years of unexpired lease, the net wealth is 8 times the maintainable rent. The net maintainable rent

is worked out as the difference of gross maintainable rent (i.e., actual rent or municipal valuation whichever is higher) less of taxes collected by local bodies and 15 per cent of gross maintainable rent.

The net maintainable rent increases by 15% on the amount of advance taken by the landlord from his tenant if the advance exceeds three months' rent. A payment of premium for letting is divided by the number of years of lease to be added to the net maintainable rent. The existence of an excess unbuilt area requires the value to be increased by 20 per cent to 40 per cent depending on the ratio of built of land to open area.

The recent changes in wealth tax exhibit elements of simplicity in the rate structure. At the same time, the explicit direction for taxing the urban land and properties such as farm houses may increase the tendency to undervalue land and property and the use of black income in such activities.

### **3. Income Tax on House Property**

Under section 22 of the Indian Income tax Act, the legal owner in whose name the property stands pays the tax. When the property is occupied by the owner for the purposes of his business or profession, the tax is collected under a different head called "profits and gains from business or profession".

With the initiation of the structural reform of the Indian economy, and the fiscal reform following the report of the Chelliah Committee, the provisions of the Income Tax Act have been simplified including those relating to the taxation of income from property. The effort has been to abolish sectoral concessions over a period of time, and to levy lower taxes on taxable income consolidated out of various sources. However, certain anomalies



relating to owner-occupied premises, less favourable treatment of rented premises, allowance of depreciation for investment in rental housing, bias in favour of debt financing etc., still remain (see NIPFP 1992).

Income from house property is computed on the basis of annual value of a property. Section 23(1) lays down that the annual value of a property is the sum for which the property could reasonably be expected to let from year to year. The interpretation of reasonable letting value is the same as described in case of wealth tax above. It may be recalled that the municipal valuation of property is one of the tests applied in determining the value of a property, and suffers from all the infirmities of this base as commented upon by a number of experts and committees. (for an excellent review of the issues, see Delhi Administration 1992)

The municipal property valuation for the purpose of levying municipal taxes is called the rateable value. Some of the municipalities compute the rateable value after deducting from gross rental value a certain allowance for repair and service taxes. In such cases the net municipal rateable value is suitably increased to decide the reasonable rent of the property. In cities like Bombay, Calcutta, Delhi and Madras the municipalities compute the rateable value after deducting an allowance of 10 per cent of the gross rateable value on account of repairs. There are additional concessions in the amendments to Delhi by-laws. The municipal rateable value accordingly is increased in these cities for the purpose of income tax by one-ninth of the rateable value.

The base on which income tax liability of house property is determined takes into the account the annual value derived by the above described method or the actual rent received or receivable from tenants, whichever is higher.

Income from house properties against which tax deductions allowed are the following:

- i) Taxes levied by local authorities and borne by owner if paid in relevant year.
- ii) Statutory deduction for newly constructed residential property [up to Rs. 3,600 per annum for 5 years in respect of residential units completed after 31-3-1982 but before 1-4-1992].
- iii) Repairs and collection expenses [1/5th of annual value].
- iv) Insurance premium.
- v) Annual charge [not being capital charge or charge voluntarily created by assessee].
- vi) Ground rent.
- vii) Interest on borrowed capital.
- viii) Land revenue.
- ix) Vacancy allowance [subject to certain conditions].
- x) Unrealised rent [subject to conditions specified in rule 4].

In the case of one self-occupied property, these deductions are not admissible, except interest on borrowed capital up to a maximum of Rs. 10000. The computed income for such property is however exempt from tax.

An important change in above provisions over the previous assessment year is that of the introduction of a composite deduction. Instead of two separate rebates for collection charges (6% of annual value of the property) and repairs (1/6th of the annual value), the Act in operation during the assessment year 1993-94 provides for deduction of 1/5th of the annual value for repair and collection charges.

In case of loss from house property, the provision of set off against any other head of income in the same assessment year was done away with from the assessment year 1993-94. Any unabsorbed loss under the head "Income from house property on account of payment of interest on borrowed capital was to be carried forward to the following assessment years and set off against income from house property only, till it is fully absorbed. The earlier concession of set-off of the loss has now been restored following the Budget for 1994-95.

It is apparent that effective rate of income tax has declined under the regime of economic liberalisation. For example, in respect of income slab above Rs 1 lakh, ignoring the surcharge for a moment, the rate has come down from 30 per cent to 22 per cent. Similarly for the income slab of Rs 50,000 to Rs 1 lakh, the rate has reached 14 per cent from that of 22 per cent. This is expected to result in better tax compliance, once the various efforts for the simplification of income tax administration on the one hand, and steps for effective tax collection and the penalisation of defaulters, on the other, are in operation. It has been noted in a NIPFP study that the tax concessions for housing are regressive and there is a bias in favour of debt finance and owner occupied housing.

#### **D. Tax burden**

In this Section, an attempt is made to assess the burden of different levies on property. Some of the conclusions of previous sections are separated in the course of this description.

## **Burden of one-time levies**

From among the one-time levies, capital gains tax and stamp duty are two main imposts on which tax evasion is frequently reported. A rapid increase in the value of real estate properties has resulted in the Exchequer losing huge sums of money by way of avoidance of tax payment on the part of buyers and sellers. As a result, it has become an important motivation for evading taxes, although this has been eroded to some extent by the provisions for the pre-emptive purchase of undervalued properties above the declared value of Rs.10 lakhs.

### **1. Capital gains tax burden**

High tax burden i.e., share of tax in the income related with the transfer of a property, as a factor responsible for evading the real estate taxes is examined in the following. The base of capital gains tax in registration deed is the gains arising out of a transfer of property. For the purpose of taxation, the amount reported by an assessee is the income by way of capital gains. Thus, the actual share of capital gains in the income accrued to a seller is not transparent. Consequently, an assessment of the burden arising out of the capital gains tax is not easy as data on price of real estate properties are not available easily. An attempt is made in the following to present some broad idea on this. We have tried to piece together the information available in different sources to work out the probable burden. Mainly, use is made of the information available on capital gains reported by assessees while filing income tax returns. Capital gains as reported by individuals in the five metropolitan cities of India for the year 1990 is examined for working out the burden.

For an assessment of the burden, it is necessary to know the acquisition as well as transfer price of a property. In the absence of availability of these data and also that of the rate of appreciation of the value of properties, the amount of capital gains along with the growth rate of land price in the five cities has been considered. The assumption that the growth of land prices is equal to the rate of appreciation of properties is a limitation of the results generated by the present study. It assumes that land and building values appreciate at the same rate and may not be representing the reality. Non-availability of time series data on changing values of buildings and flats as well as non-homogeneous nature of the qualities of these properties precludes possibility of adopting a better variable.

It is seen from Table 3.5 the share of capital gains tax in the sale value of a property in the cities of Bangalore, Bombay, Calcutta, Delhi and Madras that the burden may be varying in the range of 7% to 15% in the five cities. A higher burden of 15 per cent is estimated for sellers of property in Delhi and Bangalore, whereas it could be lower (7 per cent) in case of Calcutta.

It may be useful to note that these estimates are not robust for two reasons. First, the data base used to get the inter-city burden of capital gains tax is weak due to reasons already described above. Secondly, the burden has been worked out with the help of rate of capital gains tax for the assessment year 1993-94 whereas the capital gains data are for the year 1990-91.

## **2. Stamp duty burden**

As reported above while discussing the stamp duty of important metropolitan cities, the rates are sometimes as high as 13 per cent. With residential land prices as much as Rs 6,000 per

sq. metre, the required tax payment would be Rs 780 per sq. metre. Thus, a buyer purchasing 100 sq. metres of land would end up paying Rs 78,000 as stamp duty.

**Table 3.5**

**Share of Capital Gains Tax in  
Sale Value of a Property**

	City	tax as a percentage of sale value
1	Bangalore	15.11
2	Bombay	12.95
3	Calcutta	6.87
4	Delhi	15.11
5	Madras	12.95

Source: As explained in the text.

It is apparent from Table 3.6 that at 1991 rates an honest tax payer interested in purchasing an average valued property might have paid Rs 3.48 lakh for it in Delhi. A similar purchase in cities of Bangalore, Bombay, Calcutta and Madras is found to be of the order of Rs 11.29 lakh, Rs 5.29 lakh, Rs 2.96 lakh and Rs 3.39 lakh, respectively. In case the transaction is subjected to enquiry under the State Stamp Act for ascertaining the true market value of the property, the assessment of stamp duty would still be higher. This is stated to be one of the reasons for the unwillingness of many buyers to register sale deeds in the normal course, and the tendency is either to avoid the duty by alternate legal means of transfer of title, or by power of attorney transactions.

Table 3.6

Stamp Duty Payment on Immovable Properties  
in Five Metropolitan Cities in 1992

(Rs. Lakhs)

City	Number of prop- erties auctioned	Year of sale	Average selling price	Standard deviation	Property with		average stamp duty paid	
					maximum value	minimum value		
	1	2	3	4	5	6	7	
1	Bangalore	7	1990-91	92.21	82.65	277.00	22.10	11.99
2	Bombay	19	1990-91	52.90	35.15	150.00	14.70	5.29
3	Calcutta	3	1990-91	24.64	12.86	42.73	14.03	2.96
4	Delhi	7	1989-90	43.56	25.37	85.05	14.50	3.48
5	Madras	8	1990-91	26.05	7.85	41.26	17.16	3.39

Source: Government of India,  
Appropriate authority, Income tax department.

Table 3.7

## Understatement of Sale Price of Properties in Delhi

Sl. No.	Date of Registration	Plot No.	Plot Size (in sq yards)	Apparent consideration (Rs lakh)	Fair market value (Rs lakh)
1	2	3	4	5	6
1.	02.01.1989	16, Siri Fort Rd., Masjid Moth	400	8.00	64.00
2.	04.01.1989	E-441, Greater Kailash-II	250	6.75	40.00
3.	05.01.1989	B-1/15, Hauz Khas	258	8.50	41.00
4.	11.01.1989	N-61, Greater Kailash -I	300	6.00	48.00
5.	18.01.1989	M-170, Greater Kailash -II	300	6.00	48.00
6.	19.01.1989	D-45, NDSE-II	875	6.00	105.00
7.	11.01.1989	S-410, G.K.-II	579	7.05	92.00
8.	03.02.1989	S-393, G.K.-II	300	8.10	48.00
9.	06.02.1989	A-91, NDSE-II	242	7.80	30.00
10.	01.02.1989	R-21, NDSE-II	377	8.00	45.00
11.	01.02.1989	B-505, G.K.-II	550	6.60	88.00
12.	16.03.1989	M-73, G.K.-II	250	7.25	40.00
13.	15.03.1989	D-57, Hauz Khas	278	8.00	44.00
14.	13.03.1989	K-17, Kailash Colony	311	8.00	49.00
15.	31.03.1989	K-19, Kailash Colony	311	6.00	49.00
16.	08.03.1989	G.-14, NDSE-II	500	6.30	60.00
17.	03.03.1989	J-10, Green Park	400	8.00	64.00
18.	08.03.1989	J-10, Green Park	400	8.00	64.00

Source: Sharma(1993).



Table 3.8

## Rates of Property Taxes in Delhi

(Per cent of RV)

Sl. No.	R.V. of Property (Rs. '000)	General Tax (Marginal Rate)		Education Tax	Fire Tax		Water Tax	Scavenging Tax		Total Tax Rates	
		Residential	Non-Residential		Residential	Non-Residential		Residential	Non-Residential	Residential	Non-Residential
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
<b>A. Municipal Corporation of Delhi</b>											
<b>I. In urban areas:</b>											
1.	Upto 10	10	15	1	-	-	10	2	5 & 10*	24	33-38*
2.	Over 10 to 20	20	25	1	-	-	10	2	5 & 10*	33	43-48*
3.	Over 20	30	30	1	-	-	10	2	5 & 10*	42-44	48-52 &
<b>II. On all lands &amp; buildings in village abadi areas:</b>											
1.	Upto 100	3.0	4.5	1	1	2	-	-	-	5.0+	7.5+
2.	Over 100	20.0	25.0	1	2	4	-	-	-	23.8+	30.0+
<b>III. On all lands &amp; buildings outside village abadi areas (including farm-houses, godowns, hotels, etc.):</b>											
1.	Upto 30	3.0	4.5	1	1	2	-	-	-	5.0+	7.5+
2.	Over 30 to 100	7.0	10.0	1	1	2	-	-	-	9.0+	13.0+
3.	Over 100	20.0	25.0	1	2	4	-	-	-	23.0+	30.0+
<b>Fire Tax</b>											
<b>a. Upto 4 storeys or height of 15 mtr.</b>											
1.	Upto 100				1	2					
2.	Over 100				2	4					
<b>b. Over 4 storeys or height of 15 mtr.</b>											
					3						

- Note:
1. Water tax is exempt upto the RV of Rs. 1000.
  2. Scavenging tax is exempt upto the RV of Rs. 100 in case of non-residential properties, while all the residential properties upto the RV of Rs. 1000 are exempt.
  3. Fire tax is exempt for residential properties upto the RV of Rs. 5000 and high rising Group Housing Society buildings for residential purposes will be taxed as 4 storey structures.
  4. No general tax on owner-occupied residential properties in village abadi areas.
  5. All residential properties upto the RV of Rs. 1000 and other properties upto the RV of Rs. 100 are exempt from property taxes.
  6. All owner-occupied residential properties in abadi areas of urban villages constructed before the date of notification u/s 507 of the DMC Act, 1957 and were exempt from payment of property taxes before such notification are also exempt from property taxes.
- \* On hotels and restaurants, clubs, ice factories, and cinemas.  
+ Only general tax, service taxes are leviable if these services are rendered by MCD to these areas.

Table 3.8(Contd.)

Rate Structure of Property Taxes in Other Major Municipal Corporations in India

(Per cent of RV)

Sl. No.	Corporation	Type of Property	General Tax		Water Tax	Conser- vancy Tax	Education cess		Other Taxes and cess	Total Taxes/cess	
			Slab of R V (Rs.)	Rate			Resid- ential	Non-Resi- dential		Resid- ential	Non-Resi- dential
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1.	Allahabad	All	1-300	Nil	11 13 -	26*	Nil	Nil	-	24.00	37.00
			301-500	12	11 13 -	26*	3	7	-	36.36	49.84
			501-1000	15	11 13 -	26*	5	11	-	39.75	59.65
			1000-2000	20	11 13 -	26*	6	14	-	45.20	59.90
			2001-3000	23	11 13 -	26*	7	16	-	46.61	69.68
			3000 & above	30	11 13 -	26*	10	20	-	57.00	73.00
2.	Bhopal and Khandwa	All	1-1800	Nil	-	-	-	-	-	Nil	Nil
			1801-6000	6	-	-	-	-	-	6.00	6.00
			6001-12000	8	-	-	-	-	-	8.33	8.39
			12001-18000	10	-	-	-	-	-	10.00	10.00
			18001-24000	15	-	-	-	-	-	15.00	15.00
			24001 & above	20	-	-	-	-	20.00	20.00	
3.	Gulbarga	All	All	10	7	10	10	10	28	30.80	30.80
4.	Vijayawada	Res.	All	22	-	-	-	-	-	22	29
		Non- Res.	All	29	-	-	-	-	-	-	-
		Comm.	All	29	-	-	-	-	-	-	-
5.	Amritsar	Res.	All	10	-	-	-	-	-	10.00	-
		Non- Res.	1-1800	12.5	-	-	-	-	-	-	12.50
			1800 & above	15	-	-	-	-	-	-	15.00
6.	Bombay	Res.	All	24	9	-	1	5	19-23	(48.72-	(85.90-
		Non- Res.	All	24	15	-	-	-	19-23	49.68)	88.58)
										(55.5-	63.5)

Table 3.8(Contd.)

## Rate Structure of Property Taxes in Other Major Municipal Corporations in India

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
7.	Calcutta	Res.	1-600	6	-	-	-	-	-	6	9
			601-1800	[(ARV/ 600) +10]	-	-	-	-	11-13	(5.50- 9.50)	
			1801 & above	40	-	-	-	-	-	40	60
		Non- Res.	Surcharge on above consolidated rate but not exceeding 50 % of the consolidated rate.	-	-	-	-	-	-	-	-
8.	Indore	All	1-1800	Nil	-	-	-	- 2.6 & 1.5	1.50	1.50	
			1801-6000	6.00	-	-	-	- 2.5 & 1.5	7.65	7.65	
			6001-12000	8.33	-	-	-	- 2.5 & 1.5	10.04	10.04	
			12001-18000	10.00	-	-	-	- 2.5 & 1.5	11.75	11.75	
			18001-24000	15.00	-	-	-	- 2.5 & 1.5	16.88	16.88	
			24001 & above	20.00	-	-	-	- 2.5 & 1.5	22.00	22.00	
9.	Madras	All	1-500	5.00	1	-	4#	4#	9	20.00	20.00
			500-1000	10.50	1	-	4.5#	4.5#	9	26.00	26.00
			1001-5000	12.00	1	-	5#	5#	9	28.00	28.00
			5001 & above	14.50	1	-	5#	5#	9	30.50	30.50

Notes: Cess is levied on the general property tax. Details of other taxes and cess:  
 Ahmedabad: Minimum water tax for residential properties is Rs. 3 p.m. while for non-residential it is Rs. 5 p.m. Minimum conservancy tax is Rs. 2 p.m. for all properties  
 \* : For Hotels, Clubs, etc.  
 Gulbarga : 4% General sanitary cess, 3% each on lighting, library, beggary, and 15% health cess.  
 Bombay : 1.5% fire tax for all properties.  
 Residential: 6% water benefit tax, 5% sewerage tax, 4% sewerage benefit tax, and 2.6% State education cess.  
 Non-residential: 10% water benefit tax, 8% sewerage tax, 1% free cess, 4-12% state education cess, and 25% drainage tax.  
 Indore : 2% general sanitary cess and 0.5 on lighting and 1.5% drainage tax.  
 Madras : 3.50% lighting tax and 5.50% drainage tax.  
 # : Education tax levied on AV.

Source: Delhi Administration and Respective Municipal Corporation.

### **Total burden due to capital gains tax and stamp duty**

Putting together the shares of capital gains and stamp duty in the sale value of the immovable property and assuming that the capital gains tax is shifted to buyer of the property, a broad idea can be formed on the burden imposed by these two imposts. The buyer of an immovable property may have to spend 27% to 19% on the purchase price of the property depending on the city in which the transaction takes place. While the tax burden could be more than 25% of the purchase price in Bangalore and Madras, it may be marginally lower (23%) in Bombay and Delhi. In case of Calcutta, the share of two imposts in the sale price of a property might be at a lower level of 19%. The burden would further go up in the case of leasehold property obtained from public agencies, in places like Delhi, if a portion of the unearned increment is recovered from the seller.

### **Burden of recurring levies**

It is discussed above that three taxes, viz., property, income and wealth, are levied on urban real estate properties every year. The Tax Reforms Committee (1991) took the example of a house given on rent in Delhi to show that the burden due to these taxes works out to be 63% of the income earned. While the inferences drawn by this expert body remain true of properties in other metropolitan cities, there are two important reasons for which a need arises to re-examine them. First, the rate structures of income and wealth taxes have undergone changes following the recommendation of the Committee. Second, the properties with values of different magnitude need to be assessed for tax burden to have a proper perspective of the problem.

For the purpose of working out the burden of income, wealth and property taxes, the present study makes use of the data available on the rateable value of the selected houses in Delhi. The rateable value differs depending on a house is rented fully, partially or is owner occupied. A further distinction in valuation is made to account for residential-cum-business purpose renting. From among these categories of houses, we have considered those which are fully rented for residential purposes. Such a selection highlights the tax burden falling on houses and avoids the computational necessities of partially rented houses. Applying the appropriate rates of property, wealth and income taxes we have calculated the tax burden and Table 3.9 summarises these findings.

It can be seen from the table that the burden of recurring taxes in Delhi was not significantly different from what was being observed by the Tax Reforms Committee (1991). About 55 to 63 per cent of the income accruing from renting a house fully for residential use in Delhi is spent on taxes. The table documents the rateable values of 18 houses to work out the burden of three taxes - income, wealth and property. The rental income is estimated from the rateable values and the rates of individual taxes are applied to get the burden.

A major reason for the insignificant decline of high tax burden despite the critical comments of the Tax Reforms Committee (1991) and subsequent reduction in income and wealth tax rates is the inclusion, by the present study, of minor local taxes collected with the property tax. It may be recalled that the above mentioned Committee considered the rate of property tax (30 per cent) alone while working out the tax burden on house property. However, as pointed out by it, there are other imposts such as education cess that are collected by the local bodies along with the property tax. Inclusion of these levies with the property tax would call for an effective rate of more than 42 per cent. Thus, the present tax burden of 63 per cent on house property is in fact a lower one than that of the earlier years. Despite such a

decrease, however, the burden continues to be significant. That the taxes are siphoning off a significant proportion of the rental income is also pointed by Sharma(1993). It is for example, pointed out that the burden of recurring taxes on middle income group (MIG) and high income group (HIG) houses given on rent in Delhi comes to 47.43 per cent and 56 per cent, respectively.

#### **Income from House Property - Approach to Taxation**

While the large scale building of residential complexes and letting them out has declined over the years because of the rent control laws, a number of medium and high income earners let out whole or part of their houses in order to supplement their income. The affluent also let out large houses for securing huge rents in big cities. There are many malpractices in the property market like the purchase of many houses out of black money in a number of fictitious names so as to avoid taxes. This also avoids the need to declare the rents received from such properties. We have referred to the practice of receiving puggrees or large interest free deposits. In many cases, rents go unreported because rent agreements are not registered, and landlords do not issue receipts. (This position would change in Delhi once the amendments to Delhi Rent Control Act, now before the Parliament, are enacted.) Large number of properties, which yield billions of rupees as rent income do not contribute to the state revenues, and income from house property is not taxed at all, or taxed only on a fraction of the income.

Wherever many properties are purchased by someone in many different names, but the rent is kept below the taxable limit in each name, the real owner evades tax on the income from house property completely. The result is that not even 20% of the rents are being subjected to income tax. This is clear from the figures of Income Tax Returns filed by tax payers disclosing the income

from house property. The figures compiled by the CBDT are available for the Assessment Year 1989-90, when the non-taxable income limit was Rs.20,000.

**Table 3.9**  
**Rate Schedule of Income Tax**

Income	Tax Rate
(i) < Rs. 35,000	Nil
(ii) > Rs. 35,000 < Rs. 60,000	20% of the amount by which the total income exceeds Rs. 28,000
(iii) > Rs. 60,000 < Rs. 1,20,000	Rs. 5000 plus 30% of the amount by which the total income exceeds Rs. 50,000
(iv) > Rs. 120,000	Rs. 23,000 plus 40% of the amount by which the total income exceeds Rs. 1,00,000

There is no surcharge from the assessment year 1995-96

**Source:** Government of India, Income Tax Act, 1993

Table 3.10

## Payment of Property, Wealth and Income Taxes Out of Rental in Delhi in 1992

	Properties with serial number												
	1	2	3	4	5	6	7	8	9	10	11	12	13
1. Proposed rateable value(Rs. 000) (w.e.f 1.12.1988)	432.00	324.00	216.00	162.00	108.00	108.00	75.60	68.04	55.35	54.00	54.00	50.76	43.20
2 Estimated rental income [(1)/0.9]	80.00	360.00	240.00	180.00	120.00	120.00	84.00	75.60	61.50	60.00	60.00	56.40	48.00
3 Property tax													
i. Property tax payable <sup>a</sup>	181.44	136.08	90.72	68.04	45.36	45.36	31.75	28.58	23.25	22.68	22.68	21.32	18.14
ii. Property tax rebate <sup>#</sup>	45.36	34.02	22.68	17.01	11.34	11.34	7.94	7.14	5.81	5.67	5.67	5.33	4.54
iii. Actual property tax payable	136.08	102.06	68.04	51.03	34.02	34.02	23.81	21.43	17.44	17.01	17.01	15.99	13.61
4 Wealth tax													
i. 15% standard deduction	72.00	54.00	36.00	27.00	18.00	18	12.60	11.34	9.23	9.00	9.00	8.46	7.20
ii. Property tax paid	64.08	48.06	32.04	24.03	16.02	16.02	11.214	10.10	8.21	8.01	8.01	7.53	6.40
iii. Total(i & ii)	136.08	102.06	68.04	51.03	34.02	34.02	23.81	21.43	17.44	17.01	17.01	15.99	13.61
iv. Net maintainable rent [(1)-(iii)]	295.92	221.94	147.96	110.97	73.98	73.98	51.79	46.61	37.91	36.99	36.99	34.77	29.59
v. Net wealth <sup>\$</sup>	3699.00	2774.25	1849.50	1387.13	924.75	924.75	647.33	582.60	473.93	462.38	462.38	434.63	369.90
vi. Wealth tax payment	36.99	27.74	18.50	13.87	9.25	9.25	6.47	5.83	4.74	4.63	4.62	4.35	3.70
5 Income tax													
Deductions*													
i. Local taxes	64.08	48.06	32.04	24.03	16.02	16.02	11.21	10.10	8.21	8.01	8.01	7.53	6.41
ii. Repair and collection (1/5th of annual value)	96.00	72.00	48.00	36.00	24.00	24.00	16.80	15.12	12.30	12.00	12.00	11.28	9.60
iii. Other deductions (1% of annual value)	4.80	3.60	2.40	1.80	1.20	1.20	0.84	0.76	0.62	0.60	0.60	0.56	0.48
iv. Total deduction	164.88	123.66	82.44	61.83	41.22	41.22	28.85	25.97	21.13	20.61	20.61	19.37	16.49
v. Taxable income	315.12	236.34	157.56	118.17	78.78	78.78	55.15	49.63	40.37	39.39	39.39	37.03	31.51
vi. Income tax payable	129.20	96.90	64.60	48.45	32.30	23.63	16.54	14.88	12.11	11.81	11.82	11.11	9.45
6 Taxes (3, 4 & 5) as percentage of rental income	62.97	62.97	62.97	62.97	62.97	55.75	55.75	55.75	55.75	55.75	55.75	55.75	55.75

Notes:- <sup>a</sup> : An average property tax rate of 42% is applied to rateable value.

<sup>#</sup> : There is provision of 25% rebate on tax for time payment.

<sup>\$</sup> : Net wealth equals 12.5 times of net maintainable rent.

\* : Deductions allowed are given in the Income tax Act. 'Other deductions' used in the table are assumed to be 1% of the annual value.



Out of a total number of 39,58,500 returns filed for that year, only 5,58,358 disclosed income from house property. The gross tax assessed on it was only Rs.142 crores or 1.6% of the total income tax collections of Rs.9078 crores. Out of these persons who declared income from house property, the major proportion of 5.11 lakhs were individuals, the others being HUF's, companies, firms and others. Out of the individuals who declared income from house property, 3.82 lakhs earned less than Rs.50,000 per year, and 1.01 lakh earned between Rs.50,000 to 1 lakh, and thus it is the middle class which is declaring the income from house property.

The extent of under-reporting of income from this source is seen from the number of returns in States with large cities like Maharashtra (1.02 lakhs), Delhi (45151), Tamil Nadu (42201) and West Bengal (49040). As against this, Bombay alone would have rented properties of 3 lakhs, Calcutta 2 lakhs, Madras 1.5 lakhs and Delhi 5 lakhs. It appears possible to induce larger declaration of income from house property and to realise more revenue if all rental income, by whatever name called, is subjected to a uniform rate of income tax of 20% on the model of capital gains tax.

#### **Pre-emptive Purchase of Immovable Property and Tax Evasion**

The Appendix gives details of the amendments made in the existing scheme of Chapter XXC of the Income Tax Act, providing for the pre-emptive purchase of undervalued property and its subsequent auction through an Appropriate Authority. The provisions under this Chapter were enacted in order to check the tendency in big cities for the deliberate under-reporting of the sale consideration of property in view of the use of black money

in the transaction, and in order to avoid the payment of capital gains tax, stamp duty, unearned increment fee etc., at the time of sale, and to save on recurring levies later.

The operation of the Chapter was reviewed by the PAC in its 52nd report to the Lok Sabha. The large number of pre-emptive purchases made through the Appropriate Authorities notwithstanding, the effectiveness of the provisions in checking the use of black money in real estate or in the realising additional revenues for the Department was questioned. The Income Tax Department had not even fully realised till 1993 the entire budget expenditure on the purchase of properties from the sale proceeds of the 467 auctioned properties. Purchase orders had been passed for only 812 out of 22811 cases till the end of December 1992. There were not enough safeguards against the deliberate understatement of sale consideration of less than Rs.10 lakh, on the basis of split transactions each having less than Rs.10 lakh value, purchase on agreement to sell plus GPA and a cash receipt, manipulated court decree, and steps to depress the market value of the property by taking the prospective buyer as the tenant at a low rent a few months before the sale deed. The PAC noted the lack of coordination and exchange of information between the Income Tax Department, the Appropriate Authorities, the Registering Officers under the Registration Act and the municipal authorities. Sometimes, the Registering Officers accepted stamp duty for a value more than Rs.10 lakh, even if the declared value was less than Rs.10 lakh, but did not report the matter to the Appropriate Authority. The existing provisions do not permit the reopening of registered transactions for pre-emptive purchase after the registration of the document. There were instances of the Income Tax Department not initiating action to levy gift tax or capital gains tax, even where the Appropriate Authority (AA) had fixed the correct value at many times the declared value. The parties to the sale naturally benefit from the lack of coordination and are often able to get away with the underreporting of the value and lesser incidence of different taxes. It is necessary to empower the

Table 3.11

## Acquisition of Properties by Appropriate Authority

City	No. of 37-I forms received	No. of NOC's issued	Purchase order passed	Writ pending	Properties sold in public auction
Delhi	2987	1948	127	89	38
Jaipur	21	9	4	3	-
Chandigarh	31	17	7	6	-
Gurgaon	240	27	7	-	-
Faridabad	3	1	-	-	-
Bombay	7618	6383	253	78	136
Pune	988	723	47	14	15
Nagpur	95	83	1	1	-
Calcutta	799	539	44	34	4
Bhubaneshwar	15	12	-	-	-
Cuttack	-	-	-	-	-
Madras	1377	1041	53	16	34
Coimbatore	82	59	7	3	-
Madurai	8	8	-	-	-
Bangalore	3268	1551	70	42	22
Hyderabad	333	218	7	5	1
Cochin	89	54	2	-	-
Trivandrum	64	17	1	1	-
Ahmedabad	346	294	42	10	22
Surat	39	36	2	1	-
Indore	62	61	-	-	-
Bhopal	8	8	-	-	-
Baroda	3	1	-	-	-
Lucknow	51	26	8	6	3
Kanpur	26	14	1	1	-
Patna	51	21	2	2	-
Ghaziabad	3	1	-	-	-
Noida	3	1	-	-	-
	18610	13153	685	312	275

## Memoranda items to the table

Order passed (No)	685
Apparent consideration	Rs.257,17,48,813
Properties sold (No)	275
Apparent consideration	Rs 1065149298
Sale price	Rs 1403134834
Profit	Rs 337985536

Source: Government of India, CBDT,

"Progress report of work done Under Chapter  
XXC upto the Month of June, 1991".

Appropriate Authority to reopen cases of registration based on solid evidence of deliberate underreporting, and also look into cases of declared value of less than Rs.10 lakh brought before the Sub Registrar, on the basis of regular reporting of transactions above Rs.5 lakh to the AA.

The ultimate remedy, apart from amendments to the Chapter XXC, as suggested in the NIPFP 1994 report on the Stamp Act, lies in the installation of a uniform system of valuation of land and property for all tax purposes, as proposed in the same report, and better coordination of different Central and State agencies concerned with the taxation of property.

### **Conclusion**

Notwithstanding the efforts initiated under the regime of economic reform, the burden of real estate taxes continues to be high. While the two one-time imposts, stamp duty and capital gains taxes require a payment of 19 per cent to 27 per cent of the purchase price of a property, three recurring levies, income, wealth and property taxes, takes away 63 to 55 per cent of the income accruing from renting a house fully for residential use. The direction of policy change for reducing the tax burden has so far been more concerned with the problems of individual taxes which may not be sufficient for reducing the incentive for underreporting the value of land and buildings in the document of transfer presented for registration. A programme of reducing the combined burden arising out of taxation of real estate by governments in Central, State and local bodies level seems pertinent to deal with the problem of undervaluation. Moreover, there is a need to revamp the administrative structure dealing with real estate transactions with a view to minimise the loss of time and harassment of tax payers.

## Appendix to Chapter 3

### Pre-emptive Purchase of Immovable Property

#### Sections 269 UC, 269UD & 269UE

#### Introduction

The Supreme Court in its judgment in the case of C.B. Gautam vs. Union of India (1992) delivered on 17th November, 1992 has upheld the constitutional validity of Chapter XXC. Its observations are as follows:

"The legislative history of Chapter XXC and the stand taken by the CBDT as evident from Instruction No. 1488 make it clear that the powers of compulsory purchase conferred under the provisions of Chapter XXC are being used and are intended to be used only in cases wherein an agreement to sell an immovable property, there is a significant under-valuation of the concerned property, namely of 15% or more. If the appropriate authority is satisfied that in an agreement to sell immovable property, the apparent consideration is less than the fair market value by 15% or more it may draw a presumption that this under-valuation has been done with a view to evade tax; of course, such a presumption is rebuttable and the intended seller or purchaser can lead evidence to rebut such a presumption.

A reasonable opportunity to the affected parties of being heard before an order for purchase under section 269UD is made must be read into the provisions of Chapter XXC.

The reasons recorded by the appropriate authority for making the order of pre-emptive purchase are to be communicated to affected parties.

Such reasons must be germane to the object for which Chapter XXC was introduced, namely, to counter attempts to evade tax.

#### **Amendments**

The rulings of the Supreme Court required the following amendments in the Chapter XXC:

- (1) The time limit for passing the order is to acquire a property is extended from two months to three months from the end of the month in which Form No. 37-1 is filed.
- (2) Before acquiring a property, the appropriate authority will give a reasonable opportunity of being heard. The opportunity will be given to (a) the person in occupation of the immovable property when the transferor is not in occupation of the property, (b) the transferee and (c) every other person whom the appropriate authority knows to be interested in the property.
- (3) The intending transferor and transferee will be required to enter into an agreement for sale in writing at least four months before the intended date of transfer.
- (4) The appropriate authority shall give the grounds for making pre-emptive purchase in the order itself.
- (5) In respect of any statement under section 269UC received by the appropriate authority on or after 1st June, 1993, if any stay has been granted by any court against the passing of an order for purchase of the immovable property under Chapter XXC, the period of three months for passing the order will be reckoned

with reference to the date of vacation of the stay order. In other words, in such a case, the order will have to be passed before the end of three months from the date of vacation of stay order.

- (6) The holder of a bona fide lease or encumbrance can continue to remain in possession of the property if, in terms of the agreement for transfer, he is eligible to continue to be in possession of such property even after the transfer.
- (7) Where an agreement for sale provides that the property is intended to be sold free of all encumbrances or leasehold rights, the order for purchase of such property under section 269UD(1) would result in the said property vesting in the Central Government free from such encumbrances or leasehold interests.
- (8) A right is given to the appropriate authority to declare any encumbrance or leasehold interest as void if it is created with a view to defeat the purpose of Chapter XXC. In such cases, the property will vest in the Central Government, free from such encumbrance or leasehold interest.

The changes relating to extending the period for (a) filing the statement and (b) passing the order come into effect from 1st June, 1993. The other changes have come into effect retrospectively from the date of judgment, that is, 17th November, 1992.

## CHAPTER 4

### ECONOMIC REFORM, LEGAL BOTTLENECKS AND BLACK MONEY

#### Economic Reform Policies After 1991

In the official statements of the Government of India on the New Economic Policy (see for instance, the Discussion Paper brought out by the Finance Ministry in 1993), the objective of economic reform is stated as bringing about rapid and sustained improvement in the quality of life of the people, and fostering an economic environment which promotes rapid, broad-based development. This was undertaken in India in the framework of the structural adjustment and economic stabilisation in the context of various policy measures agreed with the World bank and the IMF for addressing the serious economic crisis facing the country in June 1991.

The reform covered the areas of fiscal imbalances, foreign trade and payments regime, tax system, financial sector changes, industrial policy and licensing system, promotion of investment by the NRI's and other foreign investors, expansion and diversification of the capital market with adequate monitoring, and deregulation and privatisation of various services. Industrial licensing was abolished for all except a few environmentally sensitive and hazardous industries, and private sector, including foreign institutional investors, was allowed entry in most of the areas. MRTP control was liberalised, and the private entrepreneurs were free to invest, modernise and expand, subject only to certain locational and environmental controls. The new policy is aimed to attract foreign investment in priority industries upto or beyond 51% of equity, by simplifying rules and procedures and by offering terms on par with other countries. Special measures were announced



to attract NRI investment in all areas including real estate, with considerable repatriation benefits, and joint ventures with foreign companies were encouraged in power and other sectors. Partial convertibility of the rupee (full convertibility on trade account has been recently announced) and a stable market-determined exchange rate provided an enabling environment for exports, including service exports and inflow of remittances. The FERA has been amended to remove a number of constraints on the operation of foreign investors and the repatriation of profits and dividends, and to decentralise dealings in foreign exchange.

Extensive reform in direct and indirect taxes has been carried out in pursuance of the report of the Chelliah Committee. The recent budgets have introduced major changes in the system of personal and corporate taxation, wealth tax, capital gains taxation, presumptive taxation of traders and professionals, reduction and simplification of customs and excise duties, and taxation procedures and enforcement. Wide-ranging reform has been carried out progressively in the financial and banking sector in the light of the report of the Narasimham Committee. The proportion of bank funds pre-empted through the SLR is being reduced, and the CRR is being operated as an instrument of inflation control. The interest rate structure has been almost fully deregulated with full freedom to fix rates for loans above Rs. 2 lakh with the prescription of only lending rates for lower advances and a ceiling on deposit rates. There is considerable autonomy to the banks, flexibility in their investment management, subject only to capital adequacy and income recognition norms. The Government of India has revised the rates on its own instruments to market levels, and limited the creation of ad hoc Treasury Bills. There are good prospects of the privatisation of the insurance sector, while a number of privately owned commercial banks have already been licensed.

Similar reforms have been carried out in the capital market under the guidance of the SEBI. Not only is the volume of new issues going up (769 issues in 1993-94 of the value of Rs.12537 crores), but various new instruments are hitting the market to cater to a vastly increased number of small and big investors. A vibrant market in debt instruments of different rates and maturities is developing, which will be nurtured by the National Stock Exchange and other specialised institutions. Securitisation of housing mortgages and other debt instruments is expected to impart liquidity to the market. The corporate sector is entering new fields like merchant and commercial banking, insurance, infrastructure development, real estate etc.,

#### **Required Supportive Steps**

It has been noted by the Central and State governments and the investors alike that the success of the economic reform programme is conditioned by the extent of dismantling unnecessary controls, liberalisation of constraining regulations and laws, speedier and less expensive procedures for the approval of industrial and real estate activity and for concluding various transactions in the capital market and elsewhere, rationalisation and reduction of the total burden of Central, State and local taxes, simplified procedures for the levy and collection of various taxes and duties, expansion in the availability of roads, power and other infrastructure, speedier access to civic services and approvals, and a transparent and single window administration that is less corruption and delay-prone. The actions in this regard are required to be taken at various levels of government, and involve delegation and decentralisation, procedural changes, and legal amendments.

## **Reform and Black Money**

Before looking at a few specific legal obstacles of relevance to the economic reform process and the generation of black money, it is useful to spell out what the reform process may imply for the flow of black money into the economy. The stable exchange rate preceded by the de facto devaluation of the rupee has removed a major avenue of investment of black money, based on hawala rates for dollars. The simplified and decentralised exchange regime, and the liberalisation of repatriation facilities has also removed another source for the parking of black money. The simplified systems of capital gains taxation and the exclusion of financial assets from the definition of wealth have contributed to a more transparent fiscal regime. The entry of the corporate sector into the real estate industry, with the increasing practice of rating such companies, has introduced greater professional ethics in the system. The vast expansion of the capital market has created enlarged avenues for the investment of cash surpluses.

At the same time, the economic reform process has increased the demand for urban real estate, both commercial and residential, for various types of urban facilities, increased provision of water supply, sanitation and power supply, and has also resulted in manifold increase in the incomes of the top income groups in the economy. Since the decisions in respect of investment and expanded provision of housing and urban services rest mainly with the state and local agencies, and since the overall regime of regulations and approval procedures in the urban areas has not significantly improved despite the reform in the macroeconomic spheres, the pressure on available supplies of vacant land and built premises has increased substantially in the major cities, and the growing townships. This has led to the unremitting increase in land and housing prices, and rents, as well as continued speculative demand for urban real estate. This demand is fed partly by the earnings in the booming share market, and the

tendency even of corporate enterprises to invest temporary cash surpluses (as for instance seen in the case of the use of funds realised by a number of companies from Eurobonds) in the appreciating real estate, and the perception of higher yields for black money from an asset in scarce supply.

#### **Speculation and Price Rise in Urban Land and Property**

The National Housing Policy has referred to the freeze on transactions in the urban land market, and the monopolistic position of public housing agencies on the availability of serviced land, unwarranted increase in prices, and the exclusion of the poor from the formal land market. The result has been a spurt in speculative pressure on land and housing, held as an asset subject to future appreciation, and the mushroom growth of slums and unauthorised colonies. While a certain increase in the prices of land and housing is an inevitable concomitant of the process of economic growth and urbanisation, the rate of increase in land and housing prices and rents in the major cities of India has been far above the general wholesale price index, and the spot prices in some of the prime areas of major cities rival those of affluent western cities. The auctions of properties purchased by the Appropriate Authority in Bombay in recent months have fetched prices far exceeding the reserve price, indicating a strong speculative demand. This has been commented upon by a number of official reports and experts (see Government of India 1979 and 1988; Tandon 1987; Gupta 1982; and the report of the National Commission on Urbanisation 1988). The details of population growth of a few major cities, the assessed housing gap, and land prices may be seen in the tables annexed to this Chapter.

While the expert studies and the Committees appreciate the consequence for housing and land prices on account of the rising incomes and speculative demand in the context of limited growth in the supply of serviced land, they attach equal importance to the inappropriate public interventions in land policy since the

seventies and the present and legal and regulatory system for the distortions in the land market and the price spiral. It is also attributed to the inadequate capacity of public agencies to acquire and develop in sufficient magnitude, and to release the land on terms affordable to bulk of the population, instead of aiming to realise maximum revenue from periodic auctions as has been the practice of DDA. The instances of fruitful involvement of private developers in land assembly and the development of housing colonies have been small, except in the case of colonisation in Haryana or a few joint sector projects in U.P., and the private developers have been obliged to operate outside the pale of law or in peripheral areas, primarily to cater to the demand of the higher income groups.

#### **Regulatory Framework for Land and Housing**

The preceding chapter discussed the taxation policy on real estate as a possible unintended factor for the generation of black money. It appears credible to infer that a high tax burden could be providing enough incentive to both buyer and seller in real estate market to resort to illegal means for evading taxes. In addition to this, there are other regulatory policies in the real estate market that are held responsible for the emergence of the black money operation. The Rent Control Acts in different States and the Urban Land (Ceiling and Regulation) Act, have often been cited in support of such a view (see, Government of India, 1979, 1985 & 1993). In the course of the assessment of one of these policies, for example, the Government admits that the implementation of the Urban Land (Ceiling and Regulation) Act has severely undermined the operation of the market in land, contributed to spiraling land and property prices, and, has not achieved the original purposes of broadening the ownership and minimising speculation and profiteering (see, Government of India, 1993). The following discussion reviews the important provisions

of these Acts that might have led to the distortion of the land and property market and diminishing additional supplies, and encouraged the use of the black money.

#### **Urban Land (Ceiling and Regulation) Act**

The effects of the Urban Land (Ceiling and Regulation) Act are stated as follows: First, by the imposition of ceiling on vacant land and acquisition of surplus land at nominal compensation, the Act is alleged to be responsible for creating scarcity in urban land supply and pushing up prices in the urban agglomerations. This in turn has led to the generation of speculative conditions in the real estate market. Second, restrictions imposed by the Act on land transactions and transfers have given rise to the practice of unregistered dealings and power of attorney transactions, as admitted by a number of private developers during this study. Under such conditions, the formal financial system relying on registered property transactions and recorded titles has found itself unable to finance and regulate the real estate sector except for the operations of the public agencies, and a small minority of private and cooperative agencies in possession of valid title to land. Those operating in the unorganised money market are reported to have taken control of the urban real estate and the middle class as well as the poor people are priced out of the urban housing market (see Government of India, 1985). It becomes imperative therefore to look into the features of the Urban Land (Ceiling and Regulation) Act to gain insight on the problem of black money.

#### **Objective of Urban Land (Ceiling and Regulation) Act**

The Urban Land (Ceiling and Regulation) Act, 1976, was expected "to provide for the imposition of a ceiling on vacant urban agglomeration, for the acquisition of such land in excess of the ceiling limit, to regulate the construction of buildings on such land and for matters connected therewith, with a view to

preventing the concentration of urban land in the hands of a few persons and speculation therein and with a view to bringing about an equitable distribution of land in urban agglomerations to subserve the common good". Thus the main objectives of the Act have been to (i) impose a ceiling on vacant land in notified urban agglomerations, and to acquire the land in excess of the ceiling; (ii) to regulate the construction of buildings so as to prevent the concentration of urban land in a few hands for speculation and profiteering; and (iii) to bring about an equitable distribution of urban land. Thus its stated objective was to redistribute the urban land rather than to provide an alternative mechanism for land acquisition and have construction through the exemption clause was used to permit construction of flats on surplus land in the public interest.

The Act influenced the functioning of real estate market and the operation of market forces. The ownership and possession of vacant land in urban areas was kept within the limit of a ceiling. The ceiling was varying according to the classification of the agglomeration (500 sq. metres in category 'A' to 2,000 sq. metres in category 'D'). The State Governments acquired powers to take over the excess vacant land as well the disposition of the land. The payment for the acquisition of the excess vacant land was made in cash and in bonds. The compensation rate was decided to be ranging from Rs. 10 per sq. metre downwards in categories A & B to Rs. 5 downwards in categories C & D subject to a maximum limit. Certain restrictions on the transfer of land in notified urban agglomerations came into effect. Finally, restriction on the size of dwelling units in future residential buildings was imposed. There was a provision which allowed landowners to retain the excess land for building dwelling units for economically backward sections of the society according to prescribed guidelines.

The purpose of the Act in an era of planned economic development that brings about rapid urbanisation characterised by skewed pattern of land holdings, does not seem to be without

foundation. When there is concentration of urban land in a few hands and a rapid increase in urban population generates higher demand for developed and serviced land, real estate holdings prices could acquire monopolistic character and prices become subject to speculative pressures.

It is evident from the findings of National Sample Survey (8th and 17th rounds) that the land distribution pattern in urban India is highly skewed. An analysis of NSS data by Gupta (1982) showed that only about 4 per cent households with holdings of 10 acres and above of urban land owned almost 75 per cent of all land. On the other hand, the findings of the study indicates, 55 per cent of the households did not own any land.

In order to appreciate the view advanced by the critics of the Urban Land (Ceiling and Regulation) Act, it will be appropriate to look for those aspects of the Act that went against its basic objective. For that purpose, the present study considers the assessment of the Committee on Controls and Subsidies (Government of India, 1979) as well as the National Commission on Urbanisation (NCU) (Government of India, 1987 & 1988).

#### **Operation of Urban Land (Ceiling and Regulation) Act**

The implementation of the Act is alleged to have retarded building activity in most of the large cities and towns (see, Government of India, 1979 and 1988). An important factor that was responsible for such an outcome is pointed out to be the administrative and legal barriers imposed by the enforcement authorities on the land market. The Committee on Controls and Subsidies, for instance pointed out, "The cumbersome procedures and restrictions, and the discretion vested in competent authorities have led to corruption, delay and harassment to the public". The provisions such as requirement of the approval of competent authorities prior to sanction of building plans for



construction on vacant land or grant of permission to owners where the excess land-holding is marginally in excess of the limit created difficulties to carry on construction of dwelling.

Realizing the bottlenecks created by the Act, the Government of India advised the State Governments to exempt excess land held for industrial and commercial purposes, in the public interest. Guidelines were issued for expediting approval to building plans for construction on vacant land where the Act permits such use, or to relax and grant permission to owners where the excess land-holding is marginally in excess of the limit provided by law, and where such excess cannot be suitably converted into a dwelling area for others. Despite these guidelines, however, delays in clearances under the Urban Land (Ceiling and Regulation) Act persisted and the building activity continued to be hampered.

The result of retarded building activity, according to the Committee on Controls and Subsidies, is the serious housing shortage in many urban centres of the country. The sluggish growth of employment in construction and other related economic activities as the second round effect has also drawn the attention of the Committee. While there was a spurt in private construction in some selected areas, mainly due to remittances from expatriates abroad, or in areas where luxury accommodation was in high demand, there is insignificant growth of formal construction activity, especially for the poor, compared to what would have come up in the absence of the Urban Land (Ceiling and Regulation) Act in the notified areas.

There is a dominant view that holds that the Urban Land (Ceiling and Regulation) Act has not fulfilled its objectives. The committees that have gone into an evaluation of the performance of the Act have expressed their dissatisfaction (see, for example, Government of India 1979, 1983, 1987 and 1988). Findings of these expert bodies centred around four propositions, viz.,

1. In acquisition of surplus land, the Act was ineffective;
2. speculation and profiteering in land did not stop;
3. two sections, e.g., 20 and 21, of the Act virtually nullified all its provisions;
4. the Act gave rise to a great deal of corruption and there was scope for harassment of the citizen at several stages.

The following discussion briefly attempts to recapitulate the findings of the Commissions.

#### **1. Acquisition of Surplus Land**

Supporting the non-achievement of the basic objective, it was pointed out that very little vacant land was acquired. While the estimated excess vacant land in the country was 66,000 hectares, all that could be acquired as on 30th October 1978 was only 271 hectares (see, Table 4.1). Continuing with the same question of the non-achievement of the basic objective, the NCU in its interim report, undertook an incisive analysis of the performance of the Act and confirmed the view held by Committee on Controls and Subsidies. It would be useful to document the evidence used by the Commission for drawing the inference on the Act.

The Commission looked at the operation of the Act by considering the estimates of the excess vacant land after scrutiny and the land actually taken over. Table 4.2 below reproduced from its report show that only about a quarter of the land which was vested was taken into possession.

The actual acquisition of vacant land in the major cities was much less. A few examples, as given in Table 4.3 below indicate this feature. Giving the nature of acquisition, the Committee observed that in Hyderabad much of the vacant land acquired was on the periphery used for either agriculture or lay waste. So almost nothing was acquired within the built-up areas of the city. Even in Calcutta, only 34.67 hectares of land could be taken into possession notwithstanding the presence of a Government with a commitment to land reforms. In case of Delhi there was no allotment of land for housing, while only 10 hectares could be allotted in Madras. It was only in Hyderabad that 283.43 hectares of land had been allotted for housing, largely to the Hyderabad Urban Development Authority, the Andhra Pradesh Housing Board, etc.

**Table 4.1**  
**Acquisition of Vacant Land**

Item	Hectares	Percentage
(A) Estimates of excess vacant land after scrutiny	166192	100
(B) Vacant land acquired and vested in Govt.	14589	8.78 of (A)
(C) Excess vacant land of which physical possession has been obtained	3852	2.32 of (A)
(D) Land used by Govt. for housing construction	651	0.37 of (A)

Source: Interim report of the National Commission on Urbanisation, (Government of India, 1987).

**Table 4.2****Land Taken into Possession in Major Cities**

Name of City	Land taken into possession (in hactare)
Delhi	2.00
Madras	71.52
Ahmedabad	58.53
Hyderabad	440.40
Calcutta	34.67

Source:- Same as Table 3.2

**Table 4.3****Land Exempted Under Section 20**

Name of State/ Union Territory	No. of applica- tions received	No. of exemp- tions granted	Extent of land exempted in hect.
Andhra Pradesh	4515	2024	999.67
Assam	6	1	0.14
Bihar	200	2	4.38
Gujarat	33918	28681	25437.00
Karnataka	5025	3551	5861.90
Madhya Pradesh	3781	539	2244.07
Maharashtra	9702	2424	2099.21
Orissa	124	8	4.35
Rajasthan	3008	289	333.41
Uttar Pradesh	26969	1951	21.05
West Bengal	4369	449	2287.30
Chandigarh	31	13	771.95
Delhi	6357	4052	110.66
Pondicherry	13	10	17.37
Cantonment Areas	583	154	223.20
<b>Total</b>	<b>99314</b>	<b>44201</b>	<b>40418.90</b>

Source:- Same as Table 3.2

Table 4.4

## Land Acquired and Land Exempted Under the Act

(in hectares)

State/Union Territory	Land acquired and vested with Govt.	Excess vacant land of which physical possession taken	Land exempted under Sec 20	Land exempted under Sec. 21	Total exemption
Andhra Pradesh	1522.51	452.78	999.6	103.96	1103.56
Assam	18.99	-	0.14	-	0.14
Bihar	20.46	15.11	4.38	-	4.38
Gujarat	218.00	124.00	25437.00	1804.00	27241.00
Karnataka	1007.12	499.21	5961.90	4.44	5866.34
Madhya Pradesh	1807.54	603.86	2244.00	7.30	2251.30
Maharashtra	4494.69	877.07	2099.21	1015.34	3114.50
Orissa	58.00	-	4.35	-	4.35
Punjab	-	-	333.41	-	333.41
Rajasthan	830.75	21.48	21.05	64.81	85.86
Uttar Pradesh	4872.58	1238.61	2287.30	423.85	2711.15
West Bengal	112.24	19.63	771.95	2.54	774.49
Chandigarh	-	-	3.20	-	3.24
Delhi	251.12	1.99	110.66	-	410.66
Pondicherry	5.18	0.66	17.37	-	17.37
Cantonment Area	95.46	0.03	223.20	18.59	241.79
<b>Total</b>	<b>14588.64</b>	<b>3851.83</b>	<b>40418.90</b>	<b>3444.83</b>	<b>43863.50</b>

Source: Ministry of Urban Development, GOI

## **2. Speculation and Profiteering in Land**

In its evaluation of the speculation in land the Commission looked into price as an indicator of the land market behaviour. When the price increase follows a secular trend of general price increase and there are no significant jumps, it could be inferred that there was no speculation. For this purpose, the NCU took the price movement of Ahmedabad city as, "Large scale exemptions have been given which at least permit construction to be undertaken." It was found that in 10 years of post-land ceiling Act there was a dramatic increase in land prices.

## **3. Sections 20 and 21**

Sections 20 and 21 of the Act relate to exemptions. It was found that out of 43863.50 hectares of land exempted, only 3445 hectares were for E.W.S. housing and 40419 hectares were exempted on other grounds.

It is evident from the Tables 4.3 and 4.4 that a large tract of land have been retained by the owners taking advantage of the exemption provisions. About 60 per cent of the exemptions were given in the State of Gujarat alone.

## **4. Corruption and Harassment of Citizens**

The evidence that about a quarter of the excess land had been exempted and these exemptions did not effectively lead to construction of houses for the poor drew adverse comment from the Commissions. They also took note of the serious complaints in enforcement of the Act and the allegation of a great deal of corruption. The provisions of the Act were such that there were several stages at which the citizens could be harassed. For example, these were requirements such as preparation of the draft statement and the final statement under Sections 8 and 9, the issue of notification of acquisition under Section 10, the

obtaining exemptions under Sections 20 and 21, the obtaining of permission to construct under Section 29, which had ample scope for exercise of discretionary power of the enforcement authorities.

Section 21 effectively lays down that when an owner of land in excess of the ceiling limit has to prepare a scheme for constructing a dwelling unit not exceeding 80 square metres in plinth area would have to be given exemption. However, the process is not automatic and requires the sanction of the competent authority. With a motive of pecuniary gains on the part of the concerned public authority, harassment to a citizen cannot be ruled out.

Section 20, on the other hand gives powers to grant exemption. This provision, for all practical purposes, has been used by the Governments such as that of Gujarat, in a way that large vacant areas never came into public ownership.

#### **Recommendations**

Despite the critical views held on the operation of the Act the Commission endorsed its objectives and, therefore, they recommended its retention with major amendments. Keeping in view the importance of the amendments to Urban Land Ceiling Act in the implementation of the objectives of economic liberalisation, we reproduce below the recommendations of the interim report of the NCU:

- (1) The Act must remain on the Statute Book, all excess lands must be identified and notified as surplus and be made liable to acquisition.

- (2) All surplus vacant land must be quickly released for city development, in particular housing, with special emphasis on housing for the middle and lower income groups and the economically weaker sections.
- (3) In order that the owners of surplus land be encouraged to use it for house construction rather than indulge in unnecessary litigation to retain it, they may be permitted, with a minimum of formality, to build housing units of the prescribed limit of 80 square metres of plinth area.
- (4) If the owners are unable to construct such dwellings, they may be permitted to transfer the land to a co-operative housing society which may either develop Group Housing or make land available in plots of not more than 100 sq. mts to its members for house construction.
- (5) The facility mentioned in items (3) and (4) above will be available for five years from the prescribed date. If within this period the land has not been utilised as above, the provisions of Sections 10, 11 and 14 of the Act will be applied ipsofacto.
- (6) During the period of 5 years permitted for utilisation of the land in the prescribed manner, the surplus vacant land should be subject to a cess/tax. The amount of such cess/tax should be Rs.3/- per square metre in category D towns. In category C, B and A towns, the Central or State Government, by general or special notification, may prescribe a cess/tax ranging from Rs.5/- to Rs.50/- per square metre, depending on location, value etc. of land. This tax/cess will be applicable to vacant Government land also. Where land is held by a Housing Co-operative



Society as plotted development, the society will be responsible for paying the cess/tax on all unbuilt plots.

- (7) The land owner will cease to pay cess/tax on completion of construction equivalent to at least 50% of the prevailing FAR/FSI.
- (8) Where within the prescribed period of five years the land has been brought under construction, but the said construction is in violation of the prescribed use or plinth area, a penalty amounting to a hundred times the prescribed vacant land cess/tax shall be imposed on the holders of the land. Such a penalty will be recoverable as arrears of land revenue. Alternatively, the state will have the option to confiscate the land and the structures built thereon.
- (9) Include under Section 19 properties consisting of buildings and lands notified as being of archaeological, historical and cultural significance by a Competent Authority.
- (10) Recognising that the State must continue to provide land and shelter to the urban poor, the Commission recommends that the entire proceeds of the vacant land cess/tax and penalties for misuse be credited to a Shelter Fund. The proceeds of the shelter fund would be wholly applied to the city from which it is collected and will be specifically utilised for land acquisition and development of serviced sites for the urban poor and for construction of housing for them.

It is clear from the above description that the policy prescriptions on the urban land may not be its total decontrol. Since one of the basic approaches of economic liberalization

programme is that of greater reliance on the market forces in place of the previous policy of control and regulation, it is expected that the on-going reform measures will continue in a way that revamps the enforcement structure of preceding policy regime on Urban Land Ceiling Act. This is seen in the announcement of the Government of India about proposed amendments to the Act and recent discussion paper released by the Ministry of Finance, Government of India. It is stated in one Finance Ministry paper of 1993 that, "Success in industrial and commercial restructuring will also hinge on our ability to devise sensible policies for use of urban land. ... The process of industrial restructuring requires large outlay of funds, which are presently blocked in land held by many concerned units. The ULC Act has to be suitably amended to facilitate the use of these blocked resources for productive restructuring. Meanwhile, States such as Maharashtra are permitting the utilisation of vacant land for social housing by stipulating extensive guidelines. Tamil Nadu has announced a scheme of guided urban development, involving the development by the landowner and developers of the land and the construction of dwelling units and plots of various sizes including a stipulated proportion of units for lower income groups, with a provision for cross subsidy from part of the land, and state assistance for the provision of off-site infrastructure.

The Discussion Paper of the Finance Ministry adds : "ULC Act is not the only impediment to sensible land use policy. In Bombay, it has been estimated that as many as 57 approvals have to be obtained for construction of a housing project. Predictably, housing construction is greatly delayed and property prices soar to levels which choke off the healthy development of new commercial and industrial venture in urban areas. Housing construction and growth in wholesale and retail trade offer high potential for employment growth which is currently inhibited by policies of land use and rent control. Quite clearly, the design and implementation of sensible land use policies will be critical for the success of overall industrial and commercial policy

reform. In large measure, the responsibility rests with the State and local governments." (Government of India, (1993)). Various reform measures outlined in the National Housing Policy need to be urgently pursued to enlarge the supply of buildable land at reasonable prices and to reduce the scarcity value of land. The Government of India has announced recently in the Parliament that large scale amendments to the ULC Act would soon be introduced, in the light of the consensus reached with the states.

### **The Rent Control Acts**

The genesis and operation of the Rent Control laws are described in the official document on the Model Rent Control Bill, circulated by the Government of India before the Parliament in 1992. The black market practices such as a 'pugree' or a 'salami' which a new tenant is often asked to pay are attributed to the Rent Control Acts (RCAs)(see, Government of India, 1979 and 1992d). It is pertinent, therefore, to document some of the features of the Rent Control Acts that may help evaluating the functioning of black money. Although the policy on rent control is undergoing modification in recent years with initiatives like the Model Rent Control Bill (see, Government of India, 1992d), and the introduction of comprehensive amendments to the Delhi Act, the major motivation of reforms does not seem to have come from the problem of black money directly, but rather from the need to expand the supply of rental housing, to facilitate regular revision of rents in line with inflation, and restore a better balance between the interests of the landlords and tenants. This is evident from the documents like National housing Policy (Government of India, 1992c) and Property Tax Reforms in Delhi (Delhi Administration, 1990). The additional objectives are the speedy disposal of cases related to disputes under the Act, the imparting of buoyancy to municipal revenues by enabling periodic revision of rateable value of house property based on current

market rates. Moreover, as stated in the **Model Rent Control Legislation** (see, Government of India, 1992d), the current reform aims at:

- a) promoting adequate supply of rental housing for different income groups by assuring adequate return and ensuring proper maintenance of old housing stock, especially in inner city areas;
- b) establishing a better balance between the interests of bonafide tenants in terms of security of tenure and those of landlords in terms of adequate return and easy resumption of possession in genuine cases;
- c) making rent control acts less inhibitive;
- d) reducing litigation under the RCA.

Thus there is a need to assessing the impact of changed legislation introduced in the rent control on the operation of black money.

#### **Operation of Rent Control Act**

It is widely recognised now that the Rent Control Acts have become ineffective either in protecting tenants against high rents or in ensuring proper maintenance of premises. The yield from old-tenanted properties and the difficulties of evicting the low-rent paying tenants has led to emergence of various unhealthy practices to avoid and evade rent control Acts, as described in the new report. For the purpose of this study, the black money is generated in the course of the demand for key money by the landlord at the time of installing a new tenant to offset the impact of low rents and risk of losing the property. The landlord

is also obliged to buy out the tenants by the offer of cash or flats, in case he desires to take up redevelopment of old properties with unutilised FAR.

Two concepts that have drawn repeated attention of policy makers are "fair" and "standard" rent. Standard Rent (SR) is fixed by the rent controller. Basically, the SR is fixed for the premises at some historical date or the cost of investment. Usually such rents are less than the prevalent market rent. The provision of fair rent, on the other hand, relates to the prevailing rate at the time of the commencement of tenancy and is much higher than the SR. Under inflationary conditions, these rents become lower than the market rents. Conflicts with landlords crop up as rents once fixed are difficult to increase. The only way to get a higher rent for the premises is to evict the old tenant and re-let the house at higher rent. Consequently, important provisions such as notification of tenancies and allotments through the rent controller have remained unimplemented.

Table 4.5

Enactment of Rent Control Legislation in Various States in India

State	Name of the present Act	Year of enactment of the present Act	Years of enactment of earlier Acts
Andhra Pradesh	Andhra Pradesh Buildings (Lease, Rent and Eviction) Control Act	1960	1953, 1954, 1949
Assam	The Assam Urban Areas Rent Control Act	1972	1946, 1949, 1956, 1962
Bihar	The Bihar Building (Leases, Rent & Eviction) Control Act	1977	1942, 1946, 1947
Bombay	Saurashtra Rent Control Act	1951	1918, 1920, 1923, 1939, 1942, 1944, 1947
Delhi	The Delhi Rent Control Act	1958	1939, 1939, 1941, 1944, 1946, 1947, 1952, 1956, 1956
East Punjab	The East Punjab Urban Rent Restriction Act (Extension in Chandigarh)	1974	1941, 1947, 1949, 1949
Goa, Daman & Diu	The Goa, Daman and Diu Buildings (Lease Rent and Eviction) Control Act	1968	
Haryana	The Haryana Urban (Control of Rent and Eviction) Act	1973	
Himachal Pradesh	The Himachal Pradesh Urban Rent Control Act		
Jammu & Kashmir	The Jammu & Kashmir Houses and Shops Rent Control Act Circular No. 136 1952	1966	
Karnataka	The Karnataka Rent Control Act	1961	1941, 1951
Kerala	The Kerala Buildings (Lease & Rent Control) Act	1965	1950, 1959, 1959
Madhya Pradesh	The Madhya Pradesh Accommodation Control Act	1961 1950	1946, 1949, 1946, 1950, 1956, 1957, 1950 1950, 1955, 1955
Meghalaya	The Meghalaya Urban Areas Rent Control Act	1972	
Orissa	The Orissa House Rent Control Act	1967	1947, 1947, 1952, 1952, 1958
Pondicherry	The Pondicherry Buildings (Lease & Rent Control) Act	1969	
Rajasthan	The Raj. Premises (Control of Rent & Eviction) Act	1950	1948, 1948, 1949, 1949, 1944
Tamil Nadu	The Madras Buildings (Lease and Rent Control) Act	1960	1941, 1941, 1945, 1945, 1946, 1949
Uttar Pradesh	The UP Urban Buildings (Regulation of letting, Rent and Eviction) Act	1972	1946, 1947
West Bengal	The West Bengal Premises Tenancy Act	1956	1920, 1923, 1924, 1949, 1943, 1946, 1948, 1950.

Source: Government of India, 1988

Table 4.6

## Selected Features of Rent Control Acts of Different States/Union Territories

State/Union	Year of enactment of the present Act	Initial period of exemption, if any	Period allowed for reporting vacancy, if required
Andhra Pradesh	1960	Indefinite when Rent > Rs 1000; 10 years when Rent < Rs 1000	10 days
Assam	1972	None	
Bihar	1977	None	
Delhi	1958	None	7 days
Goa, Daman & Diu	1968	4 years	
Gujarat	1947	None	
Haryana	1973	10 years	
Himachal Pradesh	1971	None	
Jammu & Kashmir	1966	Where annual income of tenant > Rs 20,000	
Karnataka	1961	5 years	15 days
Kerala	1965	None	15 days
Madhya Pradesh	1961	5 years	As per orders
Maharashtra	1947	None	
Meghalaya	1972	None	
Orissa	1967	5 years	
Pondicherry	1969	None	7 days
Punjab	1949	None	
Rajasthan	1950	None	
Tamil Nadu	1960	5 years, and when rent > Rs 400	7 days
Tripura	1975	None	15 days
Uttar Pradesh	1972	10 years/20 years	7 days
West Bengal	1956	None	

Source: Government of India, 1988.

Tables under the chapter on economic reform and legal bottlenecks

### Impact of Rent Control Acts

There is a view among policy makers, nearly unanimous, that the social objectives of rent control Acts have not been realised. The frozen rents have led to emergence of practices like key money. Thus, apart from creating a black market in rental housing, the Acts have become instrumental in reducing the accessibility of low income groups to rental housing as they cannot afford to pay large deposits, and the

failure to develop a vibrant rental market. The widening divergence of interest between landlords and tenants has increased litigation and criminal cases over rented properties. At another level, the average impact of the Acts on supply of rental housing has been adverse. It is pointed out in the paper on model rent control legislation that there was (i) a negative effect on investment in new rental housing, (ii) withdrawal of supply from existing rental housing stock and (iii) accelerated depreciation due to inadequate maintenance.

#### **Nature of Reform**

The process of reform is likely to exert, albeit indirectly, a dampening pressure on the strength of black market practices such as 'pugree'. It may come through the increased supply of rental housing at rents agreed between the landlords and tenants, and the exemption of the newly let out properties as well as properties carrying more than Rs. 3500 rent per month from rent control, which would ease the scarcity situation that gives strength to the operation of black market practices. The provision for the initial establishment of market rates in a gradual fashion, annual revision of the agreed rents, the provision for short term tenancies, and the liberalised litigation procedure for ensuring summary eviction of the tenant for prescribed reasons, will restore the confidence of landlords, and reduce the differential between the standard rent and the market rent.

The model rent control legislation brought out by the Government (See, Government of India, 1992d) improves on the provisions incorporated in the 1988 Delhi Amendment Act. There are elaborate specifications on (i) exemptions, (ii) Standard Rent (SR) determination procedure, (iii) tenant-eviction rules, (iv) streamlining of judicial procedure, and powers of Rent Controller, (v) maintenance obligations of landlords and (vi) obligations of a tenant. The present reform of rent control seems to be an attempt to strike a balance of interest between landlord and tenants. The Parliament has already passed a bill to amend the Constitution to enable the establishment of State level Rent Tribunals, outside the jurisdiction of High Courts, and this has been



ratified by the State Legislatures. The enactment of the State laws in line with the model law is expected to help establish rents to market levels, with safeguards for low income tenants. The reform therefore aims at encouraging rental housing construction and also reducing the scope for illegal premium in the rental services.

### **Conclusion**

The recently initiated reform in land policies and rent control expect to ensure a proper environment for increasing the supply of serviced land and housing for rental and ownership needs, and is likely to help reducing the influence of black money in real estate. There are hopes that a substantial part of the rental housing market in urban India could be market determined and that landlords would be more confident about letting their houses wholly or partially thanks to the speedy and simple litigation system. It is needless to point out that the success of the reform also hinges on the improvement in approval procedures for land development and house construction and amendments to the Urban Land (Ceiling and Regulation) Act, and other measures outlined in the National Housing Policy. The deregulation of the urban land and housing sector, as well as steps to ensure more transparent systems of conveyance of property, and the rationalisation of various burdens on real estate would hopefully reduce the influence of black money, by impacting on both the demand and supply side of the equation. Simultaneous steps would of course have to be taken to increase the access of the low income groups to adequate shelter on affordable terms, within the overall strategy for poverty alleviation and urban basic services outlined in the NHP and other official documents.

## Chapter 5

### LINK BETWEEN REAL ESTATE MARKET AND BLACK MONEY

#### Introduction

In the earlier chapters, we have analysed how the existing fiscal laws, and the regulatory framework in land and housing, are responsible for a constrained supply market in real estate with strong inducements for under-reporting and the generation of black money. Although the rise of black money in various activities of real estate has drawn considerable attention in urban India, views on the major factors responsible for its entry into the sector differ. Many people believe that the Government intervention, by disrupting the functioning of real estate market, has encouraged underground dealings in land and buildings (see, for example, Government of India 1979 & 1988). Others highlight the incentives that the buyers and the sellers have for under-reporting the transfer of immovable properties (see, NIPFP, 1985). Thus, it appears that the nexus between real estate and black money is based on both Government policies and various incentives provided by operation of these policies.

The attraction of transactions in real estate as a black income generating activity is the focus of some studies (see, NIPFP, 1984 & 1985). Two commonly observed factors that make the sector attractive are, (i) low probability in the detection of tax evasion with a low cost penalty rate on being caught and (ii) high rate of appreciation on investments in real estate market (despite the low return on post tax declared income from property).

It is not difficult to see that probability of being detected for the non-payment of taxes is reduced considerably in transactions made through the power of attorney. But, as noted in the earlier chapter, tax evasion also becomes easier because of difficulties involved in determining the correct value of urban land and buildings, and the multiple levels at which property is sought to be valued by different agencies for the imposition of one-time or recurring levies on conveyance or contribution to municipal and state revenues, or in the course of deciding on the pre-emptive purchase of undervalued property. Due to valuation problems, and the practice of payment of sale consideration partly in undisclosed money, capital gains from the transfer of immovable properties are not transparent and become important source of black money (NIPFP, 1985).

The rate of return on investments in real estate activities, according to some studies is in the range of 25 to 36 per cent per annum (see, for example, NIPFP, 1984) despite the preferred low return on rental or ownership housing net of all taxes (NIUA 1989). The attraction stems from anticipated appreciation and the use of black money. The return of this magnitude seems to be on the higher side than in other organised sectors. The findings of the above studies are based on surveys conducted to find out the source of housing finance and functioning of informal credit markets. The attraction of investment in land and building as sources of rapid appreciation of value is difficult to set aside in the mind of the public.

The two factors pointed out above concerning the attractiveness of the real estate market are closely related. The high rate of return on investment in some activities of this market is realised mainly due to non-payment of taxes like capital gains and stamp duty. A common method of evading the payment of tax is the undervaluation of properties. This strategy works well in the real estate as both buyers and sellers have an incentive in carrying out it. While the seller of real estate property gains

from the undervaluation by paying lower capital gains tax and the subsequent wealth tax, the buyer saves in terms of less payment of stamp duty and registration fees. The saving for both the parties is a substantial amount as can be seen from the exercise, involving the use of tax evaded wealth both in buying and selling the house, carried out in the course of a NIPFP study on the evaluation of tax concessions in housing (NIPFP 1992).

In the above exercise, Rs. 7.5 lakh is taken to be the actual market-determined sale price. Of this, Rs. 4.5 lakh is assumed to be white. This is roughly the situation for houses sold at Rs. 2.5 lakh by housing authorities, according to real estate brokers. The property tax and also the income tax (if the house is let) are based on the reported price of the house. It may be mentioned that, since the rate of appreciation of rents lags behind the rate of appreciation of property, this house will earn less than 10 per cent of the market value. We assume that this house will earn only as much rent as other similar houses. In such a scenario, the rental would be 6.6 per cent (4 per cent) of the reported value of the house (true purchase price). This implies a reduction in inflows during the operating years. However, the net gain will increase in the terminal year when the house is sold, given that the true sale price of the house is underreported. If 16 per cent is the reported appreciation in land value, untaxed unreported appreciation would be 40 per cent of the total sale price. The present value of housing investment in this case is Rs. 1.23 lakh for a 30% bracket taxpayer compared to Rs. 0.56 lakh for an all white sale. Under-reporting of the sale price by 40 per cent is found to result in this case in an evasion of tax of a little more than Rs. 5.6 lakh which is about Rs. 75 per 100 of investment. In a different case where a dishonest person gets a house from a public housing authority, and sells it after holding it for 25 years, but does not disclose the full capital gains from the sale of the house. In this case, the evasion of tax is even higher than in the previous case at Rs. 137 to 100 of investment.

The capital gains tax, for example, was much higher as a percentage of the property value not long ago. After the changes introduced through the Finance Bill, 1992, a flat rate of 20 per cent is payable by individuals as capital gains after indexing on the lines of the legal provisions. The stamp Acts as noted in the preceding chapter, on the other hand, attract a tax ranging from 8 to 13 per cent (besides ad valorem registration duties of 1 to 2 per cent in a number of states). This is apart from the problem of determination of higher than declared value for the levy of stamp duty on the basis of a statutory enquiry.

As both buyers and sellers have an incentive in under-reporting, this link between real estate and black money can be called **incentive-induced**. It is well documented in the recent analyses. There are other instances of black money generation that could be added to this group. For example, the present study has information on incentive-induced black money cases by interviewing a cross section of people in the important metropolitan centres. Some of these are given in the following.

(i) Buyers and sellers often take advantage of the existing Rent Control Act to undervalue property. The seller claims that he was forced to sell his property at a lower price since his tenant was refusing to vacate. As the seller was not interested in getting into the legalities of eviction, he claims he sold the property at whatever price it could fetch, and this argument is advanced before the Appropriate Authority under Chapter XXC of the IT Act.

(ii) Undervaluation of the property in projects like construction of farm houses appears to be quite common. Since it is difficult to ascertain the true market value of such projects, both the builder and the buyer find it somewhat easy to undervalue the property.

(iii) By overestimating the cost of production, builders manage to show low profit, and consequently escape paying taxes on it.

(iv) Often buyers approach builders with the suggestion that though they can purchase the property at the listed price, it would not be possible to pay the entire amount in 'white'. The builder, if convinced that the buyer has funds, gives him a "special discount". Schemes like a promotional discount or a personal relation discount serve the purpose of showing that a price lower than the listed one is paid. The unaccounted balance is paid by the buyer in cash that is not entered in the book of accounts of the builder.

At times, the incentive-induced black money generation is a result of the real estate policy of the Government. For example, the incentive to evade stamp duty is induced by the policy of high rate of tax on transfer of immovable properties. So there are **policy-induced** links as well. To appreciate this, the widely recognised sources of black money in real estate are given below and the list is made from the findings of NIPFP (1985).

- i) Undeclared capital gains;
- ii) unpaid stamp duty and registration fees;
- iii) transfers through power of attorney;
- iv) payment of 'pugree' for rented accommodation;
- v) bribe allegedly paid to Government officials for obtaining clearance to construct houses and transfer of properties;
- vi) alleged payment of bribe for manipulating the law related to the use of land.

The above list is by no means exhaustive. Yet, it can be seen that the last four of the above sources are largely due to policy-induced distortions in the real estate market. It also can be seen that the policy- and incentive- induced links are not mutually exclusive. As noted in the previous Chapter, the important legislations like building bye-laws and Master Plan provisions enacted with the intention of planned development of cities have been pointed out as factors responsible for generating black money in real estate. During our discussions with some builders in Delhi, it was stated that, while rates vary from one department to another, bribes and commissions to officials often account for 10 to 12 per cent of the value of the property. It is not uncommon to find the need to pay bribe and commissions to officials associated with giving clearance to construction of building or registration of transferred deeds.

However, the dynamism exhibited by the circulation of black money in activities of real estate in recent years is difficult to understand in terms of incentive- and policy-induced links alone. Features such as self-perpetuating growth of black money and participation of real estate agents, who help use of black money and help expansion of its quantum, have to be considered to understand the present dimension acquired by the problem.

It is indeed difficult to disaggregate the quantum of black money in terms of its continuation and withdrawal from circulation in real estate. As is pointed out by the study of NIPFP(1984) a substantial proportion, perhaps in the range of half to two-thirds of black income, is spent on consumption. So, there is a possibility of at least one-third of the black income getting reinvested. The evidence on the proportionate reinvestment in the real estate market is not available. Hence, it is difficult to draw any precise conclusion on the quantum of black money used for generating more black money. For having some idea on the nature of accumulation, the following discussion will attempt to identify

the category of people who could often be investing their capital in real estate and simultaneously keeping themselves away from the system of formal financial market.

The major emphasis of the present discussion will be on the operation of informal financial market that serves as the entry point of black money. Many real estate agents depend on informal credit to finance their activities and it is seen that black money may not be generated only by big builders and developers and individual home owners through the financial market.

### **Informal Credit Market and Black Money**

Evaluation studies on housing finance show that formal credit market in India has played a limited role in housing sector (see Gupta, 1982; NIPFP, 1984). Consequently, the informal credit market and black money with it have dominated the credit supply of real estate activities. To understand the link between informal credit market and black money, it will be useful to analyse the requirement of credit by various agents working in the real estate.

It was seen while discussing the functioning of real estate market in Chapter 3 that the economic agents present there can be identified as private individuals, real estate agents and builders and developers. Their dependence on informal credit market can be seen from the following discussion:

#### **1. Individuals**

Private individuals as home owners have greater access to institutional credit. Despite this, as a study on housing finance (NIPFP, 1984) points out, 74 per cent of finance of the housing activities comes from informal sources. The share of the moneylender's fund in this is pointed out to be very small. So it



can be presumed that black money may not be entering through individual home owners in a significant way, except to the extent that they are inveigled into paying, or accepting, a part of the sale consideration in black under the temptation of realising a higher sale price as a seller, or under duress of not being able to buy the flat otherwise at the quoted price. Individual home owners also make significant capital gains by way of selling land or building in developed pockets of the city. The role of real estate agents and small constructors as customers of individual sellers will be seen below.

## 2. Builders and Developers

Builders and developers mostly finance their activities through advances taken from the prospective buyers. Their own investment in a project is limited to funds necessary for acquiring and developing the land. As the requirement of funds at this stage of the project is relatively large, there is some scope for black money to enter. The present analysis does not have much information on the **modus operandi** of this group to arrange their initial finances and is in no position to draw any inference. In general, the following discussion gives the impression that there is no strong case to show the dependence of big builders on the informal credit market, but it is clear that the smaller builders depend on the informal money market. This has been documented to some extent in the NIPFP study on housing finance in India, as well as the study of metropolitan housing finance by Mehta and Mehta.

A builder negotiates with a seller of land and executes a sale agreement. Usually, 10 per cent of the agreed sale price is paid immediately. After the agreement is signed, the builder announces the housing or land availability scheme. The interested buyers are often asked to pay 10 per cent of the cost to start with. Installments of the remaining amount are paid as the work of development and construction progresses.

### 3. Real Estate Agents

Real estate agents largely depend on the informal credit market to meet their financial requirements. It may be noted that credit is not available from formal financial institutions for the purchase of land. Therefore, the real estate agents approach the money lenders in case of immediate requirement of capital. Since they cannot provide adequate collateral, moneylenders do not deal with unknown borrowers. Agents known to financiers of informal credit market have greater access to the finance.

A procedure like the above becomes a significant factor for the low probability of being caught due to tax evasion. The owner of the finance, i.e., the moneylender, is not involved directly in the property transactions. The real estate agent deals with the sales and purchases of properties after borrowing the necessary finance. He has an incentive of not revealing the quantum as well as the source of unorganised financial market.

The influential nature of black money can be understood by considering the sale and purchase of small plots of vacant land and residential buildings in the developed pockets of the city. Transactions in this category of activities in the real estate market, although infrequent in nature, are important because of the higher price charged per property. The payment of cash involved in these transactions seldom enters the formal financial market. Another method adopted by the real estate agents as well as small developers is to purchase the land and change the residential premises into commercial complexes. The underreporting of the actual value of a property is substantial in these types of transactions. The magnitude of such commercialisation of residential premises is on the increase in big cities like Delhi, and this was recognised by an abortive move of the Government of India to penalise such transactions heavily.

## **Conclusion**

The above discussion points out the inadequacy of understanding the dynamic character of black money with the help of incentive- and policy-induced links between black money and real estate. The entry points of black money into the real estate market were assessed by considering three groups of participants, viz., individual home owners, real estate agents and big builders and developers. Based on the financial source of these participants, the study highlighted an important link between informal credit market and real estate operation. As the credit of informal market enters for investment or speculative purchases, its accumulation over time emerges as a distinct possibility.

## Chapter 6

### ESTIMATION OF BLACK MONEY IN REAL ESTATE

#### Introduction

The phenomenon of black money in the real estate sector has drawn much attention of the policy makers in India. The legislations that have been introduced time and again to curb its menace indicate the concern for the problem (see, Government of India, 1964, 1971, and 1986). Yet, the quantum of black money in the sector is not known. Estimated on the basis of tax evasion cases detected by the Income Tax Department in respect of immovable property transfers so far, the quantum of black money gives only a partial view of the problem. There are other categories of tax evaded income centred around the real estate property transactions such as brokerage and rental income, which remain outside the purview of an analysis (see also, Government of India, Ministry of Finance, 1992b).

An important prerequisite for estimating black money by using tax evasion cases in respect of immovable property transfers is the need to understand the concept of 'black income' involved. It is usually understood that black income is generated whenever the value of immovable properties in the transfer deed is understated. However, all transfers of immovable property need not add to the national income of the economy and therefore need not result in generation of black income (see, NIPFP, 1985).

The basic problem hampering the estimation of black money in real estate is that both the buyer and seller tend to under-report the actual value of the property. The payment of registration fee, stamp duties, capital gains tax and wealth tax are reduced due to such a strategy. Such practices make it imperative to look for

other sources of information in order to estimate the magnitude of under-reporting. An important source is the market determined value of properties. The difference between the market value and the declared value of properties at the time of registration gives the extent of under-reported income. However, fair market value of real estate properties is not easily available. Studies in the past that estimated black money in real estate, therefore, had to depend upon piecemeal data from different sources (see, NIPFP, 1985). Even with such an approach, the tax evasion cases like brokerage fees charged by real estate agents and interest income on loans raised by the property dealers from informal market have remained outside the estimation of the quantum of black money.

#### **Black Money: Estimate of Some Recent Studies**

Estimation of the quantum of black money in the real estate sector of India in recent years has been attempted by two studies, viz., NIPFP (1985) and Tandon (1987). These studies have applied the term black money in the real estate as interpreted by the Income Tax Department, namely, in terms of the undeclared capital gains detected in the real estate transactions. It is useful to keep in mind that many other sources of tax evasion in respect of real estate properties have not been included in the above analyses. In estimating black money the four data sets used in these studies are, (i) acquisition of properties by the Income Tax Department under chapter XXC of the Income Tax Act, (ii) registered value of immovable property transferred, (iii) share of black money in a transaction through interviewing of persons 'in the know of the business' and (iv) survey of real estate brokers on the undeclared value of property at the time of transfer.

Assessing the quantum of black money on the basis of data (ii) and (iii) above, the study by Tandon(1987) puts the magnitude of black money in real estate in the range of Rs. 4685-10541 crore

for the year 1983-84 and Rs. 5097-11469 crore for 1984-85. Against this, the NIPFP (1985) study puts the estimate at a lower level of Rs. 3664 crore for the year 1980-81.

The NIPFP (1985) study had also estimated the share of black money in the real estate separately for three important metropolitan cities, viz., Delhi, Bombay and Madras using the data mentioned above against (i) and (iv). In the case of Delhi, the estimate based on data in (iv), is over Rs. 240 crore in the year 1982-83. Similarly the estimate for Madras was in the range of Rs. 172 to Rs. 677 crore and for Bombay, it was more than Rs. 364 crore. These estimates, it was observed, are on the lower end as many important transactions like property transfers through 'powers of attorney' in Delhi and Bombay were left out.

Estimation of black money on the basis of the income tax data as given by (i) above, however, indicated only half the amount shown by the data collected through the survey of real estate brokers. The emergence of significantly different amounts of estimated black money from the two data sets required the NIPFP (1985) study to choose, *a posteriori*, the result of only one. While the brokers valuation survey was preferred for the estimation of black money in the three metropolitan centres, presumably, doubts persisted on the choice. Therefore, the estimation of black money in the real estate across States had to adopt a black-white ratio of 40:60 on the basis of data sources (ii) and (iii) mentioned above.

The global estimate of black money in real estate is worked out in these studies by applying the above proportion to the recorded values in sale deeds. Although all property transactions are recorded, such data as sales deeds are not available separately. As a result, the registered value of all immovable properties transferred are used for the estimation of the black component. This brings in a possibility of upward bias in the estimation. The NIPFP(1985) study assumed that the share of

non-sale transactions like mortgages, gifts and leases in the total value of immovable properties transferred is insignificant and, therefore, included all non-sale transactions as well. But, the assumption of these transactions forming an insignificant share may not be true always.

This was suggested by the data collected for the present study from Bangalore. Table 6.1 shows the share of sale transactions in the total registered value of immovable properties transferred for Bangalore during 1987-91. It shows that sale deeds are about 60 to 70 per cent. The assumption of insignificant share of the non-sale deeds in the registered value of immovable properties thus had an impact on the estimated value of black money in the studies of NIPFP (1985) and Tandon (1987). The upward bias could have been significant as shown by the Bangalore data. Therefore, it discounts the estimates of black money in the real estate in the studies. Considering the indications of recorded property transfers in Bangalore, it is reasonable to scale down the estimated value of black money in the studies of NIPFP(1985) and Tandon(1987) by approximately 20-30 per cent.

As for the black money component, there is some agreement between studies, such as NIPFP (1985) and Tandon (1987) that it is about 40 to 60 per cent of a property transfer. It has been pointed out that this view is based on the extensive interviews held with the 'persons in the know of business'. One serious limitation of this information, however, is that it is acquired through talking to people rather than from the records of the books of account. Since almost every one, irrespective of his city of habitation points out the same range of black-white ratio in the transfer of immovable property, it can be termed as the **common gossip** on the probable range of black money in the real estate.

Table 6.1

Intervals of Black Income Generation in  
Real Estate Transaction

(in percentage)

Year	Bangalore		Bombay		Delhi		Madras		Total	
	L.P	U.P	L.P	U.P	L.P	U.P	L.P	U.P	L.P	U.P
1986-87	NA	NA	NA	NA	NA	NA	31.45	58.87	36.56	70.83
1987-88	26.34	54.83	21.36	34.86	35.51	53.69	28.34	50.54	33.06	45.75
1988-89	NA	NA	22.81	30.93	24.85	55.97	NA	NA	24.28	44.19
1989-90	NA	NA	30.97	43.62	NA	NA	NA	NA	26.38	39.99
1990-91	19.9	59.58	23.72	81.48	NA	NA	23.97	41.28	24.36	65.06

Notes: i) N.A. : Not estimated due to less number of observations or non availability of data.

ii) U.P. : Upper Limit & L.P. : Lower Limit

Source: As described in the text.



**Table 6.2**

**Proportion of Black to White Money**

(percentage)

Year	Bangalore	Bombay	Calcutta	Delhi	Madras	Total
	1	2	3	4	5	6(1 to 5)
1986-87	NA	74.14	NA	55.43	58.36	60.13
1987-88	40.56	37.03	NA	45.22	44.40	41.75
1988-89	53.81	29.03	NA	46.46	28.48	37.11
1989-90	21.34	34.09	16.62	47.79	25.60	32.20
1990-91	49.27	50.43	16.19	NA	31.83	47.19

**Source:** As described in the text.

Being a gossip, its authenticity needs to be tested with the help of data on the real estate transactions. The following analysis is an attempt in this direction. It also is an attempt to re-estimate the total amount of black money generated in the recent years through transfer of real estate properties. The estimate is given for five important cities, viz., Bangalore, Bombay, Calcutta, Delhi and Madras.

**Estimation of the Black Money**

Throughout the following analysis, black money in a real estate property transfer is taken to be the payment received by the seller that escaped the tax net due to non-reporting. The black component, therefore, can be determined as a difference between the actual and declared payments of the property under transfer. The total payment in black in the real estate sector of a city during a year is derived by summing up the black money received by the individual transferors.

## Data Source

The analysis makes use of data collected by the income tax authorities in connection with the execution of Chapter XXC of the Income-tax Act. Under the provision of this Act, the 'appropriate authorities' in the Income tax Department can purchase any immovable property, which is being transferred for a value exceeding Rs. 10 lakh (see, Government of India, 1992a). The objective of this scheme is to counter evasion of tax through understatement of the value of immovable properties in transferred deeds.

Under this scheme, any agreement to effect the transfer of an immovable property has to be intimated to the appropriate authorities through a statement in the Form 37-I of the Income-tax Rule, 1962. On receiving the statement, the appropriate authorities may make an order for purchasing the property after pointing out reasons for their decision.

In actual practice, the appropriate authorities follow a slightly different procedure in acquiring a property. The Central Board of Direct Taxes (CBDT) requires the appropriate authorities to acquire properties from among the 37-I forms by the statistical method of random sampling.

The Appropriate Authorities maintain a register of the properties acquired by them. The register records the value of apparent consideration of the acquired properties, the date of acquisition, date of auction and the auctioned price of properties. In these data, the discrepancy between the acquisition price and the auction price of the property reflects the approximate value of under-reporting by parties involved in the transfer of property. The percentage of under-reported amount in

the property deal suggests the evaded income on which tax was not intended to be paid. In the present study, this proportion is taken as black money in a real estate property transfer.

Difficulties such as incomplete coverage and exclusion of certain categories of transactions associated with the use of the income tax data in estimating the black money is documented by Tandon (1987). These apart, as pointed out in the NIPFP (1985) study, black money generation through transactions like the power of attorney remains outside the purview of the income tax data. The money in these types of dealings is often assumed to be substantial in many urban centres. It is, therefore, not unreasonable to point out that the estimation of black money on the basis of data provided by the appropriate authorities will have a downward bias.

The estimation of black money from the data on property acquisitions is also beset with other problems. These are, mainly, associated with the implementation of the scheme of property acquisition under Chapter XXC of the Income Tax Rule. The problem of non-adherence to the method of random sampling while selecting the property to be acquired, as is suspected by the Auditor and Controller General (Government of India, 1992a), could be considered as an example. Also, the estimated black money from the sample could be biased upward if the appropriate authorities are trying to minimise the possibility of acquiring a property unless its value is not understated to a significant extent. Thus, the appropriate authorities would be acquiring only those properties which are suspected to be undervalued significantly.

The acquisition data analysed in the present study have the following features: (i) The difference between the value of acquisition and the auctioned price is at least 15 per cent of the former; (ii) the date of acquisition and date of auction is less than a year. The condition (i) above follows the prescription of the Income Tax Department in evaluating the authenticity of the

declared value of a property. While it ignores the error in evaluating the market value of the property by the appropriate authorities, condition (ii) assumes that the possibility of appreciation of market value of the property due to a lapse of time between the acquisition and sale is not significant.

### **Black Income in Transactions**

#### **i. Uniform share of black income across cities**

The common gossip among the different sections of people connected with real estate properties points out that the share of black money component in a property transfer is uniform. For instance, the share of cash payment for which no receipt is given, in general, is stated to be in the range of 40 to 60 per cent in all the metropolitan centres considered in the present study. This range is indicated to have remained unchanged among the cities over the recent years. It will, therefore, be useful to see if the uniformity suspicion gets support from the data of the sample used in the present study.

Table 6.2 gives the proportion of the black to white payment in real estate property transfer. The payment in black for the purposes of the table refers to the difference between the acquisition price of the property and its auction price as stated by the appropriate authorities.

On an average, the black to white ratio of immovable property transfer does not show constancy over time. It may be seen from the table that five metropolitan centres together show a black to white ratio of 40 : 60 in the year 1986-87. This proportion, however, indicates a much lower magnitude of less than 40 per cent in the succeeding years. Results presented in the table record a consistent decline in the black-white proportion except the year 1990-91.

The percentage of under-reporting in the five metropolitan cities individually does not support the uniformity belief either. Delhi, for example, has recorded a narrow range of 45 to 55 per cent of black to white proportion in the years reviewed. The magnitude of unreported money is found to vary with a wider range over years in the remaining cities.

Thus, contrary to the common gossip which gives the impression that the share of payment in black in the total value of transferred property is in the same range among cities, the income tax data used in the study indicates inter-city variation. Out of five metropolitan cities considered here, Delhi, in general, has registered a higher percentage of black money in the transfer of properties. It can be seen from the table that the component of black money in property transactions has remained above 45.22 per cent, irrespective of the year considered while the other cities often exhibit much lower magnitudes. Calcutta appears on the lower side of the scale with only 17 per cent of black component in the transfer of immovable property.

The probable reason for the higher magnitude of black money in Delhi could be due to a wide range of factors such as housing shortage, rising rents, the very rapid growth of population and incomes in the city, inadequate supply of houses by the DDA and above all the locational value of the city as the capital of the country. The housing as well as land supply policy of the DDA

needs to be examined closely for the possibility of finding the reasons for speculative buying, which encourages underhand dealings.

The existing information on Calcutta does not support the view that the under-reporting of transferred property values is as high as in other cities. This finding, however, has serious limitations. The income tax data on the acquisition of property in the case of Calcutta do not have many observations and could be inadequate for evaluating the black money component in the real estate of the city.

It is believed by many people that the share of black money in the transfer of immovable property could be in a specific range of the transacted property. For example, that the range of 40 to 60 per cent of the total value of transfer involves payment in black is a dominant view. When expressed in terms of black to white proportion it would be in the range of 66 to 150 per cent. Such an impression didn't get support from the data used in the study. While the range of black-white ratio during 1986-87 in the four cities combined was 37 to 71 per cent, the subsequent years showed a much lower range. As the interval in which the black money could be found was as low as 26 to 40 per cent of the white during the year 1989-90, it is difficult to substantiate the belief that the share of black money is invariant to time.

At the individual level also, cities registered wide inter-year variation in the range of black to white ratio. While Delhi recorded a comparatively lower fluctuation between the years 1987-88 and 1988-89, Bombay displayed a much wider range. As Table 6.2 showed, the black-white ratio in Delhi might be in the range of 36 to 54 per cent and 23 to 56 per cent during 1987-88 and 1988-89, respectively. In case of Bombay, the similar intervals for the years 1988-89 and 1990-91 were 22 to 31 per cent and 24 to 81 per cent.

## Results of Statistical Test

The black-white ratio, contrary to the common belief, was found to vary across cities as well as over time. The observed variation, however, has to be significant in order to reject the common belief on the constancy of black component among cities. In other words, it is necessary to test that the city-specific as well as time-specific effects do not vary significantly. To see this, the following propositions were tested with the help of an analysis of variance.

- i. The proportion of black to white money in a city does not vary over time;
- ii. The proportion of black to white money among cities does not vary at a particular point of time;
- iii. The proportion of black to white money among cities does not vary over a period of time.

The observed differences in the black-white ratio among cities as well as over time in a particular city are not significant, statistically. Results of the analysis of variance of the above three propositions presented in Table 6.3 may be seen for details. It could be seen that the F-ratios presented for the variation in the black-white ratio of individual cities over time, between cities in a given year and between cities over years failed to reach the level of significance even with 10 per cent error.

Table 6.3

## Analysis of Variance

Test for difference over time in a city	Sum of square		Degree of freedom		Mean Square		F-Ratio
	T.S.S.	E.S.S.	T.S.S.	E.S.S.	T.S.S.	E.S.S.	
Bangalore	996.40	15363.61	3	13	332.13	1181.82	0.28
Bombay	9854.13	114459	4	45	2463	2543.53	0.97
Delhi	610.40	12146.41	3	25	203.47	485.86	0.42
Madras	956.36	7689.43	4	22	239.09	349.52	0.68
<b>Between cities in a year</b>							
1986	2282.21	9640.28	2	10	1141.11	964.03	1.18
1987	1460.26	12511.49	3	33	486.75	379.14	1.28
1988	1708.89	15056.83	3	22	569.63	684.40	0.83
1989	1345.42	1935.38	4	12	336.35	161.28	2.09
1990	3288.14	110514.5	3	29	1096.05	3810.85	0.29
<b>Between years</b>	<b>2485.09</b>	<b>162075.9</b>	<b>4</b>	<b>121</b>	<b>621.27</b>	<b>1339.47</b>	<b>0.46</b>

N.B.: T.S.S.- Total Sum of Square; E.S.S.- Error Sum of Square



## **Black Money in Transfer of Immovable Property**

### **Methodology of estimation**

That the share of black money in transferred value of immovable property could be in a specific range is a general belief in the important metropolitan centres. For example, the range, 40 to 60 per cent of the actual value of transfer involves payment in black is the common perception. If this range is the representative of the black money generated in the transfer of immovable properties, then an estimate of the black money from the sample should not be significantly different from it.

The following analysis attempts to estimate the black money from the sample of immovable properties acquired by the appropriate authorities. Using the sample mean, an interval will be calculated in which the black to white proportion of the real estate transactions could be present.

It is necessary to estimate the mean from the truncated sample distribution. The frequency distribution of the sample at the disposal of the study is truncated because data are only for those properties whose apparent value exceeds Rs. 10 lakh. The sample, therefore, does not include information on the black money generated by transactions of lower than Rs. 10 lakh value.

The present study estimates the quantum of black money through two stages. First, the sample observations are used to get the expected means of auctioned and acquired value of properties. Second, an estimation of the total black money is showed as the difference between these two parameters. It may be recalled that the sample distribution would be truncated since properties acquired by the appropriate authorities refer to transfer of immovable properties whose value exceeds Rs. 10 lakh. The expected mean of total under-reported value of properties is estimated on the assumption that the point of truncation of the sample

distribution is Rs. 10 lakh (for details of estimation see the appendix to Chapter 6). The corresponding point in the case of auction value of properties, on the other hand, is Rs. 11.5 lakh due to the condition (i) above, which said that the difference between acquisition and auction price should be at least 15 per cent in order to confirm the suspicion of under-reporting. So, it is not unreasonable to assume that the truncation point of the auction price is above 15 per cent of the truncation of acquired properties.

The difference between the market and acquired price of properties gives the black money received by the seller of the real estate property. Given the mean and standard deviation of the two series above and a naive assumption of their independence, the expected value of black money generation can be estimated.

The interval with 10 per cent error around the mean value of black money generated in the recent years is approximately Rs. 8.2652 to Rs. 10.1977 lakh. It works out to be 66 to 73 per cent of the value of the property transferred.

#### **Probable Quantum of Black Money**

Given the nature of underhand dealings in the black market and the heterogeneous quality of urban immovable properties, it is extremely difficult to arrive at a global estimate of black money in transactions. Whenever an estimation of the total value of black component is attempted, it has a limited purpose of providing some qualitative information on the magnitude of the problem.

The estimation of the quantum of black money due to transfer of real estate properties in each of the five metropolitan cities in the present study is not free from limitations of a weak data base and this needs to be spelt out more clearly. It can be seen that the observations on the immovable property transfers are not

comparable strictly among the five cities included in the analysis. While the registered value of sale deeds in the cities of Bangalore and Bombay is utilised for computing the black money in the real estate, the base of the immovable properties transferred in case of Delhi, Madras and Calcutta is different. In respect of these three cities, the registered value of sale deeds, i.e., the base of estimating black money, is assumed to represent 70 per cent of the registered value of immovable properties.

It is easy to see that the assumption in case of Delhi, Madras and Calcutta assigns 30 per cent of the registered value for purposes like mortgages, gifts and leases. Ideally these transactions should be separated from the total value of registration in order to get the base from which the black money could be estimated. Non-availability of data on the registered value of immovable properties at the desired level of disaggregation makes it difficult to arrive at the actual base for estimating the black money. The estimate, therefore, could be biased, although, not to the extent of the earlier studies.

The other limitation of the estimation could arise out of the truncated sample of immovable properties from which the black money is estimated. As discussed above the appropriate authorities acquire the suspected cases of immovable properties only when the value of transfer exceeds Rs. 10 lakh. Being high valued properties, the price could have an element of bias when only a small number of buyers would be participating in the auction of the acquired property. Subsequently the black money estimation, from the difference between acquired and auction price, may not reflect its actual dimension.

#### **Estimation from Income Tax Data**

The interval in which the black money generated in the real estate transactions could be present is estimated with the help of i) sale deeds and/or immovable property transferred and ii) mean

value of black money estimated from properties acquired and auctioned by the appropriate authorities. The upper and lower limits of the interval in which the black component could be present is obtained by applying the standard error of the estimated mean of the black money. The estimation of the interval has 10 per cent error.

It appears that money not reported to taxation authorities while registering transactions of properties is a substantial sum. The unreported money in transactions during 1988-89 works out to be in the range of Rs. 1672 crore to Rs. 2329 crore in the five metropolitan cities (Table 6.4). During the succeeding years, the black component records a higher level than that of 1988-89 even though only four cities were considered.

Delhi among the cities, records the highest amount of black money. The range is worked out to be Rs. 538 crore to Rs. 750 crore during the year 1988-89. Madras, with a range of Rs. 421 crore to Rs. 587 crore for the same year takes the second place. With Rs. 73 crore to Rs. 102 crore as the lower and upper limit of black money during 1988-89, Calcutta registers the last place of under-reporting.

Table 6.4

Intervals of Black Income Generation in  
Real Estate Transaction

(Rs. Crore)

Year	Bangalore		Bombay		Calcutta		Delhi		Madras		Total	
	L.P	U.P	L.P	U.P	L.P	U.P	L.P	U.P	L.P	U.P	L.P	U.P
1986-87	NA	NA	134.26	187.00	NA	NA	301.84	420.41	246.88	343.86	682.98	951.27
1987-88	333.71	464.80	222.55	309.97	57.39	79.93	329.16	458.46	297.69	414.63	1240.50	1727.79
1988-89	426.84	594.51	212.44	295.90	73.08	101.78	538.36	749.83	421.37	586.89	1672.09	2328.92
1989-90	422.17	588.00	216.13	301.03	NA	NA	570.63	794.79	572.94	798.00	1781.87	2481.82
1990-91	607.30	845.86	318.19	443.18	NA	NA	465.10	647.79	622.53	867.07	2013.12	2803.90

Notes: i) NA- Not estimated due to non availability of data  
ii) U.P- Upper Limit & L.P.- Lower Limit

### **Estimation from Common Gossip**

In contrast to the above estimation of black money from the income tax data, earlier studies have used the black-white ratio as indicated by common gossip in regard to the transfer of immovable property. When this ratio is applied to the approximate value of declared sales deeds, the black money component is obtained. The quantum money estimated through this alternative view is given below:

The level of black money on account of real estate transactions in the five metropolitan centres as indicated by Table 6.5 may be increasing in recent years. Depending on assumptions of 40:60 and 60:40 as the black-white proportions, there could be as much as Rs. 574 crore to Rs. 1, 292 crore of undeclared money during the year 1988-89. On the other hand, a greater sum of Rs. 612 crore to Rs. 1377 crore might have entered the market in the succeeding year.

Estimated on the basis of common gossip, the black money in Delhi during the year 1988-89 could have been in the range of Rs. 185 crore to Rs. 416.29 crore. Madras came next to Delhi with a range of Rs. 145 crore to Rs. 326 crore.

The black component in the transfer of real estate properties as pointed out by common gossip indicates that the quantum of payment in the city of Madras during the years 1989-90 and 1990-91 is the highest of all cities. It can be seen that the payment in black due to the real estate property transfer in the city is recorded to be Rs. 214 crore to Rs. 481 crore during 1990-91, while the range for Delhi during the same year is Rs. 160 crore to Rs. 359.42 crore.

Table 6.5

Estimated Black Income in Real Estate

(Rs. Crore)

Year	Banglore	Bombay	Calcutta	Delhi	Madras	Total
	1	2	3	4	5	6(1 to 5)
<b><u>At 40:60 Black-White Ratio</u></b>						
1986-87	NA	46.11	NA	103.66	84.79	234.56
1987-88	114.61	76.43	19.71	113.05	102.24	426.03
1988-89	146.59	72.96	25.10	184.89	144.71	574.25
1989-90	144.99	74.23	NA	195.98	196.77	611.96
1990-91	208.57	109.28	NA	159.73	213.80	691.37
<b><u>At 60:40 Black-White Ratio</u></b>						
1986-87	NA	103.75	NA	233.24	190.77	527.76
1987-88	257.87	171.97	44.34	254.35	230.03	958.57
1988-89	329.83	164.16	56.47	416.00	325.60	1292.07
1989-90	326.22	167.01	NA	440.94	442.72	1376.90
1990-91	469.28	245.88	NA	359.39	481.04	1555.59

Source: As described in the text.

On the basis of the two sources of information the estimated black income in the five metropolitan centres during 1988-89 indicated to be around Rs. 1292 crore to Rs. 2329 crore. As may be seen above, with 60 per cent black in the total value of a transfer as suggested in common gossips, the quantum of black money would be close to that obtained from the lower limit of the interval estimated on the basis of income tax data.

### **Conclusion**

The generation of black money due to the transfer of immovable properties in the five metropolitan cities was estimated to be in the range of 66 per cent to 73 per cent of the declared value. Compared to the earlier studies that considered the range of 40 to 60 per cent of the value of immovable property transferred to be paid in black, the present estimate indicates a higher share. Although the estimates are based on data regarding transactions few years ago, our recent studies and interviews with developers in the course of the effect of stamp duties on real estate show that the use of black money in real estate continues to be pervasive, owing to the persistence of the reasons for undervaluation and incentives for the use of black money, noted earlier.

The finding, that a greater share of the value of immovable property is made in black, could be attributed to some improvement, although little, in the quality of data and methodology of estimation in the present study. The earlier studies relied on common gossip for determining the black-white ratio in the transfer of immovable property which might not have helped in estimating the cash payment without receipt. The present study tried to overcome that problem by using the data of the pre-emptive acquisition and subsequent sale price of the properties. These data, as pointed out above, are not completely



free from biases. But their analytical value is likely to be more precise as they come from recorded values of real estate property transfers in contrast to the common gossip of earlier studies.

In estimating the quantum of black money in the real estate, the present study used the method of truncated sample distribution. This method of estimation is expected to have given a more precise estimate of black money in real estate compared to other studies which relied on simple averages of sample observations.

**Table 6.6**

**Registered Value of Immovable Properties**

(Rs. crore)

Year	Calcutta	Delhi	Madras	Total
	1	2	3	4(1 to 3)
1986-87	NA	222.13	181.69	472.99
1987-88	42.23	242.24	219.08	790.11
1988-89	53.78	396.19	310.10	1089.40
1989-90	NA	419.95	421.64	1170.41
1990-91	NA	342.28	458.14	1277.19

**Table 6.6 (Contd.)**

**Value Recorded in Sale Deed of Immovable Properties**

(Rs. crore)

Year	Bangalore	Bombay	Calcutta	Delhi	Madras	Total
	1	2	3	4	5	6(1 to 5)
1986-87	NA	69.16	NA	155.49	127.18	351.84
1987-88	171.91	114.65	29.56	169.57	153.36	639.05
1988-89	219.89	109.44	37.64	277.34	217.07	861.38
1989-90	217.48	111.34	NA	293.96	295.15	917.93
1990-91	312.85	163.92	NA	239.60	320.70	1037.06

**Note:** The value of sale deeds in case of Calcutta, Delhi and Madras is 70 per cent of the registered value of immovable properties transferred.

**Source:** Inspector General of Registration (in concerned cities).

## Appendix to Chapter 6

### Expected Mean and Variance from a Truncated Sample Distribution

The expected mean and variance from a truncated sample distribution are estimated with the help of moment generating function. The following description sums up the method:

When  $y$  follows a normal distribution with mean ( $\mu$ ) and variance  $\sigma^2$  and truncation point is  $c$ ,

$$E(y/ \text{truncation } c) = \mu + \sigma z(\alpha)$$

and

$$V(y/ \text{truncation } c) = \sigma^2 (1 - \beta(\alpha))$$

where  $E$  stands for expected value,  $\alpha = (c - \mu) / \sigma$  and  $z(\alpha) = \phi(\alpha) / (1 - \Phi(\alpha))$  if sample observation is greater than  $c$ ;  $\beta(\alpha) = z(\alpha)(z(\alpha) - \alpha)$ .  $\phi(\alpha)$  and  $\Phi(\alpha)$  denote the probability density and distribution functions of the variable  $y$ .

In the income tax data mentioned above, the degree of truncation in the sample is approximately 98 per cent due to the following reasons: The percentage of property acquired by the appropriate authorities in the total registered value of immovable properties during the corresponding period on average is less than 2 per cent in the metropolitan centres considered above. This indicates that the probability of properties having more than Rs. 10 lakh value is 2 per cent.

The sample for the purpose of estimating the mean values of properties acquired and auctioned is the pooled observations of data of five metropolitan cities since 1986-87. The pooling of the time series and cross section data is expected to increase the

number of observations for normal distribution of the sample. As the analysis of variance in the data did not show significant difference among cities, it is expected that the pooled observations will not introduce any systematic bias in the determination of the sample mean. Of the 126 observations, the sample mean of values of properties acquired and auctioned works out to be Rs. 37.3196 lakh and Rs. 53.0065 lakh, respectively.

Suppose for convenience that the properties acquired and auctioned come from a log normally distributed population. Then the log of properties acquired and auctioned will have normal distribution with, say, mean  $\mu$  and standard deviation  $\sigma$ . In terms of the above formulation, properties acquired will be:

$$E(y/ y > \log 10) = \log 37.3196$$

or  $E(y/ y > 2.3026) = 3.6195$

It is also apparent that  $\text{Prob}(y > 2.3026) = 0.02$ .  
Therefore from the above,

$$E(y/ y > 2.3026) = \mu + (\sigma \phi(\alpha) / (1-\phi(\alpha)))$$

where

$$\alpha = (2.3026 - \mu) / \sigma$$

Since it is known that  $\phi(\alpha) = 0.98$ ,  $\alpha = \phi^{-1}(0.98) = 2.054$ .

Then

$$2.054 \sigma = 2.3026 - \mu \tag{1}$$

Again given that  $\alpha = 2.054$ ,  $\phi(\alpha) = \phi(2.054) = 0.0484$ .

Hence

$$3.6195 = \mu + \sigma(0.0484/0.02)$$

or  $3.6195 = \mu + 2.42 \sigma \tag{2}$

The solution of (1) and (2) above gives  $\mu = - 5.0880$  and  $\sigma = 3.5981694$ .  $E(y)$  of the series will be given by  $E( e^r ) = \exp( \mu + \sigma^2/2 )$  when  $r$  follows a normal distribution with mean  $\mu$  and variance  $\sigma^2$ . It may be pointed out that an assumption of normal frequency distribution of the black-white ratio would indicate such an interval with approximately 10 per cent error. This gives the mean value of the properties under-reported and it works out to be Rs. 3.97 lakh.

The mean value of the properties auctioned is also estimated following the same procedure described above. The truncation point in case of this series is Rs. 11.5 lakh. Solving for the values, it was found that  $\mu = - 6 .1332023$  and  $\sigma = 4.1750483$ . The expected value of auction price, which is considered as the market value of real estate property in the present study is Rs. 13. 9596 lakh.

## Chapter 7

### POLICY OPTIONS

#### 1. Introduction

In the urban real estate market of India, high incidence of black money has emerged as a serious problem and a number of policy measures are required to curb its influence on the activities of this sector. In the following discussion, steps that are required to be undertaken in the real estate market are highlighted. It is expected that the recently introduced economic liberalisation policy of India aiming at the removal of policy-generated barriers for the smooth functioning of a competitive market will provide a congenial atmosphere for controlling the problem.

#### 1. Measures on Policy-induced factors

The policy-induced distortions in real estate and the necessity of bringing greater supply of land to market is considered at length by the National Commission on Urbanisation (Government of India, 1988) and National Housing Policy (Government of India, 1992c). Of particular relevance are steps to expand land and housing supply, modifications of the Urban Land (Ceiling & Regulations) Act and the Rent Control Acts, the greater involvement of the private sector in land assembly and development through various enabling measures, the reform of the Land Acquisition Act. All these steps, if implemented in concert by the Central and State governments together with the financial institutions, and in consultation with the real estate industry and local authorities, would help in reducing the incentive for the generation and the use of black money. Some of the policy pronouncements are reproduced below to highlight the direction of change desired for the real estate market:

"To bring increasing quantities of land to the market, the Urban Land (Ceiling & Regulation) Act, 1976, should be drastically amended and supplemented by taxation measures that would discourage landowners from keeping their land vacant and encourage proper utilisation.

The Land Acquisition Act should be amended to enable negotiated assembly of land including the development of land through town planning schemes, speedy acquisition of compact land for various urban projects, eliminate delay, while ensuring timely payment to the affected citizens.

All laws which inhibit or restrict the recycling of land, including those occupied by sick mills and public agencies should be suitably modified.

The State must facilitate housing activity of different income groups as well as the cooperative and organised private sector by eliminating constraints, by ensuring access to essential inputs, and by removing legal and regulatory obstacles. It should not itself become a direct builder, except for assuring shelter to the poor and deprived groups not served by the formal system."

The supply of serviced land at an affordable price for housing activity is emphasised repeatedly by various policy documents in recent years, and in the policy seminars of experts and state officials. The strength of black money in real estate is likely to weaken considerably when the land market become more competitive and transparent, with widespread information on the availability and prices of housing products at different price ranges in different localities.

The sequence of the reform, however, is important. As a prerequisite to unrestricted transactions in the land market, provision should be made for supply of credit from the organised

finance market to individual buyers for various forms of housing activity, either directly, or through cooperatives, or, in the case of the poor and the informal sector, through community level savings and loan associations. It is necessary also to arrange for the access of the real estate industry to institutional finance, subject to appraisal procedures on par with other industries, and for its access to the capital market on the basis of rating criteria developed by CRISIL. This would induce the public and private housing agencies to offer houses on long term hire purchase, or provide tieups for the purchasers with financial institutions. A well developed property titling system is essential in order to obviate elaborate title search requirements as at present, and it is also to instal speedy foreclosure provisions to guard against default.

The removal of policy-generated barriers on the functioning of real estate market must be accompanied by adequate provisions to ensure to remove barriers to competition and the entry of small builders. It was discussed while analysing the influence of market structure on anticompetitive behaviour of firms that the presence of a small number of operators in the real estate market could lead to tacit collusion for sustaining a monopoly price. Therefore, pending the enactment of legislation by the state governments of laws to promote and regulate real estate operations on the lines of the Model Bill referred to earlier, the bodies like Consumer Courts or competent enforcement authorities like Monopolies and Restrictive Trade Practices (MRTP) Commission may be required to monitor the conduct of real estate operators in the regime of decontrol and liberalisation. It is also necesasay to build up comprehensive citywide information on the operations of developers and property agents in different cities, with details of their housing products, track record, quality of performance, market standing etc., on the lines envisaged by the National Housing Bank as part of the scheme for NRI housing. This would also facilitate the introduction of rating and benefit the genuine developers.



## 2. Policy on Incentive-induced Factors

That the real estate property transactions provide incentive to both buyer and seller to under-report the value of property is well documented by now (see, for example, NIPFP, 1985; Tandon, 1987 and Dange, 1983). The policy measures that would help to reduce speculative investment in land and property and that help in reducing the incentive of under-reporting the property values in transactions undertaken by participants of the real estate market have been suggested by most of the studies. The long term agenda for fiscal reform, following the examination of the Chelliah Committee report would hopefully introduce a regime of greater tax compliance and lesser motivation for income concealment and tax avoidance.

### **Tax rate**

In property transactions, avenues of tax evasion are generally reported to be capital gains tax, gift tax, stamp duty and registration fees, and others listed in the earlier chapter as one time levies. However, there are other levies in the real estate market such as brokerage fees charged by real estate agents and the interest paid on loans raised from the informal market for financing the acquisition of immovable properties and 'pugree' money paid by tenants in cities such as Bombay which are never reported to the taxation authorities. The recent reform programme in India aims to reduce the incentive of tax evasion by initiating the steps like indexation of gains and the reduction of rate of capital gains taxation and the reform of stamp Act and Registration Act (see, for details, Government of India, 1986 & 1992b and the interim report of NIPFP 1994).

With the evasion of capital gains tax persisting, the need for reliance on the improvement in probability of detection as well as penalty rate as deterrent measures continues. The

probability of detection and the tax evasion being inversely related, the favourable impact of increasing the former need not be emphasized. With the effective increase in the probability of being caught, the measure of tax reduction on capital gains and stamp duties, along with improved procedures for the payment of stamp duty and the registration of documents, will reduce the incentive of evasion.

The property transfer through 'power of attorney' is expected to come down with the proposal for its compulsory registration and the charging of stamp duty on par with normal conveyance. The reduced hassles of transfer of property and the reduced burden of conveyance costs would also reduce the incentive for power of attorney transactions.

The operation of the provisions for pre-emptive acquisition of property by the appropriate authorities under the provision of Chapter XXC of the Income tax Act has been reviewed already. The proposals under consideration here include the raising of the limit to Rs. 50 lakhs in order to reduce the volume of transactions requiring the clearance of the Authority, giving powers to the Appropriate Authority to investigate even cases of declared valuation below the value of Rs.10 lakhs, making the penal provisions more deterrent, and greater coordination with the state Registration departments and the income tax officials. The Annual Report 1990-91 of the Ministry of Finance observed that there has been a sharp rise in the declared consideration in the sale agreements in respect of properties of the value exceeding Rs. 10 lakh, and that the sale agreements generally reflects a more realistic profile of real estate price in various localities. However, as pointed out by the PAC, the provisions are evaded in a variety of ways including the deliberate splitting of transactions and undervaluation. As an instrument for controlling the use of black money in real estate and for reducing tax avoidance, the provisions have a lot of limitations in the present form, as recognised by the income tax officials themselves. The

introduction of uniform valuation for all fiscal purposes and for acquisition of land on the basis of annually notified rates of land and property would obviate the need for the large scale use of Chapter XXC, and considerably reduce the scope for deliberate undervaluation.

Under the provision of pre-emptive acquisition, the loss of income to the seller happens to be the penalty. It is equal to the difference between the auction and the declared price of the property. This penalty has not served as a deterrent to tax evasion as seen above in the earlier Chapter. The rate of penalty prescribed under the provision of pre-emptive acquisition may not be severe enough a punishment to deter the incentive for evading the capital gains taxation. For, the expected gain from successful evasion appears to be substantial as compared to the loss due to penalty on being caught.

At another level, perhaps less elegant, is to acquire any property suspected of underreporting, irrespective of the magnitude of its value. With the existence of a provision like pre-emptive acquisition of all suspected underreported properties, the incentive to evade tax is likely to be minimised due to increased threat of acquisition and probability of detection. These provisions may not require greater involvement of the Government resources than that at present. This would tie in also with the proposed system of uniform valuation base for all properties. Apprehensions expressed by some studies that under the provision of pre-emptive acquisition the Government will get entangled in the real estate business (see, for example Tandon, 1987) could be taken care of by involving the state and local agencies in the management of the acquired properties. As the extent of undervaluation comes down, such across-the-board acquisition would be seen to be a short term measure, and not required to be used extensively. In the long run, fiscal measures that increase the incidence and motivation of proper reporting and registration of property transaction should always be preferred.

To reiterate what has been stated earlier, there are two crucial requirements for the successful operation of provisions, such as pre-emptive acquisition. Correct assessment of values of urban immovable properties and adequate published information on rent-prices as well as house supply situation are essential for reducing the incentive of black transaction. There is a problem of asymmetric information on these in many urban centres in the country which is exploited by the agents of black market operators to generate speculative conditions in the urban property markets. A regular publication of area-wise property values and availability of houses and plots would serve the purpose of reducing the price setting role of real estate agents.

Together with the removal of regulatory impediments and the installation of simplified and speedy approval procedures by the concerted action of different levels of government (which is an avowed objective of the economic reform process also), and the introduction of appropriate fiscal measures as noted above, the role of black money in real estate will face a decline. Whether the black money and wealth will find alternate avenues in the economy and continue to flourish is of course dependent on the vigour of enforcement of penalties for tax evasion, the success of fiscal policy in inducing income declaration and tax compliance, the containment of speculative pressures in the capital market, bullion and foreign exchange, and the progressive reduction of influence of the unorganised sector in finance and other operations.

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